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.

A/CN.9/SER.A/1999

UNITED NATIONS PUBLICATION
Sales No. E.00.V.9
ISBN 92-1-133629-5
ISSN 0251-4265
CONTENTS

INTRODUCTION ................................................................. vi

Part One. Report of the Commission on its annual session; comments and action thereon

THE THIRTY-SECOND SESSION (1999)


C. General Assembly: report of the United Nations Commission on International Trade Law on the work of its thirty-second session: report of the Sixth Committee (A/54/611) .................................................................................. 50

D. General Assembly resolution 54/103 of 9 December 1999 ......................................................... 51

Part Two. Studies and reports on specific subjects

I. ASSIGNMENT IN RECEIVABLES FINANCING


II. ELECTRONIC COMMERCE


C. Working paper submitted to the Working Group on Electronic Commerce at its thirty-third session: proposal by the United States of America: note by the secretariat (A/CN.9/WG.IV/WP.77) ................................................. 205


III. PRIVATELY FINANCED INFRASTRUCTURE PROJECTS

Draft chapters of a legislative guide on privately financed infrastructure projects: report of the Secretary-General (A/CN.9/458 and Add.1-9) .............................. 247

IV. COORDINATION AND COOPERATION


B. Uniform Rules for Contract Bonds (UCRB): report of the Secretary-General (A/CN.9/459/Add.1) .................................................. 390

V. INTERNATIONAL COMMERCIAL ARBITRATION

Possible future work in the area of international commercial arbitration: note by the secretariat (A/CN.9/460) .................................................. 395

VI. INSOLVENCY LAW

Possible future work in the area of insolvency law: proposal by Australia (A/CN.9/462/Add.1) .................................................. 415

VII. CASE LAW ON UNCITRAL TEXTS (CLOUT) ................................. 419

VIII. STATUS OF UNCITRAL TEXTS

Status of Conventions and Model Laws: note by the secretariat (A/CN.9/462) .................................................. 421

IX. TRAINING AND ASSISTANCE

Training and technical assistance: note by the secretariat (A/CN.9/461) .................................................. 423
Part Three. Annexes

I. BIBLIOGRAPHY OF RECENT WRITINGS RELATED TO THE WORK OF
   UNCITRAL: NOTE BY THE SECRETARIAT (A/CN.9/481) ........................ 431

II. CHECK-LIST OF UNCITRAL DOCUMENTS ....................................... 441

III. LIST OF UNCITRAL DOCUMENTS REPRODUCED IN THE PREVIOUS
      VOLUMES OF THE YEARBOOK .................................................... 445
INTRODUCTION

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

The present volume consists of three parts. Part one contains the Commission’s report on the work of its thirtieth session, which was held in Vienna, from 17 May to 4 June 1999, and the action thereon by the United Nations Conference on Trade and Development (UNCTAD) and by the General Assembly.

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

Part three contains the bibliography of recent writings related to the Commission’s work, a list of documents before the thirty-second session and a list of documents relating to the work of the Commission reproduced in the previous volumes of the Yearbook.

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

<table>
<thead>
<tr>
<th>Volume</th>
<th>Years covered</th>
<th>United Nations publication, Sales No</th>
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<tbody>
<tr>
<td>I</td>
<td>1968-1970</td>
<td>E.71.V.1</td>
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<tr>
<td>II</td>
<td>1971</td>
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<td>1972</td>
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<td>E.73.V.9</td>
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<td>E.74.V.3</td>
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<td>V</td>
<td>1974</td>
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<td>1975</td>
<td>E.76.V.5</td>
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<td>VII</td>
<td>1976</td>
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<td>1977</td>
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<tr>
<td>IX</td>
<td>1978</td>
<td>E.80.V.8</td>
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<td>1979</td>
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<td>XI</td>
<td>1980</td>
<td>E.81.V.8</td>
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<td>XII</td>
<td>1981</td>
<td>E.82.V.6</td>
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<td>XIII</td>
<td>1982</td>
<td>E.84.V.5</td>
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<td>1989</td>
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<td>1992</td>
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<td>1994</td>
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<td>1997</td>
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<td>1998</td>
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Part One

REPORT OF THE COMMISSION
ON ITS ANNUAL SESSION;
COMMENTS AND ACTION THEREON
THE THIRTY-SECOND SESSION (1999)

(Vienna, 17 May–4 June 1999) (A/54/17) [Original: English]

CONTENTS

INTRODUCTION ............................................. 1-2

I. ORGANIZATION OF THE SESSION .................. 3-11
   A. Opening of the session ............................ 3
   B. Membership and attendance .................... 4-8
   C. Election of officers ................................ 9
   D. Agenda ............................................ 10
   E. Adoption of the report .......................... 11

II. PRIVATELY FINANCED INFRASTRUCTURE PROJECTS .... 12-307
   A. Background ...................................... 12-16
   B. General remarks .................................. 17-21
   C. Consideration of draft chapters ................. 22-307

III. ELECTRONIC COMMERCE ......................... 308-318
    A. Draft uniform rules on electronic signatures .... 308-314
    B. Future work in the field of electronic signatures 315-318

IV. ASSIGNMENT IN RECEIVABLES FINANCING .......... 319-330

V. MONITORING THE IMPLEMENTATION OF THE 1958 NEW YORK CONVENTION .................. 331-332

VI. INTERNATIONAL COMMERCIAL ARBITRATION: POSSIBLE FUTURE WORK ................. 333-380
    A. Introduction .................................... 333-336
    B. General remarks ................................ 337-339
    C. Discussion of specific items ................... 340-379
    D. Conclusion ..................................... 380

VII. POSSIBLE FUTURE WORK ON INSOLVENCY LAW .... 381-385

VIII. CASE LAW ON UNCITRAL TEXTS ................ 386-389

IX. TRAINING AND TECHNICAL ASSISTANCE ........... 390-397

X. STATUS AND PROMOTION OF UNCITRAL TEXTS ........ 398-401

XI. GENERAL ASSEMBLY RESOLUTIONS ON THE WORK OF THE COMMISSION .................. 402-409

XII. COORDINATION AND COOPERATION ............... 410-421
    A. Transport law .................................. 410-418
    B. Asian-African Legal Consultative Committee .... 419
    C. International Institute for the Unification of Private Law .. 420-421
INTRODUCTION


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.

I. ORGANIZATION OF THE SESSION

A. Opening of the session

3. The United Nations Commission on International Trade Law (UNCITRAL) commenced its thirty-second session on 17 May 1999. The session was opened by the Secretary of the Commission, on behalf of the Under-Secretary-General for Legal Affairs, the Legal Counsel.

B. Membership and attendance

4. The General Assembly, by its resolution 2205 (XXI), established the Commission with a membership of 29 States, elected by the Assembly. By its resolution 3108 (XXVIII) of 12 December 1973, the Assembly increased the membership of the Commission from 29 to 36 States. The current members of the Commission, elected on 28 November 1994 and on 24 November 1997, are the following States, whose term of office expires on the last day prior to the beginning of the annual session of the Commission in the year indicated:


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

6. The session was attended by observers from the following States: Armenia, Azerbaijan, Belarus, Belgium, Bolivia, Canada, Costa Rica, Croatia, Cuba, Cyprus, Czech Republic, Gabon, Georgia, Greece, Guinea, Holy See, Indonesia, Kuwait, Lebanon, Malaysia, Morocco, Namibia, Poland, Republic of Korea, Saudi Arabia, Slovakia, South Africa, Sweden, Switzerland, Tunisia, Turkey, Ukraine, Venezuela and Yemen.

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

(a) United Nations system: Economic Commission for Europe; United Nations Industrial Development Organization; International Monetary Fund

(b) Intergovernmental organizations: Asian-African Legal Consultative Committee; Asian Clearing Union; International Institute for the Unification of Private Law; Permanent Court of Arbitration


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

C. Election of officers

9. The Commission elected the following officers:

Chairman: Mr. Reinhard G. Renger (Germany)
Vice-Chairmen: Mr. Antonio Paulo Cachapuz de Medeiros (Brazil)
Mr. Dumitru Mazilu (Romania)
Mr. Abubakr Salih Mohamed Nur (Sudan)
Rapporteur: Ms. Shahnaz Nikanjam (Islamic Republic of Iran)

D. Agenda

10. The agenda of the session, as adopted by the Commission at its 651st meeting, on 17 May 1999, was as follows:

1. Opening of the session.
2. Election of officers.
3. Adoption of the agenda.
4. Privately financed infrastructure projects.
5. Electronic commerce.
8. International commercial arbitration: possible future work.
9. Case law on UNCITRAL texts (CLOUT).
10. Training and technical assistance.
11. Status and promotion of UNCITRAL legal texts.
13. Coordination and cooperation.

14. Other business.
15. Date and place of future meetings.
16. Adoption of the report of the Commission.

E. Adoption of the report

11. At its 675th meeting, on 4 June 1999, the Commission adopted the present report by consensus.

II. PRIVATELY FINANCED INFRASTRUCTURE PROJECTS

A. Background

12. At its twenty-ninth session, in 1996, after consideration of a note by the Secretariat on build-operate-transfer and related types of projects (A/CN.9/424), the Commission decided to prepare a legislative guide to assist States in preparing or modernizing legislation relevant to those projects. The Commission requested the Secretariat to review issues suitable for treatment in such a legislative guide and to prepare draft materials for consideration by the Commission.

13. At its thirtieth session, in 1997, the Commission considered an annotated table of contents setting out the topics proposed for inclusion in the legislative guide (A/CN.9/438). The Commission also considered initial drafts of chapter I, "Scope, purpose and terminology of the guide" (A/CN.9/438/Add.1), chapter II, "Parties and phases of privately financed infrastructure projects" (A/CN.9/438/Add.2), and chapter V, "Preparatory measures" (A/CN.9/438/Add.3). After an exchange of views on the nature of the issues to be discussed and possible methods for addressing them in the guide, the Commission generally approved the line of work proposed by the Secretariat, as contained in those documents. The Commission requested the Secretariat to seek the assistance of outside experts, as required, in the preparation of future chapters, and invited Governments to identify experts who could be of assistance to the Secretariat in that task.

14. At its thirty-first session, in 1998, the Commission had before it revised versions of the earlier chapters, as well as initial drafts of additional chapters, which had been prepared by the Secretariat with the assistance of outside experts and in consultation with other international organizations. The documents included a revised table of contents (A/CN.9/444) and a draft of the introduction to the legislative guide (A/CN.9/444/Add.1), which combined, with amendments, the contents of documents A/CN.9/438/Add.1 and 2. Further documents included...
initial drafts of chapter I, “General legislative considerations” (A/CN.9/444/Add.2), chapter II, “Sector structure and regulation” (A/CN.9/444/Add.3), chapter III, “Selection of the concessionaire” (A/CN.9/444/Add.4), and chapter IV, “Conclusion and general terms of the project agreement” (A/CN.9/444/Add.5). The Commission considered various specific suggestions concerning the draft chapters, as well as proposals for changing the structure of the legislative guide and reducing the number of chapters. The Commission requested the Secretariat to continue the preparation of future chapters, with the assistance of outside experts, for submission to the Commission at its thirty-second session.

15. At the current session, the Commission had before it the complete draft of the legislative guide, which consisted of the following: “Introduction and background information on privately financed infrastructure projects”, and chapters I, “General legislative considerations”, II, “Project risks and government support”, III, “Selection of the concessionaire”, IV, “The project agreement”, V, “Infrastructure development and operation”, VI, “End of project term, extension and termination”, VII, “Governing law”, VIII, “Settlement of disputes” (A/CN.9/458/Add.1-9, respectively). The Commission was informed that the Secretariat had changed the overall structure of the legislative guide and combined some of its chapters.

16. Concern was expressed that not all of the documents relating to the draft legislative guide were available in every official language prior to the commencement of the Commission’s session. The Secretariat was requested to take the necessary measures to ensure the consistency and technical accuracy of the various language versions of the legislative guide.

B. General remarks

17. The Commission expressed its satisfaction with the progress of the work of preparation of the legislative guide. The draft guide was viewed as being of particular interest to those countries that strive to attract foreign investment capital in order to finance such projects. The Commission noted, however, the importance of keeping the appropriate balance between the objective of attracting private investment for infrastructure projects and the protection of the interests of the host Government and the users of the infrastructure facility.

18. The Commission noted and generally approved the structure of the draft legislative guide, as set out in document A/CN.9/458. It was observed that it was the first occasion on which the draft guide was available in its entirety. While it was generally felt that the draft chapters covered most of the central issues pertaining to privately financed infrastructure projects, the view was expressed that the document was rather lengthy and that adjustments were necessary in order to make the guide more accessible to the intended readers.

19. The Commission also noted the revised style and presentation of the legislative recommendations, so as to reflect the notion of concise legislative principles, to which the Commission had referred at its thirty-first session. The Commission was reminded of the need to draft the guide so that it would be useful for those to whom it would be directed. It was noted that the legislative guide would constitute a useful tool for Governments in reviewing and modernizing their legislation pertaining to privately financed infrastructure projects. It was suggested, however, given the legal culture unique to each State, that the guide should identify and elaborate various issues and then provide a range of alternative policy options. It was pointed out that, depending on the legal tradition of the host country, the issues discussed in the legislative guide might be addressed in more than one legislative instrument. Furthermore, in some countries, no legislative action might be needed in connection with a number of the issues dealt with in the guide. In order to take into account the various options available to host countries, it was suggested that the guide should include model legislative clauses, as appropriate.

20. However, various representatives pointed out the potential difficulty and undesirability of formulating model legislative provisions on privately financed infrastructure projects in the light of the complexity of the legal issues typically raised by those projects, some of which concern matters of public policy, as well as the diversity of national legal traditions and administrative practices. It was further pointed out that, as currently formulated, the draft chapters of the legislative guide offered the necessary flexibility for national legislators, regulators and other authorities to take into account the local reality when implementing, as appropriate, the legislative recommendations contained therein.

21. Having noted the various views expressed, it was felt that the Commission should keep under consideration the desirability of formulating model legislative provisions, when discussing the legislative recommendations contained in the draft chapters, and in this connection identify any issues for which the formulation of model legislative provisions would increase the value of the guide (see below, paras. 40-43). Regardless of the final decision that might be taken by the Commission in that regard, it was agreed that the legislative recommendations contained in each chapter needed to be reformulated for greater uniformity. The Commission agreed that the Secretariat, with the assistance of experts, should review the recommendations in their entirety, so as to make them more coherent and consistent with one another.

C. Consideration of draft chapters

Introduction and background information on privately financed infrastructure projects (A/CN.9/458/Add.1)

22. An earlier draft of the introduction (A/CN.9/444/Add.1) had been considered by the Commission at its thirty-first session.\footnote{Ibid., para. 204.}

\textsuperscript{3}Ibid., para. 23-49.
23. The Commission considered various proposals for restructuring the introduction. It was suggested that, for ease of reading, the purpose of the legislative guide could be more clearly stated if the introduction were preceded by a short description of privately financed infrastructure projects, of the special characteristics of those projects and their modes of financing, as well as the historical background against which they were being carried out. This might be achieved by adding short introductory remarks to the existing introduction, which might draw on the substance of paragraphs 54 to 59 thereof. The introduction might then be given a different title, such as "Scope, definitions and background information on privately financed infrastructure projects".

24. Another suggestion, which gathered the support of various representatives, was that there was no need to add a separate introductory portion of new text, and that the purpose of the guide could be further clarified by reorganizing the various portions of the introduction, which should be retained with its current title. In particular, it was suggested that paragraphs 54 to 56 should be moved before section A of the introduction, which should be followed by the historical background information contained in paragraphs 57 to 82 and by the current sections B, C, D and E in that order.

Section A. Purpose and scope of the guide

25. It was suggested that the purpose of the legislative guide might be more clearly conveyed by making reference, in the current section A, to the central requirements for, and objectives of, privately financed infrastructure projects from the perspective of both the public and the private sectors. They included, from the perspective of the private sector, elements such as the need for certainty, stability and transparency, investment protection provisions and appropriate guarantees against inappropriate interference by the contracting authority. From the perspective of the public sector, central concerns were the need to ensure the continuity of the service, the observance of environmental and safety standards, adequate monitoring of the project performance and the possibility of revoking a concession when applicable requirements were not met. Cross-references should be added, as appropriate, to the subsequent portions of the guide where those matters were dealt with in more detail.

26. For the purpose of clarifying the relationship between the legislative recommendations and the accompanying notes, the Commission decided to insert after paragraph 2 of the introduction language along the following lines:

"Each chapter of the guide is divided into legislative recommendations ("recommendations") and notes on legislative recommendations ("notes"). The recommendations contain a set of recommended legislative principles. The notes offer an analytical introduction with references to financial, regulatory, legal, policy and other issues raised in the subject area. The notes provide background information to enhance the understanding of the recommendations."

Section B. Terminology used in the guide

27. The view was expressed that the notion of "public infrastructure" was not adequately defined in paragraph 6, since it was linked to the notion of "public services", which, in turn, was defined in paragraph 8 by a reference to "public infrastructure". That situation, it was said, reflected the difficulty of formulating a definition of "public services", a notion which might be differently understood in various legal systems. It was suggested that, in revising the introduction, the Secretariat should consider alternative ways of describing the types of infrastructure and services covered by the guide.

28. It was suggested that the terminology used in the various language versions of the guide should be reviewed so as to ensure that the expressions mentioned in paragraph 15 to refer to public authorities of the host country were consistently used throughout the guide.

Section C. Forms of private sector participation in infrastructure projects

29. The paragraphs dealing with the forms of private sector participation did not elicit comments.

Section D. Financing structures and sources of financing for infrastructure projects

30. As a general comment, it was noted that section D, which dealt with financing structures and sources of financing, was closely related to both chapter II, which covered project risks and government support, and section B.I of chapter IV, which dealt with the financial arrangements in the project agreement. It was suggested that the link between those portions of the guide should be established more clearly, for example by combining the various portions of the guide dealing with financial matters into one single chapter.

31. The view was expressed that the notion of "project finance", as described in paragraphs 27 to 30, could be further clarified by elaborating on the differences between project finance and more traditional financing transactions. It was pointed out that the differences between the two financing techniques were not primarily based on whether or not guarantees by, or recourse to, the borrower's shareholders were available. In traditional financing, the lenders relied on the borrower's established credit and the borrower's established balance sheet, and it was the absence of such an established credit or balance sheet that made project finance the preferred financing modality for most projects involving the development of new infrastructure. Paragraphs 27, 28 and 30 should therefore be adjusted to reflect those circumstances.

32. It was noted that paragraphs 31 to 41 had a double purpose: on the one hand, they identified possible sources of financing for privately financed infrastructure projects; on the other hand, those paragraphs described various
types of finance that might be mobilized for those projects. It was suggested that those paragraphs should also mention other types of financing such as leasing, commercial paper, guarantees or insurance companies' support agreements. It was also suggested that, in addition to referring to export credit agencies, paragraph 41, as well as other portions of the text dealing with similar issues, should mention political risk coverage provided by agencies that promoted investment of their nationals in foreign countries.

33. In connection with the notion of combined public and private finance, which was mentioned in paragraph 43, the view was expressed that the guide should avoid the impression that the availability of public funds or subsidies for financing infrastructure projects, where that was the case, entailed the assumption by the public sector of risks which, by the very nature of privately financed infrastructure projects, should be borne by the private sector. It was pointed out that, in some legal systems, it was an essential feature of transactions of the type covered by the guide that they were carried out by the concessionaire at its own risk.

Section E. Main parties involved in implementing infrastructure projects

34. As to paragraph 47, it was suggested that the notion of "project sponsors" might be misleading, since the term "sponsor" was used in some legal systems not to refer to private entities promoting the project but to the governmental agencies that had the overall responsibility for the implementation of privately financed infrastructure projects. It was suggested either to use other terms instead of "sponsors" or to adjust the text to avoid the possibility of such a misunderstanding. It was also suggested that the last sentence of paragraph 47 should refer to the fact that the project company was often required to be established under the laws of the host country.

35. It was suggested that paragraph 49 should refer not only to the negotiation of inter-creditor agreements, but also to the possibility that the lenders would negotiate a common loan agreement.

Section F. Infrastructure policy, sector structure and competition

36. The first sentence of paragraph 61 was felt to convey a categorically negative judgement about infrastructure monopolies, in particular in some language versions. It was proposed that that sentence should be redrafted so as to avoid the impression that the guide took a position of principle in a matter considered to involve issues of domestic policy.

37. The question was asked whether the last sentence of paragraph 66, which appeared to have a prescriptive connotation, might be deleted. In reply, it was pointed out that the sentence in question merely referred to one of the interests taken into account by developing countries when considering the desirability of opening certain infrastructure sectors to competition, and that it reflected a suggestion that had been made at the Commission's thirty-first session.³

38. The view was expressed that paragraph 82, in particular its second sentence, seemed to advocate the privatization of infrastructure operators in order for a country to effectively reform its infrastructure sector. It was suggested that that sentence should be deleted and the remainder of the paragraph should be redrafted accordingly.

I. General legislative considerations
(A/CN.9/458/Add.2)

General remarks

39. The Commission noted that an earlier draft of chapter I had been contained in document A/CN.9/444/Add.2. The Commission also noted that section D of the current draft chapter I incorporated the substance of some portions of former chapter II, "Sector structure and regulation" (A/CN.9/444/Add.3), that dealt with organizational and administrative matters pertaining to the functioning of regulatory bodies, following the Commission's decision at its thirty-first session to delete the earlier chapter II and to move the substance of the discussion contained therein to other chapters of the guide.⁴

40. By way of a general comment, it was suggested that the number of legislative recommendations contained in the guide should be reduced and that the recommendations should be limited to matters of a clear legislative nature. The view was also expressed that some of the legislative recommendations were more of a descriptive nature and should more appropriately be included in the notes. The Commission agreed that the guide should not contain an excessive number of legislative recommendations, and that that objective should be borne in mind by the Commission when considering individual chapters of the guide.

41. The Commission engaged in a discussion concerning the style of the legislative recommendations. According to one view, which was endorsed by various representatives, the style of the legislative recommendations was excessively cautious, and stronger language should be used in formulating them. It was pointed out that, in many instances, the advice contained in the accompanying notes was formulated in stronger terms than the recommendations themselves.

42. In response to those views, it was observed that, at the thirty-first session of the Commission, the Secretariat had been requested to draft the legislative recommendations in the form of "concise legislative principles",³⁰ and that the preference had been expressed for the use of flexible, rather than imperative, language.

43. After consideration of the various views expressed, it was generally agreed that it was not the purpose of the

³Ibid., para. 105.
⁴Ibid., paras. 101 and 102.
³⁰Ibid., para. 204.
guide to impinge upon national sovereignty or to be overly prescriptive on the contents of domestic legislation. Nevertheless, the Commission generally felt that it would be appropriate to formulate its recommendations in stronger terms. It was also agreed that possible options for formulating the legislative recommendations could be considered in the course of their review by the Commission, bearing in mind the need for ensuring the greatest possible uniformity in that regard.

44. With regard specifically to draft chapter I, the proposal was made that the draft chapter should outline the general principles that should inspire a domestic legislative framework for privately financed infrastructure projects, in particular the principles of transparency, fairness, openness and competition.

45. It was pointed out that the question of the law governing the implementation of privately financed infrastructure projects was logically related to the issues discussed in the draft chapter. The question was thus asked whether draft chapter VII, “Governing law” (A/ CN.9/458/Add.8), could be shortened and combined with draft chapter I. In response, it was observed that an earlier version of chapter I (A/CN.9/444/Add.2) had contained, in its sections B and C, a discussion on the possible impact of other areas of legislation on the successful implementation of privately financed infrastructure projects and the possible relevance of international agreements entered into by the host country for domestic legislation on those projects. That discussion had been expanded so as to accommodate various proposals that had been made at the thirty-first session of the Commission,11 and, for ease of reading, it had been moved to draft chapter VII, “Governing law” (A/CN.9/458/Add.8).

46. The Commission considered that the various language versions of the next draft legislative guide should be carefully reviewed so as to ensure terminological accuracy and consistency. Representatives were called upon to provide the Secretariat suggestions for terminological improvements of the draft guide.

General considerations (legislative recommendation 1 and paras. 1-15)

47. The view was expressed that the first sentence of legislative recommendation 1 was not sufficiently precise as to what powers were needed by the contracting authority to award infrastructure projects. It was also observed that the contracting authorities had not been identified in recommendation 1. It was therefore suggested that the recommendation needed to be further clarified.

48. In response, it was noted that the question of who had the authority to award infrastructure projects depended on the constitutional organization, legal tradition and administrative structure of the country concerned, and that it might not be feasible to formulate legislative recommendation 1 in more precise terms without describing the complexities of the internal structure and competence of the contracting authorities in various countries. It was suggested that a general reference to the authorized agencies, such as what was contained in paragraphs 17 and 18 of the notes, might be sufficient for the purposes of the draft chapter.

49. The Commission agreed that, for purposes of clarity, the phrase “with or without such conditions as may be deemed appropriate” should be added to the first sentence in legislative recommendation 1. For the same reason, the Commission further agreed to add the words “or reviewing” after the words “setting up” in paragraph 1 of the notes.

50. In connection with the second sentence of legislative recommendation 1, the view was expressed that it would not be appropriate for the guide to recommend the review of constitutional provisions, which was a politically sensitive process in many countries. The concern was also expressed that a revision or amendment of a State constitution, as indicated in legislative recommendation 1, was a complicated procedure, which might not be necessary to achieve the legislative purposes outlined in the guide. The objective outlined therein, namely to encourage private sector investment, was actually a matter of administrative, rather than constitutional law. It was suggested that, instead, reference should be made only to a review of legislative provisions. Following the same line of thought, it was also suggested that, as currently formulated, the second sentence of legislative recommendation 1 should more appropriately be included in the notes.

51. In response to those concerns, it was pointed out that the guide was addressed to legislators and policy makers in countries interested in promoting private investment in infrastructure projects. The guide itself did not address the opening of infrastructure sectors to private investment, but merely provided advice to legislators and policy makers concerning relevant legislative issues for those countries which had made a policy decision to attract private investment to infrastructure projects. The purpose of the reference, in legislative recommendation 1, to a review of constitutional provisions was to draw the reader’s attention to the need for identifying potential legal difficulties for the implementation of privately financed infrastructure projects.

52. The suggestion was made that the last sentence of paragraph 10 should be redrafted so as to make it clear that the guide did not advise against detailed sector-specific legislation as such, but only legislation that contained excessively detailed provisions on the content of the contractual arrangements between the contracting authority and the concessionaire.

53. In connection with paragraphs 12 to 15, a number of questions were raised concerning the mention of a “special legal regime” applying to privately financed infrastructure projects in some legal systems. In particular, it was suggested that the power or right of a Government to revoke or modify a contract, for reasons of public interest, raised a number of issues. The view was expressed that the financing of infrastructure projects required a stable and predictable environment and that, in the interest of

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11Ibid., paras. 63-95.
attracting investment capital, Governments would be well advised to restrain the power to revoke or modify the contract. It was suggested that Governments might wish to adopt legislation that minimized the power of a Government to interfere once a contract had been concluded. It was felt that the guide should avoid the impression that, by referring to the existence of such special prerogatives in some legal systems, it impliedly endorsed their exercise. Moreover, the guide should make it clear that the contractor was entitled to reasonable, proper compensation in case of losses due to governmental action revoking or modifying the contract.

54. In response, it was observed that paragraphs 13 and 15 adequately reflected, in a summary fashion, some of the essential features of the legal regime governing privately financed infrastructure projects under some legal systems. It was pointed out that, in those legal systems, the contracting authority had, by virtue of general rules applicable to administrative contracts, even where the contract remained silent on the point, exceptional prerogatives which it could not legally waive. Those prerogatives included, as mentioned in paragraph 13, the power to alter the terms of administrative contracts or to terminate those contracts or request their rescission by a judicial body, for reasons of public interest. Those extraordinary prerogatives were justified by the administration’s duty to act in the public interest. The exercise of such prerogatives, besides being in no way arbitrary and being in any case subject to judicial control, imposed binding obligations on the administration, especially to ensure the continuity of public services or to compensate the concessionaire for the loss incurred with the modification or termination of the contract. Since later chapters of the guide (e.g. chapter V, “Infrastructure development and operation”, and chapter VI, “End of project term, extension and termination”) dealt with the legal consequences of the exercise of such special prerogatives by the contracting authority, the concerns that had been expressed might be addressed by adding appropriate cross-references in paragraph 13.

Scope of authority to award concessions (legislative recommendation 2 and paras. 16-25)

55. It was observed that the language used in the chapeau of the legislative recommendation was unnecessarily cautious. It was suggested that the words “may wish to consider” in the chapeau be replaced by “should consider”.

56. The suggestion was made that legislative recommendation 2 (b) should be expanded so as to reflect the fact that, in some legal systems, the legal regime governing concessions included principles of law that had been developed by jurisprudence.

57. The Commission agreed that paragraph 16 needed to be revised so as to clarify the meaning of the expression “decentralized entities”.

58. In connection with paragraph 17, it was suggested that in some countries it might not be feasible to describe positively the scope of authority to award concessions, and that the guide should refer to the technique used in some countries of circumscribing such authority by identifying the fields of activity where no concessions might be awarded (e.g. activities related to national defence and security).

Administrative coordination (legislative recommendation 3 and paras. 27-32)

59. It was suggested that in legislative recommendation 3 (a) a reference should be included to the preparation by the contracting authority of studies that identified the expected output of the project, provided sufficient justification for the investment, proposed a modality of private sector participation, and described a particular solution to the output requirement. Such a study was referred to in the contracting practice of some countries as a “business case”.

60. It was also suggested that legislative recommendation 3 (a) should refer to the need for carrying out studies on the expected impact of the proposed project on the particular infrastructure sector and, as appropriate, on other infrastructure sectors.

61. It was agreed to insert the words “construction and” before the word “operation” in legislative recommendation 3 (b).

62. The Commission was advised that recent international experience had demonstrated the usefulness of establishing a central unit within the host country’s administration, with overall responsibility for formulating policy and providing practical guidance on privately financed infrastructure projects and coordinating the input of the main governmental bodies that would interface with the project company. It was suggested that a recommendation to that effect might be included in legislative recommendation 3.

63. With respect to the distribution of administrative authority among various levels of government, which was mentioned in paragraph 32, it was suggested that the text should be made stronger in urging countries to coordinate their efforts in the various governmental areas and levels.

Authority to regulate infrastructure services (legislative recommendations 4 and 5 and paras. 33-55)

64. It was suggested that recommendation 4 should provide that decisions by any regulatory body had to be taken pursuant to rules of law governing transparency in the public administration.

65. It was pointed out that the notion of independence and autonomy of regulatory bodies, as contemplated in legislative recommendation 4 (b), involved two main aspects: independence vis-à-vis the host country’s Government, and independence from the regulated industry. It was suggested that the second part of legislative recommendation 4 (a), which mentioned one of the requirements
for the independence of regulatory bodies, should be combined with legislative recommendation 4 (b).

66. On the same issue, it was also pointed out that different legal systems provided for various forms of relief, including administrative review, and that the reference to "appeal procedures" in legislative recommendation 5 (b) should not be understood as limiting such relief to judicial proceedings.

67. Still in connection with legislative recommendation 5 (b), it was noted that recent developments in the law of some countries had led to an expansion of the scope of relief against regulatory decisions so as to recognize the rights of some third parties, such as consumers or users of the facility, to appeal regulatory decisions that adversely affected their rights. It was suggested that legislative recommendation 5 (c) should be expanded accordingly.

68. The view was expressed that clarifying the appellate procedures, be they administrative, arbitration or judicial, might help in attracting private investment for public infrastructure projects. The guide should emphasize the need for timeliness in the decision-making process by regulatory bodies.

69. It was pointed out that the possibility of sub-contracting to outside experts certain regulatory tasks, which was referred to in paragraph 48, was not an appropriate solution in every situation, particularly in those countries where few resources were available. Caution was needed to avoid potential conflicts of interest. It was agreed that the last sentence of paragraph 48 should be deleted.

II. Project risks and government support
(A/CN.9/458/Add.3)

General remarks

70. Pursuant to one view, the considerations relating to the risks encountered in privately financed infrastructure projects and the common contractual solutions for risk allocation, currently set out in section B of the draft chapter, were logically related to the financial arrangements for the execution of infrastructure projects, which were dealt with in other portions of the guide, namely in section D of the introduction (A/CN.9/458/Add.1) and in section B.1 of chapter IV, "The project agreement" (A/CN.9/458/Add.5). It was therefore suggested that the discussion of those issues should be combined into one new chapter concerning the financial arrangements for privately financed infrastructure projects.

71. By the same token, it was pointed out that section C of the draft chapter, which set out policy considerations of the Government on direct government support and discussed some additional support measures, as well as sections D and E, which outlined guarantees and support measures that might be provided by international and bilateral financial institutions, were closely related to the contractual arrangements for the implementation of privately financed infrastructure projects. It was suggested that sections C to E might thus be incorporated into chapter IV.

72. Another view, which gathered wide support, was that a separate chapter dealing with issues of project risks and government support was useful to help the reader focus on the importance of achieving an effective allocation of project risks in order to ensure the successful implementation of privately financed infrastructure projects. It was also pointed out that the level of government support available to privately financed infrastructure projects might be determined for individual infrastructure sectors, and not only for individual projects. Thus, it would not be desirable to regard the relevant discussion in the draft chapter as dealing with purely contractual issues.

73. Although there was general agreement to retain the draft chapter, it was felt that the link between the issues discussed therein and the financial considerations set out elsewhere in the guide might be established more clearly in the draft chapter. One possible way of achieving that result might be to insert in the draft chapter a short section highlighting the particular requirements of project financing in terms of project risks and risk allocation.

74. It was proposed that after paragraph 2 of the notes to the legislative recommendations, language along the following lines should be added:

"In the past, debt financing for infrastructure projects was obtained on the basis of credit support from project sponsors, multilateral and national export credit agencies, Governments and other third parties. In recent years, these traditional sources have not been able to meet the growing needs for infrastructure capital and financing has been increasingly obtained on a project finance basis.

"Project finance, as a method of financing, seeks to establish the creditworthiness of the project company on a 'stand-alone' basis, even before construction has begun or any revenues have been generated, and to borrow on the basis of that credit. Commentators have observed that project finance may hold the key to unlocking the vast pools of capital theoretically available in the capital markets for investment in infrastructure. However, project finance has distinctive and demanding characteristics from a financial point of view. Principal among these is that, in a project finance structure, financing parties must rely mainly upon the project company's assets and cash flows for repayment. If the project fails they will have no recourse, or only limited recourse, to the financial resources of a sponsor company or other third party for repayment.

"The financial methodology of project financing requires a precise projection of the capital costs, revenues and projected costs, expenses, taxes and liabilities of the project. In order to predict precisely and with certainty these numbers, and to create a financial model for the project, it is typically necessary to project the 'base case' amounts of revenues, costs and expenses of the project company over a long period—often 20
years or more—in order to determine the amounts of debt and equity the project can support. Central to this analysis is the identification and quantification of risks. For this reason, the identification, assessment, allocation and mitigation of risks is at the heart of project financing from a financial point of view.

"Among the most important, yet difficult, risks to assess and to mitigate are 'political risk' (the risk of adverse actions of the host Government, its agencies and its courts, particularly in licensing and permitting, regulation applicable to the project company and its markets, taxation, and in the performance and enforcement of contractual obligations) and 'currency risk' (the risk of the value, transferability and convertibility of the local currency). For these risks, in particular, project finance structures have often incorporated insurance or guarantees of multilateral and export credit agencies as well as host Government guarantees."

75. The Commission generally agreed with the substance of the proposed addition and requested the Secretariat to consider the most appropriate place for inserting the new text (i.e. whether in the draft chapter or in the introduction to the legislative guide). The Commission further agreed that a text along the following lines should be inserted, at an appropriate place, in the draft chapter:

"Other chapters of this guide deal with related aspects of the host Government legal regime which are of relevance to the credit and risk analysis of a project. Depending upon the sector and type of project the emphasis will, of course, vary. The reader is referred in particular to chapters IV, 'The project agreement', V, 'Infrastructure development and operation', VI, 'End of project term, extension and termination', VII, 'Governing law' and VIII, 'Settlement of disputes'."

76. It was pointed out that the guide contained a large number of technical expressions used in business and financial practice, and it was agreed that the final text should contain a glossary of the technical terms used in the guide.

Project risks and risk allocation (legislative recommendation 1 and paras. 3-24)

77. The view was expressed that it was important for the contracting authority to have sufficient power to agree on an allocation of risks that suited the needs of the project, not only in its own view, but also taking into account the interests of all the parties involved. It was therefore agreed that the words "in the view of the contracting authority" should be deleted from legislative recommendation 1.

78. The suggestion was made that legislative recommendation 1 should also refer to the need for attracting capital for privately financed infrastructure projects. However, that suggestion did not attract sufficient support.

79. It was pointed out that paragraphs 6 to 15 referred largely to risks faced by the project company, but did not give sufficient attention to risks faced by the contracting authority. It was therefore agreed that paragraphs 6 to 15 should also mention risks specifically faced by the contracting authority, in particular risks related to the transfer of the infrastructure facility to the contracting authority at the end of the project term.

80. It was noted that paragraph 7 referred to the risk of project disruption due to unforeseen or extraordinary events outside the control of the parties, while paragraph 8 mentioned the risk that the project execution might be negatively affected by acts of the contracting authority, other governmental agencies or the host country’s legislature. It was observed that, in some legal systems, there were well-established principles of law that dealt with those situations. For instance, in the situation referred to in paragraph 7, some legal systems placed the concessionaire under an obligation to continue providing the services despite the occurrence of the said unforeseen or extraordinary events, subject to some reasonable limits and to the provision of adequate assistance, financial or otherwise, by the contracting authority, including payment of adequate compensation for the additional cost incurred by the concessionaire. Furthermore, in the situation referred to in paragraph 8, some legal systems recognized that the concessionaire might be entitled to a varying level of compensation depending on whether the project execution was negatively affected by acts of the contracting authority itself, of other governmental agencies or the host country’s legislature. Since neither paragraph 7 nor paragraph 8 indicated the legal consequences of the situations referred to therein, it was agreed that appropriate cross-references should be included to the subsequent portions of the guide where those matters were discussed in more detail.

81. It was suggested that, for purposes of clarity, the word "negotiators" in paragraph 17 should be replaced by the words "contracting authorities".

82. It was suggested that paragraph 18 should mention the fact that guarantees of performance provided by contractors and equipment suppliers were often complemented by similar guarantees provided by the concessionaire to the benefit of the contracting authority.

83. It was agreed that the reference to assurances against expropriation or nationalization, which were mentioned in paragraph 19, were not meant to suggest that the Government waived its sovereign right to acquire the project assets through expropriation or similar proceedings, provided that adequate compensation was paid in accordance with the rules in force in the host country and relevant rules of international law.

84. The view was expressed that the closing sentence of paragraph 24 contained an important warning to legislators in host countries about the undesirability of having in place statutory provisions that limited unnecessarily the negotiators’ ability to achieve a balanced allocation of project risks. It was agreed that it would be useful to express the same idea more prominently in subsection B.2.
85. The Commission agreed that the word “indicating” in recommendation 2 did not sufficiently stress the need for clarity about the forms of support that might be provided by the Government of the host country and that the word “stating” should be used instead.

86. In view of the fact that the chapter described various forms of support by the Government, not all of which were of a financial nature, it was agreed that recommendation 2 and paragraph 26 should be adapted accordingly.

87. The view was expressed that the last sentence of paragraph 28, which cautioned against overcommitment of governmental agencies through guarantees given to specific projects, was unnecessary or otherwise should not be interpreted as any kind of intervention in the policies of host Governments. In response, it was observed that paragraph 28 contained valuable advice to legislators, which should be retained in the guide. It was noted that some countries with considerable experience in privately financed infrastructure projects had found it necessary to introduce appropriate techniques for budgeting for, or for assessing the total cost of, government support measures in order to avoid the risk of financial overcommitment of governmental agencies.

88. In connection with paragraph 31, it was pointed out that the host country’s obligations under international agreements on regional economic integration or trade liberalization might also limit its ability to provide forms of support other than financial support to companies operating in their territories.

89. In response to a question concerning the purpose of, and the need for, paragraph 36, it was pointed out that in some countries the participation of the Government in a given project often raised an expectation that the Government would back the project fully or eventually take it over at its own cost if the project company failed, even though the Government might not be under a legal obligation to do so. The view was also expressed that the note of caution contained in paragraph 36 was useful, since equity participation might entail the transfer back to the Government of a share of project risks, and the loss of public funds, should the project company become insolvent, would inevitably have political consequences. There was, however, general agreement that the meaning of paragraph 36 might need to be clarified further, in particular the reference to possible ways for the Government to protect itself against the risks mentioned therein. It was pointed out, in particular, that contractual provisions releasing the Government from any obligation to subscribe to additional shares in the event that the project company’s capital needed to be increased might be contrary to national law in some jurisdictions.

90. In connection with paragraph 39, it was pointed out that it was also important to bear in mind, in addition to domestic competition laws, the host country’s obligations under international agreements on regional economic integration or trade liberalization. These considerations, it was suggested, also applied to paragraphs 51 to 53.

91. The view was expressed that the expression “sovereign guarantees” in paragraph 40 did not reflect the substance of the subsection and that it might imply a reference to public international law, specifically with respect to State immunity. It was suggested that the use of that expression should be reconsidered.

92. It was suggested that paragraph 41 (a) should mention the situation where the expectations under an off-take agreement might not be met, as a result of the privatization of the governmental entity concerned.

93. The risk of exchange rate fluctuations, it was said, was ordinarily regarded as a commercial risk, as stated in paragraph 44. Nevertheless, it was suggested that in cases where the project company was unable to repay funds borrowed in foreign currencies due to extreme foreign exchange rate fluctuations, the foreign exchange risk might be regarded as a political risk. In practice, Governments had sometimes agreed to assist the project company in such cases.

94. In connection with paragraphs 51 to 53, the view was expressed that governmental undertakings aimed at protecting the concessionaire from competition might in some cases be inconsistent with the host country’s obligations under international agreements on regional economic integration or trade liberalization, a circumstance which should be mentioned in the guide.

95. It was agreed that paragraph 68, as well as other relevant portions of the guide, should mention both export credit agencies and national development agencies. It was also agreed that the title of the subsection should read “Guarantees provided by export credit agencies and national development agencies”.

96. Export credit agencies, it was said, usually guaranteed payment where the buyer, for whatever reason, could not make payment. In that sense, export credit agencies provided a type of insurance. For the purpose of clarifying the scope of guarantees provided by export credit insurance, it was agreed to add the words “In the context of the financing of privately financed infrastructure projects” at the beginning of paragraph 69 (a).

III. Selection of the concessionaire
(A/CN.9/458/Add.4)

General considerations (legislative recommendation 1 and paras. 1-30)

97. It was agreed that the legislative recommendations expressed in chapter III were to be reviewed and adjusted as necessary so as to make sure that all advice in the notes that merited a legislative provision was appropriately included in the legislative recommendations, without, however, unnecessary reference in the recommendations to the administration of proceedings for the selection of a concessionaire.

98. Opinions were expressed favouring competitive methods for selecting the concessionaire, with appropriate adjustments that took into account the particular needs of
privately financed infrastructure projects. Statements were made that adherence to competitive methods was necessary to counter improper practices and corruption as well as to obtain the best value for the host Government and the users of privately financed infrastructure facilities. It was suggested that the UNCITRAL Model Law on Procurement of Goods, Construction and Services, which was based on the notion of competition in public procurement, presented a suitable basis for devising selection procedures in privately financed infrastructure projects. It was said that the relationship between procurement methods under the Model Law and selection methods for privately financed infrastructure projects was such that it would be possible to refer in the legislative guide, whenever appropriate, to the Model Law and thereby to limit chapter III of the legislative guide to those provisions that should be different from those in the Model Law.

99. In response it was stressed, however, that in some countries, pursuant to their time-honoured tradition, privately financed infrastructure projects (which involved the delegation by a State entity of the right to provide a public service) were subject to a special legal regime that differed in many respects from the regime that applied generally to the public procurement of goods, construction and services. That special legal regime placed the accent on the delegating body's freedom to choose the operator who best suited its needs, in terms of professional qualifications, financial strength, ability to ensure the continuity of the service, equal treatment of the users and quality of the proposal. However, freedom of negotiation did not mean arbitrary choice and the laws of those countries provided procedures to ensure transparency and fairness in the selection process.

100. The Commission, recalling its considerations at its previous session and considering that the legislative guide should be useful worldwide, agreed with the substance of recommendation 1, subject to clarifying that the recommendation was to be implemented in accordance with the legal tradition of the State concerned.

Pre-selection of bidders (legislative recommendation 2 and paras. 39-56)

101. It was recalled that, while the pre-selection proceedings described in the recommendation resembled in some respects traditional pre-qualification proceedings in the procurement of goods and services, it was important to distinguish the two proceedings (in order to avoid the connotation of automatic qualification (or disqualification) that was inherent in the traditional pre-qualification proceedings). It was therefore confirmed that it was appropriate to use the expression “pre-selection proceedings” in the draft chapter.

102. It was suggested that recommendation 2 should mention criteria for the pre-selection of bidders, just as recommendation 6 (d) contained criteria for evaluating proposals by bidders. Furthermore, it was said that the recommendation was somewhat incomplete in that it did not reflect all the requirements mentioned in paragraph 43; it should therefore be adjusted to reflect the substance of paragraph 43.

103. It was agreed to stress in the last sentence of paragraph 50 that it was necessary to announce in advance the intention to apply any domestic preferences in the pre-selection proceedings.

104. While some support was expressed for retaining recommendation 2 (d) (which envisaged giving to the contracting authority discretion to announce in the invitation to the pre-selection proceedings that the bidders would be compensated for costs incurred by them in preparing pre-selection documents if the project was prevented from proceeding for reasons outside their control), the prevailing view was that the recommendation should be deleted since in many countries such compensation was not envisaged. It was, however, agreed to keep paragraphs 51 and 52 of the notes, which provided useful information about this possibility. It was suggested to stress in the last sentence of paragraph 52 the need to announce the contracting authority's intention to compensate bidders in certain circumstances at an early stage, preferably in the invitation to the pre-selection proceedings.

Single-stage and two-stage procedure for requesting proposals (legislative recommendations 3-5 and paras. 58-64)

105. The Secretariat was requested to clarify (in the recommendations and in the accompanying notes) the differences in the following stages of the selection process: (a) the discussions between the contracting authority and bidders concerning the substance of proposals; (b) requests for clarifications that bidders might direct to the contracting authority; and (c) final negotiations as described in recommendation 12 and paragraphs 92 and 93. It was noted that such clarification might require some restructuring of the text.

Content of the final request for proposals (legislative recommendation 6 and paras. 65-74)

106. It was observed that one of the problems that frequently arose in practice was the excessively long time needed to award the project and negotiate the project agreement; in that connection, it was suggested that the importance of recommendation 6 (c) relating to the inclusion in the final request for proposals of the contractual terms of the project agreement should be emphasized. The presence and comprehensiveness of those terms in the final request would reduce the time needed for the conclusion of the project agreement and increase the transparency of the process.

107. The suggestion was made that recommendation 6 should reflect, with the necessary adjustments, the substance of recommendation 11 (b) (concerning the threshold with respect to quality and technical aspects of the proposals) and the substance of recommendation 12 (c)
(concerning the terms of the contract that were designated as not negotiable). It was also suggested that paragraph 71 (e) should be aligned, in the language versions where necessary, with paragraph 84 (c). Furthermore, it was suggested that paragraph 73 should refer to chapter IV, “The project agreement”, which gave more guidance to the reader on matters outlined in the paragraph.

Clarifications and modifications (legislative recommendation 7 and paras. 75 and 76)

108. It was suggested that a clearer distinction should be made in paragraphs 75 and 76 between clarifications and modifications and to refer in recommendation 7 to the possibility of extending the deadline for submission of proposals in case of extensive amendments to the requests for proposals. As to recommendation 7 (b), it was widely recognized that it was important to provide for an obligation of keeping minutes of meetings of bidders convened by the contracting authority. Nevertheless, it was said that the legal consequences of a failure to prepare the minutes did not need to be addressed in the legislative guide and that those consequences might be left to other legal rules governing the conduct of the contracting authority. A suggestion was made that any failure to keep proper minutes should not necessarily lead to the conclusion that the selection was vitiated.

Contents of the final proposals (legislative recommendation 8 and paras. 77-82)

109. It was agreed that the expression “may wish” in recommendation 8 should be replaced by a stronger term; furthermore, the recommendation should make it clear that the final proposals should provide information on all relevant factors that allowed the contracting authority to establish the responsiveness of the proposal (including, e.g. the information required to assess the level of governmental support expected by the bidder, the bid security as explained in paragraphs 81 and 82; information regarding the quality of service; and all aspects of the environmental impact of the project). As to paragraph 79 (d), it was suggested that the bidders should be required to indicate the degree to which they were ready to assume “force majeure” types of risk, i.e. risks of financial consequences of unforeseen events.

Evaluation criteria (legislative recommendations 9 and 10 and paras. 83-86)

110. It was agreed that compliance with environmental standards (recommendation 9 (d)) was a requirement and should not be included as an evaluation criterion; to do so implied the possibility of deviation from those standards. It was decided to merge recommendation 9 (d) into recommendation 8.

111. It was proposed that, since it could not be assumed that pre-selection of bidders would be carried out in all cases, the recommendations should include a provision concerning the evaluation of the qualification of bidders.

112. It was noted that in the practice of some countries a new evaluation criterion had emerged according to which the host Government was able to assess the social impact or value of the project (e.g. benefits to underprivileged groups of persons or businesses), and it was suggested that the legislative guide recognize such a “social” criterion.

113. It was pointed out that the statement in paragraph 84 (b) requiring, where feasible, the transfer of technology during every phase of the project expressed a view that might not always be acceptable because of the exclusive rights that were characteristic of proprietary information. It was suggested that in paragraph 84 (c), the words “may include” should be replaced by “should include”, and that the substance of the subparagraph should be moved into the legislative recommendations.

114. It was suggested that an expression along the lines of “proposed financial arrangements” should be included in paragraph 10 (b). It was also suggested that (among the costs to be considered in the financial proposals) the current value of maintenance costs should be added to paragraph 10 (c). Given the earlier acknowledgement that governmental support extended beyond financial support, it was agreed to adjust paragraph 10 (d) accordingly. Another criterion that was to be added to recommendation 10 concerned the extent of risk assumed by the bidder.

Submission, opening, comparison and evaluation of proposals (legislative recommendation 11 and paras. 87-91)

115. Referring to paragraphs 89 to 91, it was suggested that it was important to preserve a two-step evaluation process whereby non-financial criteria would be taken into consideration separately from, and perhaps before, financial criteria, so as to avoid situations where undue weight would be given to certain elements of the financial criteria (such as the unit price) to the detriment of the non-financial criteria. Support was expressed for that suggestion, without, however, endorsing the “two-envelope” system, according to which the contracting authority was to evaluate the technical elements of the proposal without being influenced by its price component.

116. In response to a question, it was clarified that subparagraphs (a), (b) and (c) of recommendation 11 were not to be read as alternatives. After determining that a proposal was not responsive, it was not intended that the evaluation procedure would continue.

117. In response to a concern over possible duplication, it was explained that, whereas recommendation 8 described what the contracting authority could require in the proposal, recommendation 11 provided for the rejection of incomplete proposals that had not met such requirements.

118. The view was expressed that the provisions of paragraph 87, which stipulated that proposals received by the
contracting authority after the deadline should not be opened, were too severe, and that such a situation required more detailed provisions. It was also suggested that, for the purpose of promoting transparency, paragraph 88 should include a provision that would require proposals to be opened in a public session. In response to those suggestions, it was suggested that such matters might best be left to the procurement laws of the country concerned.

119. In response to a question as to the relationship between the draft legislative guide and international rules of public procurement, such as those contained in agreements on government procurement concluded under the auspices of the World Trade Organization, it was explained that the matter was addressed in chapter VII, "Governing law". It was suggested that the Secretariat should seek comments from the World Trade Organization on draft chapter III of the legislative guide.

Final negotiations (legislative recommendation 12 and paras. 92 and 93)

120. It was pointed out that, whereas recommendation 12 outlined provisions for final negotiations between the contracting authority and the bidder that had submitted the most advantageous proposal, the contracting authority might have to negotiate with another bidder, if the first bidder would decide not to accept the contract. It was suggested that the recommendation should be revised to reflect that possibility. It was also suggested that in subparagraph (c) of the recommendation, the term "deemed" should be replaced by "designated".

Notice of project award (legislative recommendation 13 and para. 94)

121. No comments were made on recommendation 13 and paragraph 94 of the notes.

Direct negotiations (legislative recommendations 14 and 15 and paras. 95-100)

122. There was wide agreement that the principles of competition and transparency were critical to the objectives of the draft legislative guide and that, in the context of privately financed infrastructure projects, direct negotiations should be used in exceptional circumstances. It was noted, however, that in some countries direct negotiations were used and that, coupled with measures enhancing transparency, they produced satisfactory results. It was therefore agreed that paragraph 98 should be adjusted to reflect more accurately the practice and implications of direct negotiations in the selection of the concessionaire.

123. It was suggested that, as the list of exceptional circumstances authorizing direct negotiations was not exhaustive and raised issues on which national policies might differ, the list would be more appropriately included in the notes, rather than in recommendation 14. On a point of clarification as to the circumstances of urgency that would justify direct negotiations (recommendation 14 (a)), it was explained that interruption in the provision of services to the public might constitute one example. Reasons of national defence, cases where there was only one source capable of providing the required service, and overriding reasons of public interest were also viewed as circumstances under which direct negotiations were justifiable. As to recommendation 14 (e) (which allowed direct negotiations in the case of lack of experienced personnel or of an adequate administrative structure), it was said that that circumstance should not constitute a reason permitting direct negotiations because the selection process would remain prone to abuse. Hiring consultants and advisers to assist in carrying out the selection was said to be the appropriate practical solution in such a case. The contrary view, however, was that lack of experienced personnel was a real problem for some Governments which ought to be taken into account in devising legislative provisions on the selection of the concessionaire. Support was expressed for the suggestion that lack of experienced personnel should not constitute an exception that might be resorted to on a case-by-case basis.

Measures to enhance transparency in direct negotiations (legislative recommendation 16 and paras. 101-107)

124. Caution was advised as to recommendation 15 and the notes in paragraph 100, which allowed, after a competitive selection procedure had been initiated, changing the selection method in favour of direct negotiations. Since such a change was prone to abuse, it was said that the conditions for the change should be expressed more restrictively and subject to specific requirements of transparency such as an announcement in the initial request for proposals.

125. It was suggested that a provision should be included in the recommendation that would require a written justification wherever there had been a divergence from competitive principles. Other suggestions were to include a requirement that the project agreement should be open to public inspection and to require publication of the award. It was pointed out that the requirement to maintain a record of the selection proceedings, described in paragraph 107, was not reflected in the recommendation. It was considered that subparagraph (g) of the recommendation was self-evident and could be deleted.

126. It was suggested that the importance of the need to maintain confidentiality should be stressed in the notes. It was also pointed out that, after the bidding process or direct negotiations had been completed, and after the information had entered the public domain, confidentiality requirements in respect of certain parts of that information would end.

127. It was pointed out that the term "direct negotiations" rather than "negotiations" had to be used consistently throughout the recommendation and accompanying notes.

128. It was pointed out that there was an inconsistency between the title of recommendation 16 and the contents,
which extended to matters beyond measures to enhance transparency, such as measures to maintain confidentiality. Another suggestion was to revise recommendation 16 in the same manner as recommendation 14 by including the list of examples in the notes. It was decided to delete the title of recommendation 16 and leave the recommendation under the overall title “Direct negotiations”.

129. One view was that it was inadvisable to include in paragraph 101 a statement that in some countries procurement laws allowed contracting authorities virtually unrestricted freedom to conduct negotiations as they saw fit, as such a statement might be misunderstood as an endorsement. The opposing view regarded the statement as being merely a description of practice and therefore acceptable.

Unsolicited proposals (legislative recommendations 17-20 and paras. 108-128)

130. It was observed that in a number of countries no special procedures existed for dealing with unsolicited proposals and that, as a consequence, such unsolicited proposals were in those countries treated in accordance with the procedures applicable generally for awarding public infrastructure projects. A suggestion was therefore made that, from the perspective of those countries, there might be no need for the elaborate treatment of unsolicited proposals as had been suggested in the current version of the draft chapter. The Commission, however, recalling its discussion at its thirty-first session, considered that unsolicited proposals were in the interest of States and that it was therefore useful to suggest procedures for dealing with them in order, on the one hand, to attract such proposals and, on the other hand, to ensure that projects were awarded on optimal conditions.

131. It was suggested that the usefulness and clarity of recommendation 17 would be improved if it would be stated in the recommendation that unsolicited proposals were to be dealt with in accordance with the procedures established in the law (those procedures were suggested and commented upon in subsequent recommendations 18 to 20).

132. A proposal was made that an additional recommendation should be included at an appropriate place to the effect that the contracting authority, after awarding a project based on an unsolicited proposal, was obliged to publish a notice of the award.

133. As to recommendation 20 (b), it was suggested that it should be specified that “the summary of the essential terms of the proposal” to be given to other interested parties should, to the extent possible, be limited to the “output” elements of the proposal (e.g. capacity of the infrastructure facility, quality of the product or the service, price per unit) and that, in particular, the summary should not include “input” elements of the unsolicited proposal (e.g. the design of the facility, technology and equipment to be used). The reason for that limitation was to avoid disclosing to potential competitors proprietary information of the person who had submitted the unsolicited proposal.

134. It was observed that paragraph 125 (b) envisaged a “margin of preference” as a possible incentive to attract unsolicited proposals; it was pointed out that the use of a margin of preference originated in the context of procurement of goods, construction and services and that such a margin of preference worked well when applied to the price elements of a proposal, but that it was difficult to apply to non-price evaluation criteria. It was therefore suggested that consideration should be given to somewhat rewording the paragraph in order to give more guidance as to the application of the margin of preference in the context of unsolicited proposals.

Review procedures (legislative recommendation 21 and paras. 129-133)

135. It was suggested that the notes, and possibly also the recommendation, should emphasize the usefulness of a workable “pre-contract” recourse system, i.e. procedures for reviewing the contracting authority’s acts as early in the selection proceedings as feasible. The benefit of such a system was to increase the possibility of corrective actions being taken by the contracting authority before loss was caused and to reduce cases where monetary compensation was the only option left to redress the consequences of an improper action by the contracting authority.

Record of selection proceedings (legislative recommendation 22 and paras. 134-141)

136. It was suggested that the Commission should consider rewording the title of the recommendation to read “Record of selection and award proceedings”. It was suggested that recommendation 21 should be aligned with the notes, in particular to make the recommendation as strong as it was described in the notes.

IV. The project agreement (A/CN.9/458/Add.5)

General remarks

137. By way of a general comment, it was suggested that the relationship between the draft chapter and other portions of the guide might need to be reviewed. It was pointed out that a number of issues discussed in chapter V, “Infrastructure development and operation” (A/CN.9/458/Add.6), and chapter VI, “End of project term, extension and termination” (A/CN.9/458/Add.7), related to matters that were typically dealt with in project agreements.

138. The structure of the draft chapter, it was suggested, might be improved if subsection B.8, “Duration”, and subsection B.5, “Organization of the concessionaire”, would, in that order, immediately follow subsection B.1, “Financial arrangements”.

139. While no objections were voiced to those proposals, the view was expressed that, in preparing the legislative

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14Ibid., para. 171.
guide, the Commission had to deal with a variety of issues that received different legislative and contractual treatment in various legal systems. The Commission was urged to adopt a pragmatic approach when considering the overall structure of the guide and to proceed with the review of the substance of the draft chapters before making a final decision on the structure.

140. The suggestion was made that some of the legislative recommendations should expressly recommend the adoption of legislation to achieve the objectives stated in the chapter.

141. The view was expressed that, although the notes appropriately, and in a balanced manner, reflected solutions found in different legal systems, the draft chapter appeared to give more emphasis to the need for attracting financing for privately financed infrastructure projects than to the public service nature of most of those projects.

Conclusion of the project agreement (legislative recommendation 1 and paras. 5-8)

142. The Commission agreed to delete the word “simplify” in legislative recommendation 1 and to replace it by the word “facilitate” or another word with equivalent meaning.

143. With regard to the reference, in legislative recommendation 1, to the need for identifying in advance the offices or agencies competent to approve and sign the project agreement, it was suggested that such identification was an essential element of the institutional framework for the implementation of privately financed infrastructure projects in the host country. The inclusion of such a reference in the draft chapter might create the undesirable impression that the offices or agencies competent to approve and sign the project agreement could be made known only after the conclusion of the procedure to select the concessionaire. It was therefore agreed that the second phrase of legislative recommendation 1 should be moved to an appropriate place in draft chapter I, “General legislative considerations” (A/CN.9/458/Add.1).

144. The view was expressed that the second sentence of paragraph 4 needed to be redrafted so as to make it clear that it referred to general legislation, rather than to specific legislation, which in some countries might need to be adopted in respect of individual projects.

145. It was suggested that the last sentence of paragraph 8 should be revised in order to clarify the manner in which the contracting authority might undertake to compensate the winning bidder in the event that the final approval to the project agreement, where required, was withdrawn.

Financial arrangements (legislative recommendations 2 and 3 and paras. 10-21)

146. It was agreed that legislative recommendation 2 (a) duplicated the essence of legislative recommendation 6 and that the two recommendations should be combined. It was also suggested that legislative recommendations 2 (b) and 2 (c) should be consolidated in one single text.

147. The view was expressed that the last sentence of paragraph 12, which referred to the importance of ensuring that the laws of the host country did not unreasonably restrict the concessionaire’s ability to offer adequate security to its lenders, was not entirely consistent with the contents of paragraphs 32 to 40, which referred to possible legal obstacles to the creation of certain types of security and other provisions to safeguard the public interest. It was agreed that the sentence in question should be deleted.

148. It was pointed out that paragraph 13 mentioned the role played by “special-purpose vehicles” in securitization transactions. It was suggested that the draft chapter should also provide a specific legislative recommendation on that matter. In reply to that suggestion, it was observed that the notion of “special-purpose vehicles” was not known in many legal systems, and that the use of special-purpose vehicles in connection with securitization transactions required an appropriate legal framework in other areas of law. Since the draft chapter could not deal exhaustively with the matter, it was proposed that a reference to the usefulness of adopting provisions that facilitated the establishment of special-purpose vehicles should be mentioned in the appropriate part of draft chapter VII, “Governing law” (A/CN.9/458/Add.8), rather than in draft chapter IV. The view was also expressed that the discussion concerning securitization transactions in paragraph 13 was too detailed and might be usefully shortened.

149. It was noted that paragraph 17 described arrangements whereby the contracting authority or other governmental agency made direct payments to the concessionaire as a substitute for, or in addition to, service charges to be paid by the users. It was observed that some of those arrangements might involve a form of subsidy to the project company and, accordingly, might not be consistent with the host country’s obligations under international agreements on regional economic integration or trade liberalization.

150. It was suggested that the description of the different modalities of off-take agreements, which was contained in subparagraphs (a) and (b) of paragraph 20, might not be needed in the guide, since the arrangements described therein were essentially of a contractual nature.

151. It was agreed that the third sentence of paragraph 21 was not needed and that it should be deleted.

The project site (legislative recommendation 4 and paras. 22-27)

152. No comments were made on legislative recommendation 4 and paragraphs 22 to 27 of the notes.

Easements (legislative recommendation 5 and paras. 28-31)

153. It was agreed that legislative recommendation 5 should be reformulated so as to provide that the host coun-
try might wish to adopt legislative provisions that facilitated the acquisition by the concessionaire of the easements that might be needed for the construction, operation and maintenance of the infrastructure facility.

154. It was observed that the word “easement” had a narrow connotation in some legal systems, and that the statutory authority granted to the concessionaire, for example, to place water pipes or power transmission cables on property owned by third parties might not necessarily be regarded as an easement. It was agreed that that circumstance should be reflected in paragraph 29.

Security interests (legislative recommendation 6 and paras. 32-40)

155. The proposal was made that legislative recommendation 6 should make reference to the establishment of security interests over the shares of the project company, so as to reflect the discussion contained in paragraph 40.

156. The proposal was made that legislative recommendation 6 should be redrafted so as to indicate possible obstacles and limitations to the creation of security interests, according to the legal tradition of the host country, as discussed in paragraphs 32 to 40.

157. It was pointed out that security taken by lenders extending loans to privately financed infrastructure projects played primarily a defensive role, a circumstance that should be emphasized in paragraph 32. It was also suggested that paragraphs 32 to 40 should include a reference to the fact that the loan agreements often required that the proceeds of infrastructure projects should be deposited in an escrow account managed by a trustee appointed by the lenders.

158. It was observed that, in some legal systems, public service concessions were granted in view of the particular qualifications and reliability of the concessionaire and were not freely transferable. As a result of that general principle, any security given to lenders which made it possible for them to take over the project could only be admitted under exceptional circumstances and under certain specific conditions, namely: that they required the agreement of the contracting authority; that the security should be granted for the specific purpose of facilitating the financing or operation of the project; and that the security interests should not affect the obligations undertaken by the concessionaire. Those conditions, which should be mentioned in paragraphs 32 to 40, derived from general principles of law or from statutory provisions and could not be waived by the contracting authority through contractual arrangements.

159. It was suggested that the last sentence of paragraph 36, which referred to the possibility of dispensing with the requirement of specific acts of approval for each asset in respect of which a security interest was created, was not appropriate in the context of paragraphs 34 to 36 and that it should be deleted.

160. The view was expressed that security in the form of assignment of receivables played a central role in the financial arrangements for infrastructure projects, and that paragraphs 37 to 39 should elaborate further on that issue, as well as on the importance of having in place an appropriate legal framework for the assignment of trade receivables. It was agreed to insert, at an appropriate place, the substance of the discussion contained in paragraph 28 of draft chapter VII, “Governing law” (A/CN.9/458/Add.8).

161. It was agreed to delete the word “unnecessarily” in the third sentence of paragraph 40.

Organization of the concessionaire (legislative recommendations 7 and 8 and paras. 41-51)

162. It was pointed out that, where the law required the concessionaire to be incorporated under the laws of the host country, the contracting authority might lack the power to waive such a requirement without legislative authorization. For purposes of clarity, it was agreed that recommendation 7 should be redrafted so as to clarify that the contracting authority was given an option by the law, but not the power to waive statutory requirements.

163. It was agreed that, for purposes of clarity, the order of the first two sentences of paragraph 46 should be reversed.

164. In connection with paragraph 48, the view was expressed that the requirement of a certain minimum equity investment for companies carrying out infrastructure projects might be inconsistent with the host country’s obligations under international agreements on the liberalization of trade in services.

Assignment of the concession (legislative recommendation 9 and paras. 52-55)

165. The view was expressed that the question of subconcessions, which was briefly discussed in paragraph 55, had far-reaching implications in some legal systems, which deserved to be mentioned in the guide. However, that discussion was more closely related to the question of subcontracting and, therefore, it should be moved to an appropriate place in draft chapter V, “Infrastructure development and operation” (A/CN.9/458/Add.6).

Transferability of shares of the project company (legislative recommendation 10 and paras. 56-63)

166. Besides editorial and terminological suggestions, and the reiteration of some of the general remarks that had been made earlier, the legislative recommendations and the accompanying paragraphs of the notes did not elicit comments.
167. In response to a question as to the need for legislative recommendation 11, it was pointed out that past experience with infrastructure concessions had demonstrated the desirability of requiring that such concessions should have a limited duration. However, the maximum duration of concessions did not necessarily need to be provided for in legislation.

168. The view was expressed that the question of the duration of infrastructure concessions raised various issues of policy which should be elaborated upon in the draft chapter. Cross-references should also be added to later portions of the guide, such as draft chapter VI, “End of project term, extension and termination” (A/CN.9/458/Add.7), which dealt with other matters relevant for that discussion.

V. Infrastructure development and operation
(A/CN.9/458/Add.6)

General remarks

169. As a general comment, it was suggested that sections D to H of the draft chapter should be moved to draft chapter IV, “The project agreement” (A/CN.9/458/Add.6).

Subcontracting (legislative recommendation 1 and paras. 2-4)

170. In connection with recommendation 1 (a), the view was expressed that it was not sufficient to merely advise the contracting authority of the names and qualifications of the subcontractors engaged by the concessionaire. It was suggested that the contracting authority might have a legitimate interest in reviewing all of the major subcontracts negotiated by the concessionaire, and not only contracts entered into by the concessionaire with its own shareholders or affiliated persons. The Commission agreed that legislative recommendation 1 (a) should be deleted and that legislative recommendation 1 (b) should be expanded so as to cover all major contracts entered into by the concessionaire.

171. It was observed that, in some legal systems, government contractors were not free to subcontract their obligations without the prior approval of the contracting authority. Furthermore, in the context of some regional integration agreements, there were rules that prescribed the use of specific procedures for the award of subcontracts by concessionaires of public services. The concern was expressed that recommendation 1 and the accompanying notes appeared to advocate the concessionaire’s unrestricted freedom to hire subcontractors. It was suggested that the notes should be revised accordingly. The fourth sentence of paragraph 3, which stated that, for privately financed infrastructure projects, there might no longer be a compelling reason of public interest for prescribing to the concessionaire the procedure to be followed for the award of its contracts, should be deleted.

172. As a general comment, it was suggested that legislative recommendation 2 (b) was too detailed and that it might be preferable to simply state instead that the project agreement should provide for the right of the contracting authority to order variations in the construction specifications and set forth the compensation to which the concessionaire should be entitled.

173. It was suggested that the contracting authority’s right to order variations, which was mentioned in legislative recommendation 2 (b), was not limited to construction specifications, and should also encompass variations in respect of the conditions of service.

174. It was agreed that the wording of legislative recommendation 2 (c) should be brought in line with legislative recommendation 2 (b).

175. The need for limiting any suspension of the project to the time strictly necessary, it was observed, did not arise only in connection with the exercise by the contracting authority of its monitoring rights. Therefore, it was suggested that the second sentence of legislative recommendation 2 (c) should become a separate recommendation.

176. It was suggested that the contracting authority’s potential liability for defects arising from the inadequacy of the approved design or specifications might extend beyond the situations referred to in the second sentence of paragraph 9, which should be expanded accordingly.

177. The second sentence of paragraph 12, it was suggested, should also refer to the time-frame within which the concessionaire had to implement variations ordered by the contracting authority. However, one view expressed was that it was not advisable to establish a set maximum limit for the variations ordered by the contracting authority and that, therefore, the last sentence of paragraph 12, as well as the last phrase of legislative recommendation 2 (b), should be deleted.

178. The view was expressed that the last two sentences of paragraph 13 were unclear and needed to be redrafted.

179. It was suggested that the words “in excess of the agreed maximum period” in the third sentence of paragraph 14 should be deleted.

180. It was suggested that legislative recommendation 2 (d) should express the idea that acceptance of the infrastructure facility should not be denied unless the works were found to be materially incomplete or defective.

181. It was agreed that the last sentence of paragraph 16, which might imply a confusion between regulatory powers and the role of the contracting authority, should be deleted.

182. The view was expressed that the meaning of the words “final approval” and “final authorization” in respect
of construction works was unclear, and that paragraphs 5 to 17 should clarify who was responsible for accepting the works carried out by the concessionaire.

Infrastructure operation (legislative recommendations 3-6 and paras. 18-46)

183. As a general comment, it was pointed out that legislative recommendations 3 to 6 were concerned with regulatory matters that would not ordinarily be dealt with in the project agreement. In response, it was noted that the type of instruments used to deal with the matters discussed in paragraphs 18 to 46 varied according to the legislative practice and administrative tradition of the country concerned. The guide should therefore reflect the fact that, for those legal systems which did not provide for regulation of the operation by legislative means, the issues contemplated in legislative recommendations 3 to 6 would need to be addressed in the project agreement. Furthermore, project agreements often supplemented regulatory provisions so that, in practice, there existed a certain degree of duplication that the guide should take into account.

184. It was suggested that the beginning of the third sentence in paragraph 18 should be rephrased to refer not only to countries that had general legislation on concessions, but also to those that planned to have such legislation.

185. It was suggested that the last sentence in paragraph 22 should be rephrased to indicate that it would not merely be advisable, but essential, to require that the project agreement set forth the circumstances under which the concessionaire might be required to carry out extensions in its service facilities and the appropriate methods for financing the cost of any such extension. It was also suggested that the paragraph should begin with the phrase "in some legal systems".

186. It was pointed out that, in some legal systems, the concessionaire’s obligations to ensure the continuous provision of the public service derived from general principles of law or from statutory provisions, and that it would not be possible to provide in the project agreement for the extraordinary circumstances that would justify suspending the service or even releasing the concessionaire from its obligations. It was suggested that the sentence which stated that termination typically required the consent of the contracting authority or a judicial decision could be misinterpreted as expressing advice and should either be deleted or rephrased. Alternatively, the words "in legal systems which admit such a solution" should be added to the last sentence of paragraph 24.

187. Concern was expressed that the notes did not adequately reflect the principles of equality and universality of service. One view was that equality of treatment was similar to the principle of access to public services. Another view was that those principles were distinguishable. By way of illustration, it was pointed out that a public works operator might have to ensure coverage in regions of the country where such operations might not be profitable. In such instances, it was felt that the concessionaire should have a direct right to compensation or the right to end the project. After it had been pointed out that paragraph 37 of draft chapter II, "Project risks and government support" (A/CN.9/458/Add.3), addressed that situation, it was decided to include an appropriate cross-reference. It was also pointed out that, in some systems, those principles extended to adaptability, requiring the operator to integrate technological transformations during the operation of the concession.

188. In connection with legislative recommendation 4, it was pointed out that it would not always be the project agreement that would set forth the mechanisms for periodic or extraordinary revisions of the price adjustment formula. In countries where this would be set out in legislation, it might not be possible to establish price control mechanisms by agreement. In response, it was explained that the provisions should be kept flexible because of differences in the regulatory mechanisms of countries, but it was agreed that the recommendation should be revised to take into account the concerns that had been expressed.

189. It was pointed out that the first sentence of paragraph 31 was circular and should be redrafted. It was suggested that in paragraph 33 the reference to the reviews of tariffs needed further explanation. It was pointed out that the rate-of-return method was primarily used in sectors involving an element of monopoly, such as telecommunications, power, gas and water distribution projects. For sectors with greater elasticity of demand, such as road transportation, it might not always be possible to keep the concessionaire’s rate of return constant by regular price adjustment. Thus, paragraph 34 needed to be revised. In response to those concerns, it was noted that the question of tariff regulation was one of great complexity and that the discussion in the draft chapter was only illustrative of the main methods of calculating the rate of return, depending on the type of infrastructure. It was acknowledged, however, that the notes were compressed and might require some elaboration. It was suggested that the revisions should point out the complexity of the matter and the importance of continuing demand to ensure that the operation of the facility would be able to continue.

190. It was suggested that paragraph 38 should mention the possible impact of the various policy options referred to therein on private sector investment decisions.

191. It was pointed out that the monitoring of the concessionaire’s performance might be carried out by the regulatory body, rather than the contracting authority, and that recommendation 5 (b) should be revised accordingly.

192. It was suggested that, because in some legal systems rules might only be issued by a legislative body, the sentence in paragraph 45 which stated that the concessionaire might be authorized to issue rules governing the use of the facility by the public should be revised accordingly. It was pointed out that the approval of operating rules proposed by the concessionaire was often a matter of regulation that would fall within the duties of the State. It was felt that there would be certain principles from which the concessionaire should not be able to deviate. Moreover, paragraphs 42 to 46 raised concerns related to the protec-
tion of users and consumers, since the concessionaire should not have the power to limit unilaterally its liability or the scope of its general duties in respect of the public service.

193. Another view was that, where the facility had been privately owned and developed, the owner or operator should have the right to establish the terms of use by others, most appropriately by way of contract. Caution was advised in suggesting that the right of approval in such circumstances belonged solely to the regulatory body. It was also suggested that the right of approval referred to in legislative recommendation 6 should be based on objective conditions.

194. There was general agreement that the reference to the concessionaire’s authority to issue rules governing the use of the facility by the public was not intended to imply a transfer to the concessionaire of statutory powers or of inherently governmental functions, although it was acknowledged that the latter notion evolved constantly.

195. It was agreed that the word “discretionary” in paragraph 45 should be replaced by the word “arbitrary”.

Guarantees of performance and insurance (legislative recommendation 7 and paras. 47-58)

196. In response to a suggestion, it was agreed that paragraph 49 would be revised to refer to dispute settlement in general, rather than specifically to arbitral proceedings.

197. It was suggested that, if the concessionaire was allowed to fix the sum payable under the guarantee or standby letter of credit as a small percentage of the project cost, as suggested at the end of paragraph 52, a statement to that effect would need to be included in the request for proposals.

Changes in conditions (legislative recommendation 8 and paras. 59-68)

198. It was suggested that paragraph 65 should provide that the bidder would usually strive to include into its bid documents such mechanisms as protection against the adverse financial and economic impact of extraordinary and unforeseen events that could not have been taken into account when the project agreement was negotiated.

199. It was suggested that the last line of paragraph 68 should be redrafted to reflect the two different points more clearly. It would be desirable both to introduce a ceiling for the cumulative amount of periodic revisions of the project agreement and to establish the amount of the ceiling.

Exemption provisions (legislative recommendation 9 and paras. 69-79)

200. It was suggested that, in the third sentence of paragraph 72, the words “the concessionaire” should be added to the beginning of the final phrase.

201. The view was expressed that the meaning of paragraph 73 was not entirely clear, and that a distinction should be made between exemption of liability and excuse of performance. In reply, it was pointed out that paragraph 73 had been drafted in rather general terms because some legal systems had limits on the rights of the parties to provide for exempting circumstances. In such systems, an exempting circumstance produced legal effects as soon as it occurred, whereas in other legal systems a prior finding, for instance, by a dispute settlement body, was required. It was agreed that paragraph 73 required further clarification.

Events of default and remedies (legislative recommendations 10 and 11 and paras. 80-91)

202. It was suggested that the term “serious failure” in recommendation 11 (a) might need further explanation. In response, it was pointed out that the term was used to cover different terms of art used in national laws and that it had been used in other texts produced by the Commission.

203. It was suggested that the last line of paragraph 84 should be revised to read that “it is important to limit the contracting authority’s right to intervene”. It was also noted that the previous sentence interrupted the pattern of thought expressed in the paragraph and should be relocated.

204. Clarification was sought as to the meaning of the term “apparently irretrievable” in paragraph 88. It was explained that a situation might arise whereby the concessionaire had become completely unable to provide the services; such a situation would be apparently irretrievable and would entitle the exercise of step-in rights on the part of the contracting authority or the lenders. It was noted that step-in rights should only be exercised in an extreme case.

205. Clarification was sought as to the intention of the first sentence in paragraph 90. It was explained that, in several countries, it had been necessary to introduce legislative provisions authorizing the transfer of the concession to an entity appointed by the lenders. However, nothing in paragraphs 87 to 91 was intended to affect the general prohibition against the transfer of public services concessions, which existed in some legal systems. The transfer of the concession to a new concessionaire pursuant to the exercise by the lenders of their step-in rights always required the approval of the contracting authority, a circumstance which could be emphasized in paragraph 91.

VI. End of project term, extension and termination
(A/CN.9/458/Add.7)

General remarks

206. As a general comment, it was said that some of the discussion contained in the notes to the legislative recommendations needed to focus more clearly on issues par-
208. As regards the wording of the legislative recommendations, the Commission agreed that their meaning could be made clearer by drafting them in a manner that stated the general principle expressed in each legislative recommendation, which should be followed, as appropriate, by the exceptions to the general principle.

209. The suggestion was made that subsection B.8 of draft chapter IV, “The project agreement” (A/CN.9/458/Add.5), which dealt with the duration of the concession period, should be moved to the draft chapter under discussion.

210. The view was expressed that the word “amortization”, which was used sometimes in the draft chapter, had a technical meaning in accounting practice and that, where appropriate, it would be preferable to refer instead to recovery of investment (see also below, para. 246).

Extension of the project agreement (legislative recommendation 1 and paras. 2-4)

211. It was agreed that the language in legislative recommendation 1 and the accompanying notes, in particular the references to exempting circumstances, should be brought into line with terminology used in earlier chapters of the guide.

212. The view was expressed that legislative recommendation 1 appeared to be excessively restrictive, since it implied that concessions could only be granted for a set period of time. In response, it was observed that infrastructure concessions often involved an element of monopoly and that an excessively generous regime for extending them might not be consistent with the competition laws and policies of a number of countries. Clear rules on the matter were also needed in order to ensure transparency and protect the public interest. Thus, it was appropriate to regard the possibility of extending the concession period as a measure to be used only under circumstances clearly defined in law. The words “exceptional circumstances”, in that connection, were considered to be vague and subject to different interpretation in various legal systems and should, therefore, be avoided.

213. The possibility of extending the term of the concession, it was observed, served a useful purpose as a mechanism for affording the concessionaire additional time to recover its investment, where the concessionaire had incurred a loss due to circumstances outside its control. However, it might be misleading to link such a possibility only to situations where the concessionaire was entitled to compensation from the contracting authority. In practice, situations might exist where, even without such a legal entitlement, it might be in the public interest to extend the concession period, for example, in order to allow the project to be completed. Furthermore, the current formulation of legislative recommendations 1 (a) and 1 (b) appeared to imply that there should be different standards of compensation for the two situations contemplated therein, which was not found to be entirely consistent with the text in the accompanying notes. It was generally felt that legislative recommendations 1 (a) and 1 (b) should be re-
drafted so as to refer to the circumstances under which an extension was justifiable, without mentioning the notion of compensation.

214. In response to a suggestion that legislative recommendations 1 (a) and 1 (b) should be combined, the view was expressed that, in the revision of the legislative recommendations, it was advisable to avoid confusion as to the different situations that might give rise to interruptions in the execution of the project. They included acts of the parties to the project agreement, acts of third parties (such as governmental agencies of the host country other than the contracting authority) and events outside the control of either party. Care should be taken to avoid any impression that an extension of the concession period might be possible even where it was a result of situations attributable to the concessionaire.

215. It was suggested that the reference to project suspension appeared to imply that an extension of the concession period would only be possible where a decision to suspend the project had been made. The legislative recommendation should, therefore, also mention delays in completion.

Termination by the contracting authority (legislative recommendations 2 and 3 and paras. 5-23)

216. By way of a general comment, the Commission was urged to approach with caution the issue of compensation for termination by the contracting authority, since that was a controversial area in many countries. While the draft chapter could provide an indication as to standards of compensation that had been used in practice, it might not be advisable to attempt to formulate precise recommendations as to what those standards should be in the various situations discussed in the draft chapter.

217. The view was expressed that the Commission should carefully consider the desirability of referring to termination for convenience by the contracting authority, which was contemplated in legislative recommendation 2 (c) and in paragraphs 22 to 23 of the accompanying notes. Termination for convenience increased the risk to which potential investors were exposed, which might add to the cost of financing the project. In reply, it was observed that, in some legal systems, the possibility of unilateral termination of the concession by the contracting authority was a fundamental principle of the law governing public contracts. Although the project agreement could be terminated by the contracting authority even without prior final decision by the dispute settlement body (contrary to what was suggested in paragraph 9 of the notes), that did not mean that the concessionaire was exposed to arbitrary acts of the contracting authority, since the contracting authority’s acts were generally subject to judicial control and unilateral termination required payment of full compensation to the concessionaire. The Commission agreed, however, that the third sentence of paragraph 7 might be perceived as encouraging the use of unilateral termination rights by the contracting authority and that that sentence should be deleted.

218. The Commission took note of the various views that were expressed concerning the use of the words “fair compensation” in legislative recommendation 2 (c) and a possible alternative wording for that provision. According to one view, the expression “fair compensation” was ambiguous, since the various parties involved might interpret it differently, and it might be preferable to refer simply to “compensation”. Another view was that, despite its apparent ambiguity, the expression “fair compensation” was useful, since it indicated that the compensation due to the concessionaire needed to be equitable and could not be unilaterally and arbitrarily set by the contracting authority. According to yet another view, a reference to “full compensation” would more appropriately reflect the practice in some legal systems. However, that view was objected to on the ground that the expression “full compensation”, which implied compensation of the full market value of the undertaking, did not afford the degree of flexibility needed in connection with the issue under consideration.

219. The Commission was reminded that the standard of compensation in the event of termination for convenience by the contracting authority was a sensitive issue in a number of countries since it raised considerations similar to those that applied in connection with the standard of compensation due in the event of expropriation or nationalization. The language used in the guide should take into account various general guiding principles that had been formulated on the matter, including principles contained in resolutions adopted by the General Assembly of the United Nations.

220. In connection with paragraph 13 of the notes, it was suggested that the text should refer to the need for the contracting authority to give notice to the concessionaire when the latter was found to be in serious default on its obligations. It was also suggested that the reference to the lenders’ right of substitution should be qualified by a phrase such as “where it exists”.

221. It was agreed that the draft chapter should distinguish more clearly the replacement of the concessionaire by a new entity appointed by the lenders from the possibility given to the lenders to temporarily engage a third party to cure the consequences of default by the concessionaire, which was mentioned in legislative recommendation 3 (b). Furthermore, both the legislative recommendations and the notes thereto should mention, as appropriate, that any such substitution or temporary engagement of a third party usually required the consent of the contracting authority.

222. It was suggested that paragraph 14 should be revised, since not all of the situations referred to in subparagraphs (a) to (c) constituted conditions precedent to the entry into force of the project agreement.

223. It was suggested that the words “as provided in the project agreement” in paragraph 16 (c) were inconsistent with the reference, in the same sentence, to statutory obligations, and that those words should therefore be deleted.

224. The grounds for termination mentioned in paragraph 18 (d) of the notes, it was suggested, appeared to duplicate the provisions of paragraph 18 (a). Thus, the two subparagraphs should be combined.
225. For purposes of clarity, it was suggested that the second sentence in paragraph 19 should be redrafted along the following lines: "In such cases it may be advisable to design effective mechanisms to combat corruption and bribery and to afford the concessionaire the opportunity to file complaints against demands for illegal payments or unlawful threats by officials of the host country."

226. It was agreed that the wording of legislative recommendation 2(c) should be brought into line with legislative recommendation 2(b).

227. The view was expressed that the words "exceptional situations" in the fifth sentence of paragraph 23 did not provide sufficient guidance to the readers of the legislative guide. It was therefore proposed to delete those words and to insert the words "in cases where" before the words "a compelling reason of public interest", which should be followed by the words "which should be restrictively interpreted".

Termination by the concessionaire (legislative recommendation 4 and paras. 24-29)

228. It was pointed out that the concept of unilateral termination in the part of the concessionaire was unknown in some legal systems. In those countries, the concessionaire would only be able to request a third party, such as the competent court, to declare the termination of the project agreement under exceptional circumstances. In response, it was observed that such limitations on the concessionaire’s ability to terminate the project agreement were not universally recognized and that, in practice, potential investors might be reluctant to invest in infrastructure projects in jurisdictions that limited their ability to terminate the project agreement in situations such as those mentioned in legislative recommendation 4. It was pointed out that, in the circumstances described in paragraphs 4(a) and 4(b), the concessionaire or the project investors would want the right to buy out the party in breach. It was suggested that, since the availability of such an option would be attractive to foreign investors, a reference to it should be included in the notes accompanying legislative recommendation 4. In any event, it was said that it would not be advisable to include in recommendation 4 any reference to a requirement for a judicial decision, because in many legal systems that would not be required.

229. Having considered the various views expressed, the Commission agreed that the substance of legislative recommendation 4 should be retained, but that the chapeau of that recommendation, however, should be reworded to clarify that termination by the concessionaire may be carried out only under exceptional circumstances. Furthermore, it was agreed that paragraph 24 of the notes accompanying legislative recommendation 4 should indicate that in some legal systems the concessionaire did not have the right to terminate the project agreement unilaterally, but only the right to request a third party, such as the competent court, to declare the termination of the project agreement.

230. It was pointed out that subparagraph (a) of recommendation 4, which referred to serious breach by the contracting authority or other governmental agency, did not provide examples of such a breach, as had been given in recommendation 3 in the case of breach by the concessionaire. It was suggested that appropriate examples should be included in the notes accompanying legislative recommendation 4.

231. In response to a question concerning the reference to serious breach by governmental agencies other than the contracting authority, it was explained that the type of breach contemplated in legislative recommendation 4(a) was not only failure by the contracting authority to meet its payment or other obligations under the project agreement, but would also include the breach by other governmental agencies of their obligations vis-à-vis the concessionaire, such as undertakings to provide specific forms of support to the concessionaire.

232. It was suggested that the adjective "material" or "substantial" should be added to the first sentence of paragraph 25, in order to clarify that a party might withhold performance of its obligations only in the event of a material or substantial breach by the other party. Another suggestion was that, given that not every breach would result in the right to withhold performance, it would be more appropriate for the sentence to refer to "certain types of" breach.

233. One suggestion was that it was necessary to elaborate paragraph 25 in order to specify the legal procedures that would govern the termination of the contracts referred to therein, such as the requirement in some countries for judicial decisions to justify termination by the concessionaire. Under such systems, the concessionaire would not be able to invoke a breach on the part of the contracting authority as an excuse for non-performance as stated in the notes. The prevailing view, however, was that the notes already took into account, in a well-balanced manner, the relevant rules of various legal systems in that respect, and that paragraph 25 could be maintained without change.

Termination by either party (legislative recommendation 5 and paras. 30 and 31)

234. The view was expressed that legislative recommendation 5(a) was redundant and that it should be subsumed into legislative recommendation 4(b). In response, it was explained that legislative recommendation 5(a) referred to the occurrence of exempting impediments that could operate to the benefit of either party, whereas legislative recommendation 4(b) covered unforeseen changes in conditions that would give only the concessionaire the right of termination.

235. The question was asked whether it was necessary to include a legislative recommendation on the ability of the parties to terminate the project agreement by mutual consent, as provided in paragraph 31. In response, it was noted that, in some legal systems, the contracting authority might lack authority to do what might amount to a
discontinuation of services, in the absence of approval by a specified authority of the Government.

Transfer of assets to the contracting authority (legislative recommendation 6 and paras. 33-35)

236. It was suggested that paragraph 33 should be re-drafted and that the discussion on the transfer of project-related assets also should include a reference to assets that had been built by the concessionaire. It was noted that intangible assets did not appear to have been included in that discussion.

237. It was observed that recommendations 6 and 7 did not differentiate between normal termination of the project agreement at the end of its term, and early termination. One view was that such differentiation was necessary, because the concessionaire’s right to compensation would not arise in both cases, contrary to the implication to that effect that was underlying recommendations 6 and 7. Another view was that the recommendations were sufficiently clear in addressing how to deal with project assets upon termination, regardless of the manner by which termination had occurred.

238. It was observed that recommendation 6 referred to a purchase against payment of fair market value, whereas recommendation 7 referred to a transfer against adequate compensation. It was suggested that consistent terms should be used.

239. It was pointed out that, even in cases where the concessionaire would be expected to continue to operate the facilities, the contracting authority might wish to have ownership of the project assets. Therefore, it was suggested that paragraph 35 (a) should be revised accordingly. It was suggested that, in the penultimate sentence of paragraph 35 (b), the phrase “expected to be” should be deleted. The view was also expressed that the reference to assets expected to be fully amortized, and in respect of which only a nominal price might be paid, was unclear and needed to be clarified.

240. The suggestion was made that, in the last sentence of paragraph 35 (b), the term “retention” was too narrow, since the Government might be interested in acquiring a security interest without retaining the asset. It was also pointed out that in paragraph 35 (c) it was necessary to refer to both subparagraphs (a) and (b) of paragraph 35; assets that would remain the private property of the concessionaire would be those that neither would have to be transferred to the contracting authority, under paragraph 35 (a), nor might be purchased by the contracting authority at its option, under paragraph 35 (b).

Transfer of assets to a new concessionaire (legislative recommendation 7 and para. 36)

241. It was suggested that the words “during the life of the project” in the last sentence in paragraph 36 should be deleted. It was pointed out that the first sentence in subparagraph (b) was unclear and that the relationship between residual value and the concessionaire’s financing arrangements should be explained.

242. It was suggested that the meaning of the penultimate sentence of paragraph 37 could be clarified by stating that the assets should be returned to the contracting authority in such condition as would be necessary to allow for normal functioning of the infrastructure facility, taking into account the needs of the service.

Financial arrangements upon termination (legislative recommendation 8 and paras. 39-45)

243. It was observed that in legislative recommendation 8 lost profits were included in the determination of compensation due to the concessionaire under legislative recommendation 8 (b), but were not included under legislative recommendation 8 (c). It was suggested that a consistent approach was required, both in those two recommendations and in the accompanying notes. It was pointed out that a recommendation to include lost profits in the determination of compensation payable would be viewed favourably by investors.

244. It was pointed out that paragraphs 37 and 38 also did not differentiate between expiry of the project agreement and early termination, as had been mentioned previously. For example, the contracting authority’s right to receive the assets in operating condition, mentioned in paragraph 37, might not necessarily be applicable in the case of early termination.

245. The view was expressed that, in the last sentence of paragraph 39, the term “negotiating” did not accurately capture the actual process in concluding compensation arrangements. Where the contracting authority used structured competitive procedures to select the concessionaire, the standards of compensation might often be set forth in advance in the draft project agreement circulated with the request for proposals. It was also pointed out that paragraph 39 (b) did not mention that the concept of replacement cost could be used for the purpose of establishing the value of unfinished works.

246. It was pointed out that the use of the term “amortization” in paragraph 39 caused some difficulty. One interpretation that was offered was that, as used in the guide, the term referred only to recovery of investment; as privately financed infrastructure investment was typically a combination of equity and debt, amortization of interest on debt was already included under this interpretation. The view was expressed that the definition of the term “amortization”, which was provided in the last sentence of paragraph 39, appeared too late in the draft chapter, and it was suggested that the definition should be moved to an earlier place, where the term “amortization” was first used.

247. It was pointed out that, in paragraph 41 (b), the parting concessionaire could be the one submitting a bid for the project assets mentioned therein. It was also pointed out that the term “offered” might be interpreted to mean that the project assets would be given away without
charge. The view was expressed that a provision for the contracting authority to take over the assets, even if not provided for in the project agreement, could lead to an abuse of power and that therefore the reference to this idea should be deleted.

248. The comment was made that the manner of calculation of compensation as described in paragraph 42 was inaccurate; it would not be appropriate to refer only to the concessionaire’s revenue during previous financial years in such a calculation because, particularly in the case of early termination, there might not yet have been any history of profitability. This comment was also made in respect of the second sentence in paragraph 45(b).

249. It was noted that the last sentence of paragraph 45(a) mentioned that, in the contract practice of some countries, government agencies did not assume any obligation to compensate for lost profits when a large construction contract was terminated for convenience. The view was expressed, however, that such contract practice was not a commendable one, and that the last sentence of paragraph 45(a) should be deleted.

Wind-up and transitional measures (legislative recommendation 9 and paras. 46-58)

250. As a general comment, it was suggested that paragraphs 46 to 58 should more clearly reflect the fact that the wind-up and transitional measures referred to therein might take place many years after the completion of the construction works, as opposed to similar measures taken in connection with contracts for the construction of industrial works. It was also suggested that the subject matter dealt with in those paragraphs, which involved a variety of contractual considerations, was relevant not only upon transfer of the facility to the contracting authority and should, therefore, be incorporated into chapter IV, “The project agreement” (A/CN.9/458/Add.5).

251. It was observed that the wind-up and transitional measures referred to in paragraphs 46 to 58 would typically be relevant in the context of the ordinary expiry of the concession term. In practice, there might be difficulties in implementing contractual provisions on those matters if the project agreement had been terminated by the contracting authority against the will of the concessionaire.

252. In connection with paragraphs 47 to 51, the view was expressed that obligations concerning the transfer of technology could not be unilaterally imposed on the concessionaire and that, in practice, those matters were the subject of extensive negotiations between the parties concerned. While the host country had a legitimate interest in gaining access to the technology needed to operate the facility, due account should be taken of the commercial interests and business strategies of the private investors.

253. It was pointed out that the concessionaire might not be in a position to undertake some of the transitional measures referred to in paragraphs 46 to 58, since in most cases the concessionaire would have been established for the sole purpose of carrying out the project and would need to procure the relevant technology or spare parts from third parties.

VII. Governing law (A/CN.9/458/Add.8)

General remarks

254. The Commission noted that sections A and B of the draft chapter were new, whereas the substance of sections C and D had been previously contained in an earlier version of draft chapter I, “General legislative considerations” (A/CN.9/444/Add.2). The Commission was informed that, after extensive discussions held at its thirty-first session,15 the sections dealing with the possible impact of other areas of law on the successful implementation of privately financed infrastructure projects had been considerably expanded.

255. The concern was expressed that the draft chapter was overly ambitious. While acknowledging that the development and implementation of privately financed infrastructure projects would indeed be affected by various other areas of law, it was felt that the discussion in sections C and D was to some extent peripheral to the central issues discussed in the legislative guide. It was pointed out that, within the scope of the draft chapter, it would be difficult to mention all of the relevant areas of law or to adequately address any of them in a manner that was both accurate and concise. It was therefore suggested that the provisions of draft chapter VII should be summarized and re-incorporated into draft chapter I.

256. Another view was that the draft chapter was among the most important parts of the legislative guide because it outlined fundamental issues in the domestic legal regime that would have a direct impact on the likelihood of investment for the development of privately financed infrastructure projects. It was pointed out that the discussion in sections C and D was essential in order to inform Governments of the need for legislative reform and the complexities involved in such projects. Concern was expressed that, if the content of the draft chapter was to be merged with another part of the draft legislative guide, its importance would be lost. It was therefore agreed to retain draft chapter VII, and the discussion turned to the selection of an appropriate title.

257. One view was that the title “Governing law” was misleading since the entire legislative guide was concerned with the law governing the project. A contrary view was that the title was an appropriate expression of the draft chapter’s contents, namely, the laws that would govern privately financed infrastructure projects. Yet another view was that the title suggested a discussion limited to choice of law or private international law. Possible alternative titles proposed for consideration by the Commission included “Law governing the risks of the project” and “Legal certainty required by private investment in infrastructure”.

15Ibid., paras. 63-95.
258. Doubts were expressed concerning the purpose of, and the need for, legislative recommendation 1. It was noted that, in all probability, no Government had enacted, or would be able to enact, provisions that would indicate all applicable statutory provisions. Moreover, it was pointed out that, in so far as the legal regime of the host country would govern the project agreement, it would not be necessary to stipulate which of the laws would apply. Furthermore, it was pointed out that, prior to entering into a project agreement, the concessionaire and its lenders would obtain legal opinions that would outline the applicable legislative provisions.

259. In response to those comments, it was pointed out that it was not the purpose of the legislative recommendation to suggest that the host country should list all laws that directly or remotely affected privately financed infrastructure projects. A country wishing to adopt legislation on privately financed infrastructure projects might wish to address the issues dealt with in the preceding draft chapters of the legislative guide in more than one statutory instrument. Another possibility might be for a host country to introduce legislation dealing only with certain issues that were not already addressed in a satisfactory manner in existing laws and regulations. For instance, general legislation on privately financed infrastructure projects might not provide all the details of the procedures to select the concessionaire, but rather refer, as appropriate, to existing legislation on the award of government contracts. By the same token, when adopting legislation on privately financed infrastructure projects, host countries might need to repeal the application of certain laws and regulations which, in the view of the legislature, posed obstacles to their implementation. For purposes of clarity, legislative recommendation 1 invited the host country to state, as appropriate, the main statutory or regulatory texts that governed the project agreement and those whose application was excluded.

260. After consideration of the various views expressed, it was generally felt that, although the explanations of the purpose of the legislative recommendation might be usefully reflected in the accompanying notes, the legislative recommendation itself should be substantially redrafted. It was proposed that recommendation 1 should be replaced by a provision such as the following: “The host country may wish to stipulate that, unless otherwise provided, the project agreement is governed by the law of the host country”.

261. The concern was voiced, however, that the proposed formulation might lead to different interpretations. Under one possible interpretation, recommendation 1 might be read as implying a legislative authorization for the contracting authority to agree to the choice of a law other than that of the host country to govern the project agreement. Another possible interpretation might be that, although recognizing generally that the laws of the host country applied to the project agreement, legislative recommendation 1 in the proposed new formulation suggested that the contracting authority should have the power to exclude the application of certain areas of law or specific laws. Lastly, the proposed formulation might imply that the governing law would be that of the host country unless the applicable rules of private international law mandated the application of the law of another jurisdiction. Those interpretations might give rise to numerous concerns, in particular in legal systems that did not recognize the ability of governmental agencies to agree to the application of foreign law to their contracts or whose rules of private international law mandated the application of domestic law to government contracts.

262. The Commission took note of those concerns. However, it was generally felt that the proposed new formulation of legislative recommendation 1 (see above, para. 260) more clearly reflected the purpose of the draft chapter than the current text. While it was acknowledged that the primary purpose of draft chapter VII was not to address choice-of-law issues or private international law, the view was expressed that the legislative recommendation should be worded in a manner that upheld the principle of freedom of contract. Under certain circumstances, it was said, Governments should be able to and might choose as the governing law that of another State. Possible legal obstacles to the implementation of that principle under some legal systems should be highlighted in the notes.

263. It was suggested that a cautionary note should be added to paragraph 5 explaining that, if the host country decided to indicate in its law those statutory and regulatory texts of direct application to privately financed infrastructure projects, it should be made clear that such a list would not be an exhaustive one. It was suggested that such a list might best be provided in a non-legislative document, such as a promotional brochure, rather than in legislative provisions.

264. The question was asked whether recommendation 2 (concerning the freedom to choose the applicable law) and accompanying paragraphs 6 to 8 covered also, for example, guarantees and assurances by the Government, power purchase or fuel supply commitments by a governmental agency and contracts between the concessionaire and local lenders. In response, it was observed that the freedom to choose the applicable law for contracts and other legal relationships, including those mentioned in the question, was subject to conditions and restrictions pursuant to private international law rules or certain public law rules of the host country. While rules of private international law often allowed considerable freedom to choose the law governing commercial contracts, that freedom was in some countries restricted for contracts and legal relationships that were not qualified as commercial (e.g. certain contracts entered into by governmental agencies or contracts with consumers).

265. The suggestion was made that the second sentence of paragraph 7 should be redrafted. It was noted, in that connection, that States parties to some agreements for
regional economic integration were committed to enacting harmonized private international law provisions dealing with contracts between the concessionaire and its contractors.

*Other relevant areas of legislation (recommendation 3 and para. 9)*

266. Views were expressed that recommendation 3 provided little substantive guidance to States, in particular because it attempted to cover an overly broad area and because the advice was given by way of example rather than in a complete manner. It was recognized, however, that the topics dealt with in sections C and D of the draft chapter did not lend themselves to the formulation of principles that were suitable for being incorporated into legislation. Nevertheless, legislative recommendation 3 was a useful reminder for domestic legislators that successful privately financed infrastructure projects required appropriate legislation in a number of areas of law.

*Promotion and protection of investment (paras. 10 and 11)*

267. It was suggested that it should be stated expressly that the concessionaire was covered by the provisions protecting against nationalization or dispossession. The Commission discussed the way in which that protection was to be described, and it was agreed that the best available formulation was the one used in draft chapter IV, “The project agreement” (A/CN.9/458/Add.5), paragraph 25.

268. With respect to bilateral investment agreements referred to in paragraph 11, it was said that in a number of countries rules aimed at facilitating and protecting the flow of investment (which included also areas such as immigration legislation, import control and foreign exchange rules) were based on legislation that might be, but was not necessarily, based on a bilateral treaty, and that that circumstance should be reflected in the paragraph. It was added that multilateral treaties were also a source of investment protection provisions.

*Property law (paras. 12-14)*

269. No specific substantive comments were made on paragraphs 12 to 14.

*Rules and procedures on expropriation (paras. 15 and 16)*

270. It was observed that land or access to land, as described in paragraphs 15 and 16, might be obtained by a judicial or administrative process of expropriation or by an ad hoc legislative act. It was agreed that the paragraphs should be reviewed so as to emphasize the need for expeditious and efficient expropriation proceedings should be balanced against the need to respect the rights of the owners concerned. As to the use of the term “expropriation”, which in some languages had a negative connotation (since it might suggest confiscation without adequate compensation), it was agreed that, on balance, it should be retained since other possible expressions had a technical meaning proper only to certain legal systems and were difficult to translate or to be understood by the broad readership to whom the guide was addressed.

*Intellectual property law (paras. 17-21)*

271. It was proposed that the discussion of intellectual property law should include a reference to the advisability for the host country of enacting criminal law provisions designed to combat infringements of intellectual property rights.

272. It was also proposed that the fact that some States had legislation aimed at protecting intellectual property rights in computer software and computer hardware design should be mentioned, and that, in the context of the discussion of paragraph 18, mention should be made of the Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS Agreement) concluded under the auspices of the World Trade Organization.

*Security interests (paras. 22-30)*

273. By way of a general observation, it was said that paragraphs 22 to 30 did not appropriately reflect the fact that, pursuant to the legal tradition of some countries, creation of security interests in the context of privately financed infrastructure projects (in particular as regards assets in public ownership) was subject to restrictions designed to protect the public interest. Therefore, the advice given in the paragraphs was inconsistent with those legal systems. It was agreed that the discussion in paragraphs 22 to 30 of the draft chapter should be brought into line with the discussion of security interests contained in paragraphs 32 to 40 of draft chapter IV, “The project agreement” (A/CN.9/458/Add.5). It was also agreed that the draft chapter should appropriately reflect the fact that there existed legal obstacles to the creation of security interests in some countries due to the inalienable nature of certain categories of assets in public ownership.

274. It was pointed out that proceeds or receivables related to the provision of goods or services by the concessionaire might not always be based on a contract between the concessionaire and its customers but on other types of relationships which in some legal systems were not regarded as contracts. That situation should be taken into account in paragraph 28.

275. It was proposed that in paragraph 24, possibly in the penultimate sentence, it should be indicated that limitations in the remedies available under the laws of the host country would add to the cost of lending to projects in that country.

*Company law (paras. 31-34)*

276. No substantive comments were made on paragraphs 31 to 34.

*Accounting practices (para. 35)*

277. It was agreed that the third sentence of paragraph 35, if retained in the draft chapter, should become a separate paragraph.
278. A suggestion was made that the discussion of accounting practices should refer to the advisability of using the services of professional accountants or accounting auditors. It was questioned whether the concept of “modern” and “generally accepted” accounting practices was appropriate and understandable in the same manner in different countries; possible alternative expressions that were mentioned were “contemporary” or “internationally acceptable” accounting practices.

Contract law ( paras. 36 and 37)

279. It was considered that paragraphs 36 and 37 should be adjusted to take into account the fact that in some countries some of the contracts entered into by the concessionaire did not fall under the category of contracts governed by commercial or civil law but were qualified as public or administrative contracts. The discussion in paragraphs 36 and 37 should be restricted to private contract law and the title should be modified accordingly.

Rules on government contracts and administrative law ( paras. 38-41)

280. Support was expressed for the substance of paragraphs 38 to 41.

Insolvency law ( paras. 42-44)

281. It was observed that, under some legal systems, limits might exist for the creditors’ and the debtor’s freedom to enter into agreements establishing precedence of certain claims over other liabilities of the debtor (which was discussed in paragraph 42) and that that circumstance should be clarified. It was suggested that the words “economically viable”, in the second sentence of paragraph 42, should be deleted. As to paragraph 43, it was considered that the word “priority” was not suitable to describe the relationship between the insolvency administrator and creditors.

Tax law ( paras. 45-50)

282. It was observed that, in some legal systems, the level of taxation would change from year to year depending on changes in social conditions. In such countries, investors might be favoured under economic circumstances that would permit the levels of taxation to decline over time. It was suggested that, therefore, the wording of paragraph 46, which stressed the importance of stability and predictability in the tax regime, should be amended to reflect that possibility.

Environmental protection ( paras. 51-54)

283. It was noted that the overall importance of environmental protection legislation had been addressed elsewhere in the draft legislative guide and that the focus of the discussion in the draft chapter should be on measures that could be included in such legislation in order to reduce the perceived risks associated with investment in privately financed infrastructure projects. It was pointed out that, in addition to the international instruments mentioned in paragraph 51, reference should also be made to various regional instruments. It was also suggested that mention should be made of the need for, and benefit of, environmental impact studies. The proposal was made that paragraph 54, which was felt to touch upon sensitive policy issues, was not needed in the context of the draft chapter and should be deleted.

Consumer protection laws ( para. 55)

284. It was observed that a single paragraph constituted rather brief treatment of consumer protection laws, particularly in comparison with the discussions on other areas of law that were contained in the draft chapter. It was pointed out that the legislatures in some regions had become increasingly sensitive to those issues. It was suggested that a cross-reference should be added to the provisions of draft chapter VIII, “Settlement of disputes” (A/CN.9/458/Add.9), that dealt with dispute settlement remedies for consumers. It was also suggested that the reference to the concessionaire’s right to discontinue services to customers who “fail to pay” might be rephrased more kindly.

Anti-corruption measures ( paras. 56-58)

285. It was suggested that the order of paragraphs 56 and 57 should be reversed. It was also suggested that such measures might include steps to criminalize acts of corruption, bribery and related illicit practices in order to dissuade such activities. It was pointed out that the second sentence in paragraph 56, which called for “review” of the rules covering the functioning of contracting authorities and the monitoring of public contracts, might have a negative implication in some languages and should be reworded. It was suggested that, if regional initiatives were to be covered in paragraph 58, then all regions should be included.

International agreements ( paras. 59-63)

286. It was suggested that the phrase “in addition to other international agreements mentioned throughout the draft legislative guide” should be added to paragraph 59, so that the ensuing discussion of certain international agreements would not appear to exclude others. It was suggested that regional agreements might also be mentioned.

VIII. Settlement of disputes (A/CN.9/458/Add.9)

General remarks

287. As a general observation, it was said that, while basic information about the methods of dispute settlement was useful (in particular about those methods that were not widely known or had developed recently), the draft
chapter should be more geared towards privately financed infrastructure projects and should draw on practical experiences in various countries. It was widely held that, if the discussions were not sufficiently tailored to the subject of the guide and more concise, critical messages to legislators would not be sufficiently conspicuous.

288. Statements were made to the effect that the draft chapter should refer to the phases of a privately financed infrastructure project and the different methods of dispute settlement that were suitable for, or were likely to be used in, each phase. It was suggested that the draft chapter should discuss different methods of dispute settlement from the viewpoint of how they could contribute to the smooth execution of projects and prevention of full-blown disputes.

289. To the extent that grievances against decisions by regulatory bodies would be dealt with in the draft chapter, it was suggested that the draft chapter should also address the question of the use of non-judicial grievance settlement mechanisms such as expert panels, advisory bodies or arbitration.

290. It was generally observed that some countries, in particular those where contracts between the contracting authority and the concessionaire were regarded as administrative contracts, traditionally imposed broad limits to the freedom to agree to arbitration. While some exceptions to those limits had been introduced, those exceptions, at least in some of those countries, were typically narrowly circumscribed by legislation or were based on a treaty. Furthermore, the existence of those exceptions did not change the principle that privately financed infrastructure projects were regarded as administrative contracts and that, therefore, disputes arising under those contracts were non-arbitrable. It was stated that the draft chapter should properly reflect the position of those legal systems.

291. As to arbitration as a method of dispute settlement, it was said that the draft chapter appeared to understate the potential difficulties of that method, such as the potentially high cost of proceedings, the possibility of delays, or the potentially negative implications of confidentiality of proceedings.

292. On the other hand, it was stressed that an arbitration clause in the project agreement was regarded by many investors as an assurance that any dispute would be resolved efficiently and fairly and that, since that assurance would often be seen as a crucial condition to attract private capital to projects, the contracting authority should be left free to agree to arbitration. Moreover, it was suggested that the draft chapter should place greater emphasis on the freedom to choose the place of arbitration (in the host country or elsewhere, which would have implications as to the possibility of courts of the host country to intervene in the arbitral proceedings), the freedom to choose arbitrators and the confidentiality of proceedings. It was, however, added that, prima facie, the place where the project was being carried out was most appropriate as the place of arbitration (because evidence was there and because the cost of proceedings were most likely to be the lowest there).

293. It was suggested that the draft chapter should distinguish between “domestic” arbitration (i.e. arbitration between persons having their places of business in the jurisdiction where the arbitration took place) and “international” arbitration (i.e. arbitration between persons having their places of business in different jurisdictions or arbitration that for another reason was considered as being international); that distinction, and the implications thereof, was relevant in jurisdictions where different legislative provisions applied to domestic and international arbitration. In addition, more emphasis should be placed on the dispute settlement mechanism of the International Centre for the Settlement of Investment Disputes established by the Convention on the Settlement of Investment Disputes between States and Nationals of Other States (Washington, 1965).

Disputes between the contracting authority and the concessionaire (recommendation 1 and paras. 4-64)

294. As to recommendation 1 (a), it was said that the significance of the expression “unnecessary” was unclear and that it should be deleted. While some support was expressed for its deletion, statements were made to the effect that the expression attempted to indicate, correctly, that the advice to remove statutory limitations to the contracting authority’s freedom to agree to dispute settlement mechanisms was limited to those limitations which were regarded as unnecessary pursuant to the sovereign assessment of the host country; thus, a clearer formulation was preferable to deletion.

295. As to paragraphs 2 (b) and 2 (c) of the notes, it was noted that, in some legal systems, some of the items mentioned therein might not be regarded as contracts or as commercial contracts (e.g. payment of a fee for the use of a tollroad or contracts entered into by the contracting authority).

296. It was suggested that paragraph 8 should mention that arbitral proceedings might also be based on a statutory provision rather than, as was typical, on an arbitration agreement. It was also said that the statement about the enforceability of arbitral awards needed to be nuanced by an explanation that in some jurisdictions the enforcement of an award required a judicial decision (exequatur) and that the enforcement was preceded by a verification, albeit limited, that certain fundamental principles of public policy had not been violated.

297. It was questioned whether paragraphs 11 and 12 (concerning negotiation) were needed. As to the settlement of disagreements by a referee or a dispute settlement board ( paras. 21-29), which was common in construction contracts, it was suggested that the experience of using those dispute settlement techniques during the post-construction period might be explored as to their applicability during the performance of the project agreement. It was requested that in paragraph 23 the legal nature of a decision by the referee or a dispute settlement board be clarified.

298. A number of statements were made regarding the question of sovereign immunity, which was dealt with in
recommendation 1 (b) and paragraphs 51 to 55. It was said that the question whether the host Government or the contracting authority was able to invoke sovereign immunity (either as a bar to jurisdiction or as a bar against execution) was considered as one of the core issues by investors. As to the position of Governments, it was stated that public policy considerations dictated that sovereign immunity should not be automatically waived or that any waiver should be left to the discretion of the Government. According to one view, the guide should not deal with such a sensitive question, on which no clear-cut result was obtainable; if the question was to be touched upon, the guide should not contain suggestions. According to another view, there was a need to revise national laws on that issue since what was needed was clarity; in particular investors needed clarity as to whether the contracting authority, which assumed obligations by concluding the project agreement, was deemed to have waived its immunity. As to the formulation of recommendation 1 (b), it was criticized either for being unclear as to what it sought to achieve or for being too intrusive on this politically sensitive point. In response, however, it was considered that, in view of the fact that investors needed clarity on the point, and bearing in mind that no harmonized solution on the question had yet been reached, the purpose and thrust of the recommendation should not be to suggest any particular solution, but merely to call upon States to clarify, as far as possible, what the law on sovereign immunity in the State was. It was added that several aspects of the question needed to be clarified, including whether immunity extended to foreign or domestic forums.

Settlement of commercial disputes (legislative recommendation 2 and paras. 65-76)

299. It was suggested that the title of recommendation 2 might lead to confusion and should be amended to indicate that it was concerned with settlement of disputes that arose between the concessionaire and entities other than the contracting authority.

300. Concern was expressed over both the substance and form of paragraphs 60 through 64, which addressed judicial proceedings. It was felt that the discussions, in terms of both their length and tone, were not sufficiently balanced with the discussions that dealt with other dispute settlement mechanisms in the rest of the draft chapter. Whereas treatment of alternative methods, such as arbitration, for example, included an explanation of that mechanism, no similar description was provided regarding judicial proceedings. Moreover, those paragraphs seemed to imply that judicial proceedings were not a good approach to the settlement of disputes. It was suggested that those paragraphs should be worded more subtly. In response to the comment that it was inappropriate to suggest in paragraph 62 that the judiciary might be biased in favour of the contracting authority, it was pointed out that the intended meaning was that the parties to the project agreement might have that concern.

301. It was suggested that in the future revision of paragraph 65, it might be desirable to bear in mind the determination of what would constitute a commercial contract. A fuel supply contract by a government agency was given as an example with respect to which such a determination was relevant. Another view was that it would not be advisable to enter into discussions in this draft chapter as to the meaning of a commercial contract or a commercial dispute, the meaning of which varied greatly according to the legal system concerned.

302. It was observed that conciliation was not usually provided for in "corporate instruments", a term that appeared in the heading of paragraph 67 and which was considered somewhat unclear. It was also suggested that the term "voluntary" should be clarified as it suggested that there existed both "voluntary" and "involuntary" conciliation.

303. It was suggested that the contents of paragraph 69, which described construction contracts, did not specifically relate to dispute settlement. It was also suggested that the discussion of construction contracts should mention systems of dispute settlement developed by the Fédération Internationale des Ingénieurs-Conseils (FIDIC).

Disputes involving other parties (legislative recommendations 3 and 4 and paras. 77-82)

304. It was pointed out that what might be envisioned as the "consumers" of the services or products that were produced by a concessionaire could be quite different. In one situation, the consumer might be a single government-owned utility company that would purchase power or water from the concessionaire; in another situation, the consumers might be several thousands of individual users of a toll road. The type of dispute settlement mechanisms that would be selected would have to be appropriately tailored to each situation. It was pointed out that, although that distinction was made in the notes, it needed to be incorporated into recommendation 3.

305. The view was expressed that, as privately financed infrastructure projects would grow in number and volume, disputes with consumers would become more frequent and would result in greater need for dispute settlement mechanisms. It was felt that recommendation 4, which addressed this matter, was important, but that the subject was dealt with too briefly in the accompanying notes.

306. Another view was that it would be important for consumers to have the right to resort to the courts for the resolution of such disputes. It was considered advisable that the host country should provide for legislation that would contain provisions against consumer fraud and false advertising, and that would recognize and enable consumer protection agencies to initiate litigation.

307. Some of the issues that were suggested for further discussion included the following: the relationship between regulatory bodies and arbitral proceedings, and the treatment of confidential information disclosed during the settlement of a dispute with a public regulatory body.
III. ELECTRONIC COMMERCE

A. Draft uniform rules on electronic signatures

308. It was recalled that the Commission, at its thirtieth session, in 1997, had entrusted the Working Group on Electronic Commerce with the preparation of uniform rules on the legal issues of digital signatures and certification authorities. With respect to the exact scope and form of such uniform rules, it was generally agreed at that session that no decision could be made at such an early stage of the process. In addition, it was felt that, while the Working Group might appropriately focus its attention on issues of digital signatures in view of the apparently predominant role played by public-key cryptography in the emerging electronic-commerce practice, the uniform rules to be prepared should be consistent with the media-neutral approach taken in the UNCITRAL Model Law on Electronic Commerce. Thus, the uniform rules should not discourage the use of other authentication techniques. Moreover, in dealing with public-key cryptography, those uniform rules might need to accommodate various levels of security and to recognize the various legal effects and levels of liability corresponding to the various types of services being provided in the context of digital signatures. With respect to certification authorities, while the value of market-driven standards was recognized by the Commission, it was widely felt that the Working Group might appropriately envisage the establishment of a minimum set of standards to be met by certification authorities, in particular where cross-border certification was sought.18

309. At its thirty-first session, in 1998, the Commission noted that the Working Group, in its preparation of draft uniform rules on electronic signatures throughout its thirty-first and thirty-second sessions, had experienced manifest difficulties in reaching a common understanding of the new legal issues arising from the increased use of digital and other electronic signatures. It was also noted that a consensus was still to be found as to how those issues might be addressed in an internationally acceptable legal framework. However, it was generally felt by the Commission that the progress achieved so far indicated that the draft uniform rules on electronic signatures were progressively being shaped into a workable structure. The Commission reaffirmed the decision made at its thirtieth session as to the feasibility of preparing such uniform rules19 and expressed its confidence that more progress could be accomplished by the Working Group at its thirty-third session (New York, 29 June–10 July 1998) on the basis of the revised draft prepared by the Secretariat (A/ CN.9/WG.1IV/WP.76). In the context of that discussion, the Commission noted with satisfaction that the Working Group had become generally recognized as a particularly important international forum for the exchange of views regarding the legal issues of electronic commerce and for the preparation of solutions to those issues.18

310. At the current session, the Commission had before it the report of the Working Group on the work of its thirty-third and thirty-fourth sessions (A/CN.9/454 and 457). The Commission expressed its appreciation for the efforts accomplished by the Working Group in its preparation of draft uniform rules on electronic signatures. While it was generally agreed that significant progress had been made at those sessions in the understanding of the legal issues of electronic signatures, it was also felt that the Working Group had been faced with difficulties in the building of a consensus as to the legislative policy on which the uniform rules should be based.

311. A view was expressed that the approach currently taken by the Working Group did not sufficiently reflect the business need for flexibility in the use of electronic signatures and other authentication techniques. According to that view, the uniform rules as currently envisaged by the Working Group placed excessive emphasis on digital signature techniques and, within the sphere of digital signatures, on a specific application involving third-party certification. Accordingly, it was suggested that work on electronic signatures by the Working Group should either be limited to the legal issues of cross-border certification or be postponed altogether until market practices were better established. A related view was that, for the purposes of international trade, most of the legal issues arising from the use of electronic signatures had already been solved in the UNCITRAL Model Law on Electronic Commerce. While regulation dealing with certain uses of electronic signatures might be needed outside the scope of commercial law, the Working Group should not become involved in any such regulatory activity.

312. The widely prevailing view was that the Working Group should pursue its task on the basis of its original mandate (see above, para. 308). With respect to the need for uniform rules on electronic signatures, it was explained that, in many countries, guidance from UNCITRAL was expected by governmental and legislative authorities that were in the process of preparing legislation on electronic signature issues, including the establishment of public key infrastructures (PKI) or other projects on closely related matters (A/CN.9/457, para. 16). As to the decision made by the Working Group to focus on PKI issues and PKI terminology, it was recalled that the interplay of relationships between three distinct types of parties (i.e. key holders, certification authorities and relying parties) corresponded to one possible PKI model, but that other models were conceivable, for example, where no independent certification authority was involved. One of the main benefits to be drawn from focusing on PKI issues was to facilitate the structuring of uniform rules by reference to three functions (or roles) with respect to key pairs, namely, the key issuer (or subscriber) function, the certification function and the relying function. It was generally agreed that those three functions

were common to all PKI models. It was also agreed that those three functions should be dealt with irrespective of whether they were in fact served by three separate entities or whether two of those functions were served by the same person (e.g. where the certification authority was also a relying party). In addition, it was widely felt that focusing on the functions typical of PKI and not on any specific model might make it easier to develop a fully media-neutral rule at a later stage (A/65/577, para. 68).

313. After discussion, the Commission reaffirmed its earlier decisions as to the feasibility of preparing such uniform rules (see above, paras. 309), and expressed its confidence that more progress could be accomplished by the Working Group at its forthcoming sessions.

314. As to the time-frame within which the Working Group might be expected to fulfill its mandate, a suggestion was made that the draft uniform rules should be ready for consideration and adoption by the Commission at its thirty-third session. The prevailing view was that no specific time-frame should be set. However, the Commission urged the Working Group to proceed expeditiously with the completion of the draft uniform rules. In the context of that discussion, an appeal was made to all delegations to renew their commitment to active participation in the building of a consensus with respect to the scope and contents of the draft uniform rules.

B. Future work in the field of electronic signatures

315. Various suggestions were made with respect to future work in the field of electronic commerce, for possible consideration by the Commission and the Working Group after completion of the uniform rules on electronic signatures. It was recalled that, at the close of the thirty-second session of the Working Group, a proposal had been made that the Working Group might wish to give preliminary consideration to undertaking the preparation of an international convention based on relevant provisions of the UNCITRAL Model Law on Electronic Commerce and of the draft uniform rules (A/65/576, para. 212).20 The Commission was informed that interest had been expressed in a number of countries in the preparation of such an instrument.

316. The attention of the Commission was drawn to a draft recommendation adopted on 15 March 1999 by the Centre for the Facilitation of Procedures and Practices for Administration, Commerce and Transport (CEFACT) of the Economic Commission for Europe of the Secretariat. That text recommended "that UNCITRAL consider the actions necessary to ensure that references to 'writing', 'signature' and 'document' in conventions and agreements relating to international trade allow for electronic equivalents". Support was expressed for the preparation of an omnibus protocol to amend multilateral treaty regimes to facilitate the increased use of electronic commerce.

317. Other items suggested for future work included: electronic transactional and contract law; electronic transfer of rights in tangible goods; electronic transfer of intangible rights; rights in electronic data and software (possibly in cooperation with the World Intellectual Property Organization); standard terms for electronic contracting (possibly in cooperation with the International Chamber of Commerce and the Internet Law and Policy Forum); applicable law and jurisdiction (possibly in cooperation with the Hague Conference on Private International Law); and on-line dispute settlement systems.20

318. The Commission took note of the above proposals. It was decided that, upon completing its current task, namely, the preparation of draft uniform rules on electronic signatures, the Working Group would be expected, in the context of its general advisory function regarding the issues of electronic commerce, to examine some or all of the above-mentioned items, as well as any additional items, with a view to making more specific proposals for future work by the Commission.

IV. ASSIGNMENT IN RECEIVABLES FINANCING

319. It was recalled that the Commission had considered legal problems in the area of assignment at its twenty-sixth to twenty-eighth sessions (1993-1995)21 and had entrusted, at its twenty-eighth session, in 1995, the Working Group on International Contract Practices with the task of preparing a uniform law on assignment in receivables financing.22

320. It was noted that the Working Group had commenced its work at its twenty-fourth session and had held five sessions between the twenty-eighth and the thirty-first sessions of the Commission. It was also noted that, at its twenty-fourth session, the Working Group had been urged to strive for a legal text aimed at increasing the availability of lower-cost credit (A/65/420, para. 16). In addition, it was noted that, at its twenty-fifth and twenty-sixth sessions, the Working Group had decided to proceed with its work on the assumption that the text being prepared would take the form of a convention (A/65/432, para. 28) and would include private international law provisions (A/65/434, para. 262). Moreover, it was noted that at its twenty-seventh session, the Working Group had decided that basic priority rules of the draft Convention would be private international law rules, and that the substantive law priority rules of the draft Convention would be subject to an opt-in by States (A/65/445, paras. 26-27). At its twenty-eighth session, the Working Group had adopted the substance of draft articles 14-16, dealing with the relationship between the assignor and the assignee.23

20Ibid., para. 209.
23Ibid., Fiftieth Session, Supplement No. 17 (A/50/17), paras. 374-381.
signee, and draft articles 18-22, dealing with the relationship between the assignee and the debtor (A/ACN.9/447, paras. 161-164).

321. At its thirty-second session, the Commission had before it the reports of the twenty-ninth and thirtieth sessions of the Working Group (A/ACN.9/455 and 456). It was noted that, at its twenty-ninth session, the Working Group had adopted the substance of the preamble and draft articles 1 (1) and 1 (2) (scope of application), 5 (g)-5 (j) (definitions), 18 (5 bis) (debtor's discharge), 23-33 (priority and private international law rules) and 41-50 (final provisions) (A/ACN.9/455, para. 17). At its thirtieth session, it had adopted the title, the preamble and draft articles 1-24 (A/ACN.9/456, para. 18). As a result, the whole of the draft Convention had been adopted with the exception of the optional substantive law priority rules.

322. Noting that the draft Convention had attracted the interest of the international trade and finance community, the Commission expressed its appreciation for the significant progress achieved by the Working Group. It was widely felt that the draft Convention had the potential of increasing the availability of credit at more affordable rates. It was stated that the fact that credit on the basis of international receivables was either not available at all or was available only at a high cost could give rise to serious obstacles to international trade. It was also observed that that situation placed parties from developing countries at a competitive disadvantage, to the extent that they had limited access to lower-cost credit.

323. At the same time, the Commission noted that a number of specific questions remained to be addressed by the Working Group, including the questions: whether the draft Convention would apply only to assignments in a financing context or to other assignments as well; whether certain assignments, such as those involved in securities and clearing-house transactions, should be excluded or simply dealt with differently; whether the location of a corporation should be defined, for the purposes of the scope of application of the draft Convention and of the priority rules, by reference to its place of business, place of incorporation or place of central administration; whether anti-assignment clauses contained in public procurement contracts should be treated differently from such clauses in other types of contracts; whether priority with respect to proceeds of receivables should be treated in the same way as priority with respect to receivables; whether the private international law rules should be used to fill gaps in the substantive law provisions of the draft Convention or to unify the private international law on assignment at large (i.e. so as to apply beyond the scope of application of the draft Convention); and whether the optional substantive law priority rules should be expanded or rather remain as general principles.

324. Some delegates expressed views concerning the way in which those matters might be addressed by the Working Group, including: that the draft Convention should apply only to financing transactions; that domestic practices should not be adversely affected; that particular caution should be exercised in the treatment of certain financing transactions, such as transactions relating to derivatives and clearing-house activities, so as to avoid unsettling well-functioning practices; that the exclusion of assignments of non-contractual receivables should be reconsidered; that location of a corporation should be defined in an appropriate way (e.g. by reference to its statutory seat, place of central administration or principal place of business). The view was also expressed that the draft Convention should recognize: the principle of party autonomy as to the relationship between the assignor and the assignee; the principle of debtor-protection as to the relationship between the assignee and the debtor; and the need for certainty as to the rights of third parties, such as creditors of the assignor.

325. As to the provision of the draft Convention giving the assignee a right in rem in proceeds of receivables, the concern was expressed that it might be inconsistent with fundamental principles of law in some countries. In response, it was observed that, in line with law currently existing in many countries, such a right in rem of the assignee in proceeds of receivables was recognized, under the draft Convention, only in limited cases (i.e. where the assignor had received payment in cash on behalf of the assignee and held the proceeds in a separate and easily identifiable account). In any case, it was stated, States would have to weigh the potential minimal discomfort of such a provision against its potential, significant beneficial impact on the cost and the availability of credit, in the context of transactions, such as securitization or undisclosed invoice discounting. Without discussing those statements and views, the Commission referred them to the Working Group.

326. With regard to the scope of the draft Convention, the question was raised as to whether it was within the mandate of the Working Group to decide that the draft Convention would apply to transactions outside a strictly financing context. In response, the Commission reaffirmed the flexible mandate given to the Working Group to determine how broad or narrow the scope of application of the draft Convention should be.

327. As to the relationship between, on the one hand, the draft Convention and, on the other hand, the Convention on International Factoring (Ottawa, 1988), the European Union Convention on the Law Applicable to Contractual Obligations (Rome, 1980) and the draft Convention on International Interests in Mobile Equipment and its protocols on aircraft, space equipment and railway rolling stock ("the Unidroit draft Convention") currently being prepared by a joint group of the International Institute for the Unification of Private Law (Unidroit), the International Civil Aviation Organization and other organizations, the Commission expressed its appreciation for the progress made by the Working Group in its efforts to avoid or to minimize the potential for conflicts.

328. With regard to the relationship between the draft Convention and the Unidroit draft Convention, the Commission noted that, at its thirtieth session, the Working Group had considered ways in which conflicts could be avoided (A/ACN.9/456, paras. 232-239). It was noted that, at that session, the Working Group had identified two ways, i.e. to exclude the assignment of receivables arising...
from the sale or lease of high-value equipment from the scope of application of the draft Convention or the Unidroit draft Convention and, rather than dealing with the matter by way of exclusions, to settle it by giving precedence to one or the other text if a conflict arose.

329. A number of views were expressed as to the way in which that matter could be addressed by the Working Group. One view was that assignments of receivables arising from the sale or lease of high-value equipment should be excluded from the draft Convention, since such receivables were in practice part of equipment financing. Another view was that, rather than excluding such assignments from the scope of the draft Convention in all cases, whether or not the Unidroit draft Convention applied (an approach that would inadvertently result in gaps if the Unidroit draft Convention were not widely adopted), it might be preferable to give precedence to the Unidroit draft Convention with regard to such assignments only if the Unidroit draft Convention applied in a particular case. In that connection, it was suggested that the question of which text might prevail in the case of conflict might be approached differently depending on the types of equipment involved in each particular case, since, in some equipment-financing practices, receivables were part of equipment-financing, while, in other such practices, that was not the case. Yet another view was that the possibility of excluding certain assignments from the Unidroit draft Convention should also be considered. The Commission referred those views to the Working Group.

330. The Commission expressed appreciation for the work accomplished by the Working Group and requested the Working Group to proceed with its work expeditiously so as to make it possible for the draft Convention, along with the report of the next session of the Working Group, to be circulated to Governments for comments in good time and for the draft Convention to be considered by the Commission for adoption at its thirty-third session (2000). As regards the subsequent procedure for adopting the draft Convention, the Commission noted that it would have to decide at its next session whether it should recommend adoption by the General Assembly or by a diplomatic conference to be specially convened by the General Assembly for that purpose.

V. MONITORING THE IMPLEMENTATION OF THE 1958 NEW YORK CONVENTION

331. It was recalled that the Commission, at its twenty-eighth session in 1995, had approved the project, undertaken jointly with Committee D of the International Bar Association, aimed at monitoring the legislative implementation of the Convention on the Recognition and Enforcement of Foreign Arbitral Awards (New York, 1958). It was stressed that the purpose of the project, as approved by the Commission, was limited to that aim and,

in particular, its purpose was not to monitor individual court decisions applying the Convention. In order to be able to prepare a report on the subject, the Secretariat had sent to the States parties to the Convention a questionnaire relating to the legal regime in those States governing the recognition and enforcement of foreign awards.

332. Up until the current session of the Commission, the Secretariat had received 59 replies to the questionnaire (out of, currently, 121 States parties). The Commission called upon the States parties to the Convention that had not yet replied to the questionnaire to do so as soon as possible or, to the extent necessary, to inform the Secretariat about any new developments since their previous replies to the questionnaire. The Secretariat was requested to prepare, for a future session of the Commission, a note presenting the findings based on the analysis of the information gathered.

VI. INTERNATIONAL COMMERCIAL ARBITRATION: POSSIBLE FUTURE WORK

A. Introduction

333. The Commission, during its thirty-first session, held a special commemorative New York Convention Day on 10 June 1998 to celebrate the fortieth anniversary of the Convention on the Recognition and Enforcement of Foreign Arbitral Awards (New York, 10 June 1958). In addition to representatives of States members of the Commission and observers, some 300 invited persons participated in the event. The opening speech was made by the Secretary-General of the United Nations. In addition to speeches by former participants in the diplomatic conference that adopted the Convention, leading arbitration experts gave reports on matters such as the promotion of the Convention, its enactment and application. Reports were also given on matters beyond the Convention itself, such as the interplay between the Convention and other international legal texts on international commercial arbitration and on practical difficulties that were encountered in practice but were not addressed in existing legislative or non-legislative texts on arbitration.

334. In reports presented at that commemorative conference, various suggestions were made for presenting to the Commission some of the problems identified in practice so as to enable it to consider whether any work by the Commission would be desirable and feasible.

335. The Commission, at its thirty-first session in 1998, with reference to the discussions at the New York Convention Day, considered that it would be useful to engage in a consideration of possible future work in the area of arbitration at its thirty-second session in 1999. It requested the Secretariat to prepare a note that would serve as a basis for the considerations of the Commission.


336. At the current session, the Commission had before it the requested note as document A/CN.9/460. The note drew on ideas, suggestions and considerations expressed in different contexts, such as the New York Convention Day, the Congress of the International Council for Commercial Arbitration (Paris, 3-6 May 1998), and other international conferences and forums, such as the 1998 “Freshfields” lecture. The note discussed some of the issues and problems identified in arbitral practice in order to facilitate a discussion in the Commission as to whether it wished to put any of those issues on its work programme. The considerations of the Commission on those issues is reflected below (paras. 357-370 and para. 380). During the deliberations, a number of other issues were mentioned as potentially suitable for future work by the Commission (paras. 339 and 340).

B. General remarks

337. The Commission welcomed the opportunity to discuss the desirability and feasibility of further development of the law of international commercial arbitration. It was generally considered that the time had arrived to assess the extensive and favourable experience with national enactments of the UNCITRAL Model Law on International Commercial Arbitration (1985) as well as the use of the UNCITRAL Arbitration Rules and the UNCITRAL Conciliation Rules, and to evaluate in the universal forum of the Commission the acceptability of ideas and proposals for improvement of arbitration laws, rules and practices.

338. The Commission undertook its deliberations with an open mind as to the ultimate form that future work of the Commission might take. It was agreed that any considerations as to the form would, at the current time, be tentative, leaving firmer decisions to be taken later as the substance of proposed solutions became clearer. Uniform provisions might, for example, take the form of a legislative text (such as model legislative provisions or a treaty) or a non-legislative text (such as a model contractual rule or a practice guide). It was stressed that, even if an international treaty were to be considered, it was not intended to be a modification of the Convention on the Recognition and Enforcement of Foreign Arbitral Awards (New York, 1958) (see also below, paras. 347-349). It was thought that, even if ultimately no new uniform text would be prepared, an in-depth discussion by delegates from all major legal, social and economic systems represented in the Commission, possibly with suggestions for uniform interpretation, would be a useful contribution to the practice of international commercial arbitration.

339. At various stages of the discussion, the following topics, in addition to those contained in document A/CN.9/460, were mentioned as potentially worthy of being taken up by the Commission at an appropriate future time:

(a) Gaps in contracts left by the parties and filling of those gaps by a third person or an arbitral tribunal on the basis of an authorization of the parties;

(b) Changed circumstances after the conclusion of a contract and the possibility that the parties entrusted a third person or an arbitral tribunal with the adaptation of the contract to changed circumstances;

(c) Freedom of parties to be represented in arbitral proceedings by persons of their choice and the issue of limits to that freedom based on, for example, nationality or membership in a professional association;

(d) Questions relating to the interpretation of legislative provisions such as those in article II (3) of the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards (or article 8 (1) of the UNCITRAL Model Law on International Commercial Arbitration), which in practice led to divergent results, in particular the question of the court’s terms of reference (i) in deciding whether to refer the parties to arbitration, (ii) in considering whether the arbitration agreement was null and void, inoperative or incapable of being performed, and (iii) where the defendant invoked the fact that an arbitration proceeding was pending or that an arbitral award had been issued;

(e) Questions relating to cases where a foreign court judgement was presented with a request for its recognition or enforcement, but where the respondent, by way of defence, invoked (i) the existence of an arbitration agreement, or (ii) the fact that an arbitration proceeding was pending, or (iii) the fact that an arbitral award had been issued in the same matter. It was noted that those instances were often not addressed by treaties dealing with recognition and enforcement of foreign court judgements. Difficulties arose in particular where the applicable treaty was designed to facilitate recognition and enforcement of court judgements, but the treaty itself did not allow recognition or enforcement to be refused on the ground that the dispute dealt with by the judgement was covered by an arbitration agreement, was being considered in a pending arbitral proceeding, or was the subject matter of an arbitral award.

C. Discussion of specific items

(a) Conciliation

A/CN.9/460, paras. 8-19

340. There was general agreement that the three issues identified in the note by the Secretariat (namely: admissibility of certain evidence in subsequent judicial or arbitral proceedings; role of the conciliator in subsequent proceedings; and procedures for enforcing settlement agreements) were particularly important, and were the object of ongoing discussions in professional circles involved in dispute settlement (see A/CN.9/460, paras. 8 to 19). It was widely felt that, in addition to those three issues, the possible
interruption of limitation periods as a result of the commencement of conciliation proceedings was worthy of consideration.

341. The view was expressed that the issues of conciliation might not easily lend themselves to international unification by way of uniform legislation. The desirability of preparing uniform legislative rules was questioned in view of a general concern that the flexibility of rules governing conciliation should be preserved. It was stated that most procedural difficulties that might arise in the field of conciliation could probably be solved by agreement between the parties.

342. The widely prevailing view, however, was that the Commission should explore the possibility of preparing uniform legislative rules to support the increased use of conciliation. It was explained that, while certain issues (such as the admissibility of certain evidence in subsequent judicial or arbitral proceedings, or the role of the conciliator in subsequent proceedings) could typically be solved by reference to sets of rules such as the UNCITRAL Conciliation Rules, there were many cases where no such rules were agreed upon. The conciliation process might thus benefit from the establishment of non-mandatory legislative provisions that would apply when the parties mutually desired to conciliate but had not agreed on a set of conciliation rules. Moreover, in countries where agreements as to the admissibility of certain kinds of evidence were of uncertain effect, uniform legislation might provide a useful clarification. In addition, it was pointed out with respect to issues such as facilitating the enforcement of settlement agreements resulting from conciliation (e.g. enforcing them in the same way as arbitral awards) and the effect of conciliation with respect to the interruption of a limitation period, that the level of predictability and certainty required to foster conciliation could only be achieved through legislation. It was widely felt that those issues should be dealt with by the Commission on a high priority basis.

343. After discussion, the Commission decided that a working group were to be entrusted with the subject matter (see below, para. 380) should consider whether, with a view to encouraging and facilitating conciliation, it would be useful for it to prepare harmonized legislative model provisions on conciliation that would deal with the above questions, and possibly others.

(b) Requirement of written form for arbitration agreement (A/CN.9/460, paras. 20-31)

344. It was widely considered that article II (2) of the 1958 Convention on the Recognition and Enforcement of Foreign Arbitral Awards (the New York Convention) (which required the arbitration agreement to be in written form "in a contract or an arbitration agreement, signed by the parties or contained in an exchange of letters or telegrams"), and subsequent uniform provisions modelled on that article, were often regarded as outdated. The discussion thus focused on the extent to which modernization of the New York Convention was needed in respect of the formation of the arbitration agreement, as well as the nature and the urgency of any work that might be undertaken by the Commission for such modernization. The view was expressed that, in the majority of cases, parties had no difficulty in complying with the current form requirements, that those requirements compelled the parties to consider carefully the exclusion of court jurisdiction and that, therefore, if any work should be undertaken, it should be limited to the formulation of a practice guide. While that view received some support, the Commission decided that future work was necessary with respect to matters arising in connection with article II (2) of the New York Convention, and that legislative work was among the options to be considered.

345. As regards the scope of future work with respect to article II (2) of the New York Convention, it was widely felt that work might be needed in connection with the two general issues addressed in the note by the Secretariat (A/CN.9/460, paras. 22-31), namely: the issue of the written form requirement and its implications with respect to modern means of communication and electronic commerce; and the more substantial issues of consent by the parties to an arbitration agreement where the arbitration agreement was not embodied in an exchange of letters or telegrams.

346. In addition to those two general issues, it was pointed out that special attention might need to be given to specific fact situations that posed serious problems under the New York Convention, including the following: tacit or oral acceptance of a written purchase order or of a written sales confirmation; an orally concluded contract referring to written general conditions (e.g. oral reference to a form of salvage); or, certain brokers' notes, bills of lading and other instruments or contracts transferring rights or obligations to non-signing third parties (i.e. third parties who were not party to the original agreement). Examples of such transfers to third parties included the following: universal transfer of assets (successions, mergers, demergers and acquisitions of companies); specific transfer of assets (transfer of contract or assignment of receivables or debts, novation, subrogation, stipulation in favour of a third party (stipulation pour autre); or, in the case of multiple parties, or groups of contracts or groups of companies, implicit extension of the application of the arbitration agreement to persons who were not expressly parties thereto (A/CN.9/460, para. 25).

347. Various views were expressed as to the means through which modernization of the New York Convention could be sought. One view was that the issues related to the formation of the arbitration clause should be dealt with by way of an additional protocol to the New York Convention. It was explained that redrafting, or promoting uniform interpretation of, article II (2) could only be achieved with the required level of authority through treaty provisions similar in nature to those of the New York Convention. While support was expressed for that view, concern was expressed that any attempt to revise the New York Convention might jeopardize the excellent results reached over 40 years of international recognition and enforcement of foreign arbitral awards through worldwide acceptance of that Convention. In response to that
concern, however, it was pointed out that the very success of the New York Convention and its establishment as a world standard should make it possible for UNCITRAL to undertake a limited overhaul of the text if such work was needed to adapt its provisions to changing business realities, and to maintain or restore its central status in the field of international commercial arbitration.

348. Another view was that, while no attempt should be made to revise the New York Convention directly, the desired result with respect to article II (2) might be achieved through model legislation. This could be prepared for the benefit of national legislators with a view to superseding the outdated provisions of article II (2) by relying on the more-favourable-law provision of article VII of the Convention. While support was expressed in favour of that view, it was noted that such a solution could be pursued only if article II (2) were no longer to be interpreted as a uniform rule establishing the minimum requirement of writing, but would instead be understood as establishing the maximum requirement of form. It was pointed out that the worldwide acceptance of such an interpretation was currently doubtful and could only become established as the result of a lengthy harmonization process based on case law. However, it was suggested that the Commission could usefully contribute to speeding up that process by elaborating (in addition to model legislation) guidelines or other non-binding material to be used by courts as guidance from the international community in the application of the New York Convention. It was also suggested that any model legislation that might be prepared with respect to the formation of the arbitration agreement might include a provision along the lines of article 7 of the United Nations Convention on Contracts for the International Sale of Goods to facilitate interpretation by reference to internationally accepted principles.

349. Yet another view was that an intermediary solution should be sought to avoid both the alleged dangers of revisiting the New York Convention and the possible inconvenience of relying merely on progressive harmonization through model legislation and case law interpretation. It was thus suggested that consideration might be given to preparing a convention separate from the New York Convention to deal with those situations which arose outside the sphere of application of the New York Convention, including (but not necessarily limited to) situations where the arbitration agreement failed to meet the form requirement established in article II (2). Some support was expressed in favour of that suggestion. Another view, however, was that experience indicated that the process of adopting and securing widespread ratification of a new convention could take many years, and that meanwhile there would be an undesirable lack of uniformity. It was stated that the suggested approach might be particularly suitable to deal with a number of the above-mentioned specific fact situations that posed serious problems under the New York Convention (see above, para. 346). However, with respect to a number of those situations (e.g. transfer of rights or obligations to non-signing third parties), it was widely felt that the issues at stake went to general questions regarding the substance and validity of the underlying transaction. Accordingly, doubts were expressed as to whether it would be desirable and feasible to attempt to deal with those issues in the context of a set of provisions geared primarily to the formation of the arbitration agreement.

350. With respect to the establishment of priorities, it was stated that, unless it could be envisaged to amend the New York Convention through a protocol or otherwise to prepare provisions in the nature of a treaty, work on the issues arising from article II (2) of the New York Convention should not constitute a priority, since no satisfactory solution was to be expected regarding those issues. Some support was expressed in favour of that view. The widely prevailing view, however, was that the Commission, at the current stage, should recognize that issues of formation of the arbitration agreement should be given a high priority on the programme of future work, and that none of the above-suggested approaches should be ruled out until they had been considered carefully by the Working Group to which the issue would be entrusted (see below, para. 380).

(c) Arbitrability
(A/CONF.9/460, paras. 32-34)

351. It was observed that uncertainties as to whether the subject matter of certain disputes was capable of settlement by arbitration was a matter that caused problems in international commercial arbitration (e.g. where arbitrators or parties, in particular those that were foreigners at the place of arbitration, were not aware that a particular issue was not arbitrable or where the law was unclear and parties and arbitrators were unsure to what extent an issue could be taken up in arbitral proceedings).

352. Views were expressed that it might be useful to include arbitrability in the work programme or at least to refer the topic to the Secretariat for further study. To the extent that the issue should be considered, the purpose should not be to strive for uniformity, but to stimulate transparency of solutions on that question. Work might be geared, for example, towards formulating a uniform provision setting out three or four issues that were generally considered non-arbitrable and calling upon States to list immediately thereafter any other issues regarded as non-arbitrable by the State.

353. At the same time, concerns were expressed that any national listing of non-arbitrable issues might be counter-productive by being inflexible. It was said that the question of arbitrability was subject to constant development (including through case law) and that some States might find it undesirable to interfere with that development. It was agreed that the topic should be accorded low priority.

(d) Sovereign immunity
(A/CONF.9/460, paras. 35-50)

354. The Commission noted that the matter of State immunity remained under consideration by the International Law Commission, and that the General Assembly, by its resolution 53/98 of 20 January 1999, had decided to establish a working group of the Sixth Committee to consider, at its fifty-fourth session, outstanding substantive issues
related to the Draft Articles on Jurisdictional Immunities of States and their Property, which draft articles had been prepared by the International Law Commission.

355. The Commission requested the Secretariat to monitor that work and to report on the outcome of those discussions at an appropriate time.

(e) Consolidation of cases before arbitral tribunals
   (A/CN.9/460, paras. 51-61)

356. It was pointed out that consolidation of arbitration cases into a single proceeding was not a novel issue and that it had practical significance in international arbitration, in particular where a number of interrelated contracts or a chain of contracts were entered into. Therefore, it was suggested, it might be useful for the question to be studied further. Views differed, however, as to whether the matter should be given high or low priority. It was also suggested that it might be useful for the Commission to prepare guidelines to assist parties in drafting arbitration agreements that envisaged consolidation of proceedings.

357. Another view was that it would not be realistic to expect to achieve substantive progress in that area at the current stage and that the matter should not be placed on the current work programme. After discussion, it was decided that the topic should be accorded low priority.

(f) Confidentiality of information in arbitral proceedings (A/CN.9/460, paras. 62-71)

358. It was pointed out that there were two aspects to the topic of confidentiality of information in arbitral proceedings. One aspect concerned "privacy" of arbitration, reflected in rules, agreements or methods by which the participants in an arbitral proceeding would aim at ensuring that non-participants would not become privy to the proceedings. Another aspect concerned the "duty of confidentiality", i.e. the duty of participants in an arbitration to maintain as confidential matters relating to the arbitral proceedings. It was noted that, whereas issues of privacy had been to some degree covered by arbitration rules, such as the UNCITRAL Arbitration Rules, issues of confidentiality generally had not been addressed to much extent in arbitration rules or national legislation.

359. Some support was given to the topic as one of priority. In support of that view, it was explained that parties involved in arbitral proceedings were becoming increasingly concerned over the absence of any rules in respect of confidentiality. It was felt that it would be useful to study the issues, which were becoming increasingly difficult and thorny. Another view was that, although the topic would merit study, it was not one that should be given high priority by the Commission, because of the absence of any viable solutions. It seemed to some that there was little likelihood of achieving anything more than a rule to the effect that "arbitration is confidential except where disclosure is required by law". The prevailing view was that, albeit interesting, the topic was not of high priority.

(g) Raising claims for the purpose of set-off
   (A/CN.9/460, paras. 72-79)

360. It was explained that sometimes in an arbitral proceeding the respondent would invoke a claim that the respondent would have against the claimant, not as a counter-claim, but as a defence for the purpose of a set-off. It was noted that, whereas it was often assumed that a claim raised for the purpose of a set-off had to be covered by the arbitration agreement, there existed rules (such as the International Arbitration Rules of the Zurich Chamber of Commerce, article 27) that were less restrictive in that they provided that the arbitral tribunal also had jurisdiction over a set-off defence even if the claim that was set off did not fall under the arbitration clause.

361. Views were expressed that it was generally regarded as a sound rule that an arbitral tribunal could take up a claim only if the claim was covered by the arbitration agreement and that, therefore, the consideration of the matter was unlikely to be productive. It was agreed that the topic should be accorded low priority.

(h) Decisions by "truncated" arbitral tribunals
   (A/CN.9/460, paras. 80-91)

362. It was observed that, if, during arbitral proceedings before a three-member tribunal, one of the members should resign out of bad faith, perhaps in collusion with one of the parties, it might be unfair to delay proceedings in order to permit replacement of that arbitrator, and that in such cases the remaining two arbitrators should be able to continue the proceedings and decide the case as a "truncated" tribunal. It was noted that the later in the proceedings such resignation would occur, the more grave could be the problems and loss of resources. It was noted that some arbitration rules (as noted in document A/CN.9/460) permitted, under certain circumstances, awards to be made by truncated tribunals.

363. Views were expressed that the matter deserved further study by the Secretariat and should be considered by the Commission. Some spoke in favour of dealing with the matter on the level of arbitration rules, while others thought that a model legislative provision might also be envisaged. It was noted that solutions in arbitration rules already existed and that examples of legislative solutions existed as well. Another view was that in practice a truncated tribunal would come about only rarely. It was felt that it would be inadvisable to attempt to legislate on that matter because it raised sensitive issues, because it had implications in the context of recognition and enforcement of an award made by a truncated tribunal, and because agreed solutions would be difficult to achieve. It was pointed out that truncated tribunals had acted even in the absence of express rules. In these circumstances, it was agreed that the topic should be accorded low priority.

(i) Liability of arbitrators
   (A/CN.9/460, paras. 92-100)

364. It was noted that the national laws that contained provisions on this topic generally fell into one of two
categories. In one group of laws, the focus was on circumscribing the liability of arbitrators, as well as, in some cases, other participants (in some States of that group, arbitrators were considered similar to judges and were afforded similar immunities). In the other group, the approach was to describe the standard of liability (in some of those countries, arbitrators were considered akin to hired professionals and were held to similar standards of liability as other professionals). In many countries, the matter was left unlegislated.

365. The view was expressed that the topic was worthy of further study; it was said that, as there were many countries that did not have legislation on the matter, it would be valuable if the Commission would provide model solutions.

366. Another view was that, in light of different approaches in legal systems, the matter should not be considered by the Commission because it was unlikely that a consensus could be achieved on a workable solution. By addressing the topic and not being able to reach a solution, the Commission would unnecessarily raise its profile and cause confusion. It was agreed that the topic (which should more appropriately be described as "immunity of arbitrators from liability") should be accorded low priority.

(j) **Power by the arbitral tribunal to award interest**
(A/CN.9/460, paras. 101-106)

367. It was noted that the power of the arbitral tribunal to award interest was a matter of great practical importance that arose often and potentially involved large amounts of money. It was also noted that the matter involved the question of the power of the arbitral tribunal to award interest (which in some legal systems, it was said, was not implied failing agreement of the parties) as well as rules (largely pertaining to the law applicable to the substance of the dispute) on related issues such as those mentioned in paragraph 106 of document A/CN.9/460.

368. The view was expressed that the topic was important, that it could benefit from further study and that the absence of a model legislative provision was a problem, in particular where the absence of a legislative provision would prevent the arbitral tribunal from being able to award interest.

369. Another view was that, while the topic deserved to be studied at some future time, it was not of high priority, in particular because such matters were ordinarily addressed in the contract and should be left for the parties to determine. It was said, however, that providing guidance and model solutions would facilitate arbitration. It was noted that, according to Islamic law, interest was proscribed, but that that fact did not prevent finding solutions appropriate for other legal systems. It was agreed that the topic should be accorded low priority.

(k) **Costs of arbitral proceedings**
(A/CN.9/460, paras. 107-114)

370. It was widely considered that the question of various matters relating to the costs of arbitration was not urgent. Provisions on costs were included in many arbitration rules and otherwise were best left to the agreement of the parties. It was agreed that the topic should be accorded low priority.

(l) **Enforceability of interim measures of protection**
(A/CN.9/460, paras. 115-127)

371. It was generally agreed in the Commission that the question of enforceability of interim measures of protection issued by an arbitral tribunal was of utmost practical importance and in many legal systems was not dealt with in a satisfactory way. It was considered that solutions to be elaborated by the Commission on that topic would constitute a real contribution to the practice of international commercial arbitration. It was agreed that the issue should be addressed through legislation. While suggestions were made that a convention was the appropriate vehicle for dealing with this matter, support was also expressed for the suggestion that model legislation be prepared.

372. As to the substance of future work, several observations and suggestions were made. One was that, in addition to the enforcement of interim measures of protection in the State where the arbitration took place, enforcement of those measures outside that State should also be considered. It was said that, while the possible objective of future work was to make interim measures of protection enforceable in a similar fashion as arbitral awards, it should be borne in mind that interim measures of protection in some important respects differed from arbitral awards (e.g., an interim measure might be issued ex parte, and might be reviewed by the arbitral tribunal in light of supervening circumstances). As to ex parte measures, it was observed that under some legal systems they could only be issued for a limited period of time (e.g., 10 days), and a hearing had to be held thereafter to reconsider the measure. Court assistance to arbitration (in the form of interim measures of protection issued by a court before the commencement of, or during, arbitral proceedings) was also suggested for study.

373. It was agreed that the topic should be accorded high priority.

(m) **Possible enforceability of an award that has been set aside in the State of origin**
(A/CN.9/460, paras. 128-144)

374. It was generally agreed that cases of enforcement of an award that had been set aside in the State of origin, while rare, were potentially a source of serious concern; they gave rise to polarized views, and, if harmonized solutions were not found, could adversely affect the smooth functioning of international commercial arbitration. Therefore, it was considered necessary that the Commission place that topic on its agenda and entrust a working group with exploring various possible solutions. Without fully discussing the merits of possible solutions, several were mentioned.
375. One solution was to distinguish between standards for setting aside an award that were recognized internationally and standards that were not recognized internationally; that solution could be inspired by article IX of the European Convention on International Commercial Arbitration (Geneva, 1961). Another solution could be to prepare provisions supplementing and clarifying article VII of the New York Convention, according to which a party might seek enforcement of a foreign arbitral award in a State other than where the award was made on the basis of provisions of law that were more favourable than those of the New York Convention. A view was expressed that yet another solution would be to disregard, for the purposes of enforcement, the sole fact that the award had been set aside. The possible usefulness of the Commission issuing a statement of principles was also noted.

376. It was agreed that the topic should be accorded high priority.

(n) Review and possible revision of the 1961 European Convention on International Commercial Arbitration

377. As regards the current review and possible future revision of the European Convention on International Commercial Arbitration (concluded in 1961 at Geneva under the auspices of the Economic Commission for Europe (ECE)), as referred to in the note by the Secretariat (A/CN.9/460, para. 6), UNCITRAL heard statements by the observer for ECE and the two Vice-Chairpersons of the ad hoc informal working group (the WP.5 Arbitration Convention Working Group) established for that purpose by the Economic Commission for Europe Working Party on International Contract Practices in Industry (WP.5). UNCITRAL was informed that the WP.5 Arbitration Convention Working Group was expected to review the 1961 European Convention in order to determine its continuing usefulness, its utility beyond that of existing conventions and the advisability of revising that Convention with a view to increasing its utility for existing and potential new signatories (and possible worldwide acceptance), as well as to report on current problems in international arbitration and provide suggestions as to how those problems might be addressed, and by which organization. UNCITRAL was invited to consider undertaking that work jointly with ECE, in compliance with its mandate of coordination and cooperation, and in order to avoid duplication of efforts.

378. UNCITRAL agreed that wasteful duplication of efforts should be avoided. For that reason, and in order to prevent inconsistent results, close coordination and cooperation were considered highly desirable. In order to determine the best ways of achieving those objectives, due account had to be taken of the composition and mandate of the organizations involved. In this context, it was noted that all European and the few non-European States members of ECE were either members of UNCITRAL or could actively participate in its deliberations; that UNCITRAL was the core legal body within the United Nations system in the field of international trade law; and that the subject matter of international commercial arbitration was a global issue best addressed by UNCITRAL. It was also noted that any particular issues of concern primarily or exclusively to a given region would be more appropriately dealt with by the relevant regional organization.

379. As a consequence, UNCITRAL appealed to ECE, in particular its Committee for Trade, Industry and Enterprise Development when defining the mandate of the WP.5 Arbitration Convention Working Group, to concentrate on questions specific to its region or to the functioning of the 1961 European Convention (e.g. article IV and the accompanying mechanism), while exercising restraint as regards arbitration issues of general interest or concern, which were likely to be addressed by the UNCITRAL Working Group on Arbitration. UNCITRAL requested its secretariat to assist, within existing resources, the ECE Working Group in such an undertaking. It was agreed that the concrete steps to be taken in ensuring future cooperation between the two organizations would need to be tailored according to the developments in both projects.

D. Conclusion

380. The Commission, having concluded the discussion and exchange of views on its future work in the area of international commercial arbitration, decided to entrust the work to a working group and requested the Secretariat to prepare the necessary studies. It was agreed that the priority items for the working group should be conciliation (see above, paras. 340-343), requirement of written form for the arbitration agreement (see above, paras. 344-350), enforceability of interim measures of protection (see above, paras. 371-373) and possible enforceability of an award that had been set aside in the State of origin (see above, paras. 374-375). It was expected that the Secretariat would prepare the necessary documentation for the first session of the working group for at least two, and possibly three, of those four topics. As to the other topics discussed in document A/CN.9/460, as well as topics for possible future work suggested at the thirty-second session of the Commission (see above, para. 339), which were accorded lower priority, the working group was to decide on the time and manner of dealing with them.

VII. POSSIBLE FUTURE WORK ON INSOLVENCY LAW

381. The Commission had before it a proposal by Australia (A/CN.9/462/Add.1) on possible future work in the area of insolvency law. The proposal referred to recent regional and global financial crises and the work undertaken in international forums in response to those crises. Reports from those forums stressed the need to strengthen the international financial system in three areas: transparency; accountability; and management of international financial crises by domestic legal systems. According to those reports, strong insolvency and debtor-creditor regimes were an important means for preventing or limiting financial crises and for facilitating rapid and orderly financial restructuring in case of excessive indebtedness. The proposal before the Commission recommended that, in view of its universal membership, its previous successful
work on cross-border insolvency and its established working relations with international organizations that had expertise and interest in the law of insolvency, the Commission was an appropriate forum to put insolvency law on its agenda. The proposal urged that the Commission consider entrusting a working group with the development of a model law on corporate insolvency to foster and encourage the adoption of effective national corporate insolvency regimes.

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

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

384. To facilitate that further study, the Commission was invited by the Secretariat to consider the possibility of devoting one session of a working group to ascertaining what, in the current landscape of efforts, would be an appropriate product (such as a model law, model provisions, a set of principles or other text) and to defining the scope of the issues to be included in that product. Diverging views were expressed in response. One view was that more background work should be undertaken by the Secretariat and presented to the Commission at its thirty-third session for a decision as to whether substantive work of elaborating a uniform law or another text of a recommendatory nature should be undertaken. Another view was that the question could be referred to one session of a working group, for the purpose of exploring those various issues, with a report to be made to the Commission at its thirty-third session in 2000 on the feasibility of undertaking work in the field of insolvency. At that time, the Commission would have before it sufficient information to make a final decision on that issue. It was emphasized that preparatory work for the session of the working group would require coordination with other international organizations already undertaking work in the area of insolvency law, since the results of their work would constitute important elements in the deliberations towards recommending to the Commission what it might usefully contribute in that area. It was pointed out that the importance and urgency of work on insolvency law had been identified in a number of international organizations, and there was wide agreement that more work was required in order to foster the development and adoption of effective national corporate insolvency regimes.

385. The prevailing view in the Commission was that an exploratory session of a working group should be convened to prepare a feasibility proposal for consideration by the Commission at its thirty-third session. Subsequently, after the Commission had discussed its future work in the area of arbitration (see para. 380), it was decided that the Working Group on Insolvency Law was to hold that exploratory session at Vienna from 6 to 17 December 1999.

VIII. CASE LAW ON UNCITRAL TEXTS

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

387. The Commission noted the valuable work of the national correspondents in the collection of relevant decisions and arbitral awards and their preparation of case abstracts for compilation and distribution by the Secretariat. It was pointed out, however, that there was a wide disparity in the level of participation by national correspondents, which was reflected both in the extent of reporting and in the quality of abstracts prepared. It was noted that improvements in these two areas would significantly improve the reliability of the CLOUT system and would reduce the need for major revisions by the Secretariat.

388. It was also noted that, whereas 58 jurisdictions had appointed national correspondents, there were another 30 jurisdictions that had not yet done so. These jurisdictions would be entitled to make such an appointment either by virtue of their being a party to an UNCITRAL convention currently in force or by having adopted legislation based on an UNCITRAL model law. Noting the importance of uniform reporting from all jurisdictions,
the Commission urged States that had not yet done so to appoint a national correspondent. It also urged Governments to assist their national correspondents to the extent possible in their work.

389. It was further noted that the number of States adhering to conventions or enacting legislation based on model laws elaborated by the Commission had increased significantly, and so was the caseload arising under those texts. Strong concern was expressed as to the resultant increase of the workload for the secretariat of the Commission which was unable to bear that load much longer without a significant staff increase.

IX. TRAINING AND TECHNICAL ASSISTANCE

390. The Commission had before it a note by the Secretariat (A/CN.9/461) setting forth the activities undertaken since the previous session and indicating the direction of future activities being planned, particularly in light of the increase in the requests received by the Secretariat. It was noted that training and technical assistance activities were typically carried out through seminars and briefing missions, which were designed to explain the salient features of UNCITRAL texts and the benefits to be derived from their adoption by States.

391. It was reported that since the previous session, the following seminars and briefing missions had been held: Lusaka (20-22 April 1998); Yaoundé (27 April 1998); Douala, Cameroon (28-30 April); Manama (12-13 May 1998); La Paz (18 May 1998); Cochabamba, Bolivia (20 May 1998); Santa Cruz, Bolivia (22 May 1998); Lima (25-29 May 1998); Baku (24-25 September 1998); Ulaanbaatar (21-23 October 1998); Beijing (26-30 October 1998); Bucharest (29-30 October 1998); Sofia (2-3 November 1998); Shanghai, China (4-6 November 1998); Sao Paulo, Brazil (16 November 1998); Brasilia (19-20 November 1998); Caracas (24-27 November 1998); Buenos Aires (30 November-1 December 1998); Guatemala City (11-12 March 1999); Mexico City (15-17 March 1999); Monterrey, Nuevo Leon, Mexico (20 March 1999). The secretariat of the Commission reported that a number of requests had to be turned down for lack of sufficient resources, and that for the remainder of 1999, only a part of the requests, made by countries in Africa, Asia, Latin America and eastern Europe, could be met.

392. The Commission expressed its appreciation to the Secretariat for the activities undertaken since its past session and emphasized the importance of the training and technical assistance programme for promoting awareness and wider adoption of the legal texts it had produced. It was pointed out that training and technical assistance was particularly useful for developing countries lacking expertise in the areas of trade and commercial law covered by the work of UNCITRAL. It was also observed that the training and technical assistance activities of the Secretariat could play an important role in the economic integration efforts being undertaken by many countries.

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

394. The Commission took note with appreciation of the contributions made by Finland, Greece and Switzerland towards the seminar programme. It also expressed its appreciation to Cambodia, Kenya and Singapore for their contributions to the Trust Fund for Granting Travel Assistance to Developing States members of UNCITRAL. The Commission also expressed its appreciation to those other States and organizations which had contributed to the Commission’s programme of training and assistance by providing funds or staff or by hosting seminars. Stressing the importance of extrabudgetary funding for carrying out training and technical assistance activities, the Commission appealed once more to all States, international organizations and other interested entities to consider making contributions to the UNCITRAL trust funds so as to enable the secretariat of the Commission to meet the increasing demands in developing countries and newly independent States for training and assistance, and delegates from developing countries to attend UNCITRAL meetings. It was also suggested that, in order to redress the resource difficulties facing the Commission, an attempt be made to encourage the private sector to contribute to the financing of the UNCITRAL assistance and training programme, particularly in view of the fact that the private sector benefited a great deal from the overall work of the Commission in the area of international trade law.

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

396. As to the internship programme of the secretariat of the Commission, concern was expressed that the majority of the participants were nationals of developed countries. An appeal was made to all States to consider supporting programmes that sponsored the participation of nationals of developing countries in the internship programme.
397. In order to ensure the effective implementation of its training and assistance programme and the timely publication and dissemination of its work, the Commission decided to recommend to the General Assembly to request the Secretary-General to substantially increase both the human and financial resources available to its secretariat.

X. STATUS AND PROMOTION OF UNCITRAL TEXTS

398. The Commission, on the basis of a note by the Secretariat (A/CN.9/462), considered the status of the conventions and model laws emanating from its work, as well as the status of the Convention on the Recognition and Enforcement of Foreign Arbitral Awards (New York, 1958). The Commission noted with pleasure the new actions of States and jurisdictions after 12 June 1998 (date of the conclusion of the thirty-first session of the Commission) regarding the following instruments:


(f) United Nations Convention on the Liability of Operators of Transport Terminals in International Trade (Vienna, 1991). New action by Egypt; the Convention has two States parties. It requires three more adherences for entry into force;

(g) United Nations Convention on Independent Guarantees and Stand-by Letters of Credit (New York, 1995). New actions by El Salvador, Kuwait and Tunisia; the Convention has five States parties. It will enter into force on 1 January 2000;


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

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


(m) UNCITRAL Model Law on Cross-Border Insolvency, 1997.

399. Appreciation was expressed for those legislative actions on the texts of the Commission. A request was directed to States that had enacted or were about to enact a model law prepared by the Commission, or were considering legislative action regarding a convention resulting from the work of the Commission, to inform the Secretariat of the Commission thereof. Such information would be useful to other States in their consideration of similar legislative actions. Appreciation was also expressed to the Secretariat for establishing a Web site for UNCITRAL documents, past and current. Noting the difficulties faced by the Secretariat in posting UNCITRAL documents on its Web site in all official languages in a timely fashion, it was agreed that the resources available to the Secretariat for that purpose needed to be substantially increased.

400. Representatives and observers of a number of States reported that official action was being considered with a view to adherence to various conventions and to the adoption of legislation based on various model laws prepared by UNCITRAL. It was noted that the UNCITRAL Model Law on Electronic Commerce had become the single common source often cited by many countries. The view was expressed that the recent endorsement by the International Chamber of Commerce Banking Commission would likely boost ratification of the United Nations Convention on Independent Guarantees and Stand-by Letters of Credit.

401. It was noted that, despite the universal relevance and usefulness of those texts, a number of States had not yet enacted any of them. An appeal was directed to the representatives and observers that had been participating in the meetings of the Commission and its working groups to contribute, to the extent that they in their discretion deemed appropriate, to facilitating consideration by legislative organs in their countries of texts of the Commission. It was suggested that the publication of articles in law journals and the holding of conferences to discuss UNCITRAL texts could usefully serve that purpose. It was also suggested that consideration of an UNCITRAL text by legislative organs could be facilitated by bringing to the attention of the secretariat of the Commission any concern that might be expressed with regard to such text in order that such concern might be addressed.
XI. GENERAL ASSEMBLY RESOLUTIONS ON THE WORK OF THE COMMISSION

402. The Commission took note with appreciation of General Assembly resolution 53/103 of 8 December 1998, in which the Assembly commended the Commission for the progress made in its work on receivables financing, electronic commerce, privately financed infrastructure projects and the legislative implementation of the Convention on the Recognition and Enforcement of Foreign Arbitral Awards (New York, 1958). In addition, the Commission took note with appreciation of paragraph 3 of that resolution, in which the Assembly commended the Commission for holding a special commemorative “New York Convention Day” in order to celebrate the fortieth anniversary of that Convention.

403. The Commission also noted with appreciation that, in paragraph 4 of resolution 53/103, the General Assembly appealed to Governments that had not yet done so to reply to the questionnaire circulated by the Secretariat in relation to the legal regime governing the recognition and enforcement of foreign arbitral awards.

404. In addition, the Commission noted that, in paragraph 6 of resolution 53/103, the General Assembly reaffirmed the mandate of the Commission, as the core legal body within the United Nations system in the field of international trade law, to coordinate legal activities in that field, and, in that connection, called upon all bodies of the United Nations system and invited other international organizations to bear in mind the mandate of the Commission and the need to avoid duplication of effort and to promote efficiency, consistency and coherence in the unification and harmonization of international trade law, and recommended that the Commission, through its secretariat, continue to maintain close cooperation with the other international organs and organizations, including regional organizations, active in the field of international trade law.

405. The Commission took note with appreciation of the decision of the General Assembly, in paragraph 7 of resolution 53/103, to reaffirm the importance, in particular for developing countries, of the work of the Commission concerned with training and technical assistance in the field of international trade law, such as assistance in the preparation of national legislation based on legal texts of the Commission, and that, in paragraph 8, the Assembly expressed the desirability for increased efforts by the Commission, in sponsoring seminars and symposia, to provide such training and assistance.

406. The Commission further noted with appreciation the appeal by the General Assembly, in paragraph 8(b) of resolution 53/103, to Governments, the relevant United Nations organs, organizations, institutions and individuals to make voluntary contributions to the UNCITRAL Trust Fund for Seminars and, where appropriate, to assist the secretariat of the Commission in the financing and organizing of seminars, particularly in developing countries, and in the award of fellowships to candidates from developing countries to enable them to participate in such seminars and symposia. Furthermore, it was noted that the Assembly appealed, in paragraph 9 of the resolution, to the United Nations Development Programme and other bodies responsible for development assistance, such as the World Bank and the European Bank for Reconstruction and Development, as well as to Governments in their bilateral aid programmes, to support the training and technical assistance programme of the Commission and to cooperate and coordinate their activities with those of the Commission.

407. It was also appreciated that the General Assembly, in paragraph 10 of resolution 53/103, appealed to Governments, the relevant United Nations organs, organizations, institutions and individuals, in order to ensure full participation by all Member States in the sessions of the Commission and its working groups, to make voluntary contributions to the Trust Fund for Granting Travel Assistance to Developing States members of UNCITRAL, at their request and in consultation with the Secretary-General. (That trust fund had been established pursuant to General Assembly resolution 48/32 of 9 December 1993.) The Commission noted with appreciation the decision of the General Assembly, in paragraph 11, to continue, in the competent Main Committee during the fifty-third session of the General Assembly, its consideration of granting travel assistance to the least developed countries that were members of the Commission, at their request and in consultation with the Secretary-General.

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

409. The Commission noted with appreciation that the General Assembly, in paragraph 13 of resolution 53/103, stressed the importance of bringing into effect the conventions emanating from the work of the Commission, and that, to that end, the Assembly urged States that had not yet done so to consider signing, ratifying or acceding to those conventions.

XII. COORDINATION AND COOPERATION

A. Transport law

410. It was recalled that, the Commission, during its twenty-ninth session in 1996, while not having included the consideration of issues of transport law on its current agenda, decided that the Secretariat should be the focal point for gathering information, ideas and opinions as to the problems in transport law that arose in practice and possible solutions to those problems. Such information-gathering should be broadly based and should include
among its sources, in addition to Governments, international organizations representing the commercial sectors involved in the carriage of goods by sea, such as the Comité maritime international (CMI), the International Chamber of Commerce, the International Union of Marine Insurance, the International Federation of Freight Forwarders' Associations, the International Chamber of Shipping and the International Association of Ports and Harbours. 28

411. At its thirty-first session in 1998, the Commission heard a statement on behalf of CMI to the effect that it welcomed the invitation to cooperate with the Secretariat in soliciting views of the sectors involved in the international carriage of goods and in preparing an analysis of that information. That analysis would allow the Commission to take an informed decision as to the desirable course of action. 29

412. Strong support had been expressed at that session by the Commission for the exploratory work being undertaken by CMI and the secretariat of the Commission. The Commission expressed its appreciation to CMI for its willingness to embark on that important and far-reaching project, for which few or no precedents existed at the international level; the Commission was looking forward to being apprised of the progress of the work and to considering the opinions and suggestions resulting from it. 30

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

414. It was further reported that the CMI working group had launched an investigation by means of a questionnaire addressed to all CMI member organizations covering a great number of legal systems. At the same time, international organizations involved and interested in international transport had been invited to a meeting to be held on 30 June 1999 in London, where particular issues of interest to those organizations would be discussed and added to the agenda of the working group.

415. The intention of CMI was, once the replies to the questionnaire had been received, to create an international subcommittee of CMI with a view to analysing the data and finding a basis for further work towards harmonizing the law in the area of international transport of goods. It was stated that the enthusiasm encountered so far in the industry and the provisional findings about the areas of law that needed further harmonization made it likely that the project would be eventually transformed into a universally acceptable harmonizing instrument. The Commission was assured that CMI would provide the Commission with its assistance in preparing such an instrument.

416. Expressing its appreciation to the Commission for the close cooperation with CMI in the area of transport law, the representative of CMI spoke of the need for a creative exchange of ideas among experts from different sectors interested in the carriage of goods, from different legal systems and from countries at different levels of development. In that connection, it was recalled that the Commission had on several occasions organized colloquia (such as the New York Convention Day on 10 June 1998 during the thirty-first session of the Commission in 1998), and it was suggested that it would be useful to carry out such an exchange of ideas at a broadly based colloquium, organized during the annual session of the Commission in 2000.

417. In reacting to the report on behalf of CMI, statements of gratitude were made to CMI for the work carried out so far; interest was expressed in the announced study that went beyond the liability of carriers and that would examine the interdependence among various contracts involved in the international carriage of goods and the need to provide legal support to modern contract and transport practices. It was said that increasing disharmony in the area of international carriage of goods was a source of concern and that, in order to provide a certain legal basis to modern contract and transport practices, it was necessary to look beyond the liability issues and, if need be, reconsider positions taken in the past. Furthermore, it was said that various regional initiatives in the area of transport law ought to be examined and borne in mind in any future work in that area of law.

418. The Commission expressed its appreciation to CMI for having acted upon its request for cooperation, and it requested the Secretariat to continue to cooperate with CMI in gathering and analysing information. The Commission was looking forward to receiving a report at
a future session presenting the results of the study with proposals for future work.

B. Asian-African Legal Consultative Committee

419. It was stated on behalf of the Asian-African Legal Consultative Committee (AALCC) that the Committee, at its annual sessions, was considering reports on the work of UNCITRAL. AALCC welcomed the Commission's work on privately financed infrastructure projects, took note with appreciation of the substantive progress of the Commission's work towards a draft Convention on Assignment in Receivables Financing, supported the Commission's ongoing work on electronic commerce and reiterated AALCC support for ongoing work in the field of arbitration within the context of the Commission. The Commission was informed of the resolution made at the 1999 session of AALCC mandating the Secretary-General of AALCC to explore the possibilities of convening a seminar or workshop in 1999 in cooperation with UNCITRAL and the United Nations Conference on Trade and Development. The Commission expressed its appreciation for the statement and welcomed all the efforts aimed at strengthening cooperation with AALCC.

C. International Institute for the Unification of Private Law

420. The Commission was informed that, beyond the draft Convention on International Interests in Mobile Equipment, the following items were on the agenda of the International Institute for the Unification of Private Law (Unidroit): franchising, questions of electronic commerce relating to the Convention on the Contract for the International Carriage of Goods by Road, revising and expanding the Unidroit Principles on International Commercial Contracts and transnational aspects of civil procedure. It was observed that a study group was considering the preparation of a legal guide on international franchising. It was also pointed out that another study group was considering revising or supplementing the Convention on the Contract for the International Carriage of Goods by Road with a view to ensuring that it sufficiently accommodated electronic means of communication. With regard to the Unidroit Principles on International Commercial Contracts, it was stated that they were being revised with a view to addressing matters such as agency, assignment, rights of set-off and limitation of actions. As to civil procedure, it was said that, with the cooperation of the American Law Institute, a study group was considering national rules of civil procedure that were common to many legal systems and could serve as a basis for a body of transnational rules of procedure.

421. The Commission welcomed cooperation with Unidroit. It was felt that such cooperation was necessary for the optimal use of the resources available to the respective organizations to the benefit of law unification.

XIII. OTHER BUSINESS

A. Request for endorsement of International Standby Practices and of Uniform Rules for Contract Bonds

422. The Commission had before it a note containing a request by the Institute of International Banking Law and Practice that the Commission consider recommending for worldwide use the Rules on International Standby Practices (ISP98), as endorsed by the Commission on Banking Technique and Practice of the International Chamber of Commerce. The Commission was also notified of a request from the Secretary-General of the International Chamber of Commerce that the Commission consider giving its formal recognition and endorsement of the Uniform Rules for Contract Bonds (URCB). In order to allow consideration of those requests, the Commission had before it the text of ISP98 (A/CN.9/459) and of URCB (A/CN.9/459/Add.1).

423. It was recalled that the Commission had endorsed INCOTERMS 1990 at its twenty-fifth session, in 1992, and the Uniform Customs and Practice for Documentary Credits (UCP 500) at its twenty-seventh session, in 1994. Reference was made to the importance of ISP98 as private rules of practice intended to apply to standby letters of credit. It was pointed out that the idea of preparing such rules was conceived during the deliberations of the UNCITRAL Working Group on International Contract Practices which resulted in the United Nations Convention on Independent Guarantees and Stand-by Letters of Credit. The ISP98 Rules were formulated to complement the Convention. The ISP98 drafting process itself was undertaken in regular consultation with the UNCITRAL secretariat and was also used as an opportunity to promote adoption of the Convention. In that context, the Commission noted with particular appreciation that adoption of the United Nations Convention on Independent Guarantees and Stand-by Letters of Credit had been recommended to Governments by the Banking Commission of the International Chamber of Commerce.

424. Reference was also made to the importance of URCB as a commendable practical tool and to the need for wider awareness of that instrument.

425. The Commission expressed its appreciation for the efforts that led to the elaboration of those rules of practice and welcomed the requests for their endorsement by the Commission. However, while several delegations indicated their desire to endorse the text of both ISP98 and URCB at the current session, some delegations indicated that, owing to the fact that late publication of document A/CN.9/459 and Add.1 had prevented them from carrying out the consultations required prior to endorsement, they were not prepared to endorse the text of ISP98 and URCB at the current session. The Commission regretfully felt obliged to postpone consideration of endorsement until the next session.

B. Commercial Law Association

426. The Commission recalled that the Commercial Law Association had been established in 1997 as a non-governmental international association and forum for individuals, organizations and institutions to support the work of the Commission. It noted the projects proposed for the Association, in particular, the establishment of a correspondent network to foster the development of, and reporting on, UNCITRAL-related activities around the world; the publication of an annual review containing work relating to UNCITRAL; assistance with both the preparation of UNCITRAL texts through the provision of coordinated materials, information and support; the establishment of an internship and senior scholar programme; coordination of law reform efforts with other international organizations and cooperation and joint use of resources; advising the Secretariat of possible topics for future projects; assisting with the CLOUT system; and seeking private sector support for UNCITRAL and its work.

427. The Commission heard with interest the suggestion that, in order to develop those projects and promote better knowledge and understanding of UNCITRAL and its work, a one-day forum should be held in conjunction with the thirty-third session of the Commission in 2000. Such a forum would present an opportunity not only to provide information on the work of the Commission to the international business community, but also to seek the views of Commission members and the international business community on current work and on possible future subjects.

C. Willem C. Vis International Commercial Arbitration Moot

428. It was reported to the Commission that the Institute of International Commercial Law at Pace University School of Law, New York, had organized the sixth Willem C. Vis International Commercial Arbitration Moot (Vienna, 27 March to 1 April 1999). Legal issues that the teams of students participating in the Moot dealt with were based, inter alia, on the United Nations Convention on Contracts for the International Sale of Goods, and UNCITRAL instruments on international commercial arbitration. Some 70 teams from law schools in some 28 countries participated in the 1999 Moot. The Moot involved participation of some 350 law students and the performance of the competing teams was judged by some 180 judges including arbitrators, attorneys, academics and others. The seventh Moot was scheduled to be held in Vienna from 15 to 20 April 2000.

429. The Commission heard the report with interest and appreciation. It regarded the Moot, with its international participation, as an excellent method of teaching international trade law and disseminating information about UNCITRAL texts. The Commission also noted, with appreciation, the contribution of Professor Eric E. Bergsten, former Secretary of the Commission, to the ongoing success of the Moot competition.

D. Bibliography

430. The Commission took note with appreciation of the bibliography of recent writings related to the work of the Commission, which was generally praised as a useful research tool (A/CN.9/463). The Commission appealed to all those interested in the completeness of the bibliography to send to the UNCITRAL Law Library all publications related to the work of the Commission for keeping and inclusion of the information in the bibliography.

E. UNCITRAL Yearbook and other UNCITRAL publications

431. The Commission noted that the UNCITRAL Yearbook (which appeared in English, French, Russian and Spanish) was published with a delay, and that the delay was for some language versions up to 3 to 4 years. The Commission expressed a serious concern about that fact. It was considered that the travaux préparatoires for the UNCITRAL texts, compiled in the UNCITRAL Yearbook, were an essential tool used by Governments in considering UNCITRAL texts for adoption, were widely used by judges, arbitrators and other practitioners in interpreting and using the texts of the Commission and were considered as a most useful teaching and research aid by academics and students. It was pointed out that the UNCITRAL Yearbook was often the only practical way of obtaining documents of the Commission.

432. Therefore, the Commission appealed to the General Assembly to ensure the effective implementation of the UNCITRAL publication programme and, in particular, the timely publication of the UNCITRAL Yearbook in all the languages envisaged.

F. Date and place of the thirty-third session of the Commission

433. After lengthy discussions, it was decided that the Commission would hold its thirty-third session in New York from 12 June to 7 July 2000. Concern was expressed that a session of such long duration would impose a considerable strain on resources. It was recognized, however, that a four-week session was necessary in view of the expectation that two, or possibly three, draft legal texts would be submitted to the Commission for finalization and adoption.

G. Sessions of working groups

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

(a) The Working Group on International Contract Practices is to hold its thirty-first session at Vienna from 11 to 22 October 1999. Should the Working Group not be able to conclude its work on the draft Convention on Assignment in Receivables Financing at that session, the Working Group is to hold its thirty-second session in New York from 10 to 21 January 2000;
(b) The Working Group on Electronic Commerce is to hold its thirty-fifth session at Vienna from 6 to 17 September 1999 and its thirty-sixth session in New York from 14 to 25 February 2000; (c) The Working Group on Insolvency Law is to hold its twenty-second session at Vienna from 6 to 17 December 1999. The Working Group is to hold its twenty-third session at Vienna from 20 to 31 March 2000 under the name of Working Group on Arbitration.


(b) Progressive development of the law of international trade: thirty-second annual report of the United Nations Commission on International Trade Law

6. At its 908th plenary meeting, on 29 October 1999, the Board took note of the report of UNCITRAL on its thirty-second session (A/54/17).


I. INTRODUCTION

1. At its 3rd plenary meeting, on 17 September 1999, the General Assembly, on the recommendation of the General Committee, decided to include in the agenda of its fifty-fourth session the item entitled “Report of the United Nations Commission on International Trade Law on the work of its thirty-second session” and to allocate it to the Sixth Committee.

2. The Sixth Committee considered the item at its 3rd, 4th and 29th meetings, on 11 and 12 October and 11 November 1999. The views of the representatives who spoke during the Committee’s consideration of the item are reflected in the relevant summary records (A/C.6/54/SR.3, 4 and 29).

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

4. At the 3rd meeting, on 11 October, the Chairman of the United Nations Commission on International Trade Law at its thirty-second session introduced the report of the Commission on the work of that session (see A/C.6/54/SR.3).

5. At the 4th meeting, on 12 October, the Chairman of the Commission made a statement in the light of the debate (see A/C.6/54/SR.4).

II. CONSIDERATION OF DRAFT RESOLUTION A/C.6/54/L.4

6. At the 29th meeting, on 11 November, the representative of Austria, on behalf of Algeria, Argentina, Australia, Austria, Azerbaijan, Bahrain, Belgium, Bosnia and Herzegovina, Brazil, Canada, Chile, China, Colombia, Costa Rica, Croatia, Cyprus, the Czech Republic, Denmark, Ecuador, Finland, France, Germany, Greece, Guatemala, Hungary, India, the Islamic Republic of Iran, Ireland, Israel, Italy, Japan, Lesotho, Liechtenstein, Lithuania, Luxembourg, Malaysia, Mexico, the Netherlands, Nigeria, Norway, Poland, Portugal, Romania, the Russian Federation, Singapore, Slovak, Slovenia, South Africa, Spain, Sweden, Turkey, the United Kingdom of Great Britain and Northern Ireland, and the United States of America, subsequently joined by Armenia, Bolivia, Bulgaria, Egypt, Haiti, Indonesia, Peru, Thailand, the former Yugoslav Republic of Macedonia, Ukraine and Venezuela, introduced a draft resolution entitled “Report of the United Nations Commission on International Trade Law on the work of its thirty-second session” (A/C.6/54/L.4).

7. At the same meeting, the Committee adopted draft resolution A/C.6/54/L.4 without a vote (see para. 8).

III. RECOMMENDATION OF THE SIXTH COMMITTEE

8. The Sixth Committee recommends to the General Assembly the adoption of the following draft resolution: [The text is not reproduced in this section. The draft resolution was adopted, with editorial changes, as General Assembly resolution 54/103 (see section D below).]
D. General Assembly resolution 54/103 of 9 December 1999


The General Assembly,

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

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

Emphasizing the need for higher priority to be given to the work of the Commission in view of the increasing value of the modernization of international trade law for global economic development and thus for the maintenance of friendly relations among States,

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

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

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

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

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


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

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

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

5. Reaffirms the mandate of the Commission, as the core legal body within the United Nations system in the field of international trade law, to coordinate legal activities in this field, and in this connection:

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

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

6. Also reaffirms the importance, in particular for developing countries, of the work of the Commission concerned with training and technical assistance in the field of international trade law, such as assistance in the preparation of national legislation based on legal texts of the Commission;

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

(a) Expresses its appreciation to the Commission for organizing seminars and briefing missions in Argentina, Azerbaijan, Bahrain, Bolivia, Brazil, Bulgaria, Cameroon, China, Guatemala, Mexico, Mongolia, Peru, Romania, Venezuela and Zambia;

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

8. Appeals to the United Nations Development Programme and other bodies responsible for development assistance, such as the International Bank for Reconstruction and Development and the European Bank for Reconstruction and Development, as well as to Governments in their bilateral aid programmes, to support the training and technical assistance programme of the Commission and to cooperate and coordinate their activities with those of the Commission;

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

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

11. Requests the Secretary-General to ensure and enhance the effective implementation of the programme of the Commission;

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

76th plenary meeting
9 December 1999
Part Two

STUDIES AND REPORTS ON SPECIFIC SUBJECTS
I. ASSIGNMENT IN RECEIVABLES FINANCING


CONTENTS

INTRODUCTION ................................................................. 1-15

I. DELIBERATIONS AND DECISIONS ................................. 16-17

II. DRAFT CONVENTION ON ASSIGNMENT IN RECEIVABLES FINANCING ................................. 18-173

CHAPTER IV. RIGHTS, OBLIGATIONS AND DEFENCES ....... 18-40

Section III. Third parties .............................................. 18-40

Article 23. Competing rights of several assignees .......... 18-31

Article 24. Competing rights of assignee and insolvency administrator or creditors of the assignor ........... 32-40

CHAPTER V. SUBSEQUENT ASSIGNMENTS .................. 41-66

Article 25. Scope ....................................................... 41-46

Article 26. Agreements limiting subsequent assignments .... 47-51

Article 27. Debtor's discharge by payment .................. 52-58

Article 28. Notification of the debtor ......................... 59-66

CHAPTER VI. CONFLICT OF LAWS ................................. 67-119

A. General comments .................................................. 67-73

B. Discussion of draft articles ..................................... 74-119

Article 29. Law applicable to the contract of assignment .... 74-91

Article 30. Law applicable to the rights and obligations of the assignee and the debtor .................. 92-104

Article 31. Law applicable to conflicts of priority .......... 105-110

Article 32. Mandatory rules ......................................... 111-117

Article 33. Public policy ............................................. 118-119

CHAPTER VII. ALTERNATIVE PRIORITY RULES .......... 120-123

CHAPTER VIII. FINAL PROVISIONS .............................. 124-155

Article 41. Depositary .................................................. 124-125

Article 42. Conflicts with international agreements ......... 126-129

Article 43. Application of chapter VII ......................... 130-132

Article 44. Insolvency rules or procedures not affected by this Convention .................................. 133-140

Article 45. Signature, ratification, acceptance, approval, accession ........................................ 141-142

Article 46. Application to territorial units ................... 143-144

Article 47. Effect of declaration .................................... 145-146

Article 48. Reservations .............................................. 147-148

Article 49. Entry into force .......................................... 149-150

Article 50. Denunciation .............................................. 151-155
INTRODUCTION

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

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

3. At its twenty-sixth to twenty-eighth sessions (1993 to 1995), the Commission discussed three reports prepared by the Secretariat concerning certain legal problems in the area of assignment of receivables (A/CN.9/378/Add.3, A/CN.9/397 and A/CN.9/412). Having considered those reports, the Commission concluded that it would be both desirable and feasible to prepare a set of uniform rules, the purpose of which would be to remove obstacles to receivables financing arising from the uncertainty existing in various legal systems as to the validity of cross-border assignments (where the assignor, the assignee and the debtor are not in the same country) and as to the effects of such assignments on the debtor and other third parties.\(^3\)

4. At its twenty-fourth session (Vienna, 8-19 November 1995), the Working Group commenced its work by considering a number of preliminary draft uniform rules contained in a report of the Secretary-General entitled “Discussion and preliminary draft of uniform rules” (A/CN.9/412). At that session, the Working Group was urged to strive for a legal text aimed at increasing the availability of lower-cost credit (A/CN.9/420, para. 16).

5. At its twenty-ninth session (1996), the Commission had before it the report of the twenty-fourth session of the Working Group (A/CN.9/420). The Commission expressed appreciation for the work accomplished and requested the Working Group to proceed with its work expeditiously.\(^4\)

6. At its twenty-fifth and twenty-sixth sessions (New York, 8-19 July and Vienna, 11-22 November 1996), the Working Group continued its work by considering different versions of the draft uniform rules contained in two notes prepared by the Secretariat (A/CN.9/WG.II/ WP.87 and A/CN.9/WG.II/WP.89 respectively). At those sessions, the Working Group adopted the working assumptions that the text being prepared would take the form of a convention (A/CN.9/432, para. 28) and would include private international law provisions (A/CN.9/434, para. 262).

7. At its thirtieth session (1997), the Commission had before it the reports of the twenty-fifth and twenty-sixth

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sessions of the Working Group (A/CN.9/432 and A/CN.9/434). The Commission noted that the Working Group had reached agreement on a number of issues and that the main outstanding issues included the effects of the assignment on third parties, such as the creditors of the assignor and the administrator in the insolvency of the assignor. In addition, the Commission noted that the draft Convention had aroused the interest of the receivables financing community and Governments, since it had the potential of increasing the availability of credit at more affordable rates. 


9. At its thirty-first session (1998), the Commission had before it the report of the twenty-seventh and twenty-eighth sessions of the Working Group (A/CN.9/445 and A/CN.9/447). The Commission expressed appreciation for the work accomplished and requested the Working Group to proceed with its work expeditiously so as to complete its work in 1999 and submit the draft Convention for adoption by the Commission at its thirty-third session (2000). 

10. The Working Group, which was composed of all States members of the Commission, held the present session in Vienna from 5 to 16 October 1998. The session was attended by representatives of the following States members of the Working Group: Argentina, Australia, Austria, Cameroon, China, Colombia, Egypt, France, Germany, Honduras, Hungary, India, Iran (Islamic Republic of), Italy, Japan, Lithuania, Mexico, Nigeria, Romania, Russian Federation, Singapore, Spain, Sudan, Thailand, Uganda, United Kingdom of Great Britain and Northern Ireland and United States of America.

11. The session was attended by observers from the following States: Angola, Azerbaijan, Bangladesh, Belarus, Benin, Bolivia, Canada, Costa Rica, Cuba, Czech Republic, Ecuador, Gabon, Georgia, Greece, Indonesia, Iraq, Ireland, Lebanon, Libyan Arab Jamahiriya, Madagascar, Mali, Morocco, Poland, Portugal, Republic of Korea, Slovakia, Sweden, Switzerland, Turkey, Uruguay and Venezuela.

12. The session was attended by observers from the following international organizations: Association of the Bar of the City of New York (ABCNY), European Bank for Reconstruction and Development (EBRD), European Federation of National Factoring Associations (EUROPAFACTURING), Factors Chain International (FCI), Fédération Bancaire de l’Union Européenne, The Hague Conference on Private International Law and International Bar Association (IBA).

13. The Working Group elected the following officers:

Chairman: Mr. David Morán Bovio (Spain)
Rapporteur: Mr. Jeffrey Wah-Teck Chan (Singapore)


15. The Working Group adopted the following agenda:

1. Election of officers.
2. Adoption of the agenda.
4. Other business.
5. Adoption of the report.

I. DELIBERATIONS AND DECISIONS

16. Recalling that at its previous session for lack of sufficient time the Working Group had not considered draft articles 23 and 24 and in view of the importance of those provisions, the Working Group decided to begin its deliberations by discussing draft article 23. The Working Group considered the following draft articles listed in the order in which they were discussed: draft articles 23, 5(i) to (j), 24, 5(g) to (h), 25 to 33, 41 to 50, the preamble and draft article I(1) and (2), as set forth in document A/CN.9/WG.II/WP.96.

17. The deliberations and conclusions of the Working Group, including its consideration of various draft provisions, are set forth below in Chapters III to V. The Working Group adopted the substance of draft articles 23 to 33, 5(g) to (j), 18(bis), 41 to 50, the preamble and draft article I(1) and (2), and, with the exception of draft article I(1) and (2), referred them to a drafting group established by the Secretariat to align the various language versions of the draft articles adopted.
II. DRAFT CONVENTION ON ASSIGNMENT IN RECEIVABLES FINANCING

Chapter IV. Rights, obligations and defences

Section III. Third parties

Article 23. Competing rights of several assignees

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

“(1) Priority among several assignees of the same receivables from the same assignor is governed by the law of the State in which the assignor is located.

“(2) Notwithstanding paragraph (1), conflicts of priority may be settled by agreement between competing assignees.”

Paragraph (1)

19. The Working Group was generally in agreement with the general principle expressed in paragraph (1), namely that priority should be determined by reference to the law of the State in which the assignor was located. As to the precise formulation of that principle, the Working Group discussed whether paragraph (1), in line with the approach taken in draft article 31, should include a precise reference to the time of the assignment as the point of time which should be taken into account in the determination of the law applicable to priority questions. The discussion focused on whether, in dealing with multiple assignments, paragraph (1) should settle the question as to which law should govern if the assignor moved to a new location after the assignment: the law of the location of the assignor at the time of the first or of a subsequent assignment. A number of suggestions were made, including that words along the lines of “at the time of the first assignment” or “at the time of the transfer of the receivables” should be added at the end of paragraph (1).

20. Another suggestion was to add language along the following lines in draft article 23:

“Where the assignor changes its location after the assignment, the assignee with priority under the law of the State in which the assignor was initially located retains its priority:

“(a) for a period of [six months]; or

“(b) until priority would have ceased under the law of the State in which the assignor was initially located; or

“(c) by meeting the requirements for obtaining priority under the law of the State of the new location of the assignor before priority ceases under subparagraph (a) or (b) of this article; or

“(d) if it happens to have priority under the law of the State of the new location of the assignor.”

In support of the suggested wording, it was recalled that the assignee with priority under the law of the initial location of the assignor should not lose its priority position just because the assignor relocated. On the other hand, the rights of assignees in the new location should not be forever subject to the rights of assignees from other jurisdictions.

21. While support was expressed in favour of both suggestions, it was widely felt that adding either of the suggested wordings might make the rule under paragraph (1) unnecessarily complex in view of the fact that relocation of the debtor between duplicate assignments rarely occurred in practice. The prevailing view was that, depending on whether the term “priority” and the term “location” of the assignor could be defined with sufficient certainty and predictability (draft article 5(i) and (j)), there might be no need to modify the text of paragraph (1).

22. The Working Group went on to briefly consider the definition of the terms “priority” and “location” (draft article 5(i) and (j)).

Definition of the term “priority” (draft article 5(i))

23. It was noted that in some legal systems the term was unknown and that the definition in draft article 5(i) might not provide adequate guidance as to the exact meaning of the term. In addition, it was noted that in some of those legal systems “priority” might be understood as effectiveness of the assignment erga omnes, an understanding that might result in uncertainty as to the consistency among the various provisions of the draft Convention and in particular draft articles 29, 30 and 31.

24. The view was widely shared that the term “priority” was sufficiently clear and that draft article 5(i) should be retained unchanged. It was stated that draft article 17 clarified the rights of an assignee with priority, namely to claim and retain the proceeds of a payment made to another person (for a brief discussion of the meaning of the term “priority”, see para. 108 below). After discussion, the Working Group adopted draft article 5(i) unchanged.

Definition of the term “location” (draft article 5(j))

25. The Working Group considered the exact meaning of the term “location”, for the purposes of draft article 23 only (for a discussion of the meaning of the term “location”, see also paras. 33 to 34, 88 to 89, 107 and 163 to 169 below). While it was stated that it would be more appropriate to adopt a single definition of the term “location” for the purposes of the draft Convention as a whole, the view was widely shared that different rules may be adopted to serve different purposes (i.e. one location rule for the purpose of the application of the draft Convention and a different rule for the purposes of draft articles 23 and 24).
26. As to the exact meaning of the term “location” in the context of draft article 23, diverging views were expressed. One view was that reference should be made to the principal place of business or to a combination of factors, including place of performance, central administration and principal place of business. In support of that view, it was observed that such a flexible approach would be more in line with the trends followed in practice and reflected in existing texts, including the European Union Convention on the Law Applicable to Contractual Obligations (hereinafter referred to as “the Rome Convention”), the European Union Convention on Insolvency Proceedings and the UNCITRAL Model Law on Cross-Border Insolvency. In addition, it was observed that a place-of-incorporation rule would be too simplistic and would fail to achieve its stated goal of uniformity, since it was understood differently in the various legal systems. Moreover, it was stated that a place-of-incorporation rule would inadvertently result in inappropriately subjecting the dealings of a branch office to the law of the country in which the head office was located. It was also observed that such an approach could have the unintended effect of encouraging forum shopping and allowing parties to subject priority issues to the law of a convenient jurisdiction by incorporating themselves in that jurisdiction.

27. The prevailing view, however, was that reference should be made to the place of incorporation. It was stated that it was of utmost importance for financiers to be able to easily determine the law governing the priority conflicts covered in draft article 23. On that basis, financiers would determine whether to provide credit and at what cost. For that reason, it was observed, reference should be made to a single and easily determinable jurisdiction. Any other criterion, it was said, could have the unintended effect of defeating the goal of the draft Convention to increase the availability of lower-cost credit. In addition, it was stated that guidance could not be drawn from the texts mentioned above, since, unlike the Rome Convention, the draft Convention dealt with the proprietary effects of assignment as against third parties beyond the debtor; and also unlike the texts mentioned above that dealt with insolvency, draft article 23 dealt with forward planning in the financing of a solvent assignor. Moreover, it was said that for the purposes of draft article 23 consistent results could be obtained only if conflicts between assignments made by the head office and assignments made by a branch office of the assignor were subjected to the same law.

28. In response to a question, it was said that a reference to the place of incorporation of the assignor would be more appropriate, since in some countries corporations could have more than one registered office.

29. The Working Group turned to the question of the location of unincorporated businesses, namely legal entities other than corporations (e.g. limited partnerships, trusts). The view was expressed that the matter may not need to be addressed in the draft Convention. In support of that view, it was stated that in many legal systems unincorporated businesses fell into the category of individuals. In addition, it was observed that, in any case, the amount of receivables financing undertaken by unincorporated businesses was negligible and did not need to be addressed. Moreover, it was said that normally lenders would require borrowers to create a corporation before any credit was extended. The prevailing view, however, was that the matter merited attention in the context of the draft Convention. It was stated that there was no reason to exclude financing practices involving unincorporated businesses from the scope of application of the draft Convention. In addition, it was observed that in some countries significant receivables financing practices involved unincorporated businesses.

30. As to the specific way in which the matter should be addressed, a number of suggestions were made. One suggestion was that reference should be made to the location identified by parties in their agreements. That suggestion was objected to on the grounds that such an approach could lead to inconsistent results if different assignments identified different locations, and would inappropriately allow parties to an assignment to affect the rights of third parties by their agreement. Another suggestion was to provide that unincorporated businesses were located at the place where they had their principal place of business. That suggestion failed to attract sufficient support. Yet another suggestion was that those unincorporated businesses for whose establishment a constitutive document had been filed should be considered to be located in the place where that document had been filed, while for any other unincorporated businesses reference should be made to the place in which they had their chief executive office. Broad support was expressed in the Working Group in favour of that suggestion. It was stated that the main advantage of such an approach would be that it would facilitate the identification of a single jurisdiction as the location of an unincorporated business for the purpose of identifying the law governing priority issues. After discussion, the Working Group decided to refer in draft article 23 to the place of incorporation of the assignor, leaving the exact formulation of that rule to the drafting group.

Paragraph (2)

31. Broad support was expressed in favour of the principle of allowing the assignee with priority to relinquish that priority by agreement. While the view was expressed that paragraph (2) stated the obvious and could be deleted, the Working Group decided to retain it in order to usefully clarify a point that might not be clear in all legal systems. As to the exact formulation of the principle, a number of observations were made, including that the current wording did not provide for subordination agreements made between the assignor and the assignee to the benefit of other persons and did not clarify whether subordination agreements could be concluded only at the time a dispute arose or at a previous time as well. In order to address those points, it was suggested that paragraph (2) should be reformulated along the following lines: “An assignee entitled to priority under paragraph (2) may agree with the assignor
or any other assignee at any time to subordinate its priority in favour of that other assignee". After discussion, the Working Group decided that the principle should be expressed in as broad a way as possible and left the exact formulation of paragraph (2) to the drafting group.

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

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

“(1) Priority as between an assignee and the assignor’s creditors is governed by the law of the State in which the assignor is located.

“(2) Priority as between an assignee and the insolvency administrator is governed by the law of the State in which the assignor is located.

“(3) Nothing in this article requires a court to take any action which is manifestly contrary to the public policy of the State in which the court is located.

“(4) In case an insolvency proceeding is commenced in a State other than the State in which the assignor is located,

“Variant A

except as provided in this article, this Convention does not affect the rights of the insolvency administrator or the rights of the assignor’s creditors.

“Variant B

this Convention does not affect:

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

“(b) any right of the insolvency administrator,

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

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

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

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

“(c) if the assigned receivables constitute security for indebtedness or other obligations, any insolvency rules or procedures generally governing the insolvency of the assignor:

“(i) permitting the insolvency administrator to encumber the assigned receivables;

“(ii) providing for a stay of the right of individual assignees or creditors of the assignor to collect the receivables during the insolvency proceeding,

“(iii) permitting substitution of the assigned receivables for new receivables of at least equal value,

“(iv) providing for the right of the insolvency administrator to borrow using the assigned receivables as security to the extent that their value exceeds the obligations secured, or

“(v) other rules and procedures of similar effect and of general application in the insolvency of the assignor [specifically described by a Contracting State in a declaration made under article 43].

“(5) An assignee asserting rights under this article has no fewer rights than an assignee asserting rights under other law.”

Paragraphs (1) and (2)

33. It was noted that the thrust of paragraphs (1) and (2) was to ensure that the law governing priority and the law governing the insolvency of the assignor would be the law of the same jurisdiction by subjecting priority issues to the law of the State in which insolvency proceedings in respect of the assignor were most likely to be commenced. In the case of insolvency proceedings commenced in a jurisdiction other than that in which the assignor was located, it was noted that the basic approach of draft article 24 was to preserve, to a large extent, the rights of the insolvency administrator and of the assignor’s creditors existing under law applicable outside the draft Convention. In addition, it was noted that, in order for draft article 24 to establish an appropriate balance between the draft Convention and the applicable insolvency law and for reasons of consistency with other texts, such as the European Union Convention on Insolvency Proceedings and the UNICITRAL Model Law on Cross-Border Insolvency, a different location rule might need to be established in the context of draft article 24 from the place-of-incorporation rule, which was adopted in the context of draft article 23.

34. The view was expressed that conflicts of priority between an assignee and an administrator in the insolvency of the assignor should be subjected to the law governing the insolvency proceeding (lex fori consensus). The prevailing view, however, was that paragraphs (1) and (2) appropriately subjected conflicts of priority to the law of the location of the assignor (i.e. the law of the place of incorporation of the assignor). The Working Group adopted the substance of paragraphs (1) and
Part Two. Studies and reports on specific subjects 61

(2) and referred them to the drafting group on the assumption that the terms "priority" and "location" would be given the same meaning under draft article 24 as under draft article 23, by reference to the definitions contained in draft article 5(i) and (j) (see paras. 23 to 30 above and paras. 88 to 89, 107 and 163 to 169 below).

Paragraphs (3) and (4)

35. The Working Group expressed general support in favour of the principles embodied in paragraph (3) and in the opening words and the text of Variant A. The question was raised as to whether the issue of preferential creditors who, under the law of insolvency applicable in certain countries, would have precedence over assignees was appropriately addressed by draft article 24. The Working Group generally agreed on the principle that the draft Convention should avoid undue interference with applicable insolvency law. Thus, the rights of preferential creditors (e.g. the Government for taxes or employees for wages) that might be established under domestic statutory law for reasons of public policy would need to be preserved so as not to compromise the acceptability of the draft Convention. Various views were expressed as to how that principle might be embodied in the draft Convention.

36. One view was that the rights of preferential creditors were sufficiently addressed by paragraph (3) through the reference to "the public policy of the State in which the court [was] located". In response, it was stated that the words "public policy" in paragraph (3) should not be misinterpreted as a reference to the domestic public policy of the State where the court was located. Rather, the reference to "public policy" in paragraph (3) was intended to refer to "international public policy", i.e. the restrictive notion of public policy under the rules of private international law, which would not typically include rules such as those intended for the protection of preferential creditors in statutory law in many countries. With a view to clarifying the meaning of paragraph (3), it was proposed that the paragraph should be rephrased along the following lines: "Notwithstanding paragraphs (1) and (2), the application of the provisions of the law of the State in which the assignor is located may be refused by a court to the extent that those provisions are manifestly contrary to the public policy of the State in which the court is located". After discussion, the substance of the proposal was found to be generally acceptable and was referred to the drafting group.

37. Another view was that the issue of preferential creditors might be addressed through redrafting of Variant A of paragraph (4). With a view to preserving "the rights of the assignor's creditors" (which included the rights of preferential creditors), it was suggested that the words "except as provided in this article" at the beginning of Variant A should be deleted. That suggestion was objected to on the grounds that deleting the words "except as provided in this article" would: negate the effect of paragraphs (1) and (2); affect the balance of the entire draft article 24; and make paragraph (4)
circular. In addition, the view was expressed that the words "the rights of the assignor's creditors" in the context of "insolvency proceedings commenced in a State other than the State in which the assignor [was] located" might not adequately cover the rights of preferential creditors outside an insolvency proceeding.

38. Yet another view was that the issue of preferential creditors would be appropriately dealt with by way of a declaration under draft article 44. Wide support was expressed in favour of extending the possibility of declarations or reservations in respect of preferential creditors. Such an approach, it was stated, would preserve the necessary flexibility for each Contracting State to establish specific rules for preferential creditors. It was observed that such an approach would also foster transparency by creating an obligation for those States that wished to make specific rules for preferential creditors to make their position known to the world. However, a widely shared view was that the text of draft article 44 as currently drafted was not sufficiently reflective of the suggested approach. In addition, it was said that draft article 44 could be misread as an invitation to States to make a reservation as to the entirety of their insolvency law, a result that would reduce the certainty achieved by draft article 24.

39. In order to better address the rights of preferential creditors, it was suggested that an additional paragraph (4bis) in draft article 24 should deal with the issue of preferential creditors along the following lines: "If an insolvency proceeding is commenced in a State other than the State in which the assignor is located, any non-consensual right or interest which, under the law of the forum, would have priority over the interest of an assignee, continues to have priority only to the extent that such priority was specified by the forum State in an instrument deposited with the depositary prior to the time when the assignment was made." While widespread support was expressed in favour of the proposed new paragraph, a concern was expressed that the need for Contracting States to embody in a declaration all "rights or interests" which, under domestic law, "would have priority over the interest of an assignee" might adversely affect the acceptability of the draft Convention. A concern of a drafting nature was that, should the draft Convention contain a provision along the lines of the proposed new paragraph, it should be placed within the final clauses and not in the substantive provisions of the draft Convention. After discussion, the Working Group decided that the substance of the proposed new paragraph (4bis) should be placed in the text of draft article 24 within square brackets for further consideration at a later stage. The proposed wording was referred to the drafting group.

Paragraph (5)

40. It was noted that paragraph (5) was intended to reflect the principle of non-discrimination against Convention assignees by ensuring that assignees asserting rights under the law of the State in which the assignor was located would have no less rights as against the
assignor’s creditors or the insolvent administrator than any assignee asserting rights under law applicable outside the draft Convention. As a matter of drafting, it was suggested that the word “fewer” should be replaced by the word “less.” Subject to that change, the Working Group adopted the substance of paragraph (5), and referred it to the drafting group.

Chapter V. Subsequent assignments

Article 25. Scope

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

“This Convention applies to:

“(a) assignments of receivables by the initial or any other assignee to subsequent assignees (“subsequent assignments”) that are governed by this Convention under article 1, notwithstanding that the initial or any other previous assignment is not governed by this Convention; and

“(b) any subsequent assignment, provided that the initial assignment is governed by this Convention

“as if the subsequent assignee were the initial assignee.”

Subparagraph (a)

42. It was recalled that subparagraph (a) appeared to be inconsistent with the principle of continuatio juris embodied in subparagraph (b). It was widely felt, however, that it was desirable to cover subsequent assignments that might fall within the scope of the draft Convention even if the initial assignment fell outside its scope (e.g. a subsequent assignment in a securitization transaction may be covered even if the initial assignment was a domestic assignment of domestic receivables).

43. A concern was expressed that, in combination with draft article 27, subparagraph (a) might lead to the unintended result that the debtor paying in accordance with draft article 27 might not be discharged under the law applicable to the initial assignment. It was generally agreed, however, that draft article 18(5), providing that the debtor could be discharged by paying the right person under law applicable outside the draft Convention, sufficiently addressed that concern. It was stated that draft article 27 was a special rule dealing with the specific issue of multiple notifications relating to subsequent assignments, without precluding the application of the general rules on debtor discharge contained in draft article 18.

44. After discussion, the Working Group found the substance of subparagraph (a) to be generally acceptable and referred it to the drafting group.

Subparagraph (b)

45. It was recalled that subparagraph (b) was intended to reflect the principle of continuatio juris, i.e. that the regime governing the initial assignment should govern any subsequent assignment. In the absence of such a rule, in a chain of assignments parties would not be able to have any certainty as to their rights, since each assignment could be subject to a different legal regime. It was stated that subparagraph (b) could operate well if the initial receivable was international, since any subsequent assignee would be able to predict that the draft Convention would apply to subsequent assignments by virtue of the internationality of the receivable. However, a concern was expressed that, where the initial receivable was domestic, the application of subparagraph (b) might not produce satisfactory results, since a subsequent assignee would not be able to predict the application of the draft Convention to a domestic assignment of a domestic receivable. In order to avoid a situation in which the draft Convention would apply to domestic assignments of domestic receivables, it was suggested that language along the following lines should be added at the end of subparagraph (b): “provided that, if the receivable is a domestic one, a subsequent assignment with the assignor and the assignee being located in the same State as the debtor is not governed by this Convention”.

46. It was widely felt that, while the above-mentioned concern should be borne in mind when reviewing the provisions of the draft Convention dealing with the protection of the debtor, subparagraph (b) should be drafted so as to establish a broad sphere of application for the draft Convention, thus maximizing certainty as to the legal regime applicable, in particular to bulk assignments. It was agreed that, in order to better reflect the principle “once international, always international”, subparagraph (b) should be revised to provide that the draft Convention should apply to any subsequent assignment, provided that it applied to the initial or any other assignment prior to the last subsequent assignment. Subject to that amendment, the substance of subparagraph (b) was found to be generally acceptable and was referred to the drafting group.

Article 26. Agreements limiting subsequent assignments

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

“(1) A receivable assigned by the initial or any subsequent assignee to a subsequent assignee is transferred notwithstanding any agreement between the initial or any subsequent assignor and the debtor or any subsequent assignee limiting in any way the initial or any subsequent assignor’s right to assign its receivables.

“(2) Nothing in this article affects any obligation or liability for breach of such an agreement, but a person who was not party to such an agreement is not liable for its breach.”
Paragraph (1)

48. A concern was expressed that paragraph (1) might unduly interfere with public-procurement and other Government-contract practices by disregarding the effect of anti-assignment clauses that might be inserted in those contracts. Thus, under paragraph (1), a Government or other public entity might come under an obligation to pay a party as an assignee, while the public entity might have expressly stipulated that it would not accept to deal with that party. Such an effect of paragraph (1), it was stated, might seriously affect the acceptability of the draft Convention. The Working Group took note of that concern and agreed that it might need to be considered further in the context of draft article 12, which contained the main provisions regarding anti-assignment clauses. After discussion, the substance of paragraph (1) was found to be generally acceptable and was referred to the drafting group.

Paragraph (2)

49. The discussion focused on the extent to which an assignee who was not a party to the agreement containing an anti-assignment clause might be held liable if such a clause was breached. There was general agreement that normally no contractual liability might be binding on the assignee for the obvious reason that the assignee was not privy to the agreement containing the anti-assignment clause. In addition, it was agreed that even in those exceptional situations in which third parties might be held liable under a contract theory, the draft Convention should preclude such liability.

50. With respect to tortious liability, however, various views were expressed. One view was that, if the aim of the draft Convention was to provide easier access to credit, it should avoid burdening the assignee, as potential financiers, with any liability in connection with the breach of an anti-assignment clause. The opposite view was that, under the laws of many countries, certain types of misconduct by the assignee might engage its tortious liability (for example, in the case of a possible inducement of the assignor by the assignee to assign receivables in violation of an anti-assignment clause with the intent to harm the interests of the debtor). It was stated that, to the extent that such tortious liability would only sanction malicious behaviour on the part of the assignee, the domestic tort law should apply. In addition, it was observed that mere knowledge by the assignee of the existence of an anti-assignment clause should not give rise to liability of the assignee, since such a possibility might deter potential assignees from entering into receivables financing transactions.

51. After discussion, the Working Group agreed that paragraph (2) should be redrafted to ensure that an assignee would have no contractual liability for breach of an anti-assignment clause by the assignor, while it would defer to domestic law to sanction manifestly improper behaviour. The Working Group also agreed that draft article 12(2) should be aligned with draft article 26(2) as revised.

Article 27. Debtor’s discharge by payment

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

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

53. The Working Group agreed that draft article 27 should deal with the issue of multiple notifications relating to subsequent assignments by allowing the debtor to discharge its obligation only by payment to the person or to the address identified in the notification of the last assignment. It was stated that, by requiring payment to the last assignee, such an approach would facilitate the extension of credit by that assignee and thus promote practices involving subsequent assignments. As a matter of drafting, it was suggested that the title of draft article 27 should be revised to better reflect that content of the article. With regard to situations involving both several notifications relating to the same assignment (dealt with in draft article 18(3)) and several notifications relating to subsequent assignments (dealt with in draft article 27), it was generally agreed that, under a combined application of draft articles 18(3) and 27, the debtor could be discharged only by payment to the person or to the address identified in the first notification of the last assignment. It was stated that, for draft articles 18(3) and 27 to operate well, the debtor receiving several notifications might need to know whether they related to several assignments of the same receivables by the same assignor or to subsequent assignments. The Working Group agreed that that matter could be addressed in the context of draft article 28 dealing with the content of notification in the case of subsequent assignments (see paras. 63 to 66 below).

54. As to any other matter involving the debtor’s rights and obligations, it was agreed that the draft Convention should apply whether one assignment only or subsequent assignments as well were involved. The view was widely shared that the result arose from draft article 25, which provided that the draft Convention applied to subsequent assignments “as if the subsequent assignee was the initial assignee”. In order to better reflect the understanding that other provisions of the draft Convention applied to subsequent assignments, unless a special rule had been devised for subsequent assignments, it was suggested that draft articles 25 to 28 be placed in the context of the relevant provisions of the draft Convention (draft articles 1, 12, 18 and 16 respectively), rather than in a separate chapter. The Working Group agreed that that matter could be considered in the context of the discussion of those other relevant provisions.

55. Diverging views were expressed as to the question whether the debtor should be discharged by payment to the last assignee, if an assignment in a chain of assignments was invalid, and, in particular, if the debtor knew or had notification of such invalidity. One view was that the debtor should be dis-
charged by payment to the last assignee, even if an assignment was invalid and the debtor knew of the invalidity. In support of that view, it was observed that subjecting the debtor's discharge to the validity of the assignment or to knowledge of the validity would inappropriately place on the debtor the burden of having to establish the validity of the assignment. In addition, it was stated that such an approach would inadvertently result in the debtor requiring of the assignee more than a mere notification of the assignment. Moreover, the issue whether knowledge of the invalidity of the assignment on the part of the debtor constituted fraudulent behavior which vitiated the payment could be left to law applicable outside the draft Convention.

56. Another view was that if an assignment was invalid, the debtor could not be discharged by payment to the person or to the address identified in the notification, since the “notification” would not be a notification in the sense of draft article 16(3) and “the assignee” would not be an assignee under the draft Convention. In the case of knowledge of the invalidity on the part of the debtor, it was stated, it would be against any acceptable standards of good faith to allow the debtor to be discharged by payment to the person the assignment to whom was invalid. It was thus suggested that the risk of the invalidity of the assignment should be placed on the debtor.

57. In an effort to strike a balance between the need to protect the debtor paying in good faith a person the assignment to whom was invalid and the need to protect the rights of the rightful owner of the receivables, while preserving acceptable standards of conduct, it was suggested that language along the following lines should be inserted in draft article 27: “A debtor shall be discharged notwithstanding any invalidity of any assignment in a chain of assignments if he/she pays in good faith and without notice of any invalidity of any assignment in the chain of assignments in accordance with the payment instructions set forth in the notification of the last assignment received by the debtor”. Some support was expressed in favor of that suggestion on the ground that it could produce the desirable results if combined with draft article 18(4), which entitled the debtor, if notification of the assignment was given to the debtor by the assignee, to request additional information from the assignee. On the other hand, the suggestion was objected to on a number of grounds, including the following: while a good-faith standard of protection of the debtor was justified in the case of a debt which was incorporated in a negotiable instrument, it would not be sufficient for the discharge of a debtor paying a person the assignment to whom was invalid; the principle of good faith might introduce a degree of uncertainty, since its exact meaning was neither absolutely clear nor uniform; and, in view of the fact that the notion of good faith was implicit in a number of other draft articles, to mention it explicitly only in this draft article could inadvertently result in the meaning of other draft articles being questioned.

58. After discussion, the Working Group agreed that the matter of the discharge of the debtor by payment to a person the assignment to whom was invalid arose in exceptional situations only and could be left to law applicable outside the draft Convention. The Working Group noted that the issue of invalidity could also arise in the context of the initial assignment. Accordingly, the Working Group requested the drafting group to prepare a provision to reflect that agreement and to revise draft article 27 or 18 so as to deal with the issue of multiple notifications relating to subsequent assignments.

Article 28. Notification of the debtor

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

“Notification of a subsequent assignment constitutes notification of [any] [the immediately] preceding assignment.”

60. It was recalled that, as mentioned in the context of the twenty-seventh session of the Working Group (A/CN.9/445, para. 46), draft article 28 was one of the most important articles of the draft Convention, in particular from the point of view of financiers involved in international factoring. It was explained that in international factoring the assignor assigned the receivables to an assignee in the assignor’s country (export factor) and the export factor assigned the receivables to an assignee in the debtor’s country (import factor). In view of the fact that the debtor was normally notified only of the second assignment, it was necessary to provide that such notification constituted notification of the first assignment, in order to ensure the import factor’s right to enforce the claim against the debtor. At that session, the Working Group had requested the Secretariat to add in draft article 28 a provision along the lines of article 11(2) of the UNIDROIT Convention on International Factoring (Ottawa, 1988; hereinafter referred to as “the Ottawa Convention”), which provided that “... notice of the subsequent assignment also constitutes notice of the assignment to the factor” (A/CN.9/445, para. 46).

61. As a matter of drafting, it was generally agreed that the title of draft article 28 needed to be revised to better reflect the contents of the draft article. It was decided that wording along the lines of “Notification of subsequent assignment” should be used. The matter was referred to the drafting group.

62. With respect to the text between square brackets (“[any][the immediately]”), it was widely felt that the rule embodied in draft article 28 should apply broadly to any preceding assignment. That matter also was referred to the drafting group.

63. A concern was expressed that the content of notification in the context of subsequent assignments might need to be different, since the debtor receiving a notification would need to be able to determine whether a series of subsequent assignments or of several assignments of the same receivables by the same assignor were involved. A widely shared view was that such information might be critical to the debtor, since the debtor would discharge its obligation by paying the last assignee in a chain of subsequent assignments (draft
article 27), or by paying the first assignee to notify in case of multiple assignments (draft article 18(3)). Various suggestions were made to alleviate that concern. One suggestion, which received little support, was that the draft Convention should establish two separate rules. The general rule regarding discharge of its obligation by the debtor would state that, if notification of the assignment was given by separate assignees, the debtor would be discharged by paying according to the first notification. A separate rule would apply in cases where only one notification was received but that notification disclosed on its face that it related to an assignment that was subsequent in a series of assignments. The debtor would then be discharged by paying the last assignee in the chain.

64. Another suggestion, which received considerable support, was that the notification of a series of subsequent assignments should identify the assignor and all successive assignees, so that the debtor could have certainty as to the right of the last assignee in the chain to receive payment. It was observed that the case where successive assignments were made was comparable to the situation where a bill of exchange had been transferred to successive endorsees. That suggestion was objected to on the grounds that listing all successive assignees would be excessively burdensome, contrary to established practice and potentially confusing for debtors. It was pointed out that, for all practical purposes, information regarding intermediate assignments would be of little interest to the debtor, in particular in the case of a notification given by the assignor or of a single notification.

65. Another suggestion was that the notification of the assignment should only mention the name of the initial assignor, so that the debtor could identify the receivable, and the name of the assignee to whom payment should be made. With regard to that suggestion, the concern was expressed that it would insufficiently protect the debtor, who would have no certainty as to the validity of the assignment. In response, it was pointed out that concern might be alleviated by the fact that the debtor, being familiar with the law governing discharge by payment to an assignee in the case of an invalid assignment (i.e. the law governing the receivable), would be aware of the risk of not obtaining a valid discharge and could be protected by requesting additional proof from the assignee who notified the debtor (draft article 18(4)). In addition, it was pointed out that reasonable assignees, in order to ensure that payment be made by the debtor according to their instructions, would normally provide sufficient information to the debtor.

66. After discussion, it was generally agreed that, while the notification requirement should be kept as simple as possible for practical reasons, the debtor was sufficiently protected against any uncertainty under draft article 18(4). Should the debtor require proof that a valid assignment had been made, it had a right to obtain such proof from the assignee or to obtain discharge of its obligation by paying the assignor. On that basis, the Working Group adopted the substance of draft article 28 unchanged, and referred it to the drafting group.

Chapter VI. Conflict of laws

A. General comments

67. It was noted that Chapter VI had become the subject of a discussion at a special meeting of experts organized by the Permanent Bureau of the Hague Conference on Private International Law in cooperation with the Secretariat. The Working Group welcomed that cooperation, which had validated the approach taken by the Working Group on a number of issues, and expressed its appreciation to the Secretariat and the Permanent Bureau of the Hague Conference. It was noted that the report of that meeting, prepared by the Permanent Bureau of the Hague Conference, contained recommendations on some issues, while on other issues no recommendations had been made. In particular, it was noted that specific suggestions had been made by some experts with regard to: the adoption of a rule on the location of the assignor that would be in line with article 4 of the Rome Convention or article 3 of the European Union Convention on Insolvency Proceedings; and the deletion of Chapter VI or, at least, its alignment with the Rome Convention.

68. The Working Group considered the question whether Chapter VI should be deleted altogether. In support of retention of Chapter VI, it was stated that it could usefully operate to expand the territorial scope of application of the draft Convention (under draft article 1(2) and (3) with the bracketed language), to fill gaps with regard to matters covered but not expressly settled by the draft Convention (under draft article 8(2), combined with the opening words of draft articles 29 and 30) or to provide a second layer of harmonization with regard to matters left to law applicable outside the draft Convention, even in the context of transactions not covered by the draft Convention (under draft article 1(3) without the bracketed language).

69. In favour of deleting Chapter VI altogether, it was observed that it might inadvertently result in disuniformity, since it did not form a comprehensive codification of private international law principles. In addition, it was observed that assignment did not present any special features in terms of the relationship between the assignor and the assignee to warrant the inclusion of private international law rules in a special convention. Moreover, it was stated that, from a legislative-policy point of view, the inclusion of private international law provisions in a substantive law uniform text was not appropriate. Such an approach, it was said, might inadvertently result in inconsistencies between the draft Convention and other international texts, such as the Rome Convention, which might make the draft Convention less acceptable to States. It was also stated that the goal of achieving a greater degree of certainty by including private international law provisions in the
draft Convention might be missed if the provisions of the
draft Convention were not appropriately formulated. Ex-
amples given included problems: in draft article 8(2),
which dealt with matters covered but not expressly set-
tled in the draft Convention by reference to general
principles underlying the draft Convention without
drawing any distinction between principles of substan-
tive and principles of private international law; and in
draft articles 29, 30 and 31, which did not appear to be
consistent with each other.

70. In response, it was suggested that retaining Chap-
ter VI presented the potential of providing guidance to
a number of States that were not parties to well estab-
lished international texts dealing with private interna-
tional law issues, and of facilitating access to lower-cost
credit. In addition, it was stated that the fact that some
States were parties to an international text prepared at a
regional level should not preclude a universal body like
UNCITRAL from preparing uniform rules on issues cov-
ered by such an international text. Moreover, it was
observed that even States that were parties to other pri-
ivate international law texts, such as the Rome Conven-
tion, could benefit from the provisions of Chapter VI, at
least to the extent that Chapter VI would not deviate
from well established principles of private international
law and would resolve issues that might not have been
resolved with sufficient clarity in other texts.

71. As a matter of principle, it was stated that the
Commission, rather than aiming at preparing a com-
prehensive commercial code, normally focused on partic-
ular issues raising obstacles to international trade. It was
added that whether the Commission would follow in
each particular case a substantive or private interna-
tional law approach depended on the practical use-
fulness of such rules and not on theoretical or other extran-
eous considerations. After discussion, the Working
Group decided to retain Chapter VI and to engage in a
discussion of the substance of the draft articles con-
tained in that chapter.

72. In order to make the draft Convention more ac-
ceptable to States that were parties to existing private
international law texts, it was suggested that a clause
should be included in the draft Convention allowing
States to either declare that they wished to be bound by,
or enter a reservation with regard to the application of,
Chapter VI (“opt-in” and “opt-out” clause respectively). In
favour of an opt-in approach, it was stated that it
would make the draft Convention more acceptable to
States that did not wish to adopt Chapter VI, since those
States would not need to take any specific steps to ex-
clude the application of Chapter VI. On the other hand,
it was observed that, in view of the fact that the Work-
ing Group had decided that Chapter VI would form an
integral part of the draft Convention, an opt-out ap-
proach would be more in line with normal practice.
It was observed that an opt-in approach could have the
unintended effect of discouraging States that could ben-
fit from Chapter VI from adopting it. After discussion,
the Working Group adopted the working assumption
that the draft Convention would allow States to enter a
reservation with regard to the application of Chapter VI
and referred the matter of the reformulation of draft article
48 (reservations) to the drafting group (see para. 148 below
and Annex, draft article 42(bis)).

73. With regard to the purpose of Chapter VI, the
Working Group noted that it could be used in order to
extend the territorial scope of application of the draft
Convention (draft article 1(3) with the bracketed lan-
guage), fill gaps with regard to matters covered but not
expressly settled by the draft Convention (under draft
article 8(2), combined with the opening words of draft
articles 29 and 30) or provide a second layer of harmo-
nization with regard to matters left to law applicable
outside the draft Convention, even in the context of trans-
actions not covered by the draft Convention (under draft
article 1(3) without the bracketed language). The Working
Group decided to defer discussion on the issue of the scope
or the purpose of Chapter VI until it had a chance to
consider the substance of draft articles 29 to 33 and draft
article 1(3).

B. Discussion of draft articles

Article 29. Law applicable to the contract of
assignment

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

"(1) [With the exception of matters which are set-
tled in this Convention,] the contract of assignment is
governed by the law chosen by the assignor and the
assignee. [The parties’ choice of law must be express
or [evident from the parties’ conduct and from the clauses of the assignment contract, considered as a
whole] [demonstrated with reasonable certainty by
the terms of the contract and the circumstances of the
case].

"[(2) Without prejudice to the validity of the con-
tract of assignment or to the rights of third parties,
the assignor and the assignee may agree to subject
the contract of assignment to a law other than that
which previously governed it as a result of an earlier
choice under this article or other provisions of this
Convention.]"(3) In the absence of a choice of law by
the assignor and the assignee, the contract of assign-
ment is governed by the law of the State with which
the contract of assignment is most closely connected.
In the absence of proof to the contrary, the assign-
ment contract is presumed to be most closely con-
ected with the State in which the assignor is lo-
cated."

Paragraph (1)

75. It was noted that draft article 29 was intended to
subject to the same law the contractual rights and obli-
gations of the assignor and the assignee, as well as the
transfer of the receivables, but only as between the
assignor and the assignee. In addition, it was noted that
the language that appeared in paragraph (1) within
square brackets was based on article 7 of the Inter-
American Convention on the Law Applicable to Interna-
tional Contracts (Mexico City, 1994; hereinafter referred to as “the Inter-American Convention”) and article 3(1) of the Rome Convention. Moreover, it was noted that paragraph (2) was drawn from article 3(2) of the Rome Convention.

76. Recalling its decision to defer discussion on the issue of the scope or the purpose of Chapter VI until it had a chance to consider the substance of draft articles 29 to 33 and draft article 1(3) (see para. 73 above), the Working Group decided to retain the opening words of paragraph (1) within square brackets.

77. Broad support was expressed in favour of the basic principle of party autonomy embodied in paragraph (1). As to the question of the limits of party autonomy, diverging views were expressed. One view was that the freedom of the parties to choose the law applicable to their contract should be unlimited. Another view was that parties to a contract connected with one country only should, at least, be precluded from choosing the law of another country. It was stated that, as a result of a combined application of draft articles 1(3) and 29(1), parties to a domestic assignment of domestic or international receivables could provide for the application of a foreign law to the contract of assignment, a result that was found to be unacceptable. While it was observed that the matter could be settled in the context of draft article 1(3) or draft articles 32 and 33, for lack of time, the Working Group deferred final determination of that matter until it had a chance to consider those provisions (see para. 116 below).

78. With regard to the question whether the choice of law by the parties should be express or could be implied as well, it was generally recognized that validating an implicit choice of law would be in line with current trends reflected in existing international instruments. On that basis, support was expressed in favour of both sets of bracketed language included in the second sentence of paragraph (1). On the other hand, it was stated that requiring an express choice of law would be in line with normal practice in financing transactions. In addition, it was observed that both sets of bracketed language included in paragraph (1) might introduce uncertainty.

79. The use of the term "contract of assignment" raised a number of concerns, including the following: it introduced uncertainty, since it was understood differently in the various legal systems; it might inadvertently be understood as covering not only the assignment contract but the underlying financing contract as well, which would run against the principle of the independence of the validity of the former contract from the validity of the latter ("principle of abstraction"); it might be confused with the original contract between the assignor and the debtor; it might exclude a unilateral transfer of receivables; it raised a number of contractual issues that remained unaddressed in draft article 29 (e.g. validity of a choice of law); and its use could produce inconsistent results, since it could be misinterpreted as covering the effectiveness of the assignment as against the debtor and other third parties, matters that were covered in draft articles 30 and 31 and were subjected to laws other than the law chosen by the parties. In order to address those concerns, several suggestions were made, including the suggestions to refer to "the mutual rights and obligations of the parties", to "the assignment" or to "the agreement".

80. Those suggestions failed to attract sufficient support. It was generally thought that, while, for any misinterpretations to be avoided, the term "contract of assignment" might need to be further clarified in a commentary, it should be retained, at least in the absence of any clearer wording. It was stated that the suggested reformulation of paragraph (1) in that regard would not sufficiently address the concerns expressed. It was recalled that the suggested wording had been considered by the Working Group at previous sessions and had not been found to be acceptable.

81. It was recalled, in particular, that a reference to "the rights and obligations of the parties to the assignment", which was used in a previous draft (A/CN.9/412, draft article 8), had been found by the Working Group at its twenty-fourth session to be overly restrictive in that, for example, it failed to address the issue of the time of transfer of the receivables (A/CN.9/420, para. 191) and to be creating uncertainty as to whether the rights stemming from the assignment contract only or from the underlying financing contract as well were covered (A/CN.9/420, para. 192). At that session, the use of the term "assignment" had been objected to on the grounds that it would open too widely the scope of the draft provision, in that it would also cover the effects of the assignment in the context of the relationship between the assignee and the debtor. As a result of that discussion, at its twenty-fourth session, the Working Group had agreed that the provision should make clear that: it covered the relationship between the assignor and the assignee, including such issues as validity of the assignment and transfer of the assigned receivables as between the assignor and the assignee (A/CN.9/420, para. 191); and it was limited to the relationship between the assignor and the assignee arising from the assignment, and not from the financing contract (A/CN.9/420, para. 192).

82. In addition, it was recalled that as to the reference to "the mutual rights and obligations of the assignor and the assignee", at its twenty-seventh session, the Working Group had agreed that, while the expression had been drawn from the Rome Convention, clearer wording might be needed to indicate that the law chosen by the parties should govern not only their rights and obligations but also the entire assignment contract, and that it should also reach beyond the contractual sphere to govern the proprietary effects of the assignment as between the assignor and the assignee. At that session, it had been stated that the Rome Convention might not constitute an appropriate model for drafting since the scope of the Rome Convention was limited to the contractual sphere (A/CN.9/445, para. 60).

83. In the discussion, the suggestion was made that the term "law" should be replaced by the term "rules of
law" in order to allow parties to choose principles of contract such as the UNIDROIT Principles on International Commercial Contracts. That suggestion was objected to on the ground that such a reference to general principles of law would introduce uncertainty as to the exact contents of the law applicable.

84. After discussion, the Working Group decided to delete the second sentence of paragraph (1), retaining the reference to an express choice of law by the parties. As to the term "contract of assignment", the Working Group decided to retain it on the understanding that its exact meaning would be sufficiently explained in the commentary to the draft Convention to be prepared in the future. It was agreed that the commentary should clarify in particular that the term "contract of assignment" did not cover the effectiveness of the assignment as against the debtor and other third parties, or the financing contract.

**Paragraph (2)**

85. There was general support for the principle embodied in paragraph (2) that the assignor and the assignee could agree to change the law applicable to the assignment contract, provided that such a change did not affect the rights of third parties. It was generally agreed, however, that that result could be obtained through paragraph (1) which enshrined the principle of party autonomy with regard to the law applicable to the assignment contract. In addition, the particular formulation of paragraph (2) raised a number of concerns, including the following: the reference to "validity", rather than to "formal validity" only, might give rise to uncertainty as to the law applicable to the contract; and the reference to the rights of third parties might inadvertently create the impression that a choice of law by the assignor and the assignee could affect the rights of third parties. After discussion, the Working Group decided to delete paragraph (2) on the understanding that that deletion should not have a negative implication as to the freedom of the parties to choose or to change the law applicable to the contract of assignment, a principle which was enshrined in paragraph (1).

**Paragraph (3)**

86. It was noted that paragraph (3) was intended to accommodate certainty as the main criterion and flexibility for dealing with exceptional situations, by referring to the law of the country with which the assignment was most closely connected (i.e. to the law of the country where the party who was to effect the characteristic performance of the contract was located); by creating a presumption that the assignment was most closely connected with the law of the country in which the assignor was located; and by allowing parties to rebut that presumption in exceptional circumstances (A/CN.9/445, paras. 59 and 64).

87. The Working Group considered the question whether the law chosen by the assignor and the assignee should be set aside if the choice was invalid. It was generally agreed that in the case of an invalid choice of law, the contract of assignment should be governed by the law of the State with which it was most closely connected, as provided in paragraph (3). In view of the decision taken by the Working Group in the context of its discussion of paragraph (1) to require an express choice (see para. 84 above), it was suggested that paragraph (3) should make it clear that it applied only in the absence of a "valid" or "effective" choice of law by the parties. Recalling concerns raised at its twenty-seventh session with regard to the use of those terms (A/CN.9/445, paras. 59 and 64), the Working Group decided not to include such a reference in the text of paragraph (3) but that a commentary to the draft Convention should clarify that a "valid" or "effective" choice of law was meant in paragraph (3).

88. The Working Group then turned to the question of the location rule that should be followed in paragraph (3) (for a discussion of the location rule, see paras. 25 to 32 above, as well as paras. 107 and 163 to 169 below). In that connection, the Working Group was encouraged to follow an approach that would be in line with the approach taken in other international texts and to adopt a rule referring to the place of business, rather than to the place of incorporation, of the assignor. It was stated that such an approach would be more appropriate, since the place of incorporation might have no connection whatsoever with the contract of assignment. While it was agreed that, in the case of more than one place of business, the reference to the principal place of business would not resolve the problem of transactions concluded by a branch office being subjected to the law of the location of the head office, it was stated that such a place-of-business test would be more appropriate in the context of paragraph (3). The concern was expressed that adopting a different definition for the term "location" in the context of paragraph (3) might create uncertainty. In response, it was observed that rather than formulating a different definition, paragraph (3) should refer to the law of the country in which the assignor had its place of business.

89. It was generally agreed that the scope of the rule embodied in paragraph (3) was very limited and dealt with exceptional situations, since the transactions intended to be covered involved professionals who would normally include a choice-of-law clause in their contracts. On that understanding, it was agreed that reference could be made to the place of business or, in the case of more than one place of business, to the principal place of business or, in the case of an individual, to its habitual residence.

90. In the discussion, the view was expressed that the words "in the absence of proof to the contrary" might not be necessary, since the words "it is presumed" sufficiently indicated that a rebuttable presumption was meant. However, the formulation of the second sentence was approved on the understanding that it clarified that a rebuttable presumption was involved and that it had been structured on the basis of article 16(3) of the UNCITRAL Model Law on Cross-Border Insolvency.

91. After discussion, the Working Group adopted the substance of paragraph (3) and referred to the drafting
group the matter of the reformulation of the second sentence in order to refer to the place of business or, in the case of more than one place of business, to the principal place of business or, in the case of an individual, to the habitual residence of the assignor.

Article 30. Law applicable to the rights and obligations of the assignee and the debtor

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

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

“(2) The law governing the receivable is the law governing the contract [or decision or other act] from which the receivable arises.

“(3) The law governing the contract from which the receivable arises is the law of the State with which the contract is most closely connected. A severable part of the contract which has a closer connection with another State may be governed by the law of that other State.

“(4) In the absence of proof to the contrary, the contract is presumed to be most closely connected with the State in which the assignor is located.”

Paragraph (1)

93. The Working Group was generally agreed that, in order to avoid the possibility of the assignment resulting in a change of the legal regime under which the debtor undertook its original obligation, matters arising in the context of the relationship between the assignee and the debtor should be subjected to the law governing the receivable to which the assignment related. In response to a question, it was observed that the receivable was determined under the original contract between the assignor and the debtor and did not change as a result of any assignment or subsequent assignment.

94. The Working Group considered the particular formulation of paragraph (1). Recalling its decision to defer discussion on the issue of the scope or the purpose of Chapter VI until it had a chance to consider the substance of draft articles 29 to 33 and draft article 1(3) (see para. 73 above), the Working Group decided to retain the opening words of paragraph (1) within square brackets.

95. With regard to the reference to assignability, it was generally agreed that it should be retained, although the question whether paragraph (1) covered both contractual and statutory assignability depended on whether the opening words were retained. It was stated that, if the opening words were retained, draft article 12 (contractual limitations to assignment) would cover contractual assignability, while paragraph (1) would apply to statutory assignability only. If, on the other hand, the opening words of paragraph (1) were deleted, paragraph (1) would cover both contractual and statutory assignability (for a brief reference to the law governing statutory assignability, see paras. 101, 104 and 117 below).

96. With regard to the other items referred to in paragraph (1), the Working Group was generally agreed that a more general formulation along the lines of article 12, paragraph 2 of the Rome Convention would be preferable. It was noted that article 12, paragraph 2, of the Rome Convention provided as follows:

“The law governing the right to which the assignment relates shall determine its assignability, the relationship between the assignee and the debtor, the conditions under which the assignment can be invoked against the debtor and any question whether the debtor’s obligations have been discharged.”

97. In response to a question, it was observed that the words “the conditions under which an assignment can be invoked against the debtor” referred to the conditions agreed upon by the assignor and the debtor.

98. It was stated that, unlike paragraph (1), which in attempting to list exhaustively all the items to be subjected to the law governing the receivable might inadvertently result in leaving some items unaddressed, the suggested wording would cover unanticipated issues. In addition, it was said that the suggested wording would eliminate the risk of leaving some issues unaddressed, which was increased in paragraph (1) as a result of the use of wording which tracked the language of the substantive provisions of the draft Convention.

99. As to the particular wording of paragraph (1), it was widely felt that: reference to “the right of the assignee to request payment” should not be discussed in connection with the relationship between the assignee and the debtor, but rather in the context of the relationship between the assignor and the assignee; “the debtor’s obligation to pay” was sufficiently covered by the general wording suggested above; the reference to “the debtor’s discharge” could be misread as excluding the grounds for discharge of the debtor under draft article 18(5); and the reference to “the debtor’s defences” would give rise to the question whether it covered waivers of defences (draft article 20), modifications of the original contract (draft article 21) and the recovery of payments made by the debtor to the assignee (draft article 22).

100. After discussion, the Working Group decided that paragraph (1) should be redrafted along the following lines: “[Unless the matter is settled elsewhere in this Convention,] the law governing the receivable to which the assignment relates determines its assignability, the relationship between the assignee and the debtor, the
conditions under which the assignment can be invoked against the debtor and any question whether the obligations of the debtor have been discharged".

Paragraphs (2) to (4)

101. The Working Group considered the question whether paragraphs (2) to (4) should be retained. In support of retaining paragraphs (2) to (4), it was stated that those paragraphs might be useful in defining the law governing the receivable. It was observed that, by establishing that the law governing the receivable was the law governing the contract from which the receivable arose, paragraph (2) resolved a matter which was left unaddressed in the Rome Convention and on which uncertainty prevailed as to whether that law was the law governing the original contract (lex contractus) or the law of the debtor's location (lex situs of the debt). In addition, it was said that, by providing for an objective "closest-connection" test, paragraph (3) resolved another issue left unaddressed in the Rome Convention, namely whether the lex contractus was the law chosen by the parties or the law of the country with which the original contract was most closely connected. That approach was said to be appropriate, since: the assignor and the debtor in choosing the law applicable to the original contract would normally not expect that that law governed matters arising in the context of the relationship between the assignee and the debtor; the rights of the assignee would not be negatively affected, since in the case of a domestic receivable the assignee could predict the law applicable, while in the case of an international receivable the assignee would be protected by the rebuttable presumption in favour of the law of the assignor's location established in paragraph (4); and statutory assignability involving matters of public policy or mandatory law should not be subjected to the law chosen by the assignor and the debtor. In that connection, it was stated that paragraph (3) might need to be redrafted if draft article 30 were to cover contractual assignability, so as to allow party autonomy to operate with regard to contractual assignability. Moreover, it was pointed out that, while paragraph (3) appropriately followed a flexible approach based on the well-established "closest-connection" test, paragraph (4) introduced certainty in that it created a rebuttable presumption that the law "most closely connected" with the contract was the law of the assignor's location.

102. It was widely felt, however, that paragraph (2) to (4) should be deleted. It was observed that it would be inappropriate for basic rules such as those contained in paragraphs (2) to (4) to attempt to provide private international law rules for the wide variety of contracts and practical situations that might be at the origin of a receivable. For example, it was stated that determining the law governing the contract from which the receivable arose might involve dealing with sales transactions, insurance contracts, transactions regarding ships or aircraft, operations of financial markets, and many more situations which might not realistically be dealt with under one single rule for determining the law applicable. In addition, practical examples were given of situations where, depending on the various international conventions and general private international law rules applicable to an international assignment, the presumption set forth in paragraph (4) might result in conflicting laws being applicable. In addition, it was pointed out that paragraphs (2) to (4) were inconsistent with the scope of provisions of the draft Convention in that they left unaddressed the issue of the law governing non-contractual receivables. It was generally felt that further extending the scope of the rules contained in paragraphs (2) to (4) would be unreasonable.

103. After discussion, the Working Group decided to delete paragraphs (2) to (4). It was agreed that the commentary to the draft Convention, to be prepared at a later stage, might need to make it clear that draft article 30, rather than attempting to cover all possible issues, was intended to address in a general way the question of the law applicable to matters arising in the context of the relationship between the assignee and the debtor.

104. It was stated that, in view of the deletion of paragraphs (2) to (4) and in order to avoid subjecting statutory assignability to the law chosen by the parties, paragraph (1) should be revised to clarify that it did not address the question of the law applicable to statutory assignability. However, it was generally agreed that that matter could be addressed in the context of draft articles 32 and 33 dealing with mandatory rules and public policy considerations (see para. 117 below).

Article 31. Law applicable to conflicts of priority

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

"[(1) The priority among several assignees of the same receivables from the same assignor is governed by the law of the State in which the assignor is located at the time of the assignment.

"(2) The priority between an assignee and the insolvency administrator is governed by the law of the State in which the assignor is located at the time of the assignment.

"(3) The priority between an assignee and the assignor's creditors is governed by the law of the State in which the assignor is located at the time of the assignment."

106. The Working Group considered the question of the relationship between draft articles 23 and 24, on the one hand, and draft article 31, on the other hand. It was stated that, if Chapter VI were to fill gaps with regard to issues governed but not expressly settled in the draft Convention, draft article 31 would not be necessary and could be deleted (for a brief reference to the possible scope or purpose of Chapter VI, see paras. 68 and 73 above). If, however, Chapter VI were to provide a second layer of harmonization covering even transactions falling outside the scope of the draft Convention, draft article 31 should be retained and aligned with draft articles 23 and 24. It was observed that the same approach should be followed if Chapter VI were to expand the territorial scope of application of the draft Convention
and apply to international assignments or assignments of international receivables irrespective of whether the assignor was located in a Contracting State. In such a case, it was pointed out, it should be clarified that draft article 31 applied only if Chapter IV, including draft articles 23 and 24, did not apply.

107. Recalling its decision to refer issues of priority to the law of the State in which the assignor was incorporated, taken in the context of the discussion of draft articles 23 and 24 (see paras. 25 to 32 above), the Working Group was agreed that the same approach should be followed in draft article 31. While it was noted that in other international texts dealing with matters of procedural law, reference was made to the centre of main interests of the insolvent debtor, it was stated that a different approach was justified in that context because of the different subject and purpose of the draft Convention. It was stated that, unless the draft Convention were to introduce sufficient certainty with regard to rights of assignees as against third parties, it would fail to achieve its goal of increasing the availability of lower-cost credit. In addition, it was observed that, in most cases, the State of incorporation of the assignor would coincide with the State in which the main insolvency proceeding with regard to the assignor would be opened (i.e., under the UNCITRAL Model Law on Cross-Border Insolvency, the place where the assignor had the centre of its main interests, which, in the absence of proof to the contrary, would be presumed to be the State where the assignor had its registered office). In addition, it was observed that, in those cases in which the insolvency proceeding was opened in a State other than the State where the assignor had its place of incorporation, draft article 24, as revised, would provide sufficient protection to the assignor’s creditors and the administrator in the insolvency of the assignor.

108. The concern was expressed that it might not be sufficiently clear that the term “priority” referred to the effectiveness of the assignment as against third parties other than the debtor. As a result, it was said, the debtor paying the assignee with priority under the law specified in draft article 31 (i.e., the law of the assignor’s location) may not be discharged under the law specified in draft article 30 (i.e., the law governing the receivable to which the assignment related). In response, it was pointed out that draft article 31 made it sufficiently clear that it dealt with issues arising in the context of conflicts between specified parties, and that the debtor was not one of those parties. In addition, it was observed that, in view of the inclusion in Chapter VI of draft article 30, as revised, no problem would arise in that regard. Moreover, it was stated that, in any case, the meaning of the term “priority” would not give rise to such uncertainty, since it was defined in draft article 5(1) (for a brief discussion of the definition of the term “priority”, see paras. 23 to 24 above).

109. In response to a question, it was stated that the law applicable to subsequent assignments was determined with sufficient clarity in draft article 29, as far as the contract of assignment was concerned, and in draft article 31, as far as the relationship between the assignee and the debtor was concerned. In addition, it was pointed out that draft article 31 was sufficient in covering conflicts among several subsequent assignees obtaining the same receivables from the same assignor and conflicts between a subsequent assignee, on the one hand, and the assignor’s creditors or the administrator in the insolvency of the assignor, on the other hand, since under draft article 25, as revised, the provisions of the draft Convention would apply to a subsequent assignee as if it were the initial assignee. Moreover, it was said that, for the same reason, no problem would arise if one of the successive assignees disputed the rights of the last assignee in a chain of assignments.

110. After discussion, the Working Group decided that, pending final determination of the issue of the purpose of Chapter VI (see para. 73 above), draft article 31 should be retained in square brackets, aligned with draft articles 23 and 24 and revised to include a chapeau along the following lines within square brackets: “With the exception of matters settled in chapter IV.”

Article 32. Mandatory rules

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

“(1) Nothing in this chapter restricts the application of the rules of the law of the forum in a situation where they cannot be derogated from by contract (“mandatory rules”) irrespective of the law otherwise applicable.

“(2) With regard to matters settled in this chapter, the forum may decide to apply the mandatory rules of the law of another State with which the contract of assignment has a close connection, if and in so far as, under the law of that other State, those rules must be applied whatever the law applicable.”

112. The concern was expressed that draft article 32 might generate uncertainty as to the law applicable to the contract of assignment, since the possible limitations that might derive from the mandatory rules of law of the forum or of another State with which the assignment contract was closely connected would not be known at the time of the assignment. In order to address that concern, it was suggested that draft article 32 should be deleted or, at least, consolidated with draft article 33. That suggestion was objected to on the grounds that draft article 32 was useful in restating a principle recognized in private international law instruments, such as the Rome Convention and the Inter-American Convention, according to which the mandatory rules of the law of the forum or of another State with which the contract of assignment was closely connected might prevail over the applicable law. In addition, it was noted that such a principle had a somewhat broader scope than the exclusion of the provisions of the law applicable that were manifestly contrary to the public policy of the forum under draft article 33.

113. It was generally agreed that the application of the law applicable to the contract of assignment and to
Law applicable to statutory assignability

117. Bearing in mind its earlier decision to delete paragraphs (2) through (4) of draft article 30 (see para. 103 above), the Working Group considered the question whether statutory assignability should be subjected to a law other than the law governing the receivable. It was generally agreed that the assignor and the debtor should not be allowed to evade possible statutory limitations on the assignability of receivables by choosing a convenient law to govern the receivable to which the assignment related. It was observed that such statutory limitations were intended to protect the assignor (e.g. limitations as to the assignment of wages, pensions, life insurance policies), or the debtor (e.g. statutory limitations to the assignment of taxes). However, it was widely felt that no additional provisions were necessary in draft article 30 to reflect that understanding, since statutory limitations to the assignability of receivables would normally flow from mandatory rules, which would be preserved under draft article 32.

Article 33. Public policy

118. The text of draft article 33 as considered by the Working Group was as follows:

"With regard to matters settled in this chapter, the application of the law specified by this Convention may be refused only if such application is manifestly contrary to the public policy of the forum."

119. It was generally agreed that draft article 33 should be aligned with draft article 24(3) (see para. 34 above). On that understanding, the Working Group adopted the substance of draft article 33 and referred it to the drafting group.

Chapter VII. Alternative priority rules

120. It was noted that Sections I and III of Chapter VII provided two different sets of substantive law rules for resolving priority issues, one based on the time of registration and another based on the time of assignment, while Section II dealt with distinct issues relating to registration. While the whole of Chapter VII was optional (i.e. subject to an "opt-in" clause), it was noted that a number of other options were open to States, including the option to take neither the time-of-assignment nor the registration-based priority rules nor the registration rules, but rather to retain their own domestic rules. It was noted that that approach to law unification had become the subject of criticism in expert group meetings attended by members of the Secretariat. Critics of that approach had noted that the current lack of uniformity was being institutionalized. In addition, it was noted that the registration system foreseen in the current formulation of Section II would be objectionable even to States already following a registration system. In that connection, it was noted that, if Section II were too detailed, it could preclude further developments in the field of registration, while, if it were too general, States...
would not have enough information to decide whether to adopt the registration system referred to in Section II.

121. While it was recognized that Chapter VII may not be the ideal approach to law unification, the Working Group recalled that Chapter VII was the result of a long debate which had shown that, while agreement could not be reached on one substantive law priority rule, law unification would be served by the draft Convention in several respects. It was pointed out that certainty would be enhanced, whether or not States adopted any of the options offered in Chapter VII, since draft articles 23 and 24 would establish a legal regime in the context of which Contracting States would give effect to foreign priority rules. In addition, it was said that Chapter VII would provide guidance to States that wished to modernize their existing relevant legislation or to introduce new legislation, if they had no such legislation.

122. In that connection, it was emphasized that the registration rules contained in Section II were distinct from the priority rules contained in Section I. It was mentioned that States should be allowed to opt into Section I or II or both (see para. 131 below). Thus, Chapter VII could be used by States in one of the following ways: a State could apply its domestic priority rules based on registration, but use the registration system foreseen by the draft Convention; a State could apply the priority rules of Section I, but use its own registration system; a State could opt into both Sections I and II but only with regard to assignments within the scope of the draft Convention; and a State might introduce domestic rules based on Sections I and II, to which draft articles 23 or 24 would point, and apply them with regard to all assignments, within or outside the scope of the draft Convention.

123. Moreover, it was stated that the draft Convention would promote transparency, since States would be required to make declarations that would specify the ways in which their national laws modified the priority rules of the draft Convention. The Working Group was agreed that the specific results of that codification effort would have to be left to the marketplace for evaluation and further development. After discussion, the Working Group decided to retain Chapter VII. It was generally agreed that the contents of that Chapter would need to be considered at a later stage, possibly in the light of work done by other organizations with regard to registration.

**Chapter VIII. Final provisions**

**Article 41. Depositary**

124. The text of draft article 41 as considered by the Working Group was as follows:

"The Secretary-General of the United Nations is the depositary of this Convention."

125. The Working Group adopted the substance of draft article 41 unchanged.

**Article 42. Conflicts with international agreements**

126. The text of draft article 42 as considered by the Working Group was as follows:

"(1) Except as provided in paragraph (2) of this article, this Convention prevails over any international convention [or other multilateral or bilateral agreement] which has been or may be entered into by a Contracting State and which contains provisions concerning the matters governed by this Convention.

"(2) If a State declares, at [the time of signature, ratification, acceptance, approval or accession] [any time], that the Convention will not prevail over international conventions [or other multilateral or bilateral agreements] listed in the declaration, to which it has or will enter and which contain provisions concerning the matters governed by this Convention, this Convention does not prevail."

127. General support was expressed in favour of the principle of the precedence of the draft Convention over other international instruments, although some hesitation was expressed in view of the possibility that it might be construed as a deviation from the usually more flexible approach reflected in other international instruments. With regard to the formulation of paragraph (1), it was observed that international agreements that might contain provisions on the matters covered by the draft Convention might not necessarily take the form of international conventions. It was, therefore, agreed to delete the square brackets around the words "or other multilateral or bilateral agreements".

128. It was generally agreed that a State should have the ability to declare, at any time, that the draft Convention would not prevail over international conventions or other multilateral or bilateral agreements entered into by it. Therefore, it was decided to delete the words in square brackets "at the time of signature, ratification, acceptance, approval or accession" and to remove the square brackets around the words "at any time". Furthermore, for the same reasons that had been mentioned in connection with paragraph (1), it was agreed to delete the square brackets around the words "or other multilateral or bilateral agreements".

129. Subject to the changes referred to in paragraphs 127 and 128 above, the Working Group adopted the substance of draft article 42, and referred it to the drafting group.

**Article 43. Application of chapter VII**

130. The text of draft article 43 as considered by the Working Group was as follows:

"A Contracting State may declare at [the time of signature, ratification, acceptance, approval, or accession] [any time] that it will be bound either by sections I and II or by section III of chapter VII."
131. The suggestion was made to rephrase draft article 43 in order to allow States to opt into the registration-based priority rules (Section I), or into the registration rules (Section II), or into both (see para. 122 above). However, in view of the fact that the Working Group had not reached a final decision as to the contents of Chapter VII, it was generally agreed to place square brackets around the phrase “sections I and II or by section III of chapter VII” and to revert to the matter at a future stage.

132. In line with its decision as to the formulation of draft article 42 (see paras. 128 and 129 above), the Working Group agreed to delete the words in square brackets “at the time of signature, ratification, acceptance, approval or accession” and to remove the square brackets around the words “at any time”, and referred draft article 43 to the drafting group.

Article 44. Insolvency rules or procedures not affected by this Convention

133. The text of draft article 44 as considered by the Working Group was as follows:

“A Contracting State may describe at [the time of signature, ratification, acceptance, approval, or accession] [any time] other rules or procedures governing the insolvency of the assignor which this Convention does not affect.”

134. The Working Group noted that the purpose of draft article 44 was to enhance certainty and transparency in the application of the draft Convention by requiring that States should indicate those provisions of their national laws governing the insolvency of the assignor that were not affected by the draft Convention.

135. Divergent views were expressed as to the degree of specificity that should be required in draft article 44. One view was that the declaration foreseen in draft article 44 could not fulfill its purpose of providing certainty and predictability, in particular to third parties, if it was not sufficiently specific. It was stated that requiring a declaration to be specific was necessary to avoid the possibility of such a declaration simply citing the general laws of a State on a particular topic. Another view was that a requirement for specific declarations might place too onerous a burden on States. It was stated that, if such an approach were to be followed, a State would need to make a new declaration each time it changed its domestic law in order to ensure that its own insolvency rules would prevail over draft article 24. Several suggestions were made, including the suggestions to insert language along the following lines: “declare”, “declare by describing” and “a Contracting State may, at any time, declare that, notwithstanding the provisions of this Convention, in the event of the insolvency of an assignor over which it has jurisdiction, specific national rules and procedures which are set out in its declaration under this article shall apply”. With the exception of the substitution of the word “describe” for the word “describe”, those suggestions did not receive sufficient support. In order to align draft article 44 with draft articles 42 and 43 (see paras. 128 to 129 and 132 above), as revised, it was generally agreed that the words “the time ... accession” should be deleted and the words “any time” should be retained without square brackets.

136. As a matter of principle, doubt was expressed as to whether draft article 44 was necessary at all, in view of the decision of the Working Group to retain only Variant A in draft article 24(4) (see para. 33 above). In the same vein, the view was expressed that the rule on the matter had already been laid down in draft article 24 and that all that remained to be clarified by the declarations to be made under draft article 44 was which national rules and procedures remained unaffected by the draft Convention. In any case, it was stated that it would not be advisable to redraft draft article 44 in a manner which would expand the discretion of the Contracting States to preserve their domestic laws beyond the limits provided in draft article 24.

137. The concern was expressed that the words “rules or procedures” might be excessively broad and inadvertently result in States making a declaration to preserve their entire insolvency law. In addition, it was pointed out that those words might make it insufficiently clear whether substantive or procedural rules were meant, or both.

138. The suggestion was made to include a reference to international conventions in the draft article, since the relevant rules of insolvency might derive not only from national laws but also from international conventions. In response, it was observed that international conventions and agreements were already covered under draft article 42(2) and that such an additional reference was not needed in draft article 44.

139. The view was expressed that it was not clear from draft article 44 whether States were required to submit a declaration under draft article 44 or whether such a declaration was optional, as suggested by the use of the word “may” in the draft article. In response, it was pointed out that the purpose of the draft article was not to compel a Contracting State to make a declaration. However, it was stated that, if a Contracting State failed to submit such a declaration, particular national rules or procedures concerning the insolvency of the assignor might be supplanted by the draft Convention.

140. Having considered the various views expressed, the Working Group felt that draft article 44 would need to be reconsidered in the light of advice to be obtained from insolvency law experts and referred it to the drafting group for the minor amendments referred to in paragraph 135 above.

Article 45. Signature, ratification, acceptance, approval, accession

141. The text of draft article 45 as considered by the Working Group was as follows:
“(1) This Convention is open for signature by all States at the Headquarters of the United Nations, New York, until . . .

“(2) This Convention is subject to ratification, acceptance or approval by the signatory States.

“(3) This Convention is open to accession by all States which are not signatory States as from the date it is open for signature.

“(4) Instruments of ratification, acceptance, approval and accession are to be deposited with the Secretary-General of the United Nations.”

142. The Working Group adopted the substance of draft article 45 unchanged.

Article 46. Application to territorial units

143. The text of draft article 46 as considered by the Working Group was as follows:

“(1) If a State has two or more territorial units in which different systems of law are applicable in relation to the matters dealt with in this Convention, it may, at the time of signature, ratification, acceptance, approval or accession, declare that this Convention is to extend to all its territorial units or only one or more of them, and may at any time substitute another declaration for its earlier declaration.

“(2) These declarations are to state expressly the territorial units to which the Convention extends.

“(3) If, by virtue of a declaration under this article, this Convention does not extend to all territorial units of a State and the assignor or the debtor is located in a territorial unit to which the Convention does not extend, this location is considered not to be in a Contracting State.

“(4) If a State makes no declaration under paragraph (1) of this article, the Convention is to extend to all territorial units of that State.”

144. The Working Group adopted the substance of draft article 46 unchanged.

Article 47. Effect of declaration

145. The text of draft article 47 as considered by the Working Group was as follows:

“(1) Declarations made under articles 42 to 44 and 46 at the time of signature are subject to confirmation upon ratification, acceptance or approval.

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

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

“(4) Any State which makes a declaration under articles 42 to 44 and 46 may withdraw it at any time by a formal notification in writing addressed to the depositary. Such withdrawal takes effect on the first day of the month following the expiration of six months after the date of the receipt of the notification of the depositary.”

146. The Working Group adopted the substance of draft article 47 unchanged.

Article 48. Reservations

147. The text of draft article 48 as considered by the Working Group was as follows:

“No reservations may be made to this Convention.”

148. The Working Group recalled its decision that States should be allowed to enter a reservation with regard to Chapter VI (see para. 72 above). In addition, it was suggested that the possibility for other reservations should remain open. After discussion, the Working Group decided that a provision should be inserted in Chapter VIII providing for a reservation as to Chapter VI and that draft article 48 should be revised accordingly. The Working Group referred those matters to the drafting group.

Article 49. Entry into force

149. The text of draft article 49 as considered by the Working Group was as follows:

“(1) This Convention enters into force on the first day of the month following the expiration of one year from the date of the deposit of the [fifth] instrument of ratification, acceptance, approval or accession.

“(2) For each State which becomes a Contracting State to this Convention after the date of the deposit of the [fifth] instrument of ratification, acceptance, approval or accession, this Convention enters into force on the first day of the month following the expiration of one year after the date of the deposit of the appropriate instrument on behalf of that State.

“(3) This Convention applies only to assignments made on or after the date when the Convention enters into force in respect of the Contracting State referred to in paragraph (1) of article 1.”

150. The Working Group generally agreed that the period of one year for entry into force of the draft Convention was excessively long and that it would be sufficient to provide for an interim period of six months. In addition, it was widely felt that five ratifications should be sufficient for the draft Convention to enter into force and it was agreed to delete the brackets around the word “fifth” in paragraph (2). Subject to those amendments, the Working Group adopted the substance of draft article 49 and referred it to the drafting group.
Article 50. Denunciation

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

“(1) A Contracting State may denounced this Convention at any time by means of a notification in writing addressed to the depositary.

“(2) The denunciation takes effect on the first day of the month following the expiration of one year after the notification is received by the depositary. Where a longer period is specified in the notification, the denunciation takes effect upon the expiration of such longer period after the notification is received by the depositary.”

152. The view was expressed that the denunciation of the draft Convention by a Contracting State would be likely to affect the rights of third parties, particularly in the case of assignments of future receivables, and that it might be desirable for the Working Group to consider ways in which the rights of those third parties could be protected from the adverse effects of a denunciation.

153. However, that proposal was objected to on the grounds that the right of a State to denounce an international convention was a sovereign right and that the inclusion of possible limitations to that right, including any obligation of a Contracting State to protect the rights of third parties, might be perceived as restricting the sovereignty of that Contracting State. Moreover, it was stated that the effects of a denunciation on the rights of third parties was a matter which should be better left to the applicable law, since most legal systems had rules governing the effects of changes of law on acquired rights or ongoing transactions.

154. In response, it was pointed out that the proposed amendment of draft article 50 would not restrict the right of Contracting States to denounce the draft Convention. In addition, it was stated that the proposed amendment was solely intended to provide a substantive rule dealing with the effects of a denunciation on the rights of parties located in States other than the State denouncing the draft Convention and to protect them to the extent that they had relied on the application of the draft Convention. Without such a uniform rule, third parties would need to rely on substantive rules on supervening changes of law provided under various legal systems, which might provide conflicting or unsatisfactory solutions for the situations under consideration.

155. Having considered the various views that had been expressed, the Working Group decided that the issue of the effects of a denunciation on the rights of third parties would require further consideration. Without prejudice to any solution that might be found for that issue at a later stage, the Working Group found the substance of draft article 50 to be generally acceptable, and referred it to the drafting group.

TITLE OF THE DRAFT CONVENTION

156. The Working Group postponed the discussion of the title of the draft Convention until it had completed its review of the draft Convention as a whole.

PREAMBLE

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

“The Contracting States,

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

“[Considering that problems created by the uncertainties as to the legal regime applicable to assignments in international trade constitute an obstacle to transactions in which value, credit or related services is given or promised against value in the form of receivables, including factoring, forfaiting, securitization, project financing and refinancing transactions,]

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

“Have agreed as follows:”

158. General support was expressed in favour of including in the preamble a statement of the objectives of the draft Convention. It was widely felt that such a statement could provide useful guidance with regard to the interpretation of the draft Convention, in particular if reference to the preamble was made in the context of draft article 8, which dealt with issues of interpretation of the draft Convention. However, in order to avoid unduly complicating the preamble, it was agreed that a general statement of principles would be sufficient, while further explanations could be given in the commentary to the draft Convention. It was generally agreed that such a commentary could provide useful guidance with regard to the interpretation of the draft Convention and should be prepared by the Secretariat at a later stage.

159. As to the precise formulation of the preamble, it was generally agreed that it could be retained with the addition of a few principles. Principles mentioned in the discussion included: the creation of rules that provided predictability and transparency with a view to facilitating receivables financing; the promotion of modernization and harmonization of domestic and international laws relating to assignment; the facilitation of new practices and the avoidance of interference with current practices; and the avoidance of interference with competition. With regard to the language in the second paragraph of the preamble that attempted to define and list financing practices, the view was widely shared that it should be deleted, since it could inadvertently result in excluding some practices or giving undue preference to other practices. It was generally understood, however, that the deletion of that wording would not prejudice any decision the Working Group might wish to make with regard to draft article 5(d) (definition of the term “receivables financing”). As to the question whether draft article 8 should refer to the preamble, the Working
Group postponed the discussion until it had a chance to consider draft article 8. After discussion, the Working Group adopted the substance of the preamble and referred its exact formulation to the drafting group.

Chapter I. Scope of application

Article I. Scope of application

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

“(1) This Convention applies to assignments of international receivables and to international assignments of receivables as defined in this chapter, if, at the time of the assignment, the assignor is located in a Contracting State.

“(2) [The provisions of articles [...] do not apply][This Convention does not affect the rights and obligations of the debtor] unless the debtor is located in a Contracting State [or the rules of private international law lead to the application of the law of a Contracting State to the relationship between the assignor and the debtor.]

“(3) The provisions of articles 29 to 33 apply to [assignments of international receivables and to international assignments of receivables as defined in this chapter] independently of paragraphs (1) and (2) of this article.]

“(4) Chapter VII applies in a Contracting State which has made a declaration under article 43. [If a Contracting State makes such a declaration, the provisions of articles 23(1) and 24(1), (2) do not apply in this State.]

Paragraph (1)

161. The Working Group confirmed its decision, taken at its twenty-seventh session, that the territorial scope of application of the draft Convention did not need to be expanded by reference to private international law rules along the lines of 1(1)(b) of the United Nations Convention on Contracts for the International Sale of Goods (A/ CN.9/445, para. 139). It was widely felt that the territorial scope of the draft Convention was sufficiently broad, since paragraph (1) required that, for the draft Convention to apply, only the assignor should be in a Contracting State. In addition, the view was widely shared that such a reference to the private international law rules of the forum could create uncertainty, since the parties would not know at the time of the assignment whether the forum in which a dispute might be adjudicated, unless they had agreed on a jurisdiction clause.

162. The Working Group noted that, under draft article 3, for a receivable to be international, it had to be international at the time it arose. As a result, it was noted, in the case of an assignment of future receivables, the assignor and the assignee would not know at the time of assignment whether the draft Convention would apply. In order to address that problem, it was suggested that paragraph (1) be reformulated along the following lines:

“This Convention applies to international assignments if, at the time of the assignment, the assignor is located in a Contracting State”, while draft article 3 should be revised as follows: “An assignment is international if, at the time of the assignment, any two of the following parties are located in different States: assignor, assignee, debtor”. That suggestion failed to attract sufficient support. The Working Group agreed that the problem could be addressed in the context of draft article 3.

163. The Working Group next turned to the question of the meaning of the term “location” in the context of draft article 1 (see paras. 25 to 32, 88 to 89 and 107 above). Differing views were expressed. One view was that, in order to be consistent with the location rule adopted in the context of draft articles 23 and 24 and in order to achieve certainty, the same location rule should be adopted in the context of draft article 1. It was stated that, if a different approach were to be followed, while an assignment would be covered by the draft Convention, issues of priority might not be covered, in the case of a corporation located in a State other than its place of business which was not in a Contracting State. In addition, it was observed that any other approach would increase uncertainty as to the application of the draft Convention, a result which could affect the cost and the availability of credit since assignees might not be able to determine with relative ease and certainty the place of business of the assignor.

164. Another view was that reference should be made in paragraph (1) to the place of business of the assignor. It was stated that that term was well known and established in various international instruments and in case law. In addition, it was observed that use of that term would facilitate the application of a law which had a real connection to the relevant transaction and would appropriately address the problem of transactions made through a branch office. In that regard, it was pointed out that the place of incorporation was often a fictitious place which had no link to the place in which a corporation carried on its business. It was also said that a reference to the place of incorporation could inadvertently result in subjecting transactions concluded by a branch office to the law of the State where the head office was located.

165. While it was observed that normally the place of business and the place of incorporation would coincide, in order to bridge the differences existing for the situations in which the two places differed, the suggestion was made that reference could be made to a combination of criteria, including the place of incorporation and the place of business. Language along the following lines was proposed: “An individual is located in the State in which it has its habitual residence. A company is located in the State in which it has its registered office or such other place of business the assignment is most closely connected with”. That suggestion was modified to refer directly in paragraph (1) to those criteria, without introducing yet another location rule in addition to that adopted for the purposes of draft articles 23 and 24 (“This Convention applies to assignments of international receivables and to international assignments of international assignments of
receivables as defined in this chapter if, at the time of the assignment, the assignor has either its place of incorporation, or its registered office, or its place of business to which the assignment is most closely connected in a Contracting State"). In response to a question, it was explained that the "closest connection" test was intended to apply only to the place of business.

166. A number of suggestions were made to improve the proposed wording. One suggestion, which received broad support, was to delete the reference to the assignor's registered office. Another suggestion was that greater certainty could be achieved by referring to the assignor's "principal" place of business. That suggestion was objected to on the grounds that it could create problems with organizations which often acted through their branch offices. Yet another suggestion was that the reference to the place of business should be qualified by the words "from which the assignment arises", in preference to the words of the original proposal "to which the assignment is most closely connected". It was pointed out that, while those tests had the same effect, they both had the potential to create uncertainty, since it would not be easy for third parties to establish the place of business with the closest connection to the assignment. Yet another suggestion, which was broadly supported, was that, with regard to natural persons, reference should be made to the habitual residence.

167. Broad support was expressed in favour of that suggestion. It was pointed out that that formulation combined the certainty of the place of incorporation with the flexibility of the place of business, while providing a solution to difficulties arising in relation to branch offices. In addition, it was observed that the tests were disjunctive so that all that was required in order for the draft Convention to apply was that one of the tests be satisfied. Moreover, it was observed that there was sufficient precedence for such an approach in other international instruments.

168. However, a number of concerns were expressed. One concern was that such an approach might be too flexible and introduce an unacceptable degree of uncertainty. Another concern was that a rule along those lines could inadvertently result in bringing within the scope of the draft Convention domestic assignments of domestic receivables (i.e., assignments in which the assignor, the assignee and the debtor had their places of business in the same State). In response, it was pointed out that, if the assignor was incorporated in a State other than the State in which it had its place of business, such an assignment would be an international assignment. It was mentioned, however, that that matter may be approached differently depending on whether, under the applicable company law, a foreign company would be subject to the law of the place of incorporation or to the law of the place of registration.

169. After discussion, in view of the importance of the matter and of the lack of sufficient time, the Working Group adopted the substance of paragraph (1), on the understanding that the issue of location would need to be revisited at the next session of the Working Group in the light of the various suggestions made and of the definition of internationality contained in draft article I(3).

Paragraph (2)

170. While some support was expressed in favour of the first set of bracketed language contained in paragraph (2), the prevailing view was that it should be deleted and that the paragraph should begin with the words: "This Convention does not affect the rights and obligations of the debtor". In response to a question, it was observed that "the rights and obligations of the debtor" were those arising under the original contract and the law governing that contract.

171. As to the reference to the application of the rules of private international law, differing views were expressed. One view was that it should be deleted, since it gave rise to uncertainty. Another view was that it should be retained, in order to avoid a situation where, by virtue of the private international law rules of the forum, if the assignor were located in a Contracting State, the domestic law of the assignor's location rather than the draft Convention would apply. While some doubt was expressed as to whether the result in the situation referred to would be as described, the view was widely shared that the debtor could be deprived of the protection afforded by the draft Convention, a result that should be avoided. It was thus suggested that reference should rather be made to the law governing the receivable being the law of a Contracting State. The suggestion received broad support. It was stated, however, that the debtor protection provided in the Convention may not be of a higher standard than the protection afforded by domestic law, and it may therefore be preferable to apply domestic law in some cases.

172. After discussion, the Working Group agreed that paragraph (2) should read as follows:

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

Paragraphs (3) and (4)

173. Owing to the lack of sufficient time, the Working Group decided to defer consideration of paragraphs (3) and (4) to its next session.

III. REPORT OF THE DRAFTING GROUP

174. The Working Group requested a drafting group established by the Secretariat to review the preamble and draft articles 5(g) to (j), 18(bis), 23 to 32 and 40
to 50, with a view to ensuring consistency between the various language versions.

175. At the close of its deliberations, the Working Group considered the report of the drafting group and adopted the substance of the preamble and draft articles 5(g) to (j), 18(5bis), 23 to 33 and 40 to 50, as revised by the drafting group. The text of those revised articles, as adopted by the Working Group, is reproduced in the annex to the present report.

176. With respect to the phrase in the second paragraph of the preamble that attempted to define the transactions covered by the draft Convention, the suggestion was made that it should be reintroduced in the preamble. That suggestion was objected to on the grounds that such an approach could inadvertently result in excluding certain transactions or expressing an undue preference for other transactions. The Working Group took that decision on the understanding that the elimination of that phrase in the preamble should not prejudice the Working Group's approach to draft article 5(d) (definition of "receivables financing").

177. The view was expressed that reference to the term "court" alone was too narrow, given that insolvency proceedings may be conducted by a body other than a court. It was agreed that that term should be replaced with the phrase "court or other competent authority", which was more complete and consistent with the UNCITRAL Model Law on Cross-Border Insolvency (article 4), and that the text should be amended accordingly in draft articles 5(h), 24(3) and 33.

178. It was agreed that where the text contained the terms "forum", "forum State" and the phrase "State in which the court is located", the term "forum State" should be used throughout in order to achieve consistency (draft articles 24(3) and (5), 31, 32(1) and 33).

179. With respect to draft article 26, it was suggested that it should not be adopted until a decision had been reached with regard to draft article 12. However, the Working Group decided to adopt the substance of draft article 26 on the understanding that it could be revisited, if necessary, after the Working Group had a chance to discuss draft article 12.

180. As to draft article 29, it was agreed that where the text contained the terms "assignment contract" and "contract of assignment", only the latter term should be used throughout for the sake of consistency. With regard to draft article 42, it was agreed that it should be aligned with draft articles 42bis, 43 and 44, which did not refer to the declaration taking effect, since that matter was covered in draft article 47. Moreover, it was agreed that in draft articles 42bis, 43 and 44, reference should be made to a "State", rather than to a "Contracting State", in order to cover situations in which a declaration was made at the time of signature.

181. With regard to draft article 50, it was agreed that language should be prepared by the Secretariat to address transitional issues and effects on third parties for the consideration of the Working Group at a later stage.

IV. FUTURE WORK

182. A number of issues were suggested for consideration during the next session of the Working Group. Those included: the scope of the draft Convention, in particular the definition of the terms "assignment" and "receivable"; the form of assignment, contractual limitations to assignment; and debtor’s discharge by payment. As to the order of work, the suggestion was made that the Working Group might wish to select a few important issues and address them first, without necessarily following the order of the articles in document A/CN.9/WG.11/WP.96. However, general preference was expressed in favour of the Working Group beginning its deliberations at the next session with draft article 1 and proceeding on the basis of the order in which the draft articles appeared in document A/CN.9/WG.11/ WP.96. It was widely felt that such an approach, in addition to being the normal way to proceed, would allow the Working Group to consider at its next session crucial issues, such as scope, form and contractual limitations to assignment. Moreover, it was pointed out that, following the order of the draft articles in document A/CN.9/WG.11/ WP.96 would not result in undue delays, since the Working Group could settle the less important provisions of the draft Convention without a long debate.

183. It was noted that the next session of the Working Group was scheduled to take place in New York from 1 to 12 March 1999.

ANNEX

DRAFT CONVENTION ON ASSIGNMENT IN RECEIVABLES FINANCING

PREAMBLE

The Contracting States,

Reaffirming their conviction that international trade on the basis of equality and mutual benefit is an important element in the promotion of friendly relations among States,

Considering that problems created by the uncertainties as to the content and choice of legal regime applicable to assignments in international trade constitute an obstacle to financing transactions,

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

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

Have agreed as follows:

Chapter II. General provisions

Article 5. Definitions and rules of interpretation

For the purposes of this Convention:

(g) "Insolvency administrator" means a person or body, in-
cluding one appointed on an interim basis, authorized to administer
the reorganization or liquidation of the assignor’s assets;
(h) "Insolvency proceeding" means a collective judicial or admin-
istrative proceeding, including an interim proceeding, in which
the assets and affairs of the assignor are subject to control or super-
vision by a court or other competent authority for the purpose of
reorganization or liquidation;
(i) "Priority" means the right of a party in preference to another
party;
(j) For the purposes of articles 23 and 24, an individual is located
in the State in which it has its habitual residence; a corporation is
located in the State in which it is incorporated; a legal person other
than a corporation is located in the State in which its constitutive
document is filed; and any other person is located in the State in
which it has its chief executive office.

Chapter IV. Rights, obligations and defences

Section II. Debtor

Article 18. Debtor's discharge by payment

(5 bis) Nothing in this Convention affects any ground on
which the debtor may be discharged by paying a person to
whom an invalid assignment has been made.

Section III. Third parties

Article 23. Competing rights of several assignees

(1) Priority among several assignees of the same receivables
from the same assignor is governed by the law of the State in
which the assignor is located.

(2) An assignee entitled to priority may at any time voluntar-
ily subordinate its priority in favour of a competing assignee,
whether or not that competing assignee is then in existence.
[The subordination may be unilateral or may occur by agree-
ment with the assignor, the competing assignee or any other
person.]

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

(1) Priority between an assignee and the assignor's creditors is
governed by the law of the State in which the assignor is lo-
cated.

(2) Priority between an assignee and the insolvency admini-
strator is governed by the law of the State in which the assignor
is located.

(3) Notwithstanding paragraphs (1) and (2), the application of
a provision of the law of the State in which the assignor is
located may be refused by a court or other competent authority
only if that provision is manifestly contrary to the public policy
of the forum State.

(4) If an insolvency proceeding is commenced in a State other
than the State in which the assignor is located, except as pro-
vided in this article, this Convention does not affect the rights
of the insolvency administrator or the rights of the assignor's
creditors.

(5) If an insolvency proceeding is commenced in a State other
than the State in which the assignor is located, any non-
consensual right or interest which under the law of the forum
State would have priority over the interest of an assignee has
such priority notwithstanding paragraph (2) but only to the extent
that such priority was specified by the forum State in an instrument
deposited with the depository prior to the time when the assign-
ment was made.

(6) An assignee asserting rights under this article has no less
rights than an assignee asserting rights under other law.

Chapter V. Subsequent assignments

Article 25. Scope

(1) This Convention applies to:

(a) assignments of receivables by the initial or any other
assignee to subsequent assignees ("subsequent assignments")
that are governed by this Convention under article I, notwith-
standing that any prior assignment is not governed by this
Convention; and

(b) any subsequent assignment, provided that any prior as-
signment is governed by this Convention.

(2) This Convention applies as if the subsequent assignee
were the initial assignee.

Article 26. Agreements limiting subsequent assignments

(1) A receivable assigned by the initial or any subsequent as-
signee to a subsequent assignee is transferred notwithstanding any
agreement between the initial or any subsequent assignor and the
derbor or any subsequent assignee limiting in any way the initial
or any subsequent assignor's right to assign its receivables.

(2) Nothing in this article affects any obligation or liability of the
assignor for breach of such an agreement. A person who is not
party to such an agreement is not liable under that agreement for
its breach.

Article 27. Multiple notifications

If the debtor receives notification of one or more subsequent
assignments, the debtor is discharged only by payment to
the person or to the address identified in the notification of
the last of such subsequent assignments.

Article 28. Notification of subsequent assignments

Notification of a subsequent assignment constitutes notification of
any prior assignment.

Chapter VI. Conflict of laws

Article 29. Law applicable to the contract of assignment

(1) [With the exception of matters which are settled in this
Convention,] the contract of assignment is governed by the law
expressly chosen by the assignor and the assignee.

(2) In the absence of a choice of law by the assignor and the
assignee, the contract of assignment is governed by the law of
the State with which the contract of assignment is most closely
connected. In the absence of proof to the contrary, the contract
of assignment is presumed to be most closely connected with
the State in which the assignor has its place of business. If the
assignor has more than one place of business, reference is to be
made to the place of business most closely connected to the
contract. If the assignor does not have a place of business, refer-
cence is to be made to its habitual residence.
(3) If the contract of assignment is connected with one State only, the fact that the assignor and the assignee have chosen the law of another State does not prejudice the application of the law of the State with which the assignment is connected if that law cannot be derogated from by contract.

Article 30. Law applicable to the rights and obligations of the assignee and the debtor

[With the exception of matters which are settled in this Convention,] the law governing the receivable to which the assignment relates determines its assignability, the relationship between the assignee and the debtor, the conditions under which the assignment can be invoked against the debtor and any question whether the debtor’s obligations have been discharged.

[Article 31. Law applicable to conflicts of priority]

[With the exception of matters which are settled in chapter IV:]

(a) priority among several assignees of the same receivables from the same assignor is governed by the law of the State in which the assignor is located;

(b) priority between an assignee and the assignor’s creditors is governed by the law of the State in which the assignor is located;

(c) priority between an assignee and the insolvency administrator is governed by the law of the State in which the assignor is located;

(d) if an insolvency proceeding is commenced in a State other than the State in which the assignor is located, any non-consensual right or interest which under the law of the forum State would have priority over the interest of an assignee has such priority notwithstanding subparagraph (c), but only to the extent that such priority was specified by the forum State in an instrument deposited with the depositary prior to the time when the assignment was made;

(e) an assignee asserting rights under this article has no less rights than an assignee asserting rights under other law.

Article 32. Mandatory rules

(1) Nothing in articles 29 and 30 restricts the application of the rules of the law of the forum State in a situation where they are mandatory irrespective of the law otherwise applicable.

(2) Nothing in articles 29 and 30 restricts the application of the mandatory rules of the law of another State with which the matters settled in those articles have a close connection if and in so far as, under the law of that other State, those rules must be applied irrespective of the law otherwise applicable.

Article 33. Public policy

With regard to matters settled in this chapter, the application of a provision of the law specified in this chapter may be refused by a court or other competent authority only if that provision is manifestly contrary to the public policy of the forum State.

Chapter VIII. Final provisions

Article 41. Depositary

The Secretary-General of the United Nations is the depositary of this Convention.

Article 42. Conflicts with international agreements

(1) Except as provided in paragraph (2) of this article, this Convention prevails over any international convention or other multilateral or bilateral agreement which has been or may be entered into by a Contracting State and which contains provisions concerning the matters governed by this Convention.

(2) A State may declare at any time that the Convention will not prevail over international conventions or other multilateral or bilateral agreements listed in the declaration, which it has entered or will enter into and which contain provisions concerning the matters governed by this Convention.

Article 42bis. Application of chapter VI

A State may declare at any time that it will not be bound by chapter VI.

Article 43. Application of chapter VII

A State may declare at any time that it will be bound either by [sections I and II or by section III] of chapter VII.

Article 44. Insolvency rules or procedures not affected by this Convention

A State may declare at any time that other rules or procedures governing the insolvency of the assignor shall not be affected by this Convention.

Article 45. Signature, ratification, acceptance, approval, accession

(1) This Convention is open for signature by all States at the Headquarters of the United Nations, New York, until ... .

(2) This Convention is subject to ratification, acceptance or approval by the signatory States.

(3) This Convention is open to accession by all States which are not signatory States as from the date it is open for signature.

(4) Instruments of ratification, acceptance, approval and accession are to be deposited with the Secretary-General of the United Nations.

Article 46. Application to territorial units

(1) If a State has two or more territorial units in which different systems of law are applicable in relation to the matters dealt with in this Convention, it may, at the time of signature, ratification, acceptance, approval or accession, declare that this Convention is to extend to all its territorial units or only one or more of them, and may at any time substitute another declaration for its earlier declaration.

(2) These declarations are to state expressly the territorial units to which the Convention extends.

(3) If, by virtue of a declaration under this article, this Convention does not extend to all territorial units of a State and the assignor or the debtor is located in a territorial unit to which the Convention does not extend, this location is considered not to be in a Contracting State.

(4) If a State makes no declaration under paragraph (1) of this article, the Convention is to extend to all territorial units of that State.

Article 47. Effect of declaration

(1) Declarations made under articles 42 to 44 and 46 at the time of signature are subject to confirmation upon ratification, acceptance or approval.
(2) Declarations and confirmations of declarations are to be in writing and to be formally notified to the depositary.

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

(4) Any State which makes a declaration under articles 42 to 44 and 46 may withdraw it at any time by a formal notification in writing addressed to the depositary. Such withdrawal takes effect on the first day of the month following the expiration of six months after the date of the receipt of the notification of the depositary.

Article 48. Reservations
No reservations are permitted except those expressly authorized in this Convention.

Article 49. Entry into force
(1) This Convention enters into force on the first day of the month following the expiration of six months from the date of the deposit of the fifth instrument of ratification, acceptance, approval or accession.

(2) For each State which becomes a Contracting State to this Convention after the date of the deposit of the fifth instrument of ratification, acceptance, approval or accession, this Convention enters into force on the first day of the month following the expiration of six months after the date of the deposit of the appropriate instrument on behalf of that State.

(3) This Convention applies only to assignments made on or after the date when the Convention enters into force in respect of the Contracting State referred to in paragraph (1) of article 1.

Article 50. Denunciation
(1) A Contracting State may denounce this Convention at any time by means of a notification in writing addressed to the depositary.

(2) The denunciation takes effect on the first day of the month following the expiration of one year after the notification is received by the depositary. Where a longer period is specified in the notification, the denunciation takes effect upon the expiration of such longer period after the notification is received by the depositary.


(A/CN.9/WG.II/WP.98) [Original: English]

CONTENTS

INTRODUCTION ............................................ 83

DRAFT CONVENTION ON ASSIGNMENT IN RECEIVABLES FINANCING ............................................ 84

CHAPTER I. SCOPE OF APPLICATION ..................... 84
Article 1. Scope of application ............................ 84
Article 2. Assignment of receivables ...................... 85
Article 3. Internationality ............................... 86
Article 4. Exclusions .................................... 86

CHAPTER II. GENERAL PROVISIONS ...................... 87
Article 5. Definitions and rules of interpretation ........ 87
Article 6. Party autonomy ................................ 88
Article 7. Debtor's protection ............................ 88
Article 8. Principles of interpretation .................... 88

CHAPTER III. FORM AND EFFECT OF ASSIGNMENT ...... 89
Article 9. Form of assignment ........................... 89
Article 10. Effect of assignment .......................... 89
Article 11. Time of transfer of receivables ............... 89
Article 12. Contractual limitations to assignment ....... 89
Article 13. Transfer of security rights .................... 90
INTRODUCTION

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

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

3. At its twenty-sixth to twenty-eighth sessions (1993 to 1995), the Commission discussed three reports prepared by the Secretariat concerning certain legal problems in the area of assignment of receivables (A/CONF.93/378/Add.3, A/CONF.93/397 and A/CONF.94/121). Having considered those reports, the Commission concluded that it would be both desirable and feasible to prepare a set of uniform rules, the purpose of which would be to remove obstacles to receivables financing arising from the uncertainty existing in various legal systems as to the validity of cross-border assignments (in which the assignor, the assignee and the debtor would not be in the same country) and as to the effects of such assignments on the debtor and other third parties.\(^5\)

4. At its twenty-fourth session (Vienna, 13-24 November 1995), the Working Group commenced its work by considering a number of preliminary draft uniform rules contained in a report of the Secretary-General entitled “Discussion and preliminary draft of uniform rules” (A/CONF.9/412). At that session, the Working Group was urged to strive for a legal text aimed at increasing the availability of lower-cost credit (A/CONF.9/420, para. 16).

5. At its twenty-ninth session (1996), the Commission had before it the report of the twenty-fourth session of the Working Group (A/CONF.9/420). The Commission expressed appreciation for the work accomplished and requested the Working Group to proceed with its work expeditiously.\(^4\)

6. At its twenty-fifth and twenty-sixth sessions (New York, 8-19 July and Vienna, 11-22 November 1996), the Working Group continued its work by considering different versions of the draft uniform rules contained in the notes prepared by the Secretariat (A/CONF.9/WG.11/ WP.87 and A/CONF.9/WG.11/ WP.89 respectively). At those sessions, the Working Group adopted the working assumptions that the text being prepared would take the form of a convention (A/CONF.9/432, para. 28) and would include private international law provisions (A/CONF.9/ 434, para. 262).

7. At its thirtieth session (1997), the Commission had before it the reports of the twenty-fifth and twenty-sixth sessions of the Working Group (A/CONF.9/432 and A/CONF.9/434). The Commission noted that the Working Group had reached agreement on a number of issues and that the main outstanding issues included the effects of the assignment on third parties, such as the creditors of the assignor and the administrator in the insolvency of the assignor.\(^3\) In addition, the Commission noted that the draft Convention had aroused the interest of the receivables financing community and Government.


9. At its thirty-first session (1998), the Commission had before it the reports of the twenty-seventh and twenty-eighth sessions of the Working Group (A/CONF.9/445 and A/CONF.9/447). The Commission expressed appreciation for the work accomplished and requested the Working Group to proceed with its work expeditiously so as to complete its work in 1999 and submit the draft Convention to the Commission for adoption at its thirty-third session (2000).\(^7\)

10. In order to facilitate the considerations of the Working Group and to explain the provisions of the draft Convention, this note sets forth remarks on a number of draft articles. Where necessary, suggestions for alternative or additional provisions are made for consideration by the Working Group (e.g., draft articles 2, 18 and 23). This note also contains a revised version of draft article 17 and new article 17bis (dealing with proceeds issues), which has been prepared by the Secretariat further to a request by the Working Group (A/CONF.9/447, para. 68).

**DRAFT CONVENTION ON ASSIGNMENT IN RECEIVABLES FINANCING**

**Chapter I. Scope of application**

**Remarks**

Article 1. Scope of application

1. The alternative formulation for draft article 1(1), referred to in remark 2 to draft article 1 as it appears in document A/CONF.9/WG.11/ WP.96, should be completed by adding a reference to the connecting factor of the assignor's location. Thus, it should read: "This Convention applies to international assignments, if, at the time of the assignment, the assignor is located in a Contracting State". Such a reformulation of draft article 1(1) would need to be combined with the alternative wording for draft article 3 contained in the above-mentioned remark 2.

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\(^{4}\)Ibid., para. 256.

\(^{5}\)Ibid., Fifty-third Session, Supplement No. 17 (A/53/17), para. 231.
2. The Working Group may wish to consider the question whether parties to assignments not falling within the scope of the draft Convention or parties to original contracts not located in Contracting States should be given the right to opt into the draft Convention. It should be noted, however, that, if parties opt into the law of a Contracting State, it would not be clear whether they refer to the draft Convention or the domestic law of that State (see remark 4 to draft article 1 contained in A/CN.9/WG.II/WP.96).

3. In paragraph (2), draft articles 7, 12, 16 and 18 to 22 may be listed. The Working Group may wish to consider paragraph (3), dealing with the scope of the private international law rules of the draft Convention, contained in chapter VI, in the context of its discussion of chapter VI.

4. The Working Group may also wish to consider the question of the alternative or joint application of the substantive and private international law rules of the draft Convention raised in paragraph (4), which arises if a Contracting State makes a declaration under draft article 43. Under paragraph (4), if a Contracting State does not make a declaration under draft article 43, it retains its own priority rules adopting only the private international law priority rules of the draft Convention (i.e. draft articles 23 and 24).

Article 2. Assignment of receivables

1. Under the present formulation of draft article 2, the scope of the draft Convention would be too wide, covering almost the entire field of assignment law. While such an all-encompassing approach may be desirable from a dogmatic point of view, it may not be practically feasible to introduce a wholesale reform of national assignment law. Such an approach would reduce the acceptability of the draft Convention to those States, which would be prepared to introduce specific legislation for the purpose of facilitating access to lower-cost credit, but would not be prepared to consider a displacement of national assignment law as a whole. In addition, such an approach could be objected to by the representatives of those practices that seem to function well already and do not need to be regulated by yet another legal text. Moreover, under the present formulation of draft article 2, it would be impossible for any State to adopt a registration-based priority rule, since even in countries following such a system, not all the transactions covered in draft article 2 are subject to registration.

2. The scope of application of the draft Convention would be sufficiently wide even if paragraph (2), with the exception of subparagraph (a), were to be deleted. The Working Group may thus wish to combine paragraphs (1) and (2)(a), deleting the rest of paragraph (2) and possibly including some of the types of assignment listed in subparagraphs (b) to (g) in the list of exclusions contained in draft article 4. If the draft Convention becomes successful and widely adopted, its scope of application may always be broadened by way of a protocol.

3. As to the reference to consideration being given in return for the transfer of receivables, which is contained in paragraph 2(1) and is intended to ensure that only assignments of a financing nature are covered, the Working Group may wish to consider deleting it and excluding in draft article 4 assignments that are made without value, credit or related services being given or promised in return. In its present formulation, paragraph (1) suggests that consideration always flows from the transfer, which may not always be accurate. In addition, reference to value may raise the question whether “fair value” is meant.

4. It should be noted that draft article 2(1) is intended to cover all types of transfers of receivables by agreement, including contractual subrogation, novation and pledge. An indicative list of the types of contractual transfers covered, which appeared in a previous draft (A/CN.9/WG.II/WP.93, draft article 2(2)) was deleted with a view to avoiding creating the impression that transfers not listed were not covered (A/CN.9/445, para. 151).

5. Paragraph (3) may not be necessary, since draft article 13 sufficiently addresses issues relating to the transfer of rights securing the assigned receivables. In addition, paragraph (3) may be too broad in that it equates any right arising under the original contract, including rights on confidential information, rights relating to the enforcement of other rights and security rights, to a receivable. Unlike the UNIDROIT Convention on International Factoring, Ottawa, 1988 (hereinafter referred to as “the Ottawa Convention”), from which paragraph (3) was drawn, the draft Convention deals with the transfer of property rights in receivables and it may not be appropriate to deal in such a broad way with the transfer of property rights in other assets (on this point, see remarks to draft articles 17 and 17bis).

6. Thus, the Working Group may wish to consider a revised version of draft article 2, which could read as follows:

“(1) For the purposes of this Convention, “assignment” means the transfer by agreement from one person (“assignor”) to another person (“assignee”) of its right to payment of a monetary sum (“receivable”), arising under a contract between the assignor and the debtor, whether the contract is for the sale or lease of goods, the provision of services or credit, the licensing of technology, intellectual property or information].

“(2) “Assignment” includes the transfer of property in receivables and the creation of rights in receivables as security for indebtedness or other obligation.”

7. Under this formulation of draft article 2, the draft Convention would apply to assignments of contractual receivables (if the bracketed language contained in para. (1) is deleted) or to assignments of some types of
contractual receivables only (if the bracketed language is deleted). Paragraph (2) is intended to ensure that both outright assignments and assignments by way of security are covered by the draft Convention (use of the words “outright” or “absolute” is avoided, since they may be meaningless in other languages and the word “transfer” may not be sufficient to reflect outright assignments, since, in some jurisdictions, assignments by way of security also involve a transfer of receivables).

Article 3. Internatioality

1. The Working Group may wish to address the question whether the location of the parties is the appropriate criterion for determining the international character of a transaction or whether reference should be made to other criteria, such as the place in which a transaction may be negotiated, concluded or performed, or to no criterion at all, on the understanding that any element of internationality, e.g., a choice of foreign law or foreign currency, should be sufficient to render a transaction international. The present formulation of draft article 3 is based on the understanding that certainty with regard to the application of the draft Convention is of utmost importance since it may have a beneficial impact on the cost and the availability of credit.

2. The Working Group may also wish to address the question of internationality of a receivable or an assignment in the case of a multiplicity of assignors, assignees or debtors. An assignment to several assignees may occur, e.g., in the context of a syndicated loan. An assignment by several assignors may occur, e.g., in the context of a loan transactions involving several assignors from the same corporate group assigning their receivables (assignments of jointly owned receivables occur rarely in practice and may not need to be addressed in the draft Convention). A multiplicity of debtors is normally involved in bulk assignments.

3. In the case of a multiplicity of assignors or assignees, an assignment or a receivable may be considered international even if only one assignor or one assignee is located in a country other than the country in which the other party to the transaction is located. Such an approach would allow assignors and assignees to plan in order to structure their assignment so that it would fall under the draft Convention or not. At the same time, however, it might open ways for manipulations in financing transactions (e.g., in a syndicate of banks, the leading bank could include in the transaction a foreign bank and thus bring the transaction within the scope of the draft Convention). On the other hand, the internationality of each assignment or receivable may be determined on whether it meets the criteria of internationality set forth in draft article 3. For example, in the case of a syndicate of assignees (lenders) of domestic receivables, with some assignees being domestic and some being foreign, only the assignment to a foreign assignee would be international and fall within the scope of the draft Convention. In view of the fact that, in syndicated loans, each lender receives its own promissory note from the assignor (borrower), such an approach would not be unusual and inconsistent results may be avoided, if domestic assignees opt into the draft Convention.

4. With regard to cases involving a multiplicity of debtors, covering bulk assignments involving both domestic and international receivables would not raise problems in the context of third-party effects, since, under draft articles 23 and 24, the law of the assignor’s location would address all priority conflicts. In addition, unless the draft Convention applied even if one debtor were located in a country other than the assignor’s country, it would be difficult to find an acceptable criterion to limit the application of the draft Convention. However, such an approach might inadvertently result in debtors being unable to predict whether the draft Convention would apply and possibly affect their rights and obligations. That result could be mitigated by the requirement that the draft Convention would not apply to a debtor, unless that debtor would be located in a Contracting State, and by including in the draft Convention an adequate debtor-protection system. In some practices, commingling receivables owed from debtors located in different countries may be avoided through the bundling of receivables based on the location of the debtor.

5. A related question is whether, in the case of a multiplicity of assignors, all of them need to be in a Contracting State for the draft Convention to apply. For that purpose, it should be sufficient if even only one assignor were located in a Contracting State. Otherwise, joint assignors could avoid the application of the draft Convention by including in the transaction an assignor located in a non-Contracting State. The same question would be raised as regards the application of those provisions of the draft Convention that deal with the rights and obligations of the debtor, in case of a multiplicity of debtors. In such a case, a different approach may be more appropriate in order to protect debtors from uncertainty as to the legal regime applicable to their rights and obligations, namely to require that all debtors need to be located in a Contracting State (for a brief discussion of these matters, see A/CN.9/445, paras. 156-159).

6. Another related question is whether an assignment to an agent or trustee, acting on behalf of several persons, some of which are domestic and some of which are foreign, should be considered as an assignment to the agent or trustee or as an assignment to all persons. It may be useful for the draft Convention to provide that an assignment to an agent or trustee acting on behalf of several persons should be an viewed as an assignment to the agent or trustee, in order to avoid having to determine the location of all the parties represented by the agent or trustee.

Article 4. Exclusions

1. The Working Group may wish to consider listing in draft article 4 some of the transactions mentioned in draft article 2(2) and possibly other transactions, e.g.
the assignment of the beneficiary’s right to demand payment or the assignment of the proceeds of an independent guarantee or stand-by letter of credit covered by articles 9 and 10 of the United Nations Convention on Independent Guarantees and Stand-by Letters of Credit (hereinafter referred to as the “Guarantee and Standby Convention”). If certain of the transactions listed in draft article 2(2) are not excluded, the Working Group may wish to consider introducing special rules with regard to some of them. For example, if receivables arising from deposit accounts are not excluded, draft article 18 might include an additional provision, under which the depositary institution, even after notification, could discharge its obligation by paying the balance to its customer rather than to the assignee, unless the depositary institution, or its customer, has consented to payment to the assignee or such payment is ordered by court.

2. The Working Group may also wish to consider referring in subparagraph (b) to “instruments for the payment of money”. Thus, all instruments transferred by endorsement or delivery would be excluded, irrespective of whether they are negotiable. In addition, the question of the exact meaning of the term “negotiable” would be overcome. On the other hand, such an approach may inadvertently result in an excessive limitation of the scope of the draft Convention. While an exclusion may be needed in order to ensure that the rights of a protected holder of a negotiable instrument would not be subjected to the rights of an assignee, it may not be necessary in the case of a transferee, who is not a protected holder and takes a non-negotiable instrument subject to adverse claims.

3. The Working Group may in addition wish to clarify whether only assignments from the old to the new owner of a business are excluded or also assignments by the new owner to an institution financing the sale of the business. While the present wording of subparagraph (c) appears as excluding both, there may be no reasons for excluding the financing of corporate acquisitions.

Chapter II. General provisions

Remarks

Article 5. Definitions and rules of interpretation

1. A commentary to the draft Convention may usefully clarify that the exact meaning of contract conclusion referred to in subparagraph (b) is left to law applicable outside the draft Convention and that, in any case, this term does not include contract performance.

2. The Working Group may wish to consider deleting subparagraph (d). Even if it were possible to appropriately define “receivables financing”, it may not be necessary for the purposes of defining the scope of application of the draft Convention, if a reference to the facilitation of receivables financing is included in the preamble to the draft Convention and assignments that are not of a financing nature are excluded from the scope of application of the draft Convention. In addition, such a definition may inadvertently result in excluding some practices that might develop in the future.

3. In order to accommodate the concerns expressed with regard to written form requirements for the assignment to be effective, the Working Group may wish to delete in subparagraph (e) the reference to authentication, i.e. signature, requirements. It is understood that, under such an approach, practices involving some type of writing, e.g. a list of receivables or a form with standard contract terms, would not be invalidated (such an approach, however, may not be consistent with modern trends in electronic commerce where only an authenticated electronic communication would qualify as “writing”). Alternatively, rather than deviating from a written form rule which has attracted the support of the overwhelming majority of the Working Group, the Working Group may wish to consider excluding certain practices from the written form rule (e.g. transactions involving a prolonged reservation of title) or allowing those States that wish to preserve purely oral assignment practices to make a reservation as to the application of the form rule.

4. In subparagraph (f), a reference to draft article 16(3) should be added to the effect that a notification which does not meet the minimum requirements set forth in draft article 16(3) would not be effective under the draft Convention. If the Working Group reaches agreement on the minimum contents of notification, it would not be necessary to provide that a notification without the minimum content of draft article 16(3) may, e.g. cut off the debtor’s rights of set-off becoming available after notification (see bracketed language in draft article 19(2)) or preclude the debtor from modifying the original contract without the consent of the assignee (see draft article 21(4)).

5. It should be noted that “priority”, under subparagraph (i), is not intended to affect in itself the substantive rights of parties, which remain subject to their mutual agreements. This means that an assignee with priority does not obtain a right in the assigned receivables unless it has such a right under the assignment contract. The thrust of subparagraph (i) is thus that the assignee with priority is given a right of preference in the order of payment in case there are several claimants. Whether the assignee with priority may retain any surplus remaining after the satisfaction of its claim or has to turn over that surplus to the assignor or to the claimant who is next in the order of priority, depends on law applicable outside the draft Convention. If, under such law, an assignment is an outright assignment, a change in the substantive rights of the parties may inadvertently occur, since the assignee with priority will obtain the full value of the receivables and will not be obliged to account for or to return any balance remaining to the assignor or to the claimant who is next in the order of priority.

6. In view of the fact that in several jurisdictions a company may have several places of registration, the Working Group may wish to refer in subparagraph (j) to
the place of incorporation or other organization. Even if such an approach were to be followed, a different rule may need to be devised in order to avoid subjecting the dealings of a branch office to the law of the country in which the head office is located. In addition, the Working Group may wish to consider the question whether such a location rule might be held unenforceable for public policy reasons (e.g. if the place of incorporation has no relationship whatsoever to the assignment contract). Moreover, the Working Group may wish to consider the situation in which the assignor is located in a tax haven with no developed rules on assignment or priority issues (a problem that exists regardless of the location rule to be adopted in the draft Convention). A combined application of the private international law and the substantive law priority rules may address the problem, at least to some extent.

7. The Working Group may wish to delete subparagraph (k) in view of the fact that, at the previous session of the Working Group, it raised a number of concerns, including that, while it is intended to function as a default rule, it fails to cover the situation in which the parties had not specified the time of the assignment (see ACN.9/447, para. 30).

Article 6. Party autonomy

The Working Group may wish to consider referring in paragraph (1) to draft articles 13(1), 14(2) and (3), 15, 16 and 17. While draft articles 10 and 11 recognize party autonomy as to the time of which the receivables need to be identifiable and as to the time of which the receivables are transferred, they are both subject to the rights of third parties and referring to them in paragraph (1) may have the unintended effect of allowing the assignor and the assignee to modify the rights of third parties. Alternatively, the Working Group may wish to consider adopting a more general formulation referring to the right of the parties to exclude or vary by agreement their respective rights and obligations, without affecting the rights of "third parties" (i.e. in the context of para. (1), the debtor and the third parties referred to in draft articles 23 and 24; and, in the context of para. (2), the assignee and the third parties referred to in draft articles 23 and 24).

Article 7. Debtor’s protection

1. Under the draft Convention, the debtor’s legal position may be affected in a number of ways including: an assignment in breach of a no-assignment clause will be valid (draft article 12); the way in which the debtor may discharge its obligation may change (draft article 18); the debtor may be unable to raise against the assignee certain defences or rights of set-off that it could raise against the assignor, e.g. those arising in the case of breach of a no-assignment clause (draft articles 12(2) and 19(3)); the debtor may be unable to waive certain defences (draft article 20); the debtor’s right to modify the original contract after notification will be limited (draft article 21(2)); and the debtor will be unable to recover from the assignee payments made despite the fact that the assignor may have failed to earn the assigned receivables by performance or that the assignee may not have made the required payments to the assignor (draft article 22).

2. Paragraph (1) is intended to ensure that the assignment does not affect the rights and obligations of the debtor in any other way. The following example may be useful in demonstrating this approach. Under draft article 16(3), the assignee may specify in the notification the person to whom or the address to which payment is to be made. However, as a result of draft article 7(1), the assignee may not effect any other change in the terms of the original contract, unless otherwise provided in the original contract.

3. Paragraph (2) is aimed at ensuring that, irrespective of the changes to the legal position of the debtor that may result from the draft Convention, the country and currency of payment shall not be affected.

Article 8. Principles of interpretation

1. A commentary may usefully clarify whether certain issues that are not explicitly addressed in the draft Convention are left to other law applicable outside the draft Convention or they constitute gaps to be settled in conformity with the general principles on which the draft Convention is based and, in the absence of such principles, in conformity with the law applicable by virtue of the rules of private international law (in either case, the rules contained in chapter VI would be helpful).

2. Issues not explicitly addressed in the draft Convention include: the meaning of an outright assignment and an assignment by way of security; possibly the question of the form of the contract of assignment (two of the three variants of draft article 9 refer the matter to the law applicable); the accessory or independent character of a security right, which is the basis for determining whether it is transferred automatically with the receivables the payment of which it secures, or whether a new act of transfer is needed; the consequences of a breach of representations by the assignor; to a large extent, the assignability of a receivable (the draft Convention covers it to some extent in that it specifies a number of receivables that are assignable, including future receivables and receivables not identified individually, and in that it deals with contractual limitations to assignment, but leaves other types of receivables and other statutory limitations to assignment unaddressed); the question whether the assignor is liable towards the debtor for assigning its receivables in violation of an anti-assignment clause; the question whether the right of the assignee to request payment is a right ad personam or in rem; the debtor’s obligation to pay (the draft Convention deals with the debtor’s discharge only); the discharge of the debtor on grounds other than those specified in the draft Convention (e.g. by paying the rightful claimant even in case the notification received does not meet the requirements of the draft Convention); the defences and rights of set-off that the
debtor may raise against the assignee (the draft Convention provides that the debtor has against the assignee the same defences and rights of set-off that it would have against the assignor, without, however, specifying them); agreements between the debtor and the assignee by which the debtor waives its defences and rights of set-off towards the assignee; and questions of priority among several assignees of the same receivables, between the assignee and the insolvent administrator and between the assignee and the assignor’s creditors (the basic priority rules of the draft Convention currently are private international law priority rules, although two alternative substantive law priority rules are offered to States to choose from, if they wish).

Chapter III. Form and effect of assignment

Remarks

Article 9. Form of assignment

The Working Group may wish to consider stating in paragraph (1) first the rule (e.g. “An assignment has to be in writing”) and then the legal consequences (“An assignment in a form other than in writing is not effective”). In addition, the Working Group may wish to consider an alternative formulation of variant A which would be dealing with evidence rather than effectiveness of the assignment (e.g. “An assignment needs to be evidenced by writing”), or a different formulation of variant B, e.g. “An assignment has to be in writing, unless the law of the State in which the assignor is located provides otherwise”. Moreover, the Working Group may wish to consider deleting draft article 9 altogether or, at least, limiting its application to international assignments only. Assignors and assignees may not need the protection of a provision along the lines of draft article 9; debtors are protected, since they do not have to pay until they receive written notification of the assignment; and third parties are protected through fraud rules of the law applicable outside the draft Convention (for additional alternatives, see remark 2 to draft article 5(e) above).

Article 10. Effect of assignment

The reference in the opening words should be to draft articles 23 and 24. This reference is intended to ensure that the effectiveness of the assignment does not prejudice the rights of third parties. The debtor is not included in the parties referred to in draft articles 23 and 24. As a result, the assignment is effective as against the debtor as of the time it is made, i.e. even before notification. However, the debtor is protected, since, under draft article 18, it may refuse to pay the assignee before notification. The debtor may choose to discharge its obligation by paying the assignee. In such a case, however, the debtor takes upon itself the risk of having to pay twice if no assignment took place or it was ineffective. Thus, notification forms the basis for a defence of the debtor but is not made a condition of the effectiveness of the assignment.

Article 11. Time of transfer of receivables

1. As a result of draft article 11, an assignment transfers the receivables to which it relates at the time agreed upon between the assignor and the assignee or, in the absence of such an agreement, at the time of the assignment, subject to the rights of third parties other than the debtor. This also means that the assignment becomes effective as against the debtor even before notification.

2. Under the bracketed language contained in paragraph (1)(b), parties may not set a time of transfer that is earlier than the time of the assignment. As long as discretion of the parties does not affect the rights of third parties, there does not seem to be any reason why parties should be precluded from agreeing on any point of time for the transfer of the assigned receivables. The Working Group may wish to modify draft article 11 in order to ensure that the parties have the discretion to set the time of transfer of the assigned receivables even with regard to receivables that exist at the time of the assignment.

Article 12. Contractual limitations to assignment

1. Under its current formulation, draft article 12 would cover contractual limitations contained in contracts, even if the debtor is a Government or a consumer, as well as contractual limitations contained in assignments or subsequent assignments or aimed at precluding competitors of a company from taking over or effectively controlling that company. The Working Group may wish to consider whether this all-encompassing approach is appropriate and, in particular: whether Governments would normally seek protection by way of contractual or statutory limitations to assignment (statutory limitations are not covered in draft article 12); and whether such anti-assignment clauses are likely to be included in normal consumer contracts in view of the relative small bargaining power of consumers.

2. Under paragraph (2), the assignee does not “get into the shoes of the assignor” but rather receives the receivables free of defences and rights of set-off of the debtor arising from a breach of contract by the assignor. While that result may be acceptable with regard to contractual liability, it may be objectionable with regard to liability based on tort principles, which may arise in case the assignee knew or ought to have known of the anti-assignment clause. On the other hand, if the assignee is exposed to tort liability, paragraph (2) may be meaningless, since the assignee would not have contractual liability anyway. In any case, paragraph (2) does not protect the assignee in the case where the debtor terminates the original contract as a result of the breach of the anti-assignment clause by the assignor.
Article 13. Transfer of security rights

1. The reference contained in paragraph (1) to other law (i.e. the law governing the receivable) or agreement of the parties is intended to avoid referring to accessory security rights that may not be universally understood in the same way. The term “law” is intended to cover both statutory and case law.

2. The thrust of paragraph (2) is that security rights are to be treated in the same way as receivables and thus their transfer despite a contractual limitation should be effective. Paragraph (3) is intended to ensure that the principles embodied in paragraphs (1) and (2) apply to possessory security rights as well, as long they do not prejudice the rights of the debtor or the person granting the property right. Should the Working Group change its position with regard to draft article 12(2), it may need to reconsider paragraph (3) with a view to preserving any liability of the assignee towards the debtor for the transfer of a security right in violation of a contractual limitation (at least in case the assignee knew or to ought to have known about the anti-assignment clause).

Chapter IV. Rights, obligations and defences

Section I. Assignor and assignee

Remarks

Comments to draft articles 14 to 22 refer to those provisions as they were adopted by the Working Group at its previous session and reproduced in the annex to the report of that session.

Article 14. Rights and obligations of the assignor and the assignee

1. Under draft article 14, party autonomy prevails with regard to the relationship between the assignor and the assignee, since, with the exception of the provision dealing with written form requirements, there is no provision in the draft Convention dealing with the rights and obligations of the assignor and the assignee in a mandatory way. Draft article 14 makes also reference to trade usages to which the assignor and the assignee have agreed, practices established between themselves, unless otherwise agreed, and widely known and generally observed international usages.

2. Paragraphs (2) and (3) originate from article 9 of the United Nations Convention on Contracts for the International Sale of Goods (Vienna, 1980; hereinafter called “the Sales Convention”). While paragraph (2) is identical with paragraph (1) of article 9 of the Sales Convention, paragraph (3) is slightly different in that it is limited to international assignments only and does not include the requirement of actual or constructive knowledge for an international usage to become applicable to the assignment. Thus, a domestic assignment of international receivables will not be subjected to international usages and third parties would not need to establish what the parties to the assignment knew or ought to have known.

Article 15. Representations of the assignor

1. Representations normally form an essential part of the contract of assignment, and draft article 15 is intended, on the one hand, to give legislative strength to party autonomy in that regard and, on the other hand, to function as a default rule allocating the legal and credit risk as between the assignor and the assignee in case they have not done so in their contract.

2. Under paragraph (1)(a), the assignor represents that it is the owner of the receivable being assigned and has the right to assign it. As a result of draft article 12, which validates an assignment made despite an anti-assignment clause contained in the original contract, it is understood that the assignor has the right to assign even if the original contract contains an anti-assignment clause. As to statutory limitations to the assignability of a receivable, paragraph (1)(a) places the risk on the assignor, since the assignor is in a better position to find out whether such a limitation exists.

3. Paragraph (1)(b) is intended to ensure that the assignee will have a cause of action against the assignor in case subsequent to the assignment it turns out that the assignor has already assigned the receivables (the issue of whether the assignee can turn against another assignee who received payment is a distinct issue dealt with in the context of the provisions addressing priority issues). Such a representation is normally included in outright assignments and refers to previous outright assignments. In assignments by way of security, however, it is normal practice to assign receivables several times while assignees are given different priority rights. Thus, in such assignments such a representation may not be appropriate.

4. Under paragraph (1)(c), in the absence of an agreement to the contrary, the assignor represents that the debtor will not have against the assignor any defences or rights of set-off based on the original contract or other, unrelated, contracts, which the debtor could raise, under draft article 19, against the assignee. The approach taken in the paragraph is justified on the assumption that the assignor is in a better position to know whether its contractual partner, the debtor, will have defences or rights of set-off as a result of the non-performance or faulty or late performance of the original contract by the assignor. Such an approach may also be justified on the grounds that such a representation on the part of the assignor, which will reduce the risk of the transaction for the assignee, is likely to reduce the cost of credit.

5. Paragraph (2) adopts an approach generally followed in legal systems, namely that the credit risk of the debtor’s payment default is on the assignee, unless the assignor agrees otherwise.
Article 16. Notification of the debtor

1. With a view to preserving non-notification practices, paragraph (1) establishes a right, not an obligation, to notify the debtor. Paragraph (1) also accommodates those situations in which notification is given to the debtor along with an instruction to continue to pay the assignor, which is of importance to practices, such as securitization, in which the assignee does not have the necessary structure to receive payment or do bookkeeping.

2. As a result of the combined application of paragraphs (1) and (2), the assignor and the assignee may agree not to notify the debtor, but that does not preclude the assignee from notifying the debtor and requesting payment, even though the assignee may be liable to compensate the assignor for any damages it may have suffered as a result of the assignee’s breach of the non-notification agreement.

3. Another important feature of paragraphs (1) through (3) is that no distinction is made between notification and request for payment. This approach largely reflects current good practice which is aimed at ensuring certainty as to how payment is to be made. Such certainty benefits the assignee, who is interested in payment being made by the debtor in accordance with the assignee’s instructions. It also benefits the debtor, who needs to be clear as to how to discharge its obligation. Even in cases in which payment is to continue to be made to the assignor, the notification normally includes such an instruction to the debtor.

4. The need for certainty for both the assignee and the debtor is the main justification for the content of the notification as specified in paragraph (3), i.e. that the notification has to contain a reference to the fact of the assignment, the assigned receivables and the identity of the assignee and the payee.

5. Notification has important consequences under the draft Convention. It triggers a change in the way in which the debtor may discharge its obligation (draft article 18(2)); it affects the rights of set-off that the debtor may raise against the assignee (draft article 19(2)); and it limits the ability of the debtor to revise the original contract without the consent of the assignee (draft article 21(4)).

6. If the Working Group confirms the position taken so far as to the content of the notification, the wording of draft articles 18(2) and (3) should be aligned with draft article 16(3). Other than draft article 16(3), which refers generally to the address (i.e. the bank account, post office box or other address to which payment is to be made), draft articles 18(2) and (3) require identification of the bank account in the notification.

7. In addition, if the Working Group confirms its position with regard to draft article 16(3), it may wish to address in the context of draft article 18 a question which is currently not addressed therein, namely the question whether the assignee or the person giving notification may send a second notification correcting an error or changing the payment instructions contained in the first notification (see remark 6 to draft article 18 below).

8. Moreover, the Working Group may wish to consider the question whether a notification which does not meet the minimum requirements set forth in draft article 16(3) should nevertheless cut off the debtor’s rights of set-off becoming available after notification or limit the debtor’s ability to revise the original contract after notification without the assignee’s consent (see remarks to draft articles 19(2) and 20(4) below).

9. Paragraph (4) is aimed at ensuring that the notification is designed to be understood by the debtor. In view of the important consequences of notification under the draft Convention, paragraph (4) establishes certainty by way of a “safe harbour” rule, i.e. a rule under which notification in a language specified in the original contract would be effective. In addition, paragraph (4) recognizes by implication the effectiveness of multilingual notifications.

10. The Working Group might wish to consider the location of draft article 16 in the draft Convention. Presently, draft article 16 is placed in section I of chapter IV, since notification is a right of the assignor and the assignee. However, at the same time, notification affects the rights of the debtor, a matter which is dealt with in section II of chapter IV.

Article 17. Right of the assignee to payment

(1) Subject to articles 23 and 24, unless otherwise agreed between the assignor and the assignee:

(a) the assignee is entitled to claim payment of the assigned receivable from the debtor and, if payment with respect to the assigned receivable is made to the assignee, to retain whatever is received in total or partial discharge of the assigned receivable (“proceeds”);

(b) if payment with respect to the assigned receivable is made to the assignor, the assignee is entitled to claim payment from the assignor and to retain any proceeds.

(2) If payment with respect to the assigned receivable is made to another person over whom the assignee has priority, the assignee is entitled to any proceeds.

(3) The assignee may not retain an amount in excess of its right in the receivable.

References:
A/CN.9/WG.II/WP.96, article 17
A/CN/9/447, paras. 48-62

Remarks

1. Draft article 17 is intended to ensure that the assignee has effective rights in whatever is received in
discharge of the assigned receivable. The opening words of paragraph (1) are intended to ensure that the right of the assignee to claim and retain payment is without prejudice to the rights of third parties, such as other assignees obtaining the same receivables from the same assignor, the assignor’s creditors and the administrator in the insolvency of the assignor. They are identical with the opening words of draft articles 10 and 11; and like the opening words in those draft articles, they are premised on the assumption that the assignee may claim payment from the debtor even before notification, while the debtor, under draft article 18, has a right to refuse payment on the grounds that it received no notification.

2. Paragraph (1) is a default rule applicable only if the assignor and the assignee have not otherwise settled the matter of payment in their contract. Subparagraph (a) establishes the assignee’s right to claim payment from the debtor and to retain such payment once made. Subparagraph (b) entitles the assignee to claim payment from the assignor, if payment is made to the assignor, and to retain such payment. The reference to discharge of the assigned receivable is intended to cover situations in which payment is made in kind, which is the case, e.g. where the assignee claims the goods sold to the assignor or retains goods returned by the debtor.

3. Paragraph (3) establishes the right of the assignee to claim payment with respect to the assigned receivable from other persons, to whom such payment has been made, provided that the assignee has priority over those persons. While the assignee may claim payment of the full amount of the assigned receivable, it may not retain an amount in excess of its right in the assigned receivable (e.g. in case of a loan secured through a receivable of higher value, in excess of the amount of the loan plus the interest or other costs owed).

4. The Working Group may wish to consider whether proceeds of proceeds should also be covered, in which case the definition of proceeds would need to be revised. Such proceeds of proceeds may be described as “different generations” of proceeds (e.g. payment is made in kind, thus the goods are first generation proceeds of the receivables; then, the goods are sold and the cheque received constitutes second generation of proceeds; thereafter, the cheque is cashed in and the cash constitutes third generation proceeds).

5. It should be noted that the draft Convention on International Interests in Mobile Equipment currently being prepared by the International Institute for the Unification of Private Law (hereinafter referred to as “the UNIDROIT draft Convention”) does not cover proceeds of mobile equipment, since it is considered that such an approach would lead to the application of the UNIDROIT draft Convention to types of assets (e.g., receivables) that are quite different from the assets for which it was designed. It is arguable, however, whether the issue of proceeds is as important in the UNIDROIT draft Convention as in the draft Convention. In the typical transaction covered by the UNIDROIT draft Convention mobile equipment may not be sold without the consent of the secured party, while in the draft Convention receivables will be reduced to cash on a regular basis.

Article 17bis. Competing rights with respect to proceeds

(1) Variant A

In case of competing rights referred to in articles 23 and 24:

(a) if the proceeds take the form of receivables, priority with respect to proceeds is governed by the law of the State in which the assignor is located;

(b) if the proceeds take the form of other assets, priority with respect to proceeds is governed by the law of the State in which they are located.

Variant B

Priority with respect to cash proceeds is governed by the law of the State in which the assignor is located. For the purposes of this article, “cash proceeds” means money, cheques, balances in deposit accounts and similar assets.

(2) Paragraphs (3) to (5) of article 24 apply to a conflict of priority arising between an assignee and the insolvency administrator or the assignor’s creditors with respect to proceeds.

References:

A/CN.9/447, paras. 63-68
A/CN.9/445, paras. 215-220

Remarks

1. While the Working Group has agreed that the assignee should be given effective rights to whatever is received in discharge of the receivable, it has been unable to reach agreement on the question whether the assignee’s right should be a personal (ad personam) or a proprietary (in rem) right (A/CN.9/445, para. 218 and A/CN.9/447, paras. 63-68). This question becomes an important one, in particular in case payment is made to the assignor and the assignor becomes insolvent. Treating the assignee’s right in the proceeds of receivables as a right in rem would reduce the risk of non-payment for the assignee, since in the case of insolvency of the assignor the assignee could take the receivables out of the insolvency estate (in the case of an outright assignment) or, at least, be treated as a secured creditor (in the case of an assignment by way of security). Such an approach would have the potential of decreasing the cost of credit. However, in many jurisdictions the assignee’s right in the proceeds of receivables is cast as a right ad personam. Thus, attempting to follow another approach would run counter to national law involving public policy considerations and could jeopardize the acceptability of the draft Convention to many States.

2. With a view to facilitating the Working Group’s consideration of this matter, priority with respect to pro-
ceeds is dealt with provisionally in draft article 17bis. If the Working Group decides to retain this article, it may wish to consider moving it right after draft article 24 dealing with priority with respect to receivables.

3. Variant A is based on the assumption that a single private international law rule dealing with all types of Proceeds would not be acceptable. While the assignor’s location would provide a single and easily determinable point of reference, it appears that it would be objectionable to subject the rights of, e.g. a holder of a negotiable instrument or the beneficiary of a funds transfer or the person in possession of goods received in discharge of the assigned receivable to the law of the country in which the assignor is located (the same objection could be raised with regard to the law of the assignee’s location).

4. On the other hand, referring priority issues with respect to proceeds to the law of the country in which the proceeds are located would ensure that mandatory rules of law dealing, e.g. with rights in negotiable instruments or goods would prevail. However, it would, at the same time, result in subjecting to different laws different stages of the same transaction (i.e. payment in cash, then in the form of a negotiable instrument, then in the form of a fund transfer) or different forms of the same assets (i.e. receivables and different types of proceeds). In addition, such an approach could inadvertently result in assignees structuring transactions in an artificial way in order to subject them to the law of a convenient jurisdiction (“forum shopping”).

5. Subparagraph (a) of variant A is consistent with the approach followed in the context of priority with regard to receivables. Such an approach would result in the law governing priority being the law of the jurisdiction in which insolvency proceedings with regard to the assignor are most likely to be opened (i.e. the law of the country in which the assignor is located). Variant B, which is aimed at preserving mandatory rules relating, e.g. to negotiable instruments or fund transfers, constitutes an attempt to come up with a single rule dealing with the most usual types of proceeds, namely cash proceeds. Should the Working Group prefer to take this approach, it may need to: align the definition of “cash proceeds” contained in draft article 17bis with the definition of “proceeds” contained in draft article 17; and to consider the question of “the location” of an asset. “Balances in deposit account and similar assets” appear within square brackets, since it may not be appropriate to subject conflicts of priority between financing Institutions and assignees to the law of the assignor’s location, or to include in the definition a general reference to “similar assets”, which may introduce uncertainty or even produce undesirable results.

6. It should be noted that, irrespective of the approach to be taken with regard to the law applicable to issues of priority in proceeds, the matter would remain unaddressed if the law applicable did not deal with it. However, the inclusion of a substantive law rule in the draft Convention, which would apply only in case the applicable law did not deal with the matter or which could be opted into by Contracting States, could inadvertently result in fragmentation of the law applicable and thus in increased uncertainty (the same argument may be made with regard to chapter VII, see remark 4 to chapter VII below).

7. The Working Group may wish to consider whether draft article 17bis should be retained at all. If proceeds of receivables are in the form of receivables, they would be covered by draft articles 23 and 24 anyway. If such proceeds take the form of another asset, it may not be realistic to try to address priority issues even by way of a private international law rule.

8. The question whether priority issues should be addressed in case the receivables are themselves proceeds of another asset (e.g. a conflict between an inventory financer and an assignee) is a different question. The Working Group may wish to consider whether, if an inventory financier’s rights extend under the applicable law to the receivables received from the sale of the inventory, the inventory financier is to be considered as an assignee under the draft Convention, in which case such conflicts would be covered by the draft Convention. If there is agreement in the Working Group on such an approach, this point may be clarified in the text or in a commentary to the draft Convention.

Section II. Debtor

Remarks

Article 18. Debtor’s discharge by payment

1. Draft article 18 is intended to address the question of the debtor’s discharge by providing the debtor with a right to refuse to make payment before notification. The debtor may choose to pay the assignee even before notification, but in such a case, it takes the risk of having to pay twice if it is later proven that no assignment or no valid assignment took place. Thus, notification is structured as the basis for a defence of the debtor and not as a condition for the effectiveness of the assignment, which would unnecessarily formalize the assignment.

2. Draft article 18 is not intended to deal with the debtor’s payment obligation. Neither draft article 18 nor any other article in the draft Convention establishes an obligation of the debtor to pay. This approach is based on the assumption that such an obligation remains subject to the original contract and to the law applicable to that contract, which is not the subject of this draft Convention. In addition, draft article 18 is not intended to deal with the right of the assignee to claim payment from the debtor, even before notification. This right is established in a number of draft articles, including draft articles 10, 11 and 17.

3. The basic rule about the debtor’s discharge is set forth in paragraphs (1) and (2). Before notification, the debtor “is entitled” to discharge its obligation by paying
the assignor (as mentioned above, the debtor may decide to pay the assignee). After notification, the debtor “is discharged only” by paying the assignee.

4. Paragraphs (3) through (5) deal with exceptional cases, i.e. multiple notifications about several assignments of the same receivables by the same assignor, notification by the assignee, and discharge of the debtor under the law applicable outside the draft Convention through payment to the person entitled to it.

5. In the case of multiple notifications, the draft Convention provides the debtor with a simple discharge rule, namely “pay the person identified in the first notification and be discharged” (draft article 18(3)). Whether the person who received payment will be able to retain it is a matter to be settled on the basis of the priority rules of the draft Convention. This approach is based on the assumption that assignees cannot afford uncertainty as to payment and would identify the person to whom or the address to which payment is to be made in any notification, whether payment is requested to be made to the assignor, the assignee or a third person. At the same time, debtors should not be placed in a position of having to seek legal advice in order to interpret the meaning of a notification, e.g. whether it is a bare notification or a request for payment.

6. However, draft article 18(3) does not adequately cover a different situation in which multiple notifications may be given about one and the same assignment. Such notifications may constitute a correction of an error or a change in the instructions contained in previous notifications. The assignee, who is the only rightful owner of the receivables after notification, irrespective of whether payment is to be made to the assignee, the assignor or a third person, and who is identified in the notification, under draft article 16(3), should be able to make corrections or change the instructions contained in previous notifications. Thus, the Working Group may wish to consider adding to draft article 18 a provision along the following lines: “If the debtor receives more than one notification relating to the same assignment, the debtor is discharged by paying the person or to the address identified in the last notification before payment”.

7. In the exceptional case in which the debtor may receive several notifications, some relating to more than one assignment of the same receivables by the same assignor and some relating to one and the same assignment, under a combined application of draft article 18(3) and the suggested new paragraph, the debtor would have to identify the first notification (in case of corrections or changes, the date of the first notification should probably be taken into account, provided that that notification meets the requirements of draft article 16(3)) and pay the person or to the address identified in the first notification, unless that notification had been later modified, in which case the debtor would have to pay the person identified in the last notification. From the above analysis, it becomes clear that an approach more favourable to the debtor, which would make it easier for the debtor to know how to discharge its obligation in case it receives several notifications of more than one assignment, would be to allow the debtor to discharge by paying the person or to the address identified in any of the several notifications, and leave it to the assignees or other claimants to fight among themselves for the proceeds of payment. However, such an approach might inappropriately result in harming the interests of the rightful claimant and may be an unnecessary protection, at least, in the case of corporate debtors, who should be able to sort out the rightful claimant if they receive several notifications.

8. Under paragraph (4), the debtor has the right to request the assignee serving notification to provide the debtor within a reasonable period of time with additional proof about the assignment. Such proof could take the form of a writing emanating from the assignor. As a result, the payment obligation is suspended and the debtor is not obliged to pay the amount owed or interest thereon. Theoretically, the debtor may choose to pay, during that reasonable period of time, the assignor or the assignee, but such payment would be made at the debtor’s own risk. What would be a reasonable period of time is a matter of interpretation in view of the relevant circumstances. In order to avoid the resulting uncertainty, the Working Group may wish to set a certain time-limit that could not be exceeded in any case. It should be noted, however, that any time-limit may be arbitrary.

9. The thrust of paragraph (5) is that draft article 18 should not exclude any other grounds for discharge of the debtor that may exist under the law applicable outside the draft Convention, whether contractual or non-contractual. This approach is premised on the assumption that, as long as the desirable economic result is achieved (i.e. payment is made to the person entitled to payment, a judicial or other authority or a public deposit fund) and, e.g. despite the lack of a notification in accordance with the draft Convention, there is no reason to deny the debtor a valid discharge.

Article 19. Defences and rights of set-off of the debtor

1. The thrust of draft article 19 is that the debtor may raise against the assignee, at any time, any defences or rights of set-off, arising under the original contract, that it could raise against the assignor. After notification, the debtor could raise only rights of set-off arising under separate dealings between the assignor and the debtor, only if they were available to the debtor at the time it received notification of the assignment. The rationale under this approach is that a diligent assignee, who notified the debtor, should not be exposed to the risks arising from dealings between the assignor and the debtor that are unrelated to the original contract.

2. While draft article 19 provides that the debtor may raise against the assignee the defences and rights of set-off that it may have against the assignor, it is not intended to specify the types of defences or rights of set-
off of the debtor. This matter remains subject to the contract(s) between the assignor and the debtor and to the law applicable thereto, which the draft Convention does not attempt to cover.

3. The exact meaning of the term "available", i.e. the question whether it means that the counterclaim has to be "actual and ascertained" or, at least, quantified at the time of the notification, is left to the law applicable outside the draft Convention.

4. The Working Group may wish to address the question whether in those exceptional cases in which the notification did not identify the person to whom or the address to which payment should be made, the notification should nevertheless have the effect of cutting off the debtor's rights of set-off arising after notification (see bracketed language in draft article 19(2), reproduced in the annex to document A/CN.9/447).

5. Paragraph (3) is intended to introduce an exception to the rule embodied in paragraphs (1) and (2) and to ensure that the debtor could not raise against the assignee the defences or rights of set-off that it could raise against the assignor (see remarks to draft article 12).

Article 20. Agreement not to raise defences or rights of set-off

1. Waivers of defences included in contracts have a tendency of increasing the access to lower-cost credit, since they are likely to reduce the risk of non-payment for assignees. In recognition of this economic reality, draft article 20 establishes party autonomy with regard to waiver of defences agreed between the assignor and the debtor.

2. There are two exceptions to the above-mentioned rule. Waivers may not be allowed under consumer-protection legislation and may not relate to certain defences which the debtor could raise if the receivables were embodied in a negotiable instrument, such as defences arising from fraudulent acts on the part of the assignee alone or in collusion with the assignor. It is assumed that defences arising from fraudulent acts of the assignor alone may be waived, since otherwise an assignee who had acted in good faith, would be required to investigate whether the original contract has been vitiated by fraud on the part of the assignor. It is understood that waivers of defences agreed between the assignee and the debtor are not covered in draft article 20. Thus, the question whether they are allowed is left to other applicable law and they are not subject to the exceptions set forth in paragraph (2).

3. In line with the requirement for the waiver to be in writing, a requirement which is intended to protect the debtor, paragraph (3) requires a writing for modifications of any waiver. At the same time, in order to protect the assignee, paragraph (3) limits the cases in which such a modification may be effective as against the assignee without the consent of the assignee.

Article 21. Modification of the original contract

1. Draft article 21 is intended to address those cases in which the original contract needs to be modified in order to be adjusted to changing needs (e.g. in construction contracts) or circumstances (e.g. an event rendering the debtor unable to perform). Thus, draft article 21 is a debtor-protection rule. At the same time, however, it is a rule aimed at ensuring that the assignee will acquire, as against the debtor, rights under the modified contract that correspond to the assigned receivable. The assignee's rights as against the assignor arising under their agreement remain unaffected by this provision (see paragraph (3)).

2. Under paragraph (1), before notification of the assignment, a modification of the original contract is effective as against the assignee in the sense that, e.g. the assignee may not claim the original amount of the receivable. In addition, the assignee acquires "corresponding rights" in the sense that it is entitled, e.g. to claim from the debtor the modified amount, while its right to claim the original amount from the assignor remains unaffected.

3. Paragraph (2) provides that, after notification, a modification of the original contract is not binding on the assignee, unless the assignee consents to it or, in the case of a partially earned receivable, modification is foreseen in the original contract or a reasonable assignee would consent to the modification. In the case of a fully earned receivable (i.e. a receivable in respect of which an invoice has been issued, even if the relevant contract has only partially been performed), the consent of the assignee is always required for a modification to bind the assignee. Such an approach is aimed at setting forth a rule that would be characterized both by certainty (no modification without the consent of the assignee) and flexibility in order to address special circumstances in which requiring the specific consent of the assignee would not be practical or desirable (e.g. minor modifications to construction contracts).

4. Paragraph (3) is aimed at ensuring that a modification in the original contract does not affect the rights of the assignee under the assignment contract. Paragraph (4) raises the question whether a notification which does not meet the requirements of draft article 16(3) should nevertheless trigger a change in the way in which a modification of the original contract would bind the assignee.

Article 22. Recovery of advances

This is the second provision of the draft Convention in which general reference is made to consumer-protection legislation (the other is draft article 20). In principle, references to mandatory rules or rules reflecting public policy should be made only in exceptional cases, in which it is not possible to reach agreement on a rule that would address such concerns. Otherwise, the goal of certainty and facilitation of access to lower-cost credit could not be achieved. In effect, a general refer-
ence to mandatory rules or rules reflecting public policy could undermine the certainty sought and inadvertently defeat the goal of the draft Convention to facilitate access to lower-cost credit, since it would be impossible to predict whether the draft Convention would apply or be set aside by a judge on the basis of not widely known or possibly extreme notions of mandatory or public policy law.

Section III. Third parties

Article 23. Competing rights of several assignees

1. While it is understood that a private international law rule dealing with priority issues could not lead to full uniformity, it could facilitate the extension of credit at more affordable rates. With the uncertainty currently prevailing as to the law applicable to questions of priority, assignees have to meet the requirements of a number of jurisdictions in order to ensure that they would obtain priority, a process which increases the cost of credit. A clear private international law provision could have a positive impact on the cost and the availability of credit, to the extent that it would allow assignees to know which law applies to questions of priority and to ensure their rights by meeting the requirements of the applicable law. In addition, a private international law rule would have the advantage of overcoming the problem of having to resolve conflicts between Convention and non-Convention assignees, since the matter would be left to the applicable law. Moreover, a private international law rule might make the draft Convention more acceptable to States, at least, to the extent that national laws governing priority would be preserved (as to the possibility of conflicts arising between the draft Convention and the Convention on the Law Applicable to Contractual Obligations, Rome, 1980, hereinafter referred to as the “Rome Convention”, see remarks to draft article 42).

2. Draft article 23, combined with draft article 5(j) (which is intended to refer to a single and easily determinable place), could provide the level of certainty sought by financiers, thus allowing for low-cost financing on the basis of receivables assigned in bulk. In the context of bulk assignments, subjecting questions of priority to the law governing the receivable could have an adverse impact on the cost and the availability of credit, since assignees would either not be able to determine at the time of the assignment the law applicable to the assignment (to the extent that future receivables would be included), or would need to examine each contract from which the receivable arose to determine the applicable law. Similarly, referring to the law chosen by the parties to the assignment and, in the absence of a choice of law by the parties, to the law with the closest relationship with the assignment contract would be impractical, since competing assignees may have chosen different laws in their assignment contracts and different assignments may be closely related to the law of different countries. In addition, it would not seem to be appropriate to subject the property effects of the assignment to the law chosen by the parties.

3. In line with the approach taken in draft article 31, the Working Group may wish to consider including in draft articles 23 and 24 a reference to the time of the assignment as the point of time which should be taken into account in order to determine the law applicable to priority questions. In addition, in draft article 23, which deals with duplicate assignments, the question would also need to be settled as to which law governs in case the assignor moves to a new location after the assignment, the law of the location of the assignor at the time of the first or of a subsequent assignment. The assignee with priority under the law of the initial location of the assignor should not lose its priority position just because the assignor relocated. On the other hand, the rights of assignees in the new location should not be forever subject to the rights of assignees from other jurisdictions. In order to achieve this result, language along the following lines may be added in draft article 23:

"Where the assignor changes its location after the assignment, the assignee with priority under the law of the State in which the assignor was initially located retains its priority:

"(a) for a period of [six months]; or

"(b) until priority would have ceased under the law of the State in which the assignor was initially located; or

"(c) by meeting the requirements for obtaining priority under the law of the State of the new location of the assignor before priority ceases under subparagraph (a) or (b) of this article; or

"(d) if it happens to have priority under the law of the State of the new location of the assignor."

4. It should be noted that, in case the assignor moves from a registration to a time-of-assignment jurisdiction, under the proposed rule the assignee would not be able to retain its priority. However, the magnitude of this problem should not be over-estimated, at least with regard to corporate assignors. If location is defined as place of incorporation, the problem with a relocation would occur only in exceptional situations, in which the assignee would need to take other measures to protect itself, including enforcing contractual clauses that might deal with relocation of the assignor or resorting to other remedies in case of fraud.

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

The Working Group may wish to consider the question whether draft article 24 should refer to "the effectiveness" of the assignment as against third parties rather than to "priority". The Working Group may also wish to consider the question whether the rule of paragraph (4) should be expanded to preserve the rights of judgement creditors existing under mandatory rules of law.
Chapter V. Subsequent assignments

Remarks

Article 25. Scope

1. While it may be desirable to cover subsequent assignments that fall within the scope of the draft Convention, even if the initial assignment falls outside the scope of the draft Convention (e.g. a subsequent assignment in a securitization transaction may be covered even if the initial assignment was a domestic assignment of domestic receivables), subparagraph (a) appears to be inconsistent with the principle of continuatio juris embodied in subparagraph (b). In addition, combined with draft article 27, subparagraph (a) may lead to the unintended result that the debtor paying in accordance with draft article 27 may not be discharged under the law applicable to the initial assignment.

2. Subparagraph (b) is intended to reflect the principle of continuatio juris, i.e. that the regime governing the initial assignment should govern any subsequent assignment. In the absence of such a rule, in a chain of assignments parties would not be able to have any certainty as to their rights, since each assignment could be subject to a different legal regime. Subparagraph (b) could operate well if the initial receivable is international, since any subsequent assignee would be able to predict that the draft Convention would apply to subsequent assignments by virtue of the internationality of the receivable. However, where the initial receivable is domestic, the application of subparagraph (b) might not produce satisfactory results, since a subsequent assignee would not be able to predict the application of the draft Convention to a domestic assignment of a domestic receivable. In order to avoid a situation in which the draft Convention would apply to domestic assignments of domestic receivables, language along the following lines should be added at the end of subparagraph (b): “provided that, if the receivable is a domestic one, a subsequent assignment with the assignor and the assignee being located in the same State as the debtor is not governed by this Convention”.

Article 26. Agreements limiting subsequent assignments

Draft article 26 is intended to address situations in which anti-assignment clauses, included in the original contract, or the initial or any subsequent assignment, prohibit any subsequent assignments. It introduces the same rule as the rule contained in draft article 12, namely that the assignment is effective and that, if any assignee is liable towards the debtor or any assignor under other applicable law outside the draft Convention for further assigning the receivable despite an anti-assignment clause contained in the original contract, in the assignment or in any subsequent assignment, that liability is not extended to any subsequent assignee (see remarks to draft article 12).

Article 27. Debtor’s discharge by payment

In case the debtor receives several notifications relating to a number of subsequent assignments, the debtor should be able to discharge its obligation by paying the person or to the address identified in the last notification received before payment. Thus, for the debtor to be able to determine that that rule would apply and not the rule of draft article 18(3) (which provides that the debtor should discharge its obligation by paying the person or to the address identified in the first notification), the notification should indicate the fact that several subsequent assignments had taken place. However, in practice, no problem may arise since normally only the last assignee would need to notify the debtor and thus the first notification would be also the last.

Article 28. Notification of the debtor

The content of notification in the context of subsequent assignments may need to be different, since the debtor receiving a notification would need to be able to determine whether a series of subsequent assignments or of several assignments of the same receivables by the same assignor are involved.

Chapter VI. Conflict of laws

Remarks

Chapter VI became the subject of a discussion at a special meeting of experts organized by the Hague Conference on Private International Law in cooperation with the UNCITRAL Secretariat. It is expected that a report of that meeting will be prepared by the Permanent Bureau of the Hague Conference and submitted to the Working Group for consideration. The Working Group may wish to consider chapter VI in the light of that report. In addition, the Working Group may wish to consider whether certain terms, e.g. location of the assignor, might need to be defined differently for the purpose of chapter VI.

Article 29. Law applicable to the contract of assignment

The Working Group may wish to consider the question whether draft article 29 should be retained or deleted. In favour of deletion, it may be argued that the contract of assignment is no different from any other contract and thus it would not be appropriate to address in the draft Convention the question of the law applicable to the assignment contract. In favour of retention, it may be argued that the assignment contract is different from other contracts in that it has, in addition to contractual, proprietary effects. This difference raises the question whether the same law should apply to both the contractual and the proprietary effects of the assignment contract. Draft article 29 is intended to subject
both the contractual and the proprietary effects of the assignment as between the parties thereto to the same law. The Working Group may wish to consider the question whether this approach is appropriate. In addition, the Working Group may wish to consider the question whether the current wording of draft article 29 is sufficient to achieve the result intended.

Article 30. Law applicable to the rights and obligations of the assignee and the debtor

One of the questions that the Working Group may wish to address in the context of its discussion of draft article 30 is the exact meaning of the term “assignability”. “Assignability” could refer to contractual assignability (i.e. whether there is an anti-assignment clause in the contract under which the assigned receivables arise), to statutory assignability (e.g. prohibition by law of the assignment of wages or pension benefits) or to both. It may be argued that draft article 30, which deals with the debtor’s rights and obligations as against the assignee, should cover only contractual assignability, which is aimed at the debtor’s protection, and not statutory assignability, which is aimed at the assignor’s protection. In paragraph (3), the Working Group may consider adding a reference to the law chosen by the assignor and the debtor, in order to accommodate the reasonable expectations of the debtor and to enable assignees to rely on choice of law clauses contained in the contracts under which the assigned receivables arise.

Chapter VII. Alternative priority rules

Remarks

1. Under the current formulation of the scope provisions of the draft Convention (i.e. draft articles 1-4), sections I (priority rules based on registration) and II (registration rules) of chapter VII would not be fully acceptable even to States following a registration approach. In such States, not all transactions presently falling within the scope of application of the draft Convention are subject to registration for priority purposes. In addition, certain provisions of section II would be objectionable in some of those States (e.g. draft article 37(3) providing that registration is effective once the data registered become available to searchers).

2. Thus the Working Group may wish to consider limiting the scope of the draft Convention and expanding sections I and II, bringing them in line with the law applicable in countries following a registration system. Alternatively, the Working Group may wish to consider substantially reducing, or even deleting, chapter VII.

3. An expansion of sections I and II would potentially make it possible for countries already following or interested in introducing a registration system to opt into sections I and II or to section II alone (see remark to draft article 43). Under such an approach, sections I and II could be used in one of the following ways: States may apply their own domestic law based on registration, but use the international registration system (either registering directly at the international registry or registering locally, as long as the data are available through the international registry; in such a case the draft Convention would address the need for one registration system or one data bank but not the need for uniform priority rules); States may apply the registration-based priority rules of the draft Convention and use the international registration system, but only for the transactions falling within the scope of the draft Convention (in such a case, conflicts between Convention and non-Convention assignees may be left outside the scope of the draft Convention); or States might apply the priority rules applicable under draft articles 23 and 24 for all transactions, domestic and international.

4. However, such an expansion of sections I and II might create a number of difficulties, including that: the draft Convention could inadvertently result in fragmentation of the law, in particular if each State were given the discretion to apply sections I and II in different ways as described above; the draft Convention would become very lengthy and its application would be significantly complicated; section III would probably need to be expanded and a third alternative priority rule based on notification would need to be added; and such an endeavour could be very time-consuming.

5. On the other hand, reduction of chapter VII to a few general principles would considerably simplify the draft Convention and make it more acceptable to States and easier to apply. In addition, under such an approach the draft Convention would recognize registration in principle, allowing States interested in registration to set up such a system, at the national or international level. Moreover, the draft Convention would be compatible with such laws following a registration-based approach. As to the preparation of model legislative provisions on security rights in receivables and possibly other assets aimed at providing guidance to States without detailed legislative rules in this field, this endeavour should be viewed as a significant separate project, which could be considered at a future point of time, probably in cooperation with other organizations active in this field of law.

Chapter VIII. Final provisions

Remarks

Article 42. Conflicts with international agreements

1. Under draft article 42, it is left to each State to determine whether to give precedence to this Convention or to another Convention dealing with matters governed by the draft Convention. For example, a State having ratified or considering ratification of the Ottawa Convention will have to determine whether to give precedence to the draft Convention or to the Ottawa Convention.

2. The Working Group may wish to consider ways in which an overlap between the draft Convention and the
Ottawa Convention may be avoided or, at least, minimized. It may be useful to note that the Ottawa Convention applies only to notification factoring and to factoring transactions in which at least two of the three types of the services mentioned in article 1 are provided (i.e. funding, insurance and bookkeeping); and to the contract of factoring, not to the resulting transfer (thus, it does not deal with priority issues). In addition, the Ottawa Convention applies to such transactions only if: the factoring contract relates to receivables arising from contracts involving the sale of goods and the supply of services; the receivables are international, i.e. the supplier (assignor) and the debtor have their places of business in different States; and all parties involved, i.e. the factor (assignee), the supplier and the debtor have their places of business in Contracting States. It thus seems that, while the scope of application of the Ottawa Convention is rather limited compared with the scope of application of the draft Convention, the transactions falling under the Ottawa Convention would be covered also by the draft Convention.

3. The problems arising from such an overlap would be limited, if the draft Convention were to adopt the same substantive solutions as the Ottawa Convention. However, there are certain differences between the Ottawa Convention and the draft Convention, since under the Ottawa Convention: parties to the factoring contract or the underlying sales contract may exclude the application of the Ottawa Convention as a whole; the validity of the assignment of future receivables or of bulk assignments is recognized only as between the parties to the factoring contract (in other terms, third-party-effects of the factoring contract are not covered); the debtor’s duty to pay the assignee is triggered by notification and requires that the debtor does not have notice of a superior right of any other person; notification needs to reasonably identify the receivables and the factor; an assignment made despite an anti-assignment clause contained in the sales contract is valid, unless the State in which the debtor is located has made a reservation; the debtor may recover payments from the factor if the factor has not discharged an obligation to make payment to the supplier; or if the factor made such payment knowing that the supplier failed to perform the underlying sales contract; subsequent assignments are covered, if the factoring contract is governed by the Convention and does not contain an anti-assignment clause.

4. In view of the above, it appears that a State which wishes to adopt both conventions and give precedence to the Ottawa Convention would have to accept that its law on certain types of factoring contracts covered by the Ottawa Convention will be somehow different from its law on factoring and other contracts falling outside the scope of the Ottawa Convention. Alternatively, a State would have to give precedence to the draft Convention, in order to address a wide variety of transactions and to benefit, e.g. from the priority provisions contained in the draft Convention.

5. Similarly, the Working Group may wish to consider ways in which an overlap with the Rome Convention may be avoided. Under article 12(1) of the Rome Con-

vention, “the mutual obligations of assignor and assignee under a voluntary assignment of a right against another person” are governed by the law which under the Convention applies to the contract of assignment (i.e. under article 4, the law chosen by the parties and, in the absence of a choice of law, the law of the country with which the contract of assignment is most closely connected). The law governing the right to which the assignment relates (i.e. the law applicable to the contract under which the right arose) governs its “assignability, the relationship between the assignee and the debtor, the conditions under which the assignment shall be invoked against the debtor and any question whether the debtor’s obligations have been discharged” (article 12(2)).

6. The conflict between article 12 of the Rome Convention and draft articles 29 and 30 of the draft Convention seems to be more a matter of drafting and less a matter of policy and could be avoided if those draft articles were slightly reformulated to be brought in line with article 12 of the Rome Convention.

7. With regard to potential conflicts with draft article 31, the situation is different, since it is not clear whether the Rome Convention addresses issues of priority and, if so, what is the law applicable. Under one view, article 12 does not, and cannot, cover priority issues in that it deals with the contract of assignment and not with the transfer of property in receivables; thus, there can be no conflict with draft article 31. Under another view, article 12 covers priority issues and subjects them either to the law governing the receivable or to the law chosen by the parties to the assignment. In either case, in typical receivables financing transactions involving bulk assignments, it would be very difficult for third parties to ascertain the law applicable and the application of any of those two laws would produce inconsistent results. Thus, it is arguable whether application of either of those two laws would be appropriate or even compatible with the main goal of the draft Convention to ensure certainty and predictability, thus reducing the cost and increasing the availability of credit.

8. Under the circumstances, it may be argued that a rule along the lines of draft article 31 would be a welcome opportunity, even to States parties to the Rome Convention, to, at least, attempt to settle an issue, which has raised so much uncertainty. In any case, the fact that some States consider that they have been able to resolve this matter in one way does not mean that other States should be precluded from addressing it themselves and possibly resolving it in a different way. In order to accommodate both categories of States, the Working Group might wish to allow States to enter a reservation as to the application of chapter VI.

Article 43. Application of chapter VII

If chapter VII is retained and States are given various options as to how to use sections I and II, the Working Group may wish to consider rephrasing draft article 43 in order to allow States to opt into both the registration-based
priority rules and the registration rules or only to
the registration rules, applying their own domestic,
registration-based, priority rules (see remark 3 to
chapter VII).

Article 44. Insolvency rules or procedures
not affected by this Convention

In case variant A is retained in draft article 24, draft
article 44 may not be necessary, since the general word-
ing of variant A should cover all rights of the insolu-
ency administrator existing under the law governing
insolvency. Draft article 44 may be necessary, if variant
B is preferred in draft article 24, provided that it is consid-
ered that the list of rights referred to in variant B is not, and
cannot, be all-inclusive.

Article 48. Reservations

The Working Group may wish to consider whether
reservations should be allowed, e.g. with regard to draft
article 9, in case written form is introduced, or draft article
12, in case no agreement is reached on the present wording
or on the exceptions to the rule contained in draft article
12, or chapter VI, in case no agreement is reached on its
scope or contents.

C. Working paper submitted to the Working Group on International
Contract Practices at its twenty-ninth session: Receivables Financing:
Group of experts report prepared by the Permanent Bureau of the
Hague Conference on Private International Law:

note by the secretariat

(A/CN9/WG.II/WP.99) [Original: French]

1. At its twenty-fifth session, it was noted that the diffi-
culty of addressing private international law aspects of
assignment should not result in their exclusion from the
future work of UNCITRAL, but should rather lead to
closer cooperation with the Hague Conference on Pri-
vate International Law, for example, through the hold-
ing of joint meetings of experts on questions of common
interest related to assignment of receivables (A/50/17,
para. 380).

2. Accordingly, the Permanent Bureau of the Hague
Conference on Private International Law, organized in
cooperation with the Secretariat, a meeting of experts
(The Hague, 18-20 May 1998) to discuss the private
international law aspects of assignment in the draft Con-
vention on Assignment in Receivables Financing.

3. Following the meeting of this group of experts, the
Secretariat received from the Permanent Bureau of the
Hague Conference on Private International Law, the re-
port of the meeting drafted in French. The document in
question is attached to the present note in the form in
which it was received by the Secretariat.

ANNEX

WORKING GROUP ORGANIZED BY THE HAGUE CONFERENCE ON PRIVATE
INTERNATIONAL LAW IN COOPERATION WITH THE UNCITRAL SECRETARIAT

Assignment of receivables

Report prepared by Catherine Kessedjian,
Assistant Secretary-General of the Hague Conference on Private International Law,
with the assistance of trainee, Patrick Wautelet

At the invitation of the Hague Conference on Private Interna-
tional Law, in cooperation with UNCITRAL, a working meeting
was held in The Hague in the offices of the Permanent Bureau of
the Conference from 18 to 20 May 1998.

The meeting was attended by experts from 16 States.

The purpose of the discussion was to weigh the advantages
and disadvantages of the provisional choices made by the
UNCITRAL Working Group assigned the tasks of preparing a
draft Convention on Assignment in Receivables Financing, ascer-
taining any difficulties posed by these choices and, if possible,
validating them or proposing other options. Where the provisions
proposed in the draft Convention were considered liable to give rise
to too many problems but no alternative could be proposed, the
experts recommended that the main points of the discussion be
outlined in the present report without any specific proposal being
put forward.

The discussion was organized around the following five
main topics, which now serve as a framework for this report:
(1) the role of conflict-of-laws rules in delimiting the geographi-
cal scope of application of the Convention; (2) the concept of
internationality and its different applications in the draft Con-
vention; (3) the definition of the concept of “location”; (4) conflict-of-laws rules designed to compensate for the absence of a substantive solution; and (5) general conflict-of-laws rules designed to be applicable even when the Convention is not applicable.

By way of introduction, mention should be made of certain general principles underlying the work of UNCITRAL, as recalled by a number of experts: (1) the proposed rules must reflect the needs of modern financial practice; and (2) the rules must serve to increase the certainty and predictability of the solutions; they must permit the bulk assignment of present and future receivables. These principles provided the background to the working group’s discussions.

(1) The role of conflict-of-laws rules in delimiting the geographical scope of application of the Convention

The first article of the draft Convention provides as follows:

(1) This Convention applies to assignments of international receivables and to international assignments of receivables as defined in this chapter, if, at the time of the assignment, the assignor is located in a Contracting State.

(2) [The provisions of articles [...] do not apply] [This Convention does not affect the rights and obligations of the debtor unless the debtor is located in a Contracting State (or the rules of private international law lead to the application of the law of a Contracting State to the relationship between the assignor and the debtor).

It may be noted that different methods have been chosen in the two paragraphs of the first article cited above: the first paragraph merely states a precise geographical criterion without referring to the rules of private international law, while the second paragraph (intended as a partial exception to the first paragraph) proposes possibly enlarging the scope of application of the Convention vis-à-vis the debtor when the law applicable to his relationship with the assignor (the law governing the assigned receivable) is that of a Contracting State. The experts therefore looked at the possibility of harmonizing the two provisions with the aim of incorporating in paragraph 1 an enlargement of the scope of application through the rules of private international law.

1.1 The experts first of all discussed the very principle of employing private international law rules in order to increase the number of cases in which the Convention might be applicable. Such a method has already been used by UNCITRAL in the Vienna Convention on Contracts for the International Sale of Goods of 11 April 1980, which, in its article 1, paragraph (1)(b) provides that the Convention is applicable “when the rules of private international law lead to the application of the law of a Contracting State”. One of the chief advantages of such a provision, as we know, is to permit application of the Convention in cases where, in its absence, a State would be able to apply the domestic law of the State designated by the conflict-of-laws rule, even if that State has ratified the Convention.

It was recalled that this provision, which was inserted at a late stage in the Vienna Convention negotiations, proved so controversial that a reservation option was attached to it. The provision itself raised practical problems of application, commercial operators being for the most part unaware of the particular procedures employed in private international law, procedures which are, moreover, further complicated by the possibility open to each State of issuing a reservation.

Quite apart from this practical difficulty, however, a fundamental problem is posed by the task of determining what are the rules of private international law that have to be applied. One of the experts suggested that these rules could be drawn from the Convention itself, provided that it contain general rules going beyond the application of the substantive rules of the Convention. In actual practice, in the context of the Vienna Convention, it is the private international law rules of the jurisdiction competent to deal with a dispute that have to be applied. If this solution were to be adopted in connection with the draft Convention on Assignment in Receivables Financing, it could jeopardize the achievement of the two fundamental objectives of the Convention, namely certainty and predictability. At the time that assignor and assignee negotiate the assignment, the location of the jurisdiction competent to deal with any disputes arising may be difficult to determine, especially if the parties have not agreed on a jurisdiction clause.

This difficulty is minimized, however, if the parties have made a choice of law. In this case, though, the basic argument adduced against the use of private international law rules is that the Convention contains rules on priority and, more generally, on the rights of third parties. These provisions are said to be among the main achievements of the Convention. But the rights of third parties cannot be made to depend on the choice of a law or jurisdiction by the parties to the assignment. Consequently, it was recommended that paragraph 1 of the first article should not be amended.

1.2 The second paragraph of the draft Convention already contains a clause extending the Convention to the debtor if the law applicable to the relationship between assignor and debtor is that of a Contracting State, even if the debtor is not located in the territory of a Contracting State. The justification for this proposition is the idea that the Convention contains substantive provisions to protect the debtor which are supposed to be known to the latter in the two cases covered by this text. Such a provision, however, would make it extremely difficult to effect bulk assignments because, in order to assess the risks involved, the assignee would have to determine the law applicable to each individual receivable assigned. Granted, the same difficulty is raised by the requirement that the debtor be located in a Contracting State, in which circumstances the assignment could include receivables due from debtors located in Contracting and non-Contracting States. However, in this case, if the

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1 The reference text is document A/CN.9/WG.II/WP.96.
2 Regarding the definition of this term, see section 3 below.
3 Note that the difference in method is due to the fact that the second paragraph was not the subject of discussion by the UNCITRAL Working Group since it was introduced recently in the draft text.
4 Regarding this question, see section 5 below.
5 Some consider this statement to be too general. If the competent jurisdiction is not a Contracting State of the Convention, it is not bound by article 1(1)(b) and is not required, under public international law, to apply the Convention even if its private international law designates the law of a Contracting State. This same difficulty arises in a general manner if the dispute is brought before an arbitral tribunal which, say, does not constitute a jurisdiction and is not bound, a priori, by the international conventions. However, it could be asserted that, on the contrary, the arbitral tribunals must take account of all the international conventions in force. Many arbitral tribunals proceed according to this principle. These two points of contention might be sufficient in themselves to discourage the drafters from adopting this approach.
6 The experts made constant reference to these two objectives in the course of the discussion, thus demonstrating that each rule proposed (substantive rule or conflict-of-laws rule) must fulfil these requirements.
assignee wishes to distinguish between these receivables in order to evaluate the risks involved, the strict geographical criterion provides a means of doing so without any great difficulty, which would not be so if it were necessary to proceed by means of conflict-of-laws rules.

Accordingly, the experts recommend deleting the reference to private international law in the second paragraph of the first article.7

(2) Internationality

Having decided to maintain article 1.1 in its present wording, the Working Group went on to discuss the necessity of defining the concept of internationality in the two cases covered by this article, namely assignment of international receivables and international assignment of receivables.

It was recalled that there was a well-established tradition at the Hague Conference on Private International Law of not defining internationality. Comparative studies show that at least two concepts of internationality coexist in most countries: a legal concept and an economic concept. The legal concept consists in taking account of either the nationality or the geographical location of the parties concerned. The economic concept relates to the flow of goods, persons, financiers and so forth across borders. According to the latter sense of the term, a relationship qualifies as "international" if it was entered into by partners located in the same territory but with one of the elements of the relationship to be performed in a different State.

The advantage of the legal concept lies essentially in its simplicity and the consequent enhancement of the certainty and predictability of solutions. The economic concept, on the other hand, makes it possible to increase the number of operations to which the international rules will be applicable. These international rules are often unified and more flexible, which is why many firms prefer to qualify their relationships as international.

In the context of the Hague Conventions, the drafters have always avoided reducing the concept to one or other of the two alternatives. The coexistence of the two criteria and possibly others has not been deemed prejudicial to the proper operation of conventions in the sphere of private international law.

However, in the context of the Convention under discussion, it was explained that firms have to be able to determine with certainty and in advance the cases where the Convention is applicable. To that end, it was felt necessary to formulate a definition, for which only precise, objective and straightforward criteria were considered to be sufficient.

It was apparent from the discussion of suitable criteria for adoption that various practical problems might arise from the definition of internationality in connection with bulk assignments. The way it is worded in the draft, article 3 allows the assignment of both international and domestic receivables through one and the same operation. The group felt that the solution to this problem did not lie in modifying the internationality criteria but in possibly adding a provision specifying that the rights and obligations of the debtor with respect to an assigned domestic receivable would not be affected by the Convention.

Consequently, the group decided to recommend that article 3 of the draft be retained in its current wording.

(3) The definition of the concept of location

Several provisions in the draft Convention contain a reference to the location of one of the parties to the assignment of a receivable.

Article 5(j) proposes that this concept be defined as follows:

A person is located in the State in which it has its registered office, or, if it has no registered office or in the case of an individual, its habitual residence.

It was recalled that, traditionally, a distinction needed to be drawn between rules applicable to individuals and rules applicable to corporations or other group entities.

As regards individuals, modern private international law favours relating location to habitual residence rather than domicile. The notion of habitual residence is more flexible and more factual, while also reflecting the reality of the individual's place in a given legal, economic and social system.8

With regard to corporations, comparative law shows that the countries continue to be divided into those that take as their criterion the registered office (place of registration)9 and those that prefer the actual head office. We might mention here that a variety of terms are used to denote the actual head office, including central administration, principal place of business and centre of main interests.

For proponents of the "head office" alternative, this term affords the advantage of locating the corporation at the centre of its business interests and corresponds in functional terms to the concept of habitual residence for individuals. "Registered office", however, denotes a deliberate choice on the part of the corporation, which may be dictated by concerns that are totally divorced from the nature of its activity but relate rather to the internal organization of the corporation10 or to tax-related decisions.

It has to be noted that private international law has not achieved any major successes in harmonizing the definition of the seat of corporations, each country remaining loyal to its traditions. By way of illustration, we cite article 58 (first paragraph) of the Treaty of Rome constituting the European Community, unmodified by subsequent Treaties, which provides as follows:

Companies or firms formed in accordance with the law of a Member State and having their registered office, central administration or principal place of business within the Community

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7From the point of view of attempting to systematize the criteria to be taken into consideration in determining the habitual residence of an individual, valuable insights are provided by the article by Dr. E. M. Clive, "The Concept of Habitual Residence", The Juridical Review, 1997, pp. 137-147.

8The question was raised as to whether the concept of "séjour statutaire" corresponded precisely to the notion of "registered office", employed in the English version of the draft Convention. The point was not explored in any great detail.

9It is worth mentioning, for instance, that Delaware, in the United States, has evolved a highly sophisticated corpus of legislative and doctrinal rules enabling companies to administer their internal organization to best effect, which accounts for the decision of many enterprises to locate their registered office in that state despite not having any business activity there.
shall, for the purposes of this Chapter, be treated in the same way as natural persons who are nationals of Member States.

Article 3 of the European Union Convention on Insolvency Proceedings, signed in Brussels on 23 November 1995, provides as follows in article 3, paragraph 1:

... In the case of a company or legal person, the place of the registered office shall be presumed to be the centre of its main interests in the absence of proof to the contrary.

Likewise, the UNCITRAL Model Law on Cross-Border Insolvency refrains from making a choice, since its article 16, paragraph 3, provides:

In the absence of proof to the contrary, the debtor's registered office, ... is presumed to be the centre of [its] main interests.

In contrast to this majority trend that thus seems to be emerging in the direction of not making a choice between the two alternatives in order to keep closer to the actual economic situation of the corporation concerned, the draft Convention on Assignment in Receivables Financing makes a choice by opting for the registered office, as indicated above.

One argument adduced in favour of this choice relates to the necessity of being able to identify the location of the assignor with certainty. In this respect, it is the view of some experts that the registered office is the only satisfactory option.

However, it is recalled that in the vast majority of cases, the registered office and the actual head office are the same. In cases where the company has opted for a dichotomy, the applicability of the Convention, which is essentially focused on the location of the assignor, will all but entirely preclude applicability of this text because the countries in which, traditionally, companies locate their registered office remain outside efforts to harmonize the law, hardly ratifying any of the available conventions.

If one looks at the matter from the point of view of the assignee, for which the applicability of the Convention is very important and whose rights and obligations depend for the most part, given the silence of the Convention's substantive rules, on the law governing the assignor, the short-term certainty represented by the registered office of the assignor may prove counter-productive in the cases of dichotomy referred to in the previous paragraph.

The group dwelt at length on the subject of the mobility conflict. The group was divided as to whether it was easier to change a registered office or an actual head office. Short of coming down in favour of one or the other, this point was not felt to be likely to have any influence over the choice between the two alternatives. That said, the experts were unanimous in the view that a provision ought to make it possible to settle the mobility conflict in the context of conflict-of-laws rules.

In conclusion, the group considers that the definition relating to individuals should be separated from that adopted for corporations and other group entities.

As regards individuals, the group decided in favour of the criterion of habitual residence.

In the case of corporations, no final conclusion emerged.

Nonetheless, it was proposed to take as a basis the definition given in article 4, paragraph 2, of the Rome Convention of 19 June 1980 on the Law Applicable to Contractual Obligations, which provides as follows:

Subject to the provisions of paragraph 5 of this Article, it shall be presumed that the contract is most closely connected with the country where the party who is to effect the performance which is characteristic of the contract has, at the time of conclusion of the contract, his habitual residence, or, in the case of a body corporate or unincorporate, its central administration. However, if the contract is entered into in the course of that party's trade or profession, that country shall be the country in which the principal place of business is situated or, where under the terms of the contract the performance is to be effected through a place of business other than the principal place of business, the country in which that other place of business is situated. or, if not, to take as a basis the European Union Convention on Insolvency Proceedings mentioned above.

At all events, the experts came to the conclusion that, whatever the final choice made as to registered office or actual head office, it was probably necessary to envisage a separate rule for cases where the assignor acted through an autonomous establishment, branch office or other entity without distinct legal personality.

(4) Conflict-of-laws rules designed to compensate for the absence of a substantive solution

The group of experts was in agreement as to the valuable role that the conflict-of-laws rules could play in connection with the draft Convention by completing the process of harmonizing the law in the field of assignment of receivables with respect to those issues for which the negotiators had not succeeded in identifying substantive rules. This applies to questions of form, assignability, the right to the proceeds of receivables, the law of priority and competing rights in the event of insolvency of the assignor. Each of these points will be tackled individually.

4.1 Form

The current wording of article 9 of the draft Convention offers several variants. Variant A envisages a substantive rule requiring assignment in written form. Some experts, however, have indicated that this substantive rule is unacceptable for a small number of countries whose tradition would thus be upset by the Convention. It is therefore highly likely that the draft Convention will not be able to contain a provision worded as in variant A.

The question then arose as to the law applicable to form in the absence of any substantive rule. What variants B and C of the same article propose, albeit with some fairly substantial differences between them, are in fact two conflict-of-laws rules. These rules do not, however, correspond to the present trend in private international law towards favouring an alternative conflict rule designed

16Nonetheless, it was suggested that variant A be maintained and that States be allowed to issue a reservation if they so wish.
to validate the contract or legal transaction. It was shown, moreover, by several experts that there is little chance of a conflict-of-laws rule achieving the objective sought by a provision on form.

On mature consideration, it is felt that the aim pursued by form in the context of the draft Convention is not so much a question of validity as identification of the content of the assignment or, in other words, proof of that content. The experts were in agreement, therefore, that a substantive rule was preferable to a conflict rule. This rule could be reformulated in relation to the current variants proposed in the Convention and could be reworded as follows:

"A receivable is deemed to have been assigned if its assignment is proven by any means ..."

A further possibility would be to combine variants B and C, but the group of experts did not have time to look more closely into the possible drafting of such a combined text.

4.2 Assignability

The question of assignability consists of two separate and distinct problems: contractual assignability and statutory assignability.

4.2.1 The experts considered the question of whether it was reasonable for the Convention to stipulate a rule such as that contained in article 12 of the draft, whereby a receivable is assignable even if it has been the subject of an anti-assignment agreement between the assignor and the debtor. In this regard, the experts discussed whether article 12 could be modified by article 30, which establishes a conflict-of-laws rule to settle questions relating to the assignability of a receivable without specifying whether such a conflict rule applies to both statutory and contractual assignability. This point will need to be clarified in order to delimit the application of articles 12 and 30 respectively.

In view of the impossibility of ascertaining whether or not national provisions on contractual assignability are mandatory, it was suggested that a comparative law study might be undertaken before finally confirming this provision of the draft, which would appear to seriously threaten autonomy of will and contractual predictability from the point of view of the debtor. The experts did not, however, make any recommendations in this respect.

4.2.2 As regards statutory assignability that is not governed by article 12 but by article 30 (conflict rule), the discussion focused on the sufficiency or otherwise of the public policy exception or that concerning the mandatory rules. The group of experts concluded that, on balance, they were not sufficient. A conflict-of-laws rule was therefore deemed necessary. It might designate the law governing the assigned receivable. Such a law did not, however, seem to be satisfactory in the case of bulk assignments.

4.3 The right of the assignee to the proceeds of receivables

This right was governed by an article 17, for which new wording should be proposed by the UNCITRAL Secretariat. The concept of "right to the proceeds" seems to be unknown in the civil-law systems, although it may be akin, without being identical, to a right to follow property.

All the conflict-of-laws rules examined in the course of the discussion were shown to have their limitations. To be absolutely sure of success, it would be necessary to apply two conflict rules cumulatively: the law of assignment and the law applicable to the proceeds into which the receivable has been transformed. In the face of the complexity of such a solution, the experts take the view that it would be better not to seek a solution in a conflict-of-laws rule.

4.4 Priority rights

Article 23 of the draft Convention proposes that priority among several assignees for the same receivables from the same assignor be made subject to the law governing the assignor.17

This provision was considered to be a good rule by the experts (or, at any rate, the least bad possible), given that:

(a) The law governing the assigned receivable is impossible to apply in the case of bulk assignments, which is essentially where the question of priority arises because it comes into play if the assignor has assigned to several assignees a comprehensive set of receivables, an increasingly common procedure in financial management;

(b) The debtor is protected by substantive provisions of the Convention and the conflict-of-laws rule thus proposed will not apply unless the Convention itself is declared applicable in its entirety.

4.5 Competing rights in the event of insolvency of the assignor

Article 24 of the draft Convention provides that the issue of the competing rights of an assignee and the insolvency administrator or the assignor's creditors is subject to the law governing the assignor.

The justification given for this choice is that if an insolvency proceeding is opened, it will be so in the place where the assignor is located. This justification, however, argues in favour of a different definition of the concept of the location of the assignor with respect to article 24 if the definition of this concept is maintained in the form currently appearing in article 5(1), i.e. registered office. Both the European Union Convention and the UNCITRAL Model Law on Cross-Border Insolvency allow the presumption to be reversed in favour of the actual head office in the event of a dichotomy with the registered office.

The provisions of article 24, paragraphs 3 and 4, were designed to compensate for this deficiency. It has to be said that these provisions are rather complex. The wording of paragraph 3 is somewhat unusual. It reverses the operation of the public policy exception, the aim of which is normally to prevent the application of a foreign measure, law or decision. A new formulation, which reflects practice in the field more closely, might be proposed as follows:

"The application of the provisions of the present article may be refused if they are manifestly contrary to the public policy of the forum State."

With regard to paragraph 4, the cases covered might not encompass all the specific cases that might arise in practice.18

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17The question of the mobility conflict was raised again with reference to this text. It has already been mentioned in section 3 above. It will have to be dealt with in language to be added, as indicated earlier.

18The group of experts did not discuss article 24, paragraph 5. However, on re-reading a doubt arose as to the precise scope of this provision.
(5) General conflict-of-laws rules intended to be applicable even when the Convention is inapplicable

The process proposed is to combine chapter VI of the draft Convention, comprising articles 29 to 33, with article 1, paragraph 3.

This process is not unprecedented in UNCITRAL; it was used in the 1995 Convention on Independent Guarantees and Stand-by Letters of Credit. But this Convention contains only two private international law provisions, which are limited in their scope of application and are, moreover, far from controversial and hence unlikely a priori to cause any great upheavals in the law of the Contracting States.

Chapter VI of the current draft of the Convention, however, is a different matter altogether. In the first place, some experts commented that States not parties to the 1980 Rome Convention on the Law Applicable to Contractual Obligations, or to a different Convention, feel a need to harmonize their conflict-of-laws rules in the field of assignment of receivables. These experts regard the negotiation of the UNCITRAL Convention as a good opportunity to attempt to achieve this.

This is the reason why chapter VI of the draft has been inserted and why it seeks to regulate not only the assignment contract but also its effects on third parties and its effects on the property transfer of the receivables in question.

The primary purpose of chapter VI is to establish conflict-of-laws rules for the assignment contract. However, this contract does not bear any special features in terms of the relationship between assignor and assignee such as to warrant the presence of a conflict-of-laws rule in a special convention. Quite possibly a need is now being perceived worldwide to harmonize the conflict-of-laws rules in contractual matters, but a special convention does not provide the right context for such an endeavor.

The same goes for the conflict-of-laws rule applicable to the assigned receivable. In the first place, in the actual context of what is envisaged for the Convention, the assigned receivable may take widely differing forms (namely, contractual or tort-based). However, article 30, which again seeks to provide a general rule applicable to contractual receivables, says nothing specific about other types of receivable, except for a rather cryptic reference to a “decision or other act”. At all events, questions of the law applicable to the assigned receivable are not specific to assignments of receivables.

In view of the foregoing, some experts ventured to suggest that chapter VI should be deleted in its entirety from the Draft Convention.

If need be, one might envisage retaining a text inspired by article 30, paragraph 1, but only provided that it is redrafted by removing the references to mechanisms specific to the substantive provisions of the Convention, which in the case, say, of the general conflict-of-laws rules would not be applicable. It was therefore proposed that this provision be calqued on article 12, paragraph 2, of the Rome Convention on the Law Applicable to Contractual Obligations, which provides as follows:

The law governing the right to which the assignment relates shall determine its assignability, the relationship between the assignee and the debtor, the conditions under which the assignment can be invoked against the debtor and any question whether the debtor’s obligations have been discharged.

The aim, after all, of article 30 (with new wording to be determined) is to protect the debtor, and this aim should inform the drafting of this text if it is retained.

With regard to article 31, the choice of the law governing the assignor, which might work well with regard to the substantive rules of the Convention, presents a real danger when the rule is isolated from its context. The debtor might be obliged to pay twice, once under the provisions of the law governing the assigned receivable and a second time under the law governing the assignor. There is no guarantee protecting the debtor from a real conflict between these two laws if the law is applied independently of the substantive rules of the Convention.

It is also noteworthy that, in its current wording, article 31 contains no provision concerning a conflict between subsequent assignees.

The group of experts noted that it is difficult to propose an “ideal” conflict-of-laws rule for this point. The application of the law governing the assigned receivable, which seems to be the most logical and sensible choice, presents a major difficulty in cases where the assignment relates to multiple receivables subject to...
different laws. The law governing the assignment contract, another possible choice, challenges the principle of the relative effect of conventions because it makes the rights of third parties dependent on the voluntary agreement of the parties to the assignment contract. Furthermore, the law of the assignor does not offer sufficient protection to the debtor, as already mentioned above.

As regards the mandatory rules and public policy, the question was raised as to their precise scope and the need to retain the reference to the issues dealt with in this chapter. The experts stressed that the scope of application of these provisions should not be extended beyond the issues covered in the chapter on conflict of laws.

Lastly, a point of purely procedural convention was raised during the discussion. If the Convention contains an “opt-in” clause, which is the way things seem to be moving, it will be necessary to stipulate that when a State takes up the option, the substantive provisions of the Convention prevail over the general conflict rules if the criterion for application of the substantive provisions is fulfilled.


1. At its twenty-eighth session, the Working Group considered, in the context of its discussion on draft article 18 dealing with the debtor’s discharge by payment, the relationship between the notification and the payment instructions. At that session, the view was expressed that a clear distinction should be drawn between the notification of the assignment and the payment instructions (A/CN.9/447, para. 74). While some support was expressed in favour of that view, the Working Group adopted the substance of draft articles 16 and 18 without drawing such a distinction (A/CN.9/447, paras. 75-78).

2. Following the twenty-eighth session of the Working Group, the Secretariat received from the delegation of the United States of America a proposal for a revision of draft articles 5, 16 and 18. The proposal is intended to give an opportunity to the Working Group to reconsider its decision with regard to draft articles 16 and 18. The text of that proposal is reproduced in the annex to this note as it was received by the Secretariat.

ANNEX

Discharge of the Debtor by Payment

Proposed Revision of Articles 5, 16, and 18

Article 5. Definitions and Rules of Interpretation

(f) “Notification of assignment” means a writing sent by the assignor or the assignee indicating that an assignment has taken place, identifying the assignor or assignee, and reasonably describing the receivables assigned.

(g) “Payment instruction” means a writing sent by the assignor or the assignee reasonably describing the receivables to which it applies and an address or account to which payment is to be made.

Article 16. Notification of the debtor

(1) Unless otherwise agreed between the assignor and the assignee, the assignor or the assignee or both may send the debtor a notification of assignment and a payment instruction not at variance with article 7(2).

(2) A notification of assignment or payment instruction sent in breach of any agreement described in paragraph (1) is not ineffective for purposes of Article 18 by reason of such breach, but nothing in this article affects any obligation or liability of the party in breach of such an agreement for any damages arising as a result of the breach.

Article 18. Debtor’s discharge by payment

(1) Subject to paragraphs (2) to (4), the debtor is discharged by paying in accordance with a payment instruction

(a) received from the assignor either (i) before the debtor receives a notification of assignment, or (ii) accompanying a notification of assignment if that notification is sent by the assignor;

(b) received from the assignee either (i) after the debtor receives a notification of assignment, or (ii) accompanying a notification of assignment if that notification is sent by the assignee

to the same extent as it would be discharged by paying the same amount to the assignor if there were no assignment.

(2) If the debtor receives more than one notification of assignment relating to an assignment of the same receivables by the same assignor, “notification of assignment,” as used in paragraph (1), refers to the first such notification of assignment received.

(3) If the debtor receives a notification of assignment from the assignee, the debtor is entitled to request the assignee to provide within a reasonable period of time adequate proof that the assignment has been made and, unless the assignee does so,
the debtor is discharged by paying the assignor. Adequate proof includes, but is not limited to, any writing emanating from the assignor and indicating that the assignment has taken place.

(4) This article does not affect the discharge of the debtor by payment to the person entitled to payment, to a competent judicial or other authority, or to a public deposit fund.

Remarks

1. The purpose of this proposal is to effectuate the view expressed at the twenty-eighth session of the Working Group that a clear distinction should be drawn between the notification of the assignment and the payment instructions. The distinction is important because of the wide variety of transactions involving assignment of receivables. In some cases, no notification of assignment is given at all. In other cases, notification of assignment is given to the debtor, but the debtor is not instructed to pay anyone other than the assignor; in such cases, an instruction to pay the assignee may be given later. In still other cases, the debtor is simultaneously notified of the assignment and instructed to pay the assignee. Articles 16 and 18 should provide clear rules for all such cases. In light of the theme of debtor protection that runs through the draft convention, the rules governing the debtor’s right to discharge should reflect the likely understanding of the debtor of the communications it receives regarding assignment of the receivable.

2. To effectuate this view, the proposal distinguishes between “notification of assignment” and “payment instruction,” defining both terms in Article 5. The remainder of the proposal follows the structure of WP.96. Article 16 provides rules governing the right, as between the assignor and the assignee, to send a notification of assignment or payment instruction and the effect as between those parties of breach of any agreement with respect to such notification or instruction. Article 18, on the other hand, provides rules for determining the circumstances under which the debtor may be discharged by payment to the assignor or assignee.

3. Article 18 reflects the view that it is a payment instruction, rather than a notification of assignment, that brings about a change in the actions that will entitle the debtor to discharge. Even if the debtor has received a notification of assignment the debtor is entitled to discharge by paying the assignor as if there were no assignment until it receives a payment instruction from the appropriate party. Article 18 provides that the appropriate party to send a payment instruction is the assignor until the debtor receives a notification of assignment and is the assignee thereafter; in addition, either the assignor or assignee may send a payment instruction accompanying a notification of assignment.


CONTENTS

INTRODUCTION .......................................................... 1-16

I. DELIBERATIONS AND DECISIONS ..................................... 17-18

II. DRAFT CONVENTION ON ASSIGNMENT IN RECEIVABLES
FINANCING ................................................................. 19-227

   A. Title ...................................................................... 19
   B. Preamble ............................................................... 20-21
   C. Discussion of draft articles ........................................ 22-227

CHAPTER I. SCOPE OF APPLICATION ................................. 22-52
   Article 1. Scope of application ...................................... 22-37
   Article 2. Assignment of receivables ............................. 38-43
   Article 3. Internality ................................................... 44-45
   Article 4. Exclusions .................................................. 46-52

CHAPTER II. GENERAL PROVISIONS ............................... 53-85
   Article 5. Definitions and rules of interpretation ............ 53-78
   Article 6. Party autonomy ............................................. 79-80
Article 7.  Debtor's protection ................................. 81
Article 8.  Principles of interpretation .......................... 82-85

CHAPTER III.  FORM AND EFFECT OF ASSIGNMENT .......... 86-126
Article 9.  Form of assignment .................................. 86-92
Article 10. Effect of assignment ................................. 93-97
Article 11. Time of transfer of receivables .................... 98-103
Article 12. Contractual limitations to assignment .......... 104-116
Article 13. Transfer of security rights .......................... 117-126

CHAPTER IV.  RIGHTS, OBLIGATIONS AND DEFENCES .......... 127-227
Section I. Assignor and assignee ................................. 127-167
Article 14. Rights and obligations of the assignor and the assignee ... 127-128
Article 15. Representations of the assignor .................... 129-130
Article 16. Right to notify the debtor ........................... 131-144
Article 17. Right to payment ..................................... 145-159
Article 17bis. Competing rights with respect to proceeds ...... 160-167

Section II. Debtor .................................................. 168-208
Article 17ter. Principle of debtor-protection .................. 168-176
Article 17quater. Notification of the debtor ................... 177-180
Article 18. Debtor's discharge by payment ..................... 181-193
Article 19. Defences and rights of set-off of the debtor .... 194-199
Article 20. Agreement not to raise defences or rights of set-off ... 200-204
Article 21. Modification of the original contract .......... 205-206
Article 22. Recovery of payments ............................... 207-208

Section III. Other parties ......................................... 209-227
Article 23. Competing rights of several assignees .......... 209-210
Article 24. Competing rights of assignee and creditors of the assignor or insolvent administrator ............ 211-222
Multiple parties ................................................. 223-227

III. REPORT OF THE DRAFTING GROUP .......................... 228-229

IV. FUTURE WORK .................................................. 230-231

V. RELATIONSHIP BETWEEN THE DRAFT CONVENTION AND THE UNIDROIT DRAFT CONVENTION ON INTERNATIONAL INTERESTS IN MOBILE EQUIPMENT ........................................... 232-239

Annex ............................................................ 140
INTRODUCTION

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

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

3. At its twenty-sixth to twenty-eighth sessions (1993 to 1995), the Commission discussed three reports prepared by the Secretariat concerning certain legal problems in the area of assignment of receivables (A/CN.9/378/Add.3, A/CN.9/397 and A/CN.9/412). Having considered those reports, the Commission concluded that it would be both desirable and feasible to prepare a set of uniform rules, the purpose of which would be to remove obstacles to receivables financing arising from the uncertainty existing in various legal systems as to the validity of cross-border assignments (where the assignor, the assignee and the debtor were not in the same country) and as to the effects of such assignments on the debtor and other third parties.3

4. At its twenty-fourth session (Vienna, 8-19 November 1995), the Working Group commenced its work by considering a number of preliminary draft uniform rules contained in a report of the Secretary-General entitled “Discussion and preliminary draft of uniform rules” (A/CN.9/412). At that session, the Working Group was urged to strive for a legal text aimed at increasing the availability of lower-cost credit (A/CN.9/420, para. 16).

5. At its twenty-ninth session (1996), the Commission had before it the report of the twenty-fourth session of the Working Group (A/CN.9/420). The Commission expressed appreciation for the work accomplished and requested the Working Group to proceed with its work expeditiously.4

6. At its twenty-fifth and twenty-sixth sessions (New York, 8-19 July and Vienna, 11-22 November 1996), the Working Group continued its work by considering different versions of the draft uniform rules contained in two notes prepared by the Secretariat (A/CN.9/WG.II/ WP.87 and A/CN.9/WG.II/WP.89). At those sessions, the Working Group adopted the working assumptions that the text being prepared would take the form of a convention (A/CN.9/432, para. 28) and would include private international law provisions (A/CN.9/434, para. 262).

7. At its thirtieth session (1997), the Commission had before it the reports of the twenty-fifth and twenty-sixth sessions of the Working Group (A/CN.9/432 and A/CN.9/434). The Commission noted that the Working Group had reached agreement on a number of issues and that the main outstanding issues included the effects of the assignment on third parties, such as the creditors of the assignor and the administrator in the insolvency of the assignor.5 In addition, the Commission noted that the draft Convention had aroused the interest of the receivables financing community and Governments, since it had the potential of increasing the availability of credit at more affordable rates.6

8. At its twenty-seventh and twenty-eighth sessions (Vienna, 20-31 October 1997, and New York, 2-13 March 1998), the Working Group considered two notes prepared by the Secretariat (A/CN.9/WG.II/WP.93 and A/CN.9/ WG.II/WP.96). At its twenty-eighth session, the Working Group adopted the substance of draft articles 14 to 16 (assignor and assignee) and 18 to 22 (debtor and other third parties) and requested the Secretariat to revise draft article 17 (A/CN.9/447, paras. 161-164 and 68 respectively).

9. At its thirty-first session (1998), the Commission had before it the report of the twenty-seventh and twenty-eighth sessions of the Working Group (A/CN.9/445 and A/ CN.9/447). The Commission expressed appreciation for the work accomplished and requested the Working Group to proceed with its work expeditiously so as to complete its work in 1999 and submit the draft Convention for adoption by the Commission at its thirty-third session (2000).7

10. At its twenty-ninth session (Vienna, 5-16 October 1998), the Working Group considered two notes prepared by the Secretariat (A/CN.9/WG.II/WP.96 and A/CN.9/ WG.II/WP.98), as well as a note containing the report of a group of experts prepared by the Permanent Bureau of

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6Ibid., para. 256.
the Hague Conference on Private International Law (A/CN.9/WG.II/WP.99). At that session, the Working Group adopted the substance of the preamble and draft articles 1(1) and (2) (scope), 5 (g) to (j) (definitions), 18(bis) (debtor’s discharge by payment), 23 to 33 (priority and private international law issues) and 41 to 50 (final provisions; A/CN.9/455, para. 17).

11. The Working Group, which was composed of all States members of the Commission, held the present session in New York from 1 to 12 March 1999. The session was attended by representatives of the following States members of the Working Group: Algeria, Argentina, Austria, Botswana, Burkina Faso, Cameroon, China, Colombia, Egypt, Fiji, France, Germany, Honduras, Hungary, India, Iran (Islamic Republic of), Italy, Japan, Kenya, Mexico, Nigeria, Romania, Russian Federation, Singapore, Spain, Sudan, Thailand, United Kingdom of Great Britain and Northern Ireland and United States of America.

12. The session was attended by observers from the following States: Belarus, Bolivia, Canada, Croatia, Czech Republic, Ecuador, Gabon, Indonesia, Iraq, Ireland, Kuwait, Lesotho, Netherlands, Pakistan, Poland, Republic of Korea, Saudi Arabia, Senegal, Sweden, Switzerland, Turkey and Venezuela.

13. The session was attended by observers from the following international organizations: Association of the Bar of the City of New York (ABCNY), Cairo Regional Centre for International Commercial Arbitration, Commercial Finance Association (CFA), European Federation of National Factoring Associations (EUROPAFACTURING), Factors Chain International (FCI), Fédération bancaire de l’Union européenne, International Bar Association (IBA), International Institute for the Unification of Private Law (Unidroit) and Union internationale des Avocats (UIA).

14. The Working Group elected the following officers:

Chairman: Mr. David Morán Bovio (Spain)
Rapporteur: Mr. Aly Gamaleldin Awad (Egypt)


16. The Working Group adopted the following agenda:

1. Election of officers.
2. Adoption of the agenda.
4. Other business.
5. Adoption of the report.

I. DELIBERATIONS AND DECISIONS


18. The deliberations and conclusions of the Working Group, including its consideration of various draft provisions, are set forth below in chapters III to V. The Working Group adopted the title, the preamble and draft articles 1 to 24 and, with the exception of draft articles 23 and 24, referred them to a drafting group established by the Secretariat to align the various language versions.

II. DRAFT CONVENTION ON ASSIGNMENT IN RECEIVABLES FINANCING

A. Title

19. The Working Group decided to defer discussion of the title of the draft Convention until it had completed its review of chapter I and draft article 5 (see paras. 60-65).

B. Preamble

20. The text of the preamble as considered by the Working Group was as follows:

"The Contracting States,

"Reaffirming their conviction that international trade on the basis of equality and mutual benefit is an important element in the promotion of friendly relations among States,

"Considering that problems created by the uncertainties as to the content and choice of legal regime applicable to assignments in international trade constitute an obstacle to financing transactions,"
"Desiring to establish principles and adopt rules relating to the assignment of receivables that would create certainty and transparency and promote modernization of law relating to receivables financing, while protecting existing financing practices and facilitating the development of new practices,

"Also desiring to ensure the adequate protection of the interests of the debtor in the case of an assignment of receivables,

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

"Have agreed as follows:"

21. It was noted that, in order to reflect in the preamble the main objectives of the draft Convention in a more balanced way, the principle of debtor-protection had been moved from draft article 7 to the preamble (and to draft article 17 ter; see paras. 81 and 168-176). Subject to that change, the Working Group adopted the preamble and referred it to the drafting group (in the context of its consideration of draft article 5 (d), the Working Group reopened discussion on the preamble; see paras. 60-65).

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

"(4) The provisions of articles 29 to 33 apply [to assignments of international receivables and to international assignments of receivables as defined in this chapter independently of paragraphs (1) and (3) of this article] [independently of the provisions of this chapter]. However, the provisions of articles 29 to 31 do not apply if a State makes a declaration under article 42bis.

"(5) Chapter VII applies in a Contracting State which has made a declaration under article 43.

"(6) In the case of an assignment of more than one receivable by more than one assignor, this Convention applies if any assignor is located in a Contracting State. In the case of an assignment of more than one receivable owed by more than one debtor, this Convention does not affect the rights and obligations of any debtor unless that debtor is located in a Contracting State or the law governing the receivable owed by that debtor is the law of a Contracting State.

"(7) This Convention applies to additional practices listed in a declaration made by a State under draft article 42ter."

C. Discussion of draft articles

Chapter I. Scope of application

Article 1. Scope of application

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

"(1) This Convention applies to:

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

"(b) assignments of receivables by the initial or any other assignee to subsequent assignees ("subsequent assignments") provided that any prior assignment is governed by this Convention; and

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

"(2) This Convention applies to subsequent assignments as if the subsequent assignee who exercises its right to assign were the initial assignor and as if the subsequent assignee to whom the assignment is made were the initial assignee.

Paragraphs (1) to (3)

23. It was noted that, at its previous session, the Working Group had already adopted the substance of paragraphs (1) to (3) (A/CN.9/455, paras. 169 and 172). It was also noted that draft article 25, dealing with the scope of application of the draft Convention with regard to subsequent assignments, had been incorporated into draft article 1 slightly modified (to the effect that the subsequent assignee who further assigned the receivables previously assigned was treated as the initial assignor, while the subsequent assignee who received the receivables previously assigned was treated as the initial assignee).

24. While there was general support for the substance of paragraphs (1) to (3), several suggestions were made with regard to the placement in the text of paragraph (2). One suggestion was that it should be included in draft article 5, since it contained a rule of interpretation. Another suggestion was that it should be retained in chapter I (either in draft article 1 or in draft article 2), since it related to the scope of the draft Convention. The Working Group adopted paragraphs (1) to (3) and referred the question of their specific formulation and of the placement of paragraph (2) to the drafting group (in the context of its consideration of draft article 5 (I)), the Working Group reconsidered the reference to the "time of assignment", contained in paragraph (1); see paras. 76-78.

Paragraph (4)

25. It was noted that paragraph (4) dealt with the question of the scope or the purpose of the private international law
rules of the draft Convention (chapter VI). In addition, it was noted that, if the first set of bracketed language were to be deleted, the private international law rules of the draft Convention would apply irrespective of whether the assignor or the debtor would be located in a Contracting State, or whether the law governing the receivable would be the law of a Contracting State. Moreover, it was noted that, if the bracketed language were to be deleted and the second set of bracketed language were to be retained, the private international law provisions of the draft Convention would apply independently of the other scope provisions contained in chapter I, in particular of the definition of internationality contained in draft article 3. It was also noted that the Working Group would need to consider a number of questions, including the questions whether: paragraph (4) should be moved to chapter VI; States should be allowed to adopt only chapter VI; and whether additional language should be inserted in the draft Convention to ensure that a Contracting State would apply the substantive law provisions before resorting to the application of the private international law provisions of the draft Convention.

26. While it was noted that, at its previous session, the Working Group had made the decision to apply the application of chapter VI subject to an opt-out clause (A/CN.9/455, para. 72), the view was expressed that chapter VI should be deleted or, at least, its application should be made subject to an opt-in clause. While some support was expressed in favour of that view, the prevailing view was that chapter VI should be retained in the draft Convention, subject to an opt-out by States, and that the matter should be revisited when the Working Group had an opportunity to consider the substance of chapter VI.

Paragraph (5)

27. It was noted that chapter VII had been moved to the annex to the draft Convention. General support was expressed in favour of making the application of the annex subject to an opt-in by States. Subject to replacing the reference to chapter VII with a reference to the annex, the Working Group adopted paragraph (5).

Paragraph (6)

28. It was pointed out that the concept of multiple parties arose in a number of provisions (i.e. draft articles 1 (6), 3 (2) and (3), 5 (k)). In view of the fact that the concept related to specific practices, the Working Group decided to defer consideration of those provisions until it had completed its review of the draft Convention, in order to allow for consultations with regard to the practices involving multiple parties (see paras. 45 and 223-227).

Paragraph (7)

29. The Working Group decided to defer discussion of paragraph (7) until it had an opportunity to consider draft article 2 (see para. 43).

Territorial scope of application and internationality ("location")

30. Before concluding its deliberations on draft article 1, the Working Group considered the meaning of the term "location" for the purposes of determining the territorial scope of application of the draft Convention and the internationality of an assignment or a receivable. It was noted that draft article 5 (k), which had been prepared by the Secretariat in order to reflect the discussions of the Working Group at its previous session (A/CN.9/455, paras. 163-169), defined "location" for the purposes of draft articles 1 and 3 by reference to the place of business with the closest connection to the relevant contract, introducing a rebuttable presumption that that place was the place where a legal person had its central administration. It was also noted that, in view of draft article 5 (j) which defined "location" for the purpose of draft articles 23 and 24 by reference to the place of incorporation, the Working Group would need to consider the question whether a single definition for the purposes of the draft Convention as a whole would be preferable.

31. Diverging views were expressed. One view was that "location" of a legal person should be defined by reference to its place of incorporation. In support of that view, it was stated that a place-of-incorporation approach would result in reference being made to a single and easily determinable jurisdiction. Such an approach, it was said, would provide certainty as to the application of the draft Convention, thus potentially having a beneficial impact on the availability and the cost of credit. In addition, it was observed that, if "location" of a legal person were to be defined by reference to the closest relationship of a transaction with a particular place business, it would be very difficult, in particular for third parties, to determine in each case where the relevant place of business might be. It was stated that such an approach would have a negative impact on the availability and the cost of credit.

32. Moreover, it was pointed out, in order to avoid producing inconsistent results, the Working Group would have to define the term "location" for the purposes of the draft Convention in the same way as it had defined it for the purposes of draft articles 23 and 24 (i.e. by reference to the place of incorporation). It was also stated that in a variety of service-related transactions, in which services were provided by various branch offices of a corporation, it would be difficult and unnecessary to refer to the place of business of the branch offices that were involved in the transaction. In such a case, it would be easier and more sensible from a practical point of view to refer to the place of incorporation of the company. It was further pointed out that reference to the place of business with the closest relationship to the assignment might lead to inconsistent results (e.g. various assignments of the same receivables by the assignor might be subject to different legal regimes, simply because they might be most closely connected with different jurisdictions).

33. Another view was that "location" should be defined by reference to that place of business which was most closely connected with the relevant contract. In favour of that view, it was pointed out that a place-of-business approach would provide sufficient certainty, since it was a well-known term, used in a number of uniform laws and sufficiently explained in existing case law. In addition, it was stated that such an approach would provide flexibility.
in that it would result in focusing in each case on the relevant place of business, i.e. the place of business which would be most closely connected with the relevant transaction (the assignment for the assignor and the assignee, and the original contract for the debtor).

34. While a place-of-incorporation approach had been found to be acceptable in the context of draft articles 23 and 24, it was stated that such an approach would not be appropriate for the purpose of the scope provisions, since the place of incorporation could be a fictitious place and referring to it in that context could inadvertently result in the application of the draft Convention to purely domestic transactions. In that connection, it was observed that, while a place-of-incorporation approach could be followed in order to protect the rights of third parties, it would not be workable with regard to the debtor, since it could inadvertently result in exposing the corporate debtor/branch to the law of a fictitious jurisdiction, thus compromising debtor-protection, one of the main objectives of the draft Convention. In addition, it was pointed out that an approach based on the place of incorporation could also lead to a situation in which the draft Convention would not apply to a clearly international transaction. Moreover, it was said that use of the term “place of incorporation” might fail to promote its stated goal of achieving certainty, since that term was not universally understood in the same way and, unlike the place of business which normally appeared on the letterhead of a corporation, was not readily available to third parties. It was further mentioned that such an approach might inadvertently result in the non-application of the draft Convention to cases in which a corporation had its actual place of business in one or more places, while it was incorporated in a tax haven, which would typically not be a Contracting State. A reference to the place of incorporation, i.e. the nationality of a corporation, was said to be inconsistent with the normal approach of focusing on the residence, not on the nationality, of persons for the purpose of determining their location.

35. In order to bridge the gap between the above-mentioned diverging views, a number of suggestions were made, including the suggestions to refer to the chief executive office, to the place of organization, to the place of registration (at least with regard to the assignor and the assignee, but not necessarily the debtor, so as to address the problem mentioned in para. 33), to the place of business with a rebuttable presumption in favour of the place of central administration or of incorporation, or to the place in which a receivable was created (e.g. in the case of goods, the place from which the goods were shipped or the invoice was sent). With regard to the latter suggestion, it was stated that, while the territorial scope of the draft Convention could be determined on the basis of the place where the receivable had arisen, internationality could be defined by reference to place of registration, place of business, place of chief executive office or of habitual residence, in the case of individuals.

36. While some interest was expressed in those suggestions, the Working Group was unable to reach agreement on the definition of the term “location”. With regard to the chief executive office, place of organization or place of registration, it was observed that a reference to any of those places would result in inappropriately subjecting the transactions of branches of a corporation to the law of the head office. In addition, it was stated that use of the terms “place of organization” and “place of registration” would inadvertently result in uncertainty as to the application of the draft Convention, as those terms were not universally understood in the same way. As to the combination of the place of business with the place of central administration or of incorporation, it was stated that it failed to introduce a sufficient degree of certainty as to the application of the draft Convention and, in particular, as to the rights of third parties.

37. After discussion, the Working Group decided to retain both subparagraphs (j) and (k) within square brackets on the understanding that the matter would need to be revisited at the next session of the Working Group, in the context of all the provisions of the draft Convention in which reference to the location of a person was made (i.e. draft articles 1, 3, 9, 17bis, 19 (2), 20 (1), 22-24, 29-33 and 46 (3)).

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

“For the purposes of this Convention, ‘assignment’ means the transfer by agreement from one person (‘assignor’) to another person (‘assignee’) of the assignor’s contractual right to payment of a monetary sum (‘receivable’) from a third person (‘the debtor’), including the creation of rights in receivables as security for indebtedness or other obligation.”

39. It was noted that the draft Convention mainly focused on assignment as a transfer of property rights in receivables and that it was not intended to apply to agreements to assign, except where it expressly provided otherwise (e.g. draft articles 14-17). In addition, it was noted that, in view of the fact that the draft Convention dealt only in exceptional cases with the financing contract or the agreement to assign, the reference to “value, credit or services being given or promised” in return for the receivables assigned, which was contained in an earlier version of the definition of “assignment” (A/CN.9/WG.2/WP.96, draft article 2), could be deleted. Moreover, it was noted that, in view of the fact that often all rights arising under a contract were assigned, covering in the draft Convention only the assignment of rights to payment could result in different parts of the same transaction being subjected to different legal regimes. It was also noted that that problem would not arise in the case of assignments of contracts (which involved an assignment of contractual rights and a delegation of obligations), since such contracts were involved in exceptional transactions that could be left outside the scope of the draft Convention.

40. There was general support in the Working Group for the substance of draft article 2. It was widely felt that the
draft Convention should cover outright assignments and assignments by way of security, as well as related trans-
actions involving the transfer of receivables or the creation of security rights in receivables (e.g. contractual subro-
gation and pledge of receivables). It was stated that such an approach was appropriate in particular in view of the fact
that, in certain legal systems, significant receivables financing transactions, such as factoring, involved a con-
tractual subrogation or pledge rather than the assignment of receivables. In that connection, it was recalled that an
explicit reference to such transactions, contained in an earlier version of draft article 2 (A/CN.9/WG.II/WP.93), had
been deleted on the understanding that listing such related practices might inadvertently result in excluding some of
them (A/CN.9/445, para. 151). In order to avoid creating any doubt with regard to that matter, it was agreed that the
commentary could usefully clarify it. It was also agreed that the commentary could also elaborate on the fact that
the draft Convention, rather than creating a new type of assignment, was aimed at providing uniform rules on as-
signment and assignment-related practices currently existing under national law.

41. As to the specific formulation of draft article 2, the suggestion was made that the word “including” should be
replaced by the word “or”, since in some legal systems the creation of a security right in receivables did not constitute
a transfer. In that connection, it was recalled that the reference to the creation of security rights in receivables
had been included in draft article 2 in order to reflect the Working Group’s agreement that the mere creation of a
security interest that did not involve a transfer should be covered by the draft Convention (A/CN.9/445, para. 152).

42. With regard to receivables arising by law (e.g. tort or tax receivables), while some support was expressed in
favour of the view that the draft Convention should apply to their assignment, it was agreed that that was not neces-
sary, since no significant financing practice existed with regard to such receivables.

43. After discussion, the Working Group adopted the sub-
stance of draft article 2 and referred it to the drafting group.
In view of its decision to cover only the assignment of con-
tractual receivables, the Working Group decided to delete paragraph (7) of draft article I, which was intended
to accommodate those States that would wish to apply the draft Convention to the assignment of receivables arising
by operation of law (see para. 29).

Article 3. Internationality

44. The text of draft article 3 as considered by the Work-
ing Group was as follows:

"[(1)] A receivable is international if, at the time it
arises, the assignor and the debtor are located in dif-
ferent States. An assignment is international if, at the time
it is made, the assignor and the assignee are located in
different States.

"[(2)] In the case of an assignment of more than one
receivable by more than one assignor, the assignment is
international if any assignor and the assignee are
located in different States. In the case of an assignment
of more than one receivable to more than one assignee,
the assignment is international if the assignor and any
assignee are located in different States.

“(3) In the case of more than one receivable owed to
more than one creditor, the receivable is international if
any assignor and the debtor are located in different
States.] In the case of an assignment of more than one
receivable owed by more than one debtor, only that
receivable is international in which the assignor and the
debtor are located in different States.]"

45. The Working Group found the substance of paragraph
(1) to be generally acceptable and referred it to the drafting
group. With respect to paragraphs (2) and (3), the Working
Group deferred its final decision until it had completed its
review of the draft Convention, in order to allow for con-
sultations with regard to the financing practices involving
multiple parties (see paras. 28 and 223-227).

46. The text of draft article 4 as considered by the Work-
ing Group was as follows:

"[(1)] This Convention does not apply to assignments
made:

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

"(b) to the extent made by endorsement and delivery
or only by delivery of a negotiable instrument;

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

"[(2) This Convention does not apply to assignments
listed by a State in a declaration made under draft article
42quater.]"

Paragraph (1)

47. The substance of paragraph (1) was found to be gen-
erally acceptable. With respect to subparagraph (a), how-
ever, a concern was expressed that the reference to assign-
ments made “for personal, family or household purposes”
might introduce some uncertainty to the extent that the
purpose for which any given assignment had been made
might not always be easily determined. In order to address
that concern, it was agreed that the commentary would
clarify, possibly by way of examples inspired from case law
on article 1 of the United Nations Convention on Contracts
for the International Sale of Goods (hereinafter referred to
as “the Sales Convention”), the types of assignments
covered under the reference to “personal, family or house-
hold purposes”. With regard to subparagraph (b), it was
suggested that it might need to be reformulated in order to
clarify that endorsement was not required in all cases.
(e.g. in negotiable instruments payable to the bearer). As to subparagraph (c), it was agreed that the commentary could usefully clarify that the assignment from the old to the new owner was excluded and not the assignment from the new owner to an institution financing the sale.

48. In order to avoid any interference with well-established and sufficiently regulated practices, the Working Group considered various suggestions as to additional practices that should be excluded from the scope of application of the draft Convention. One suggestion was to exclude operations of clearing houses settling payments between banks. The example was given of uncertificated securities, the transfer of which should continue to be effected under the rules of clearing houses. Another suggestion was that netting schemes, which might play an important role in transactions involving derivatives, should be excluded from the sphere of application of the draft Convention. Still another suggestion was that repo transactions, involving the sale and the buying back of securities, should be excluded. Still another suggested exclusion concerned swap agreements (which involved an undertaking to accept a risk, e.g. a floating charge, and in which any party could be a creditor or a debtor). It was explained that transactions involving clearing houses, netting arrangements and repo or swap agreements would typically include anti-assignment clauses or would condition the assignment on acceptance by the debtor and would thus contradict draft article 12. Yet another suggested exclusion concerned real estate leases that were typically recorded in a land registry and were often subject to the law of the country where the real estate was located (i.e. the lex situs).

49. While the Working Group noted the importance of avoiding any interference with the normal operation of such transactions, it was widely felt that the issue should be considered further, possibly after additional consultation had been carried out with the relevant industry and practitioners in order to determine whether such (or other) transactions should be excluded from the scope of application of the draft Convention altogether (either in paragraph (1) or in paragraph (2) of draft article 4), or simply excluded from the scope of draft article 12.

Paragraph (2)

50. It was noted that paragraph (2) was intended to allow States to exclude assignment practices other than those listed in paragraph (1). A note of caution was struck that such an approach might not be the most appropriate approach to law unification to the extent that: the scope of application of the draft Convention might differ from State to State; and unclear declarations by States might reduce certainty with regard to the application of the draft Convention. It was noted, however, that such an approach might make the draft Convention more acceptable to States.

51. It was stated that, in its current formulation, paragraph (2) did not clarify which State would have to make the declaration so that the draft Convention would not apply to assignments listed in that declaration. In order to address the matter, it was suggested that a reference should be included in paragraph (2) to the State of the assignor’s location, since the territorial scope of the draft Convention was determined by reference to the assignor’s location. It was observed that, for the same reason, reference would need to be made with respect to the provisions of the draft Convention that dealt with the debtor’s rights and obligations to the State of the debtor’s location.

52. Subject to addressing that matter, a task with which the Working Group entrusted the drafting group, the Working Group decided to retain paragraph (2) within square brackets, deferring final decision on paragraph (2) until it had concluded its discussion on paragraph (1).

Chapter II. General provisions

Article 5. Definitions and rules of interpretation

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

“For the purposes of this Convention:

“(a) ‘Original contract’ means the contract, if any, between the assignor and the debtor from which the assigned receivable arises [or by which the assigned receivable is confirmed, determined or modified];

“(b) A receivable is deemed to arise at the time when the original contract is concluded [or, in the absence of an original contract, at the time when it is confirmed or determined in a decision of a judicial or other authority];

“(c) ‘Future receivable’ means a receivable that arises after the conclusion of the assignment;

“(d) ‘Receivables financing’ means any transaction in which value, credit or related services are provided for value in the form of receivables. Receivables financing includes factoring, forfaiting, securitization, project financing and refinancing;

“(e) ‘Writing’ means any form of communication that is accessible so as to be usable for subsequent reference and provides identification of the sender and indication of the sender’s approval of the information contained in the communication by generally accepted means or by a procedure agreed upon by the sender and the addressee of the communication;

“(f) ‘Notification of the assignment’ means a communication in writing which reasonably identifies the assigned receivables, the assignee and the person to whom or for whose account or the address to which the debtor is required to make payment;

“(g) ‘Insolvency administrator’ means a person or body, including one appointed on an interim basis, authorized to administer the reorganization or liquidation of the assignor’s assets;
“(h) ‘Insolvency proceeding’ means a collective judicial or administrative proceeding, including an interim proceeding, in which the assets and affairs of the assignor are subject to control or supervision by a court or other competent authority for the purpose of reorganization or liquidation;

“(i) ‘Priority’ means the right of a party in preference to another party;

“(j) For the purposes of articles 23 and 24, an individual is located in the State in which it has its habitual residence; a corporation is located in the State in which it is incorporated; a legal person other than a corporation is located in the State in which its constitutive document is filed and, in the absence of a filed document, in the State in which it has its chief executive office;

“(k) For the purposes of articles 1 and 3:

“(i) the assignor is located in the State in which it has that place of business which has the closest relationship to the assignment;

“(ii) the assignee is located in the State in which it has that place of business which has the closest relationship to the assignment;

“(iii) the debtor is located in the State in which it has that place of business which has the closest relationship to the original contract;

“(iv) in the absence of proof to the contrary, the place of central administration of a party is presumed to be the place of business which has the closest relationship to the relevant contract. If a party does not have a place of business, reference is to be made to its habitual residence;

“(v) several assignors or assignees are located at the place in which their authorized agent or trustee is located;

“(l) ‘Time of the assignment’ means the time specified in an agreement between the assignor and the assignee and, in the absence of such an agreement, the time when the contract of assignment is concluded.”

Subparagraph (b)

55. The view was expressed that, even if the scope of the draft Convention was limited to assignments of contractual receivables, the reference in subparagraph (b) to a decision of a judicial or other (e.g. arbitral or administrative) authority might nevertheless need to be retained in the event of a dispute over a contractual receivable. For consistency with subparagraph (a), however, the Working Group adopted subparagraph (b) without the bracketed portion of the text and referred it to the drafting group.

Subparagraph (c)

56. It was suggested that the definition of a future receivable should clarify that the operative event was the conclusion of the contract of assignment, rather than the act of assigning a given receivable. Subject to that amendment, the Working Group adopted subparagraph (c) and referred it to the drafting group.

Subparagraph (d)

57. It was noted that the definition of “receivables financing” had originally been included in draft article 5 when the term had been used in draft article 1 in order to circumscribe the scope of application of the draft Convention. It was also noted that, as the term “receivables financing” was no longer used in the text, other than in the title, in the preamble and in draft article 14 (3), the question arose as to whether there remained any need for a definition of the term.

58. There was general agreement in the Working Group that, if the term “receivables financing” was to remain in the title of the draft Convention, it ought to appear either in the definitions, or in the preamble or in the commentary. Various views were expressed with respect to the manner in which and the place where the notion of “receivables financing” should be dealt with in the draft Convention. One view was that, if the term appeared in the title, a definition had to be provided in the draft Convention. Another view was that, although a definition was not strictly necessary, it could play an instructive role. However, a concern was expressed that, if the term were to be retained in the definitions, then it could be used to interpret the scope of the draft Convention too narrowly, limiting the application of the draft Convention only to assignments of receivables made for financing purposes. Another concern, referring to the formulation of the definition of “receivables financing”, was that the current definition was incomplete and that, as a consequence, existing or future practices might fall outside of the scope of the draft Convention. It was therefore suggested that, should a definition of “receivables financing” be retained, the current text should be revised so that it would not be exclusive; under that suggestion, the beginning of the second sentence of subparagraph (d) would be amended to read that “receivables financing includes, but is not limited to, ...”.

59. Another view was that, rather than incorporating the term “receivables financing” and defining it in the text of
the draft Convention, it could be referred to in the commentary. In that connection, however, a concern was expressed that the visibility and value of the reference would be considerably minimized, in view of the fact that the commentary would not have the same status as the text of the draft Convention itself.

60. Yet another view was that the definition of the term “receivables financing” should be incorporated into the preamble. It was generally felt, however, that retaining the reference to the term “receivables financing” in both the title and the preamble, while having included no such reference in draft article 1, might result in uncertainty as to the scope of the draft Convention. A concern was expressed that the inconsistency between the title and the preamble, on the one hand, and draft article 1 on the other, would only be enhanced if the definition of receivables financing were also to be incorporated in the preamble, or retained in the definitions.

61. In an attempt to resolve that inconsistency, a suggested revision of the title and preamble was proposed. With respect to the title, it was suggested that it should be revised to read “Draft Convention on Assignment of Receivables” or “Draft Convention on Assignment of Receivables in International Trade”. As to the preamble, it was suggested that it should be revised to read as follows:

“The Contracting States,

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

“Considering problems created by uncertainties as to the content and choice of legal regime applicable to assignment of receivables in international trade,

“Desiring to establish principles and adopt rules relating to the assignment of receivables that would create certainty and transparency and promote modernization of law relating to assignment of receivables, including but not limited to assignments used in factoring, forfaiting, securitization, project financing and refinancing, while protecting existing assignment practices and facilitating the development of new practices,

“Also desiring to ensure the adequate protection of the interests of the debtor in the case of an assignment of receivables,

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

62. It was pointed out that, if the proposed changes to the title and the preamble were to be adopted by the Working Group, the definition of “receivables financing” would be superfluous and a consequential amendment would be necessary in draft article 14 (3), to replace the term “receivables financing practice” with “assignment practice”.

63. A concern was expressed that revising the title of the draft Convention might exceed the mandate that had been given to the Working Group. It was recalled that the mandate given to the Working Group was to prepare a uniform law, the main purpose of which would be to remove obstacles to receivables financing arising from the uncertainty as to the validity and legal effect of assignment of receivables in international trade. The approach taken by the Working Group, according to which, while the main focus of the draft Convention would be on financing transactions, other related transactions should not be excluded (A/CN.9/420, paras. 41-43, A/CN.9/432, paras. 14-18 and A/CN.9/434, para. 18), was not inconsistent with the mandate given by the Commission to the Working Group. In view of the fact that the decision as to the scope of the draft Convention had already been taken by the Working Group, the proposal under consideration was simply an effort to align the title with the scope of application of the draft Convention.

64. The Working Group did not make a final decision with respect to the proposed changes to the title and the preamble. It was widely felt that the discussion should be resumed at a future session, after careful consideration of the proposal and appropriate consultations had taken place. While it was acknowledged that the proposed changes would resolve the recognized inconsistency between the title, the preamble and the scope of the draft Convention, concerns were expressed over the expanded scope of application. It was also stated that, under a wider scope, the provisions for exclusions from the scope of application would take on greater importance.

65. After discussion, the Working Group decided to leave subparagraph (d) in brackets and to include the proposals for the revised title and preamble also in brackets for continuation of the discussion at a future session.

Subparagraph (e)

66. It was recalled that subparagraph (e) defined the term “writing” by combining the definitions of “writing” and “signature” contained in articles 6 and 7 of the UNCITRAL Model Law on Electronic Commerce. Under the draft Convention, a signed writing was required for the assignment, for the notification of the assignment and for the debtor’s agreement not to raise defences against the assignee. The view was expressed that, as a matter of drafting, the operation under the draft Convention of the terminology borrowed from the Model Law on Electronic Commerce (e.g. the concepts of “sender” and “addressee of the communication”) might need to be further clarified.

67. As a matter of substance, doubts were expressed as to whether the concept of a “signed writing” as defined in subparagraph (e) was appropriate as a form requirement in all instances where a “writing” was required under the draft.

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Constitution. Examples were given of practical situations (particularly in the factoring industry) where, typically, assignments were made without any signature requirement being imposed on the parties to the transaction. However, the view was expressed that, while form requirements might be inappropriate as between assignors and assignees, some sort of authentication might be needed in the context of notification of assignments to debtors and, more generally, in the area of debtor protection, where debtors might legitimately expect a degree of authenticity in the communications they received (e.g. notification of assignment or payment instructions). It was stated that the text of subparagraph (e) might constitute a good compromise between the urge to reduce formalism and the need to preserve the security of transactions.

68. It was agreed that the need for higher assurances as to the authenticity of communications might be assessed differently depending on the context in which the reference to "writing" was made and the type of contractual relationship involved. It was widely felt that, while requiring the equivalent of a signature might be detrimental to established practice in the context of draft article 9 (form of the assignment), or superfluous in the context of draft article 5 (f) (notification of the assignment), it would be more appropriate in the context of draft article 20 (agreement not to raise defences or rights of set-off). However, the concern was expressed that such a requirement would interfere with domestic practices currently existing in some jurisdictions. After discussion, the Working Group decided that subparagraph (e) should reflect the two distinct notions of "writing" and "signed writing". It was also decided that a "signed writing" should be required only for the debtor's agreement to waive its defences against the assignee. On that understanding, the Working Group adopted subparagraph (e) and referred its specific formulation to the drafting group.

Subparagraph (f)

69. The discussion focused on the question whether, as a condition of its validity, the notification of an assignment should necessarily include payment instructions. It was widely felt that there was no obvious logical link between notifying the debtor of an assignment, on the one hand, and "identifying the person to whom or for whose account or the address to which the debtor is required to make payment", on the other. It was stated that, should the debtor be notified of an assignment (which merely implied that the debtor should no longer pay the assignor) and receive no payment instructions, the debtor could normally (under the law applicable outside the draft Convention) obtain discharge of its payment obligation by paying a court or a public entity established for the purpose of receiving such payments. In addition, it was observed that conditioning the validity of the notification on the inclusion of payment instructions would disregard the rapid development of practices where assignments were notified without specific payment instructions being given.

70. Suggestions were made with a view to limiting the effect of the reference to payment instructions under subparagraph (f). One suggestion was to make the inclusion of payment instructions in the notification a mere option. Another suggestion was to qualify the reference to payment instructions by the words "if appropriate" or "if necessary". Yet another suggestion was that language should be added to subparagraph (f) along the following lines: "If the person to whom the debtor is required to make payment is not identified, payment is to be made to the assignee". The prevailing view, however, was that the reference to payment instructions ("and the person to whom or for whose account or the address to which the debtor is required to make payment") should be deleted.

71. After discussion, the Working Group decided that no reference to payment instructions should be included in subparagraph (f). Subject to that change, the Working Group adopted subparagraph (f) and referred it to the drafting group, on the understanding that the operation of the subparagraph in the context of draft article 18 (discharge of the debtor) would need to be considered at a later stage.

Subparagraph (g)

72. The substance of subparagraph (g) was found to be generally acceptable. As a matter of drafting, it was widely felt that the definition of "insolvency administrator" should include a reference to the existence of an insolvency proceeding. It was stated that such an amendment was needed to ensure consistency between the text of the draft Convention and that of the UNCITRAL Model Law on Cross-Border Insolvency (article 2 (d)). Subject to that amendment, the Working Group adopted subparagraph (g) and referred it to the drafting group.

Subparagraph (h)

73. The suggestion was made that subparagraph (h) should be revised so as to include in the definition of the term "insolvency proceeding" administrative receiverships and voluntary windings-up. That suggestion was objected to on the grounds that voluntary winding-up might take many different forms which should not be included in the scope of the definition. It was widely felt that the Working Group should adopt the definition of the term "insolvency proceeding" used in the UNCITRAL Model Law on Cross-Border Insolvency (article 2 (a)). It was observed that that definition had been carefully crafted to take into account differences among the insolvency laws of member States. After discussion, the Working Group adopted subparagraph (h) unchanged and referred it to the drafting group.

Subparagraph (i)

74. The Working Group adopted subparagraph (i) and referred it to the drafting group.

Subparagraphs (j) and (k)

75. The Working Group recalled its decision to retain the text of subparagraphs (j) and (k) in brackets (see para. 37).
Subparagraph (1)

76. The view was expressed that the parties to the contract of assignment should not be allowed to specify a time of assignment that was earlier than the time when the contract was concluded, but should be permitted to specify a later time. As a matter of drafting, it was observed that subparagraph (1) did not make it sufficiently clear that the time specified by the parties was the time at which the transfer occurred.

77. A contrasting view was expressed in favour of full party autonomy, namely, that parties should also be allowed to agree that the transfer was to take place retroactively, provided that the rights of third parties were not adversely affected. In response, it was pointed out that party autonomy was sufficiently recognized under draft article 6, subject to the rights of third parties. Accordingly, it was suggested that the reference to party autonomy in subparagraph (1) should be deleted, so that the definition would read as follows: ""Time of assignment" means the time when the contract of assignment is concluded". In support of that suggestion, it was pointed out that the time of the contract assignment was a fact, rather than a matter for determination by the parties, in contrast to the effects of the assignment, which could be freely determined by the parties, subject to the rights of third parties.

78. After discussion, the Working Group decided to delete subparagraph (1) altogether and to replace the references to the "time of the assignment" in the draft Convention by a reference to the "time when the contract of assignment is concluded". The matter was referred to the drafting group.

Article 6. Party autonomy

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

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

80. It was recalled that the text of draft article 6 was intended to provide broad recognition of the principle of party autonomy, while avoiding interference with the rights of third parties. As to which specific parties might be covered by the notion of "third parties", it was explained that, typically, in the context of an agreement between the assignor and the assignee, "third parties" were the debtor, the assignor's creditors and the insolvency administrator. In the context of an agreement between the assignor and the debtor, "third parties" were the assignee, the assignor's creditors and the insolvency administrator. It was also recalled that agreements between the assignee and the debtor were not covered by the draft Convention. On the basis of that understanding, the Working Group adopted draft article 6 and referred it to the drafting group.

Article 7. Debtor's protection

81. It was noted that the general principle embodied in draft article 7 had been reflected in the preamble, while draft article 7 had been moved to the beginning of section II of chapter IV, dealing with the rights and obligations of the debtor (draft article 117ter) (see paras. 21 and 168-176). The Working Group approved that approach.

Article 8. Principles of interpretation

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

"(1) In the interpretation of this Convention, regard is to be had to its international character and to the need to promote uniformity in its application and the observance of good faith in international trade.

"(2) Questions concerning matters governed by this Convention, which are not expressly settled in it, are to be settled in conformity with the general principles on which it is based or, in the absence of such principles, in conformity with the law applicable by virtue of the rules of private international law (of this Convention).

"(3) Questions concerning matters governed by articles 9, 17bis, 19 (2), 23 and 24 and 29 to 33, which are not expressly settled in those articles are to be settled in conformity with the general principles on which they are based or, in the absence of such principles, in conformity with the law applicable by virtue of the rules of private international law of the forum State]."

Paragraph (1)

83. The Working Group adopted paragraph (1) unchanged.

Paragraphs (2) and (3)

84. It was noted that paragraph (3) was intended to fill gaps in the private international law provisions of the draft Convention by reference to the private international law principles underlying the draft Convention and, in the absence of such principles, by reference to the private international law provisions of the forum State.

85. It was widely felt that the bracketed text in paragraph (2) and paragraph (3) was not necessary and could indeed create uncertainty, since it was not clear what principles were being referred to. It was stated that draft article 8 was inspired by article 7 of the Sales Convention, which appropriately dealt with the matter and did not need to be changed. In addition, it was observed that the reference to the private international law provisions of the draft Convention, inserted in paragraph (2), would be inappropriate in the case of a non-Contracting State. After discussion, the Working Group decided that the wording in square brackets contained in paragraph (2) and paragraph (3) should be deleted. Subject to those changes, the Working Group adopted paragraph (2).
Chapter III. Form and effect of assignment

Article 9. Form of assignment

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

“(1) An assignment in a form other than in writing is not effective [as against third parties], unless:

“(a) it is effected pursuant to a contract between the assignor and the assignee which is evidenced by a writing describing the receivables to which it relates; or

“(b) the law of the State in which the assignor is located at the time of the assignment provides otherwise.

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

Paragraph (1)

87. It was noted that paragraph (1) addressed the validity of assignments made in a form other than writing, i.e. the validity of oral assignments. It was recalled that, at previous sessions, the Working Group had observed a stark difference between those States whose legislation established a writing requirement and those States where the validity of oral assignments was recognized (A/CN.9/432, paras. 82-86, and A/CN.9/434, paras. 102-106). The provisions of paragraph (1) had arisen out of efforts to derive a minimum requirement with respect to the form of an assignment, while maintaining a workable compromise between the alternative approaches followed by those two categories of States (A/CN.9/445, paras. 201-203). Recalling its decision concerning the meaning of “writing” (see para. 68), the Working Group based its discussions on the assumption that the term “writing”, as used in paragraph (1), was to be understood as a reference to article 6 of the UNCITRAL Model Law on Electronic Commerce (i.e. without any signature or authentication requirement).

88. With respect to the purpose and scope of paragraph (1), it was generally agreed that the provision was not intended to establish a general form requirement, the non-observance of which would affect the validity of the assignment. It was stated that paragraph (1) was merely intended to protect third parties in situations where an oral assignment had taken place. Accordingly, it was generally felt that wording along the lines of “as against third parties” might be necessary. In that context, it was also suggested that, should paragraph (1) be retained, the title of draft article 9 might need to be amended to indicate more clearly that the focus of the draft article was on the protection of third parties and on oral assignments. It was pointed out that the heading of the chapter might require revision as well.

89. As regards subparagraph (a), it was stated that, if the form requirement related to the effectiveness of oral assignments as against third parties, it would be advisable to retain a reference to the description of receivables (a description which was said to be unnecessary as between the parties to the assignment). It was pointed out, however, that requiring that the assigned receivables should be “described” in the written document evidencing the assignment might not constitute a workable rule, in particular, in the case where future receivables were assigned. It was suggested that the words “a writing describing the receivables to which it relates” should be replaced by wording along the lines of “a writing reasonably identifying the receivables to which it relates”.

90. Given the minimalist nature of the form requirements contained in subparagraph (a) (which referred to an unsigned writing), the view was expressed that subparagraph (b) was not necessary, since it was difficult to envision that any domestic law would have an even lesser requirement. The concern was expressed, however, that the deletion of subparagraph (b) might invalidate assignments in those States where no writing at all was required (or where writing related to an act of a party but not necessarily to the contract as a whole), a result which could adversely affect the rights of third parties. In response, it was pointed out that the main issue addressed in paragraph (1) was the effectiveness of an assignment as against third parties, a matter that was addressed in draft articles 23 and 24. In respect of the form requirements as between the assignor and the assignee, it was observed that the matter was addressed in draft article 6. In respect of form requirements as against the debtor, it was stated that the matter was addressed in draft article 16. Any additional requirements under domestic law were not supplanting by the draft Convention. It was thus suggested that both subparagraphs (a) and (b) should be deleted.

91. The view was expressed that there was no harm in retaining both subparagraphs (a) and (b), whereas their deletion might have unforeseen consequences. The prevailing view, however, was that, if subparagraph (b) were to be retained, subparagraph (a) did not achieve its intended purpose, namely, to provide at least a minimal writing requirement for assignments. It was stated that: under paragraph (1), there was no minimal writing requirement for transactions made in writing, since the opening words of paragraph (1) excluded such assignments; and as to oral assignments, the effect of subparagraph (b) was to defer to the law of the State of the assignor, which might not establish any such requirement. After discussion, the Working Group decided to delete paragraph (1).

Paragraph (2)

92. Wide support was expressed in favour of the principle embodied in paragraph (2) that one act was sufficient to transfer several, or future, receivables. After discussion, the Working Group adopted paragraph (2) and referred its formulation and placement in the text to the drafting group.
Article 10. Effect of assignment

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

"Subject to articles 23 and 24, an assignment of existing or future, one or more, receivables, and parts of, or undivided interests in, receivables is effective, if

"(a) the receivables are specified individually as receivables to which the assignment relates; or

"(b) the receivables can be identified as receivables to which the assignment relates, at the time agreed upon by the assignor and the assignee and, in the absence of such agreement, at the time when the receivables arise."

94. It was noted that the main purpose of draft article 10 was to validate assignments of future receivables, bulk assignments and partial assignments as between the assignor and the assignee and as against the debtor, but not as against third parties. In order to indicate more clearly the purpose of draft article 10, it was agreed that the title should refer to the "effectiveness" of the types of assignment referred to in draft article 10. As to the way in which the purpose of draft article 10 might be better reflected in the text of draft article 10, it was stated that use of the term "validity" might be more appropriate, since in many legal systems the term "effectiveness" was used to reflect effects as against third parties. In response, it was observed that the term "effectiveness" was preferable to the extent that it reflected the notion of a transfer of property rights. In addition, it was pointed out that the term "validity" was not universally understood in the same way.

95. It was noted that the opening words of the chapeau of draft article 10 ("subject to articles 23 and 24"), which appeared also in the chapeau of draft article 11 (1), were intended to ensure that draft articles 10 and 11 left the rights of third parties unaffected, since, in the absence of those words draft article 10 could be read as validating the first assignment and invalidating any further assignment of the same receivables by the same assignor; and draft article 11 could be read as setting a rule dealing with the effectiveness of the assignment as against third parties, including the administrator in the insolvency of the assignor (e.g. receivables arising after the opening of an insolvency proceeding could be taken out of the insolvency estate or be subject to a security right if the assignment had taken place before the opening of the insolvency proceeding).

96. However, it was also noted that the opening words of draft article 10 might inadvertently result in the effectiveness of the assignment of future receivables or of bulk assignments being left altogether to the law applicable under draft articles 23 and 24. In order to avoid that unintended result, the Working Group decided that the opening words of draft articles 10 and 11 should be deleted. It was stated that such an approach would not give the impression that those draft articles dealt with the rights of third parties, if the draft Convention was read as a whole. In addition, it was observed that the result would rather be that the draft Convention validated such assignments, as a matter of civil or commercial law, while leaving to other law specific challenges to their validity (e.g. the invalidation of an assignment made within the suspect period before the opening of an insolvency proceeding as a fraudulent or preferential transfer). As to the question whether the matter needed to be clarified further in draft articles 23 and 24, the Working Group postponed a final decision until it had completed its review of the draft Convention.

97. General support was expressed for the principles embodied in subparagraphs (a) and (b). As to their specific formulation, a number of suggestions were made. One suggestion was that in subparagraph (a) the term "described" should be substituted for the term "specified", in order for the draft Convention to avoid invalidating practices in which the standard of "specification" of the assigned receivables was too high to be met. Another suggestion was that in subparagraph (b) the reference to agreement of the parties was not necessary in view of the general recognition of party autonomy in draft article 6. Subject to those changes, the Working Group adopted draft article 10 and referred it to the drafting group.

Article 11. Time of transfer of receivables

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

"(1) Subject to articles 23 and 24,

"(a) a receivable other than a future receivable is transferred at the time of the assignment;

"(b) a future receivable is deemed to be transferred at the time of the assignment.

"(2) If a State makes a declaration under article 43, paragraph (1) is subject to the priority rules referred to in the declaration [instead of articles 23 and 24]."

99. It was noted that draft article 11 was intended to set the time of the transfer of both existing and future receivables, as between the assignor and the assignee, as well as against the debtor, but not as against third parties. In addition, it was noted that, in line with the decision made with regard to the opening words of draft article 10 (see para. 96), the opening words of draft article 11 and paragraph (2) should be deleted. Moreover, it was noted that, in view of the decision made by the Working Group to delete draft article 5(1) (see para. 78), the reference to the time of assignment in draft article 11 should be replaced by a reference to the time of the conclusion of the contract of assignment.

100. Diverging views were expressed as to whether draft article 11 should be retained. One view was that draft article 11 did not serve any useful purpose and should be deleted. It was stated that the assignor and the assignee
could set the time of the transfer of the assigned receivables as between themselves on the basis of draft article 6. In addition, it was pointed out that draft article 10 was sufficient in providing that the assignment was effective as against the debtor even before notification, while the debtor was sufficiently protected through the defences set forth in draft article 18. Moreover, it was observed that the time of transfer as against third parties was, under draft articles 23 and 24, left to the law of the assignor's location.

101. The prevailing view, however, was that draft article 11 was useful in providing a flexible default rule with regard to the time of transfer of the assigned receivables. In addition, it was stated that draft article 11 usefully clarified that parties could specify that their contracts could take effect at a later point of time. In that connection, it was observed that, while parties could not change the time of the conclusion of the contract of assignment, they should be able to change the time of the transfer of the receivables as between themselves and as against the debtor and other third parties. It was pointed out that, while it was clear that that ability existed with regard to the relationship as between the assignor and the assignee on the basis of draft article 6, it was not clear whether it existed with regard to the debtor and other third parties. It was also said that the ability of the assignor and the assignee to set a different time of transfer as against the debtor and other third parties should be preserved and, at the same time, limited to the extent that the assignor and the assignee would be able to set a time of transfer which was later than the time of the conclusion of the contract of assignment. Such an approach would accommodate the needs of the assignor and the assignee without unduly affecting the rights of third parties. Moreover, it was pointed out that draft article 11 was useful in clarifying the meaning of other relevant provisions, such as draft articles 6, 10, 18, 23 and 24.

102. In the discussion, it was observed that, in view of the fact that "assignment" was defined as a transfer and draft article 10 referred to the effectiveness of assignment, it would be more appropriate to refer in the title of draft article 11 to the "time of the assignment".

103. Subject to the changes mentioned in paragraphs 99, 101 and 102, the Working Group adopted draft article 11 and referred it to the drafting group.

**Article 12. Contractual limitations to assignment**

104. The text of draft article 12 as considered by the Working Group was as follows:

"(1) A receivable is transferred to the assignee notwithstanding any agreement between the assignor and the debtor, or, in the case of any subsequent assignment, between the initial or any subsequent assignor and the debtor or any subsequent assignee, limiting in any way the assignor's right to assign its receivables.

"(2) Nothing in this article affects any obligation or liability of the assignor for breach of such an agreement. A person who is not party to such an agreement is not liable under that agreement for its breach.

"(3) This article does not apply to assignments of receivables arising under loan agreements, deposit accounts, independent guarantees and stand-by letters of credit, contracts concluded for personal, household or family purposes, and public procurement contracts."

105. It was noted that the main purpose of draft article 12 was to validate assignments made in violation of anti-assignment clauses, thus giving the assignee a priority position as against the assignor's creditors in the case of default by the assignor and enabling the assignee to collect directly from the debtor. It was also noted that the underlying policy was that it was more beneficial for everyone to reduce the transaction cost of examining contracts in order to ensure that they did not contain anti-assignment clauses rather than to protect the debtor from paying a person other than the original creditor (assignor).

**Paragraph (1)**

106. The substance of paragraph (1) was found to be generally acceptable. As to the reference to subsequent assignments, it was agreed that it should be limited to the identification of the parties between whom an anti-assignment clause could be agreed upon (i.e., the parties to the original contract and the parties to an initial or a subsequent assignment). After discussion, the Working Group adopted paragraph (1) and referred it to the drafting group.

**Paragraph (2)**

107. It was noted that paragraph (2) was intended to ensure that any liability that the assignor might have as against the debtor, under law applicable outside the draft Convention, for breach of an anti-assignment clause was not interfered with, while such contractual liability would not be extended to the assignee. It was also noted that paragraph (2) was not intended to address the question of the potential tort liability of the assignee, which would arise, e.g. if the assignee induced the assignor to assign its receivables in violation of an anti-assignment clause with the intent to harm the interests of the debtor or another party. In that connection, it was noted, however, that tortious liability would sanction malicious behaviour on the part of the assignee. It was also noted that mere knowledge of the existence of an anti-assignment clause would not be sufficient to give rise to liability of the assignee since such a possibility could deter potential assignees from entering into a financing transaction, a result that would run counter to the main objective of the draft Convention to promote the availability of lower-cost credit. There was general support in the Working Group for the principle embodied in paragraph (2). After discussion, the Working Group adopted paragraph (2) unchanged.
Paragraph (3)

108. It was noted that the main purpose of paragraph (3) was to establish a specific debtor-protection rule, according to which in the case of a contractual limitation to assignment, while the assignment would be effective as between the assignor (and the assignor's creditors) and the assignee, it would be ineffective as against the debtor. As a result of such a rule, certain debtors would be entitled to discharge their obligation by continuing to pay the assignor despite an assignment or its notification. Some doubt was expressed as to the appropriateness of an approach based on a list of debtors to be exempted from the rule set forth in paragraph (1). Other suggested approaches included exemptions listed in draft article 4(1) or exemptions to be made by way of declarations by States under draft article 4(2).

109. The approach used in paragraph (3), which relied on a listing of financial practices not to be interfered with by the draft Convention, was criticized on the grounds that any such list would necessarily be incomplete in view of the rapid evolution of such financial techniques and might unduly interfere with future developments in that area. As examples of financial practices that might also need to be excluded from the scope of draft article 12, swap agreements and repo or reverse repo agreements were mentioned. The alternative approach that was suggested (i.e. the inclusion of an open-ended provision describing such financial practices in sufficiently broad terms to cover existing practices and future developments) was found to be impractical in view of the difficulty of describing a wide range of heterogeneous and rapidly changing practices with sufficient precision. With respect to the individual practices listed in paragraph (3), it was pointed out that the terminology used might be insufficiently clear.

“loan agreements, deposit accounts”

110. With respect to “loan agreements”, it was explained that the aim of the provision was to recognize loan-syndication practice, under which an assignment was possible only if the terms of the loan agreement so permitted. However, it was widely felt that the words “loan agreements” might be interpreted as covering such various agreements as loans of currency or discounting of trade receivables. As to “deposit accounts”, it was widely felt that the notion itself and the legal regime that might be applied to such accounts might vary considerably from country to country.

111. After discussion, the Working Group decided that, instead of attempting to establish a list of financial practices to be excluded from the scope of draft article 12, such practices should be borne in mind when reviewing the provisions of the draft Convention dealing with debtor protection. Doubts were expressed, however, as to whether a specific debtor-protection mechanism was needed for the powerful debtors that would typically become involved in such financial transactions. It was also agreed that financial practices should be borne in mind in the review of draft article 4, to be conducted at the next session of the Working Group (see para. 49). After discussion, the Working Group decided that the reference to “loan agreements” and “deposit accounts” should be deleted from paragraph (3).

“independent guarantees and stand-by letters of credit”

112. As to independent guarantees and stand-by letters of credit, it was recalled that they had been included in paragraph (3) in view of the generally accepted rule of independent-guarantee or stand-by practice that the guarantor/issuer of an independent undertaking should not have to pay against its will a person other than the beneficiary (see, e.g. articles 10 and 11 of the United Nations Convention on Independent Guarantees and Stand-by Letters of Credit, hereinafter referred to as “the Guarantee and Standby Convention”). It was pointed out, however, that a distinction should be drawn between the transfer of the right to demand payment (article 9 of the Guarantee and Standby Convention), which was possible only if authorized in the undertaking, and the transfer of proceeds (article 10 of the Guarantee and Standby Convention), which was possible unless otherwise stipulated in the undertaking. On the understanding that the proceeds (as opposed to the right to demand payment) should be regarded as the receivable under an independent guarantee or a stand-by letter of credit, it was stated that there was no risk of conflict between the Guarantee and Standby Convention and the draft Convention. After discussion, it was agreed that the reference to “independent guarantees and stand-by letters of credit” should be deleted.

“contracts concluded for personal, household or family purposes”

113. A question was raised as to the possible interplay between the exclusion of assignments made for consumer, i.e., for personal, family or household purposes under draft article 4 and the exclusion of assignments of receivables arising from consumer contracts under draft article 12(3). In response, it was explained that draft article 4 was intended to exclude assignments made for consumer purposes, but not the assignment of consumer receivables, while draft article 12 was intended to invalidate an assignment of a consumer receivable only as against the consumer-debtor. It was recalled that the benefit expected from the draft Convention was the increased availability of credit at a lower cost. In that context, it was generally felt that excluding the assignment of consumer receivables from the scope of draft article 12 might unnecessarily limit the availability of those benefits to consumers.

114. As to the reasons why paragraph (3) sought to invalidate the assignment of consumer receivables as against consumer-debtors, it was noted that, for example, in the case of securitization of mortgage loans, an assignment against the consumer-debtor might materially increase the burden of risk imposed on the consumer-debtor (e.g. if the mortgage loan was assigned by the friendly local savings and loan bank to a foreign lender, who might be more aggressive in the collection of the outstanding amounts of
the loan or in handling any variable interest rate). While it was agreed that those reasons called for specific attention to the protection of consumer-debtors in the context of the draft articles dealing with debtor protection, it was widely felt that they should not result in an invalidation of assignments of consumer receivables as against consumer-debtors. It was pointed out that the majority of consumer contracts were contracts of adhesion where, typically, no anti-assignment clauses would be included. Thus, the practical relevance of overriding anti-assignment clauses in consumer transactions was said to be limited. After discussion, it was decided that the words “contracts concluded for personal, household or family purposes” should be deleted.

“Public procurement contracts”

115. Diverging views were expressed as to whether an assignment made despite an anti-assignment clause should be invalidated if the debtor was a Government. One view was that such an approach would not be appropriate. It was stated that once the principle embodied in paragraph (1) was accepted, there was no substantive reason why special protection should be granted to any powerful debtor. In addition, it was observed that such an approach might be unnecessary, since in any case governmental debtors could protect themselves by law. Moreover, it was pointed out that permitting anti-assignment clauses to invalidate the assignment of receivables as against a sovereign debtor could inadvertently result in raising the cost of credit for small- and medium-size suppliers of goods and services, which would make it even harder for them to compete with large suppliers for public procurement contracts, since large suppliers would normally have alternative sources of credit. The prevailing view, however, was that the specific legal regime of public procurement and other administrative contracts should be preserved, since any interference with such a legal regime might seriously affect the acceptability of the draft Convention. In addition, it was pointed out that, unless such an approach were to be followed, Government-debtors in a number of countries might be left without protection, to the extent that the non-assignability of public procurement receivables would stem not from legislation but from case law or from established practice. Moreover, it was observed that the extent to which exemptions would have a practical effect, possibly affecting competition between suppliers, as described above, would depend on the degree to which sovereign debtors would include anti-assignment clauses in public procurement contracts, and that was a decision that sovereign debtors should be free to make. It was also mentioned that, while the assignment of procurement contracts was beyond the scope of the draft Convention, the assignment of the proceeds of receivables arising from such contracts was within the scope of the draft Convention. Thus, it was said, a provision along the lines of paragraph (3), allowing a governmental debtor to discharge its obligation by paying the assignor, would appropriately address any legitimate concerns of such a debtor.

116. As to the scope of paragraph (3), it was observed that, in addition to the central Government, the paragraph might apply to emanations of the State, including local public authorities, State-owned and other public companies. It was stated that, while paragraph (3) might appropriately apply to governmental entities performing governmental functions, it should not apply to publicly owned commercial entities (e.g. airlines) or to governmental entities acting in a commercial capacity. It was agreed that a specific provision should be introduced within square brackets in the draft Convention for consideration by the Working Group at its next session, based on the relevant definitions contained in the UN/UNCITRAL Model Law on Procurement. Subject to that change and to the deletion of the other practices listed in the paragraph, the Working Group adopted paragraph (3) and referred it to the drafting group.

Article 13. Transfer of security rights

117. The text of draft article 13 as considered by the Working Group was as follows:

“(1) A personal or property right securing payment of the assigned receivable is transferred to the assignee without a new act of transfer, unless it is by law [independent] [transferable only with a new act of transfer]. If such a right is by law [independent] [transferable only with a new act of transfer], the assignor is obliged to transfer the proceeds of this right to the assignee.

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

“(3) Nothing in this article affects any obligation or liability of the assignor for breach of an agreement under paragraph (2). A person who is not a party to such an agreement is not liable under that agreement for its breach.

“(4) Paragraph (1) of this article does not affect any requirement under rules of law other than this Convention relating to the form or registration of the transfer of any rights securing payment of the assigned receivable.”

Paragraph (1)

118. It was noted that paragraph (1) was intended to reflect a principle accepted in most legal systems, namely that accessory security rights were inextricably linked with the receivable which they secured. General support was expressed for that principle. It was stated that often the value relied on by the lender extending credit to the assignor was in the right securing the receivable rather than in the receivable itself.

119. As to the exact way in which the notion of an accessory right might be expressed in paragraph (1), while
the concern was expressed that the second set of bracketed language might be circular, it was agreed that it was preferable, since it left the question of the accessory or independent nature of the security right to law applicable outside the draft Convention. In order to avoid any uncertainty as to whether the law applicable to the assignment or to the security right was meant, it was agreed that the paragraph should be revised to make it sufficiently clear that the independent or accessory character of a security right would be determined on the basis of the law governing that right. On the assumption that the beneficiary’s right to demand payment in the case of an independent guarantee or a stand-by letter of credit was not a receivable (see para. 112), the Working Group agreed that the assignor should be obliged to assign not only the proceeds but also the right to payment arising from such an instrument. Subject to those changes, the Working Group adopted paragraph (1) and referred it to the drafting group.

**Paragraph (2)**

120. It was noted that, in line with draft article 12 (1), paragraph (2) was intended to ensure that, with regard to contractual limitations to assignment, a security right would be treated as a receivable in the sense that an agreement limiting the assignor’s right to transfer a security right would not invalidate its transfer. It was also noted that, in the case of an assignment, such an agreement would in effect result in the security right being extinguished if an accessory right was involved, or, in the right being not assignable, if an independent right was involved.

121. The view was expressed that, while that rule was appropriate if the security right had been granted by the debtor, it might not be appropriate if the right had been granted by a third party (e.g. a third-party guarantor). The prevailing view, however, was that the paragraph was appropriately cast. It was stated that it would be of no concern to the third party whether to pay the assignor or the assignee, since the conditions under which that third party might have to pay would remain unchanged.

122. The view was expressed that, if the third party granting the security was a governmental entity, in the case of a contractual limitation to assignment, the assignment should be ineffective as against the governmental entity. It was stated that such an approach would be consistent with the approach adopted in draft article 12 with regard to governmental debtors (see paras. 115-117).

123. While it was observed that governmental entities, securing payment of the assigned receivable as third parties, should be treated differently from governmental debtors, it was agreed that such governmental entities needed to be exempted from the rule set forth in paragraph (2). The Working Group adopted paragraph (2) and referred the formulation and the placement of an appropriate provision to the drafting group.

**Paragraph (3)**

124. It was noted that, in line with draft article 12 (2), paragraph (3) was intended to ensure that any liability that the assignor might have, under law applicable outside the draft Convention, for the breach of an anti-assignment clause should not be affected by the draft Convention, but should not be extended to the assignee either (see para. 107).

125. It was also noted that paragraph (3) was intended to cover any liability that the assignor might have under the law governing the security right for damages suffered as a result of the assignment by the debtor or other person granting a possessory property right (e.g. if pledged shares ended up in the hands of a foreign assignee who caused damage to the debtor or other person granting the security right; A/CONF.9/434, paras. 145-146). However, in view of the doubt expressed as to whether that matter was sufficiently covered in paragraph (3), it was suggested that it should be addressed explicitly along the lines of an earlier version of paragraph (3) (A/CONF.9/WG.1/II/WP.96). After discussion, the Working Group adopted paragraph (3) unchanged and asked the drafting group to reintroduce in the text an additional paragraph as suggested.

**Paragraph (4)**

126. It was noted that paragraph (4) was intended to ensure that form requirements existing under the law governing a security right would not be affected. It was suggested that an explicit reference to the law governing the security right might be usefully added. However, the Working Group adopted paragraph (4) unchanged and referred it to the drafting group.

**Chapter IV. Rights, obligations and defences**

**Section I. Assignor and assignee**

**Article 14. Rights and obligations of the assignor and the assignee**

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

“(1) Subject to the provisions of this Convention, the rights and obligations of the assignor and the assignee arising from their agreement are determined by the terms and conditions set forth in that agreement, including any rules or general conditions referred to therein.

“(2) The assignor and the assignee are bound by any usage to which they have agreed and, unless otherwise agreed, by any practices which they have established between themselves.

“(3) In an international assignment, the assignor and the assignee are considered, unless otherwise agreed, to have impliedly made applicable to the assignment a
usage which in international trade is widely known to, and regularly observed by, parties to the particular receivables financing practice."

128. It was noted that draft article 14 had already been adopted by the Working Group (A/CN.9/447, paras. 17-24 and 161). Some doubt was expressed as to whether the opening words of paragraph (1), or paragraph (1) altogether, were necessary, in view of the fact that they appeared to be inconsistent with, or at least repeat, the principle of party autonomy set forth in draft article 6. The text of draft article 14 was referred to the drafting group with a view to ensuring consistency with draft article 6 and with the more recent amendments of the draft Convention with regard to the title of the draft Convention and the preamble (see paras. 61-65).

Article 15. Representations of the assignor

129. The text of draft article 15 as considered by the Working Group was as follows:

"(1) Unless otherwise agreed between the assignor and the assignee, the assignor represents at the time of the contract of assignment that:

"(a) the assignor has the right to assign the receivable;

"(b) the assignor has not previously assigned the receivable to another assignee; and

"(c) the debtor does not and will not have any defences or rights of set-off.

"(2) Unless otherwise agreed between the assignor and the assignee, the assignor does not represent that the debtor has, or will have, the financial ability to pay."

130. It was noted that draft article 15 had already been adopted by the Working Group (A/CN.9/447, paras. 25-40 and 161).

Article 16. Right to notify the debtor

131. The text of draft article 16 as considered by the Working Group was as follows:

"(1) Unless otherwise agreed between the assignor and the assignee, the assignor or the assignee or both may send the debtor notification of the assignment and request that payment be made to the person or to the address identified in the notification. [However, after notification is received by the debtor only the assignee may notify the debtor and request that payment be made to another person or address.]

"(2) Notification of the assignment or request for payment made by the assignor or the assignee is not ineffective for the sole reason that it is in breach of an agreement referred to in paragraph (1) of this article. However, nothing in this article affects any obligation or liability of the party in breach of such an agreement for any damages arising as a result of the breach."

132. It was noted that the Working Group, at its twenty-eighth session, had adopted the substance of draft article 16 without drawing a distinction between a notification and a request for payment. In addition, it was noted that, while some support had been expressed at that session in favour of drawing such a distinction, that approach had been objected to on a number of grounds, including the following: it unnecessarily formalized a distinction that eventually had practical importance in exceptional situations only, since assignees notifying debtors could not afford to leave any uncertainty as to whom the debtor should pay; it could inadvertently raise the cost of credit, if seen as encouraging parties to serve two "notifications", one without and one with payment instructions; and would complicate the discharge of the debtor, since the debtor would have to know the legal consequences of each type of notification (A/CN.9/447, paras. 75-78). Moreover, it was noted that the matter had come up again in the context of a discussion of draft articles 18 (3) (as to whether the assignee could change or correct the payment instructions given to the debtor with the notification), 19 (2) and 21 (4) (as to whether a notification which did not identify the payee should bring about the legal consequences described in those draft articles) and had not been resolved (A/CN.9/447, paras. 46, 74-76, 82-83, 99-100 and 135).

133. It was recalled that, at the present session, the Working Group had decided that, subject to further review of the matter in the context of draft article 18, the reference to the payee contained in the definition of "notification of the assignment" should be deleted (see para. 71). As a result, there was a need for a distinction to be drawn between a notification and a payment instruction for draft articles 16 and 18 to apply. While the Working Group postponed a final decision on the matter until it had the opportunity to review draft article 18, with a view to reflecting that distinction, a proposal was made (A/CN.9/WG.II/3/WP.100) that draft article 16 should be redrafted as follows:

"(1) Unless otherwise agreed between the assignor and the assignee, the assignor or the assignee may send the debtor a notification of assignment and a payment instruction not at variance with article 7 (2).

"(2) A notification of assignment or payment instruction sent in breach of any agreement described in paragraph (1) is not ineffective for purposes of article 18 by reason of such breach, but nothing in this article affects any obligation or liability of the party in breach of such an agreement for any damages arising as a result of the breach."

The proposal was used by the Working Group as a basis for its deliberations.

Paragraph (1)

134. A number of questions were raised. One question was whether a payment instruction could create an obliga-
tion for the debtor in addition to the obligations arising from the original contract with the assignor. In response, it was explained that draft article 16 dealt with the relationship between the assignor and the assignee and was not intended to affect the debtor's rights or obligations. Another question was whether the debtor would be discharged of its payment obligation by paying according to the original contract, while ignoring a payment instruction that was at variance with article 7 (2), i.e., with "the debtor's right to pay in the currency and in the country specified in the payment terms contained in the original contract" (A/9/WG.11/1/WP.96, draft article 7 (2)). It was suggested that the words "not at variance with article 7 (3)" could be deleted, while the matter could be reviewed in the context of the discussion of draft article 17 (2), which had replaced draft article 7 (2).

135. It was stated that, after notification, whether the notification contained a payment instruction or not, the assignor was no longer the owner of the assigned receivables. It was thus suggested that paragraph (1) should be amended to provide that after notification was given, only the assignee could issue a payment instruction. With a view to reflecting the above suggestion, it was proposed that paragraph (1) might be revised to read as follows:

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

136. General support was expressed for the substance of the proposal. A question was raised as to the reasons why the proposed text referred to the time when the notification was "sent" and not to the time when it was "received". In response, it was explained that neither the assignor nor the assignee had a way of assessing the time of receipt, which was important for the protection of the debtor, a matter that was not affected by draft article 16. After discussion, the Working Group adopted the substance of the proposal and referred it to the drafting group.

Definition of "payment instruction"

137. In the context of the discussion of paragraph (1), it was widely felt that a definition of a "payment instruction" should be provided. The following text was proposed for inclusion in the relevant article of the draft Convention:

"'Payment instruction' means a writing sent by the assignor or the assignee or both, reasonably describing the receivables to which it applies and an address or account to which payment is to be made."

138. The Working Group engaged in an initial discussion of the formulation proposed. Various suggestions were made as to how that formulation might be improved. One suggestion was that the word "writing" should be replaced by the word "information", since there was no need to subject the validity of a payment instruction to written form. In response, it was stated that, in view of the fact that the main function of a payment instruction was to provide a point of reference for the debtor's discharge under draft article 18, the existence of a writing might be useful in that it would facilitate evidence.

139. Another suggestion was that reference should be made to identification of the "person" to whom payment was to be made, in addition to the address or account, since a mere reference to "an address or account" might be insufficient if, for example, payment were to be effected by cheque. While support was expressed in favour of that suggestion, it was pointed out that in most cases notification and payment instructions would be sent to the debtor at the same time; in the few cases in which they might be sent at a different time, there might be no need to burden a payment instruction with information that would duplicate information already provided in the notification.

140. A further suggestion was that the definition should include a reference to a positive request for payment. It was explained that, under the laws of certain countries, the mere notification of the assignment, even if it did not contain a positive payment instruction, might entail the obligation for the debtor to pay the assignee. The view was expressed that the draft Convention could play a useful role in clarifying that the debtor should pay the assignee only if positive payment instructions had been given to that effect. It was widely felt, however, that the matter might need to be further discussed in view of the risk that establishing such a rule might result in two different debtor-discharge rules being applicable to domestic assignments of domestic receivables, on the one hand, and to other types of assignments, on the other.

141. With a view to reflecting some of the above suggestions and concerns, the following definition was proposed:

"'Payment instruction' means a writing sent by the assignor or the assignee or both, reasonably describing the receivables to which it applies, and containing a direction to make payment to the person, address or account specified in the writing."

142. The Working Group noted the various suggestions and postponed its decision as to the definition of "payment instruction" until it had completed its review of draft article 18 (see para. 193).

Paragraph (2)

143. It was stated that, under paragraph (2), a notification given in breach of an agreement between the assignor and the assignee should not be ineffective for the purposes of the discharge of the debtor (draft article 18), but should be ineffective for the purposes of: cutting off the debtor's rights of set-off (draft article 19); triggering a change in the way in which the original contract might be modified (draft article 21); or determining priority under the law of the assignor's location (draft articles 23 and 24). There was
support in the Working Group for the provision to the extent that it was intended to protect the debtor by setting forth a clear debtor-discharge rule, while preserving the debtor's rights of set-off and the right to modify the original contract without the consent of the assignee. As to the question whether the notification could produce other effects, e.g., provide the point of time for the determination of priority under domestic law, it was stated that the commentary should explain that such effects were not being dealt with in the draft Convention.

144. Subject to future deliberations regarding draft articles 18 to 21, the Working Group adopted paragraph (2), as proposed, and referred it to the drafting group.

Article 17. Right to payment

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

“(1) Subject to articles 23 and 24, unless otherwise agreed between the assignor and the assignee:

“(a) the assignee is entitled to claim payment of the assigned receivable from the debtor and, if payment with respect to the assigned receivable is made to the assignee, to retain whatever is received in total or partial discharge of the assigned receivable (proceeds);

“(b) if payment with respect to the assigned receivable is made to the assignor, the assignee is entitled to claim payment from the assignor and to retain any proceeds.

“(2) If payment with respect to the assigned receivable is made to another person over whom the assignee has priority, the assignee is entitled to any proceeds.

“(3) The assignee may not retain an amount in excess of its right in the receivable.”

146. It was noted that draft article 17 reflected the agreement of the Working Group that the draft Convention should recognize the assignee's right in the proceeds of the assigned receivables, leaving to law applicable outside the draft Convention the question whether that right was a personal (ad personam) or a property (in rem) right.

Paragraph (1)

147. General support was expressed in the Working Group for the principles reflected in paragraph (1). As to the particular formulation of the paragraph, a number of suggestions were made. One suggestion was that, in line with the decision taken by the Working Group with regard to the words “subject to articles 23 and 24” in draft articles 10 and 11 (see paras. 96 and 99) and in view of the fact that draft article 17 was directed towards the right of payment as between the assignor and assignee, rather than as against third parties, those words should be deleted. There was broad support in the Working Group for that suggestion.

148. Another suggestion was that the words “unless otherwise agreed between the assignor and the assignee” should be deleted. It was stated that party autonomy had already been addressed in draft article 6. However, in view of the fact that other provisions in chapter IV, section I, dealing with the rights and obligations of the assignor and the assignee contained those words, it was agreed that the words could be retained. In that connection, a note of caution was struck that the provisions of the draft Convention would need to be reviewed with a view to ensuring that they dealt with party autonomy in a consistent manner.

149. Another suggestion was that the opening words of subparagraph (a) (“the assignee is entitled to claim payment of the assigned receivable from the debtor and,”) should be deleted. It was pointed out that draft article 16 had already provided for the assignee's entitlement to request payment from the debtor and draft article 18 was sufficient in dealing with the debtor's discharge. In addition, it was observed that those words might be misread as referring to a property right of the assignee in the proceeds of receivables. There was broad support for that suggestion in the Working Group.

150. Yet another suggestion was that the term “discharge” should be substituted for the term “payment”, in order to ensure that payment in kind would be included (e.g. by way of goods returned by the debtor to the assignor). It was generally thought, however, that that change was not necessary and that the matter could be usefully clarified in the commentary.

151. A further suggestion was that subparagraph (a) should be reformulated, perhaps by avoiding the use of the term “proceeds”, which was not universally understood in the same way, in order to ensure that the assignee's right in the proceeds of the assigned receivables was not cast as a property right. Still another suggestion was that, in order to ensure that the assignee would obtain from the assignor only what the assignor had received and no more, subparagraph (b) should be reworded to read “the assignee is entitled to claim proceeds received by the latter and to retain same”. Those suggestions attracted sufficient support.

152. Another suggestion was that the assignee should be entitled to the proceeds received by the assignor, irrespective of whether payment had been received before or after notification and thus the debtor had been discharged or not. It was stated that, if, after notification, only the debtor could obtain reimbursement from the assignor, the assignee would be exposed to the risk that the assignor or the debtor might become insolvent. That suggestion received wide support.

153. Yet another suggestion was that subparagraph (b) should clarify that, if payment had been made by the debtor to the assignor after notification of the assignment, the assignee could demand payment from the debtor or from the assignor. In response, it was stated that that result would be obtained anyway, since the right of the assignee
to pursue the debtor as creditor was part of the original contract and the draft Convention was not intended to affect it; and draft article 18 (2) made it sufficiently clear that, after notification, the debtor would be discharged only by paying the assignee. It was pointed out that, from a practical point of view, the assignee would normally not pursue the debtor for a second payment unless the assignor had become insolvent. As to the right of the assignee to pursue the assignor, it was said that it was sufficiently dealt with in subparagraph (b).

154. In the discussion, the question was raised as to the interplay between draft articles 12 (3) and 17 (1) (b). In response, it was stated that, in the case of an anti-assignment clause, the assignment would be ineffective as against the assignor and the assignor's creditors, while it would be ineffective as against the debtor. As a result, the debtor, under draft article 12 (3), could discharge its obligation by payment to the assignor, but the assignee would have, under draft article 17 (1) (b), a right to demand that the proceeds of such payment be turned over to the assignee. As to the question whether that right in the proceeds would be a personal or property right, it was stated that that matter was left to the law applicable to priority in proceeds under draft article 17bis.

155. After discussion, the Working Group adopted the substance of paragraph (1) and referred the matter of the implementation of the suggestions referred to in paragraphs 147, 149, 151 and 152 above to the drafting group.

Paragraph (2)

156. The suggestion was made that paragraph (2) should be deleted or placed elsewhere in the text of the draft Convention. It was stated that, to the extent it dealt with payment to a person other than the assignor and the assignee, paragraph (2) was inconsistent with the general purpose of draft article 17. In addition, it was observed that the paragraph might be misinterpreted as granting rights to the assignee as against the assignor in cases where payment had been made to the wrong person, even if the assignee had no priority as against that person. Such a result, which would be obtained by a rule on restitution, was said to be a matter that could not be dealt with in the draft Convention.

157. The suggestion to delete or move paragraph (2) elsewhere in the text was objected to on the grounds that paragraph (2) did not only deal with cases in which payment had been made to a person who did not have priority but also with cases in which payment had been made by mistake. In addition, it was observed that paragraph (2) usefully clarified that the assignee was not entitled to anything more than the proceeds of payment.

158. After discussion, the Working Group adopted paragraph (2) and referred the implementation of the suggestions referred to in paragraph 151 above to the drafting group.

Paragraph (3)

159. The Working Group adopted paragraph (3) unchanged.

Article 17bis. Competing rights with respect to proceeds

160. The text of article 17bis as considered by the Working Group was as follows:

“(1) Variant A

“In case of competing rights referred to in articles 23 and 24:

“(a) if the proceeds take the form of receivables, priority with respect to proceeds is governed by the law of the State in which the assignor is located;

“(b) if the proceeds take the form of other assets, priority with respect to proceeds is governed by the law of the State in which they are located.

“Variant B

“Priority with respect to cash proceeds is governed by the law of the State in which the assignor is located. For the purposes of this article, cash proceeds means money, cheques, balances in deposit accounts and similar assets.

“(2) Paragraphs (3) to (5) of article 24 apply to a conflict of priority arising between an assignee and the insolvency administrator or the assignor's creditors with respect to proceeds.”

161. Diverging views were expressed as to whether draft article 17bis should be retained. One view was that it should be deleted altogether. It was stated that it was not appropriate to address in a legal text dealing with assignment of receivables property rights in assets as diverse as money, cheques, wire transfers and goods. The prevailing view, however, was that draft article 17bis should be retained. It was observed that the effect of draft article 17bis would be that the question whether the assignee's right in the proceeds of the assigned receivables would be a property (in rem) or a personal (ad personam) right would be left to the law of the assignor's or the asset's location. While it was recalled that the Working Group had not been able to agree on the question whether the assignee's right in the proceeds would be a personal or a property right, it was agreed that the matter could be dealt with by way of a conflict-of-laws provision (A/CN.9/447, paras. 63-68). It was also agreed that that provision should be placed in the context of draft articles 23 and 24, since it dealt with competing rights of third parties.

162. The discussion focused on variant A, which was found to be generally preferable. However, a number of concerns were expressed. One concern was that variant A appeared to be dealing with competing rights of third parties with regard to proceeds without creating property rights in proceeds (affecting the rights of third parties). A similar concern was that variant A addressed issues of
priority without specifying how priority would be exercised. Yet another concern was that variant A inappropriately referred to the term "proceeds", a term which was not universally understood in the same way, without defining it. It was suggested that the term "proceeds of receivables" should be defined for the purpose of the draft Convention as what was to be received with respect to receivables.

163. In order to address those concerns, it was suggested that the draft Convention should create a property right in proceeds of receivables in the limited situations where the assignor received payment in cash as a fiduciary of the assignee and held the proceeds of payment separated from its own assets. It was further suggested that such a rule could be usefully supplemented: by a rule providing that, if payment was made to the assignee, the assignee had a property right in that payment and could retain it, as long as the assignee had priority in the assigned receivable; and by a rule along the lines of variant A, which would deal with situations other than those in which the assignor received payment as a fiduciary of the assignee.

164. In order to reflect that suggestion, language along the following lines was proposed:

"(1) If proceeds of an assigned receivable are received by the assignee from the debtor, the assignee has the same priority in the proceeds as in the assigned receivable.

"(2) In the case of proceeds of an assigned receivable received by the assignor from the debtor, the assignee has the same priority in the proceeds as in the assigned receivable if:

"(a) the proceeds are money, cheques, wire transfers, credit balances in deposit accounts or similar assets (cash proceeds),

"(b) the assignor has collected the cash proceeds under instructions from the assignee to hold the cash proceeds for the assignee, and

"(c) the cash proceeds are held by the assignor for the assignee separately from other assets of the assignor, such as in the case of a separate deposit account containing only cash proceeds of receivables assigned to the assignee.

"(3) In other cases, if proceeds of an assigned receivable are received by the assignor, priority of competing rights in the proceeds is determined as follows: [...choice of law rule]."

165. Support was expressed for the proposed text. It was stated that such a rule would constitute a significant contribution to practices, such as invoice discounting and securitization, in which the assignor acted as a trustee of the assignee. In addition, it was stated that such a rule would benefit the assignor in that the assignor would be able to obtain financing without disrupting its business relationships with its clients; the assignor's creditors, to the extent that the assignor's business would grow; and the debtor, to the extent that the assignor would be more likely to extend better credit terms to the debtor. Moreover, it was observed that such a rule would not infringe on national practices, since, even in jurisdictions in which the notion of "proceeds" was unknown, cash receipts held in a separate account by an assignor acting as a fiduciary of an assignee were considered not to be part of the assignor's estate.

166. However, a number of concerns were expressed. One concern was that there was a need to protect the assignor's creditors from the appearance of wealth that the holding of the account by the assignor would inevitably create. Another concern was that the proposed text made it insufficiently clear that the assignor acted as a fiduciary of the assignee. A further concern was that, far from creating a substantive law property right of the assignee in the proceeds of the assigned receivables, the proposed text appeared to leave the issue of priority to the conflict-of-laws rules of the draft Convention. Yet another concern was that the efficiency of the proposed text depended on the assignor acting in accordance with the assignee's instructions, a result which could not be ensured with any degree of certainty. In response to that concern, it was pointed out that it was normal practice for parties to financing transactions to be rated in accordance with their track record and for transactions to be priced in accordance with that rating and the risks involved. Another concern was that such a rule would deprive the assignor's creditors, including privileged creditors such as employees, of an important asset, on which they could rely in order to obtain payment. In response to that concern, it was observed that, the assignor's estate having been enriched by the credit advanced by the assignee, it would be inappropriate to allow the assignor's creditors to obtain payment of the assigned receivables, since such an approach would result in a situation in which the assignor's creditors would have unduly benefited if the assignor became insolvent.

167. After discussion, the Working Group decided that the proposed text should be retained within square brackets for further consideration at its next session, along with variant A and paragraph (2) of draft article 17bis, and referred those provisions and the proposed text to the drafting group.

Section II. Debtor

Article 17ter. Principle of debtor-protection

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

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

"(2) With the exception of a change in the identity of the person to whom or for whose account or to the
169. The Working Group recalled its earlier decision to include in the preamble a general reference to debtor protection (see para. 21). It was noted that draft article 17ter originated in the version of draft article 7 contained in document A/CN.9/WG.11/ WP.96 (hereinafter referred to as "old article 7").

Paragraph (1)

170. It was noted that the intended effect of paragraph (1) was that, with the exception of certain debtor-related matters expressly settled in the draft Convention (i.e., in draft articles 9 to 12 and 16 to 22), the rights and obligations of the debtor were left to the contract between the assignor and the debtor and the law governing that contract. The Working Group adopted paragraph (1) and referred it to the drafting group.

Paragraph (2)

171. It was noted that the provision contained in paragraph (2) of old article 7 had been reformulated in broader terms to align paragraph (2) with draft article 16 and to avoid an interpretation a contrario of paragraph (2) that, apart from the country and the currency of payment, the assignee might change any other payment terms contained in the original contract. With a view to aligning paragraph (2) with the definition of "payment instruction", it was suggested that the words "the person to whom or for whose account or to the address of which the debtor is required to make payment" should be replaced by the words "the person, address or account" (see paras. 141 and 193). It was also suggested that, in order to reflect the decision of the Working Group to introduce a distinction between the notions of "notification of the assignment" and "payment instruction" (see paras. 138-142), the words "notification of the assignment" in paragraph (2) should be replaced by the words "payment instruction". Those suggestions received broad support.

172. It was widely felt that the reference to "the debtor's right to pay in the currency and in the country specified in the payment terms contained in the original contract" contained in old article 7 should be added to paragraph (2) to delineate the costs and risks borne by the debtor.

173. A question was raised as to whether specific provision should be made for the consumer-debtor. It was suggested that, in all instances, a consumer-debtor should be granted the possibility to obtain discharge of its obligation by paying the assignor. In support of that suggestion, it was stated that such an approach would be consistent with the proposed amendment to draft article 17bis (see para. 164), under which a debtor could continue making payments to the assignor. No support was expressed in favour of that suggestion.

174. The discussion next focused on the question whether a specific provision was needed to deal with situations where the debtor might be instructed to make payment at a place which, although located in the same country, would differ from the place stipulated in the original contract. Various views were expressed as to how the draft Convention should deal with the allocation of the costs that might result from such a change in the place of payment. One view was that, where the original contract referred to a specific place of payment, the debtor should not, without its consent, be deprived of its contractual right to pay at that place. It was explained that significant inconvenience might result for the debtor, for example, from the need to pay through a bank or branch other than the one initially stipulated. The draft Convention should thus recognize the debtor's right to ignore such an instruction, or at least to be indemnified for any cost incurred as a result of a change in the place of payment even within the same country. It was suggested that language inspired from draft article 12 (2) might be used to deal with the breach of a clause specifying the place of payment. In response, it was stated that in all practical instances where special importance was attached by the debtor to the place of payment and where the debtor was in a position to negotiate the inclusion of a specific clause in that respect, the debtor would in fact introduce an anti-assignment clause in the original contract. Thus, the question of the possible right of the debtor to seek indemnity from the assignor for breach of such a clause would be sufficiently addressed by draft article 12 (2). It was also stated that, in most practical cases, a change in the place of payment within the borders of one country would be of little relevance and would not be interpreted as a breach of contract.

175. Another view, which attracted significant support, was that in the context of certain financial practices, including factoring, it was essential to allow for the payment instructions to change the place of payment. It was suggested that in practice no additional costs were to be expected from such a change in the place of payment, and that assignees had an interest in facilitating payment by the debtor in its own country and currency, even if the original contract provided for payment in another country and currency. It was also pointed out that in most practical circumstances domestic law allowed for a change in the place of payment for domestic assignments. It was thus suggested that paragraph (2) should expressly recognize the possibility for the payment instructions to change the country of payment specified in the original contract to provide for payment in the debtor's country.

176. Subject to the changes suggested in paragraphs 171, 172 and 175 above, the Working Group adopted draft article 17ter and referred it to the drafting group.

Article 17quater. Notification of the debtor

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

"(1) Notification of the assignment is effective when received by the debtor, if it is in any language that is
reasonably designed to inform the debtor about the content of the notification. It shall be sufficient if notification of the assignment is in the language of the original contract.

“(2) Notification of the assignment may relate to receivables arising after notification.

“(3) Notification of a subsequent assignment constitutes notification of any prior assignment.”

Paragraphs (1) and (2)

178. It was recalled that the Working Group had already adopted the substance of the paragraphs that comprised draft article 17\quater. However, it was agreed that, as the Working Group had decided to differentiate between a notification of the assignment and a payment instruction, it would be necessary to incorporate the latter concept into paragraphs (1) and (2). Subject to that change, the Working Group adopted paragraphs (1) and (2) and referred them to the drafting group.

Paragraph (3)

179. The question was raised as to whether paragraph (3) had to be aligned with paragraphs (1) and (2), as a consequence of the distinction that had been made between a notification and a payment instruction. In response, it was explained that such a reference to a payment instruction was not required in paragraph (3), since in those situations where, as in the case of a factors’ chain, a receivable had been reassigned many times, there would be no business reason for the debtor to be notified until the receivable had been assigned to the last assignee in the chain. In addition, it was observed that paragraph (3) would enable the last assignee to provide to the debtor a notification which would also be considered as notification of the previous assignments. Such an approach would enable the last assignee to fill in the gaps in the chain of notifications and to give to the debtor payment instructions.

180. A number of concerns were raised, however, over the situation where there may have been an interruption in the chain of notifications in a series of subsequent assignments. One concern was that the debtor might not be able to determine with certainty the rights of the assignee. In order to address that concern, it was suggested that the notification should identify the original assignor and all assignees in the chain. In response, it was noted that the Working Group at its previous session had agreed that listing in the notification all successive assignees would be “excessively burdensome, contrary to established practice and potentially confusing for debtors” and that, while “reasonable assignees, in order to ensure that payment be made by the debtor according to their instructions, would normally provide sufficient information to the debtor”, “the debtor was sufficiently protected against any uncertainty under draft article 18(6)” (ACN.9/455, paras. 63-66). However, some doubt was expressed as to whether draft article 18 (6) was sufficient to protect the debtor. On the understanding that that matter could be addressed in the context of draft article 18, the Working Group adopted draft article 17\quater and referred it to the drafting group.

Article 18. Debtor’s discharge by payment

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

“(1) Until the debtor receives notification of the assignment, it is entitled to discharge its obligation by paying in accordance with the original contract.

“(2) After the debtor receives notification of the assignment, subject to paragraphs (3) to (8) of this article, it is discharged only by paying the person or to the address identified in such notification.

“(3) If the debtor receives notification of more than one assignment of the same receivables made by the same assignor, the debtor is discharged by paying the person or to the address identified in the first notification received.

“(4) If the debtor receives more than one notification relating to a single assignment of the same receivables by the same assignor, the debtor is discharged by paying the person or to the address identified in the last notification received before payment.

“(5) If the debtor receives notification of one or more subsequent assignments, the debtor is discharged only by payment to the person or to the address identified in the notification of the last of such subsequent assignments received before payment.

“(6) If the debtor receives notification of the assignment from the assignee, the debtor is entitled to request the assignee to provide within a reasonable period of time adequate proof that the assignment has been made and, unless the assignee does so, the debtor is discharged by paying the assignor. Adequate proof includes, but is not limited to, any writing emanating from the assignor and indicating that the assignment has taken place.

“(7) This article does not affect any other ground on which payment by the debtor to the person entitled to payment, to a competent judicial or other authority, or to a public deposit fund discharges the debtor.

“(8) This article does not affect any ground on which the debtor may be discharged by paying a person to whom an invalid assignment has been made.”

Paragraphs (1) and (2)

182. It was noted that the Working Group had already adopted draft article 18 (ACN.9/447, paras. 69-93). However, recalling its decision to delete the reference to
the payee contained in the definition of notification (see para. 71), the Working Group considered a proposal to replace the reference to a notification contained in paragraphs (1) and (2) with a reference to a payment instruction. It was stated that, in a number of practices, it was customary for a notification to be given without a payment instruction (e.g. notification relating to security arrangements). It was also observed that, for such practices to be accommodated without undermining the protection of the debtor, the discharge of the debtor would have to be based on a payment instruction rather than on a notification, since the notification would not necessarily indicate the name, address or account of the payee. Under such an approach, even if the debtor had received a notification, the debtor should be entitled to discharge by paying the assignor, as if there had been no assignment.

183. That proposal was objected to on a number of grounds. It was stated that such an approach would unduly interfere with significant practices, in which a debtor receiving a notification would normally be discharged by paying the assignee. The example was mentioned of disclosed invoice discounting, in which the notice was given for the purpose of cutting off the debtor’s rights of set-off, while the assignor continued to collect from debtors as the agent of the assignee. In addition, it was observed that such an approach would inadvertently result in the debtor being uncertain as to whom to pay in order to discharge its obligation or as to whether the draft Convention would apply in a particular case. Such uncertainty, it was said, would delay payment, which was not in the interest of assignees or assignors.

184. In order to address the concerns expressed, the proposal was modified to the extent that paragraph (1) could provide that, after notification, the debtor could discharge its obligation by paying the assignee on the condition that the notification would not indicate otherwise and would provide sufficient information for the debtor to be able to determine whom to pay. Language along the following lines was proposed: “Upon the receipt of a notification of assignment, unless the notification indicates to the contrary, the debtor is discharged only by paying the assignee if the notification of assignment provides sufficient information to enable the debtor to determine where to make payment.”

185. That proposal did not meet with approval either. It was stated that such an approach would create uncertainty and would allow the debtor to refuse or delay payment on the pretext of the absence of sufficient information. In addition, it was observed that such an approach could inadvertently result in the debtor having to take action in order to determine where to make payment in order to discharge its obligation. Moreover, it was said that normally, even in the cases in which the assignor continued to receive payment after notification, the assignor would be acting on behalf of the assignee and thus payment to the assignor should be considered as payment to the assignee.

186. It was thus suggested that reference could be made in paragraph (2) to the notification and to payment “to the assignee or to the person designated by the assignee in the notification”. The concern was expressed, however, that the proposed wording might make it insufficiently clear that a notification could be given by the assignor. In order to address that concern, a number of suggestions were made, including that the words “by the assignee” or “in the notification” should be deleted, and that reference should be made rather to payment to the assignee unless a contrary payment instruction was given. The latter suggestion received broad support. After discussion, the Working Group adopted paragraph (1) unchanged and paragraph (2), subject to the insertion of a reference to payment to the assignee unless the debtor was otherwise instructed, and referred them to the drafting group.

Paragaphs (3), (4) and (5)

187. In order to align the language of paragraphs (3), (4) and (5) with the new definition of notification adopted at the present session (see para. 71), it was agreed that the reference to the “person or to the address” contained in paragraphs (3), (4) and (5) should be deleted; and in paragraph (4) reference should be made to a payment instruction.

188. A number of questions were raised. One question was whether paragraph (3) provided an exclusive way for the debtor to discharge its obligation. In response, it was stated that, unlike paragraph (2) (which provided that the debtor “is discharged only”), paragraph (3) did not refer to an exclusive way in which the debtor could discharge its obligation, since under paragraph (3) (as under paragraphs (4) and (5)), the debtor had a choice, namely, either to pay as foreseen in paragraph (3) or to pay the person entitled to payment under paragraph (7). In the latter case, it was noted, the debtor would be taking the risk of paying the wrong person and, as a result, of having to pay twice. Another question was whether, under paragraphs (3), (4) and (5), the debtor would be discharged only if the debtor acted in good faith. In response, it was noted that at previous sessions the Working Group had agreed that making the debtor’s discharge subject to good faith standards or to the absence of knowledge about, e.g. the invalidity of an assignment or the superior right of another assignee would jeopardize certainty with regard to one of the main objectives of the draft Convention, namely, the protection of the debtor (A/CN.9/420, paras. 100-104, A/CN.9/432, paras. 168-172 and A/CN.9/434, para. 180). As to those situations in which faith of the debtor could be exceptionally relevant, it was noted that they were left to law applicable outside the draft Convention.

Paragraph (6)

189. In response to a question, it was noted that the fact that the debtor received notification could not in itself trigger the debtor’s obligation to pay, which was subject to the original contract. Thus, if the debtor received notification before the debt became due, the debtor would not have an obligation to pay either the capital of the debt or interest thereon. If notification was given after the debtor’s debt had become due and the requirements of paragraph (7)
were met, the debtor's payment obligation to pay the capital of its debt would be suspended and thus no interest would accrue. It was suggested that matters relating to interest should be addressed explicitly in the text of the draft Convention. In that connection, it was observed that such matters were often part of complex contractual arrangements and did not lend themselves to unification. It was agreed, however, that those interest-related matters could be usefully explained in the commentary.

Paragraph (7)

190. The view was expressed that paragraph (7) set forth the most important rule in draft article 18, i.e., that the debtor could be discharged by paying the rightful creditor. It was stated that all the other paragraphs of the draft article provided a "safe harbour rule" aimed at protecting the debtor if the debtor had paid the wrong person. It was thus suggested that paragraph (7) should be moved to the beginning of article 18. The suggestion was met with interest.

191. In order to avoid any interference with national law governing the discharge of the debtor, it was suggested that in paragraph (7) reference should be made to the law governing the receivable. That suggestion was objected to on the grounds that, as long as the paragraph made it sufficiently clear that the draft Convention was not intended to exclude grounds (contractual or non-contractual) for the discharge of the debtor existing under law applicable outside the draft Convention, it did not need to specify the applicable law. It was also noted that the wording of paragraph (7) was intended to track the language of the Ottawa Convention (A/CN.9/420, para. 131, A/CN.9/434, paras. 190-191 and A/CN.9/447, paras. 91-92).

Paragraph (8)

192. It was noted that paragraph (8) had been introduced in the text of draft article 18 within square brackets in order to address exceptional situations in which the debtor might pay an assignee of a non-existing assignment (A/CN.9/455, paras. 55-58). Diverging views were expressed as to whether the paragraph should be retained. One view was that it should be deleted or more specifically describe the issue addressed as that of a non-existing assignment. It was stated that the definition of assignment was sufficient in clarifying that the debtor could not be discharged if it paid an assignee deriving rights from a non-existing assignment. In addition, it was pointed out that paragraph (6), allowing the debtor to request adequate proof of the assignment in the case of a notification by the assignee, was sufficient to protect the debtor. In response, it was observed that paragraph (6) did not cover situations in which notification was given by the assignor. In that connection, some doubt was expressed as to the reasons why, in the case of notification by the assignor, the debtor should not be discharged even if the assignment was non-existing. In addition, some doubt was expressed as to whether paragraph (8) was compatible with draft article 18 as a whole, which, with the exception of paragraph (7), was intended to provide a "safe harbour rule" for the debtor in the case of payment to the wrong person. For lack of sufficient time, the Working Group tentatively decided to retain paragraph (8) within square brackets for consideration of the matter at its next session.

"Payment instruction"

193. Recalling its decision to consider the need of defining the term "payment instruction", which was used in draft article 16, as revised, and draft article 18 (2) and (4), the Working Group considered a revised definition of the term "payment instruction" (see para. 141). It was generally agreed that such a definition would not be necessary, since the meaning of the term "payment instruction" was self-explanatory. It was also agreed that the drafting group would examine draft article 18 (4) to ascertain whether any aspects of the deleted definition should be incorporated in draft article 18 (4).

Article 19. Defences and rights of set-off of the debtor

194. The text of draft article 19 as considered by the Working Group was as follows:

"(1) In a claim by the assignee against the debtor for payment of the assigned receivables, the debtor may raise against the assignee all defences or rights of set-off arising from the original contract [or from a decision of a judicial or other authority giving rise to the assigned receivable] of which the debtor could avail itself if such claim were made by the assignor.

"(2) The debtor may raise against the assignee any other right of set-off, provided that, under the law of the State in which the debtor is located[,] it was available to the debtor at the time notification of the assignment was received. [For the purposes of this paragraph, the notification of assignment is effective even if it does not identify the person to whom or for whose account or the address to which the debtor is required to make payment.]

"(3) Notwithstanding paragraphs (1) and (2), defences and rights of set-off that the debtor could raise pursuant to article 12 against the assignor for breach of agreements limiting in any way the assignor's right to assign its receivables are not available to the debtor against the assignee."

195. Noting that draft article 19 had already been adopted (A/CN.9/447, paras. 94-102), the Working Group focused on a few pending issues.

Paragraph (1)

196. Recalling its decision to exclude from the scope of the draft Convention receivables other than contractual receivables (see para. 42), the Working Group decided to delete the bracketed text in paragraph (1).
Paragraph (2)

197. The view was expressed that the question of when a right of set-off became "available" should be left to the law of the State governing the receivable, rather than to the law of the debtor's location. It was stated that such an approach would be consistent with the European Union Convention on the Law Applicable to Contractual Obligations (Rome, 1980; hereinafter referred to as "the Rome Convention") and draft article 30 of the draft Convention and would enable the parties to agree on the law governing rights of set-off. While that view enjoyed some support, greater support was expressed for the view that the matter should not be addressed in the draft Convention. It was stated that, in most cases, the law of the debtor's location was likely to apply in any event. After discussion, the Working Group agreed to delete the bracketed language contained in the first sentence of paragraph (2).

198. In view of the Working Group's decision to delete the reference to the payee from the definition of "notification" (see para. 71), it was also agreed that the second sentence contained in brackets was no longer necessary, and could be deleted.

Paragraph (3)

199. The question was raised as to the interplay between paragraph (3) and draft article 12. In response, it was noted that under draft article 12 (2) an anti-assignment clause would remain effective as between the assignor and the debtor. It was also noted that, to the extent that, under national law, an assignment might be considered to be a breach of contract, the debtor would have a cause of action against the assignor, but not against the assignee. On the other hand, it was noted that paragraph (3) was intended to ensure that the debtor would be unable to raise a breach of an anti-assignment clause as a set-off against the assignee, since such an approach would render the assignment of no value to the assignee. In addition, it was noted that governmental debtors could not lose their rights of set-off, since an assignment made despite an anti-assignment clause would not be effective as against governmental debtors and thus paragraph (3) would not apply. Subject to the changes referred to in paragraphs 196 to 198, the Working Group adopted draft article 19.

Article 20. Agreement not to raise defences or rights of set-off

200. The text of draft article 20 as considered by the Working Group was as follows:

"(1) Without prejudice to the law governing the protection of the debtor in transactions made for personal, family or household purposes in the State in which the debtor is located, the debtor may agree with the assignor in writing not to raise against the assignee the defences and rights of set-off that it could raise pursuant to article 19. Such an agreement precludes the debtor from raising against the assignee those defences and rights of set-off.

"(2) The debtor may not include:

"(a) defences arising from fraudulent acts on the part of the assignee;

"(b) defences based on the debtor's incapacity or the lack of authority of the debtor's agent to incur the debtor's liability on the original contract;

"(c) where the original contract is in writing, defences based on the fact that the debtor signed the original contract without knowledge that the debtor's signature made the debtor a party to the contract, provided that such lack of knowledge was not due to the debtor's negligence and provided that the debtor was fraudulently induced to sign.

"(3) Such an agreement may only be modified by written agreement. The effect of such a modification as against the assignee is determined by article 21(2)"

201. It was noted that draft article 20 had already been adopted (A/CN.9/447, paras. 103-121).

Paragraph (1)

202. It was agreed that, in order to cover transactions that were made both for consumer and commercial purposes, reference should be made to transactions made "primarily" for consumer purposes.

Paragraphs (2) and (3)

203. It was agreed that the reference to the agent's lack of authority to incur the debtor's liability contained in subparagraph (b) of paragraph (2) should be deleted. It was stated that it would be inappropriate to extend concepts from the law on negotiable instruments to the law of assignment, in particular in view of the possibility of the assignor acting in some cases as an agent of the debtor.

204. It was agreed that subparagraph (c) of paragraph (2) was unnecessary and should be deleted. Insofar as the draft Convention was concerned with receivables rather than negotiable instruments, obligations on the part of the debtor would not arise as a result of signature, but instead as a consequence of the will of the parties. In addition, it was observed that in any event, in some legal systems, a defence of nullity of the original contract could not be waived by the debtor. Subject to the changes referred to in paragraphs 202 to 204, the Working Group adopted draft article 20.

Article 21. Modification of the original contract

205. The text of draft article 21 as considered by the Working Group was as follows:

"(1) An agreement concluded before notification of the assignment between the assignor and the debtor that
affects the assignee’s rights is effective as against the assignee and the assignee acquires corresponding rights.

“(2) After notification of the assignment, an agreement between the assignor and the debtor that affects the assignee’s rights is ineffective as against the assignee unless:

“(a) the assignee consents to it; or

“(b) the receivable is not fully earned by performance and either modification is provided for in the original contract or, in the context of the original contract, a reasonable assignee would consent to the modification.

“(3) Paragraphs (1) and (2) of this article do not affect any right of the assignor or the assignee for breach of an agreement between them.

“(4) For the purposes of this article, the notification of assignment is effective even if it does not identify the person to whom or the account or address to which the debtor is required to make payment.”

206. Noting that draft article 21 had already been adopted (A/CN.9/447, paras. 122-135) and recalling its decision to delete from the definition of notification any reference to the concept of a payment instruction (see para. 71), the Working Group agreed to delete paragraph (4).

Article 22. Recovery of payments

207. The text of draft article 22 as considered by the Working Group was as follows:

“Without prejudice to the law governing the protection of the debtor in transactions made for personal, family or household purposes in the State in which the debtor is located and the debtor’s rights under article 19, failure of the assignor to perform the original contract does not entitle the debtor to recover from the assignee a sum paid by the debtor to the assignor or the assignee.”

208. Noting that draft article 22 had already been adopted (A/CN.9/447, paras. 136-139), the Working Group decided that consumer transactions should be qualified by a reference to transactions made “primarily” for consumer purposes.

Section III. Other parties

Article 23. Competing rights of several assignees

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

“(1) Priority among several assignees of the same receivables from the same assignor is governed by the law of the State in which the assignor is located.

“(2) An assignee entitled to priority may at any time voluntarily subordinate its priority in favour of a competing assignee, whether or not that competing assignee is then in existence. [The subordination may be unilateral or may occur by agreement with the assignor, the competing assignee or any other person.]”

210. The Working Group noted that it had already adopted draft article 23 (A/CN.9/455, paras. 18-21) and went on to consider the bracketed language in paragraph (2). Diverging views were expressed. One view was that the bracketed language should be deleted. It was stated that the first sentence of paragraph (2) was sufficient, since a voluntary subordination would necessarily have to be either unilateral or by agreement. The prevailing view, however, was that the bracketed language usefully clarified a matter with regard to which some uncertainty prevailed in some legal systems. As a matter of drafting, it was suggested that, for the sake of economy and clarity, paragraph (2) should be revised to read as follows: “An assignee entitled to priority may at any time subordinate unilaterally or by agreement its priority in favour of any existing or future assignee.” Subject to those changes, the Working Group adopted paragraph (2).

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

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

“(1) Priority between an assignee and the assignor’s creditors is governed by the law of the State in which the assignor is located.

“(2) In an insolvency proceeding relating to the assets of the assignor, priority between the assignee and the assignor’s creditors is governed by the law of the State in which the assignor is located.

“(3) Notwithstanding paragraphs (1) and (2), the application of a provision of the law of the State in which the assignor is located may be refused by a court or other competent authority only if that provision is manifestly contrary to the public policy of the forum State.

“(4) If an insolvency proceeding is commenced in a State other than the State in which the assignor is located, except as provided in this article, this Convention does not affect the rights of the insolvency administrator or the rights of the assignor’s creditors.

“(5) If an insolvency proceeding is commenced in a State other than the State in which the assignor is located, any non-consensual right or interest which under the law of the forum State would have priority over the interest of an assignee has such priority notwithstanding paragraph (2) but only to the extent that such priority was specified by the forum State in an instrument deposited with the depository prior to the time when the assignment was made.]
“(6) An assignee asserting rights under this article has no less rights than an assignee asserting rights under other law.”

212. It was noted that the text of draft article 24 had already been adopted by the Working Group (A/CN.9/455, para. 175).

Paragraph (2)

213. It was noted that paragraph (2) had been reformulated to reflect the fact that the insolvency administrator might not always be the holder of the rights of the assignor’s creditors, but might merely exercise the rights of those creditors. It was also noted that the current formulation reflected the fact that, in some reorganization proceedings, there might be no insolvency administrator. As a matter of drafting, it was agreed that, in view of the definition of “insolvency proceeding”, the words “relating to the assets of the assignor” should be deleted. Subject to that change, the Working Group adopted the revised text of paragraph (2).

Paragraph (3)

214. Doubts were expressed as to the appropriateness of limiting the impact of public policy to the cases where the applicable law was “manifestly contrary” to the public policy of the forum State. It was stated that the notion of “manifestly contrary” might not be commonly used in certain legal systems and might thus result in uncertainty as to the reach of the provision. In response, it was explained that the expression “manifestly contrary” was also used in many other international legal texts (e.g. article 6 of the UNCITRAL Model Law on Cross-Border Insolvency) as a qualifier of the expression “public policy”. It was noted that the purpose of the term “manifestly” was to emphasize that public policy exceptions should be interpreted restrictively and that paragraph (3) was only intended to be invoked under exceptional circumstances concerning matters of fundamental importance for the forum State (see Guide to Enactment of the UNCITRAL Model Law on Cross-Border Insolvency, para. 89). It was widely felt that such an approach was sufficient to preserve fundamental public policy considerations of the forum State, without unduly undermining the certainty achieved by the draft Convention.

Paragraph (4)

215. It was widely felt that appropriate explanations should be inserted in the commentary as to the meaning of the words “except as provided in this article”.

Paragraph (5)

216. The Working Group discussed the question whether, in order to ensure that draft article 24 (2) did not override national rules creating preferential (non-consensual or super-priority) rights (e.g. in favour of the State for taxes), a separate provision along the lines of paragraph (5) was required.

217. General support was expressed in favour of the principle expressed in paragraph (5), namely, the possibility for the forum State to preserve the operation of national rules creating super-priority rights. In response to a question whether that principle was already sufficiently reflected in paragraph (3), it was pointed out that, under paragraph (3), the forum State would be able to refuse the application of a provision of the law applicable under paragraph (2) if it was manifestly contrary to its own public policy, but it could not positively apply provisions reflecting its own public policy. It was also stated that the commentary could explain that paragraph (5) was intended to preserve non-consensual rights or interests with priority under the law of the forum State.

218. The discussion then focused on whether the reference placed at the end of paragraph (5) to a declaration by States enumerating those non-consensual rights that would take precedence over the rights of an assignee should be retained. Diverging views were expressed.

219. One view was that such a reference to a list of rights to be preserved by way of declaration by States should be retained. It was stated that a declaration along the lines contemplated in paragraph (5) might play an essential role in providing certainty as to the operation of the draft Convention by delineating the scope of super-priorities in a given State. In addition, it was pointed out that precedence for such an approach could be found in the draft Uniform Convention on International Interests in Mobile Equipment. Moreover, it was observed that the absence of such a declaration and the resulting uncertainty as to the nature and extent of super-priority rights recognized in a given State might significantly increase the cost of credit in that State.

220. The prevailing view, however, was that such a reference should be deleted. It was pointed out that requiring States to enumerate in a declaration non-consensual rights that would take precedence over the rights of an assignee might reduce the acceptability of the draft Convention to States, since any oversight or error in the declaration would result in such rights becoming subject to the rights of an assignee. In addition, it was stated that certainty might not be served if, contrary to the expectations on which paragraph (5) was based, declarations were not sufficiently clear and detailed, or were constantly being revised. Moreover, it was observed that the uncertainty resulting from the absence of such declarations should not be overestimated, since, while the drafting of a detailed list identifying each super-priority right might prove technically difficult, the broad categories of non-consensual rights that would typically be treated as super-priority rights were already well known to the international financing community. Furthermore, it was said that the formulation of such declarations might be constitutionally impossible for Governments in those States where super-priority rights were not exhaustively listed in statute.
221. With a view to accommodating the need for increased certainty with respect to super-priority rights in those countries that wished to do so, it was suggested that States should, at least, have the possibility of making such a declaration. Language along the following lines was proposed:

“A State may deposit at any time a declaration identifying those [non-consensual][preferential] rights or interests which have priority over the interest of an assignee, notwithstanding application of the priority rule set out in paragraph (2).”

222. Subject to the deletion of the reference to declarations by States at the end of paragraph (5) and the addition of the above-mentioned suggested wording within square brackets, the Working Group adopted paragraph (5).

Multiple parties

223. It was recalled that the Working Group had deferred consideration of draft articles 1 (6) and 3 (2) and (3) in order to allow for consultations with regard to practices involving a multiplicity of parties (see para. 28). It was stated that a multiplicity of parties could arise in three contexts: two or more debtors might be jointly (i.e. fully) and severally (i.e. independently) liable to payment of one or more receivables; two or more assignees might be joint owners of one or more receivables; or, one or more receivables might be assigned to two or more assignees.

224. It was observed that a multiplicity of debtors could arise in the case where a lender had extended credit to more than one debtor (e.g. a group of companies under common ownership) and all debtors had agreed to be jointly and severally liable under the original contract. In addition, it was stated that multiple assignees would be involved in the case where several assignees had loaned money to one assignor under a single loan agreement (e.g. a syndicated loan agreement). Moreover, it was pointed out that cases where joint assignors were involved were very rare in practice (e.g. where several assignors jointly owned one or more receivables).

225. In the case of multiple debtors, it was stated, the rights and obligations of all debtors would be subject to the rules of the draft Convention if the original contract were to be governed by the law of a Contracting State. If, however, the original contract was not governed by the law of a Contracting State and only one debtor was located in a Contracting State, each transaction should be viewed as an independent transaction. Thus, the draft Convention should be applicable only to those debtors who were located in Contracting States. In addition, a receivable should be treated as an international receivable if each debtor and the assignor were located in different countries. Moreover, it was observed that, in the case of multiple assignees or assignors, the joint ownership should be ignored in the determination as to whether the assignor was located in a Contracting State or an assignment or a receivable was international. It was agreed that the draft Convention would produce those results without the addition of language along the lines of draft articles 1 (6) and 3 (2) and (3). As a result, it was stated that there was no need to determine primary or secondary liability; the rules of the draft Convention would be applicable as if there were no joint and several liability; and applicability would be determined on the basis of the parties and the economic effect of the transaction without regard to its structure or format. After discussion, the Working Group decided to delete draft articles 1 (6), and 3 (2) and (3).

226. The discussion then focused on the question whether the location of multiple assignors and assignees could be determined on the basis of their authorized agent or trustee (draft article 5 (k) (v)). Diverging views were expressed. One view was that draft article 5 (k) (v) should be retained. It was stated that a provision along the lines of draft article 5 (k) (v) might provide useful clarification in those instances where it would be reasonable for location to be determined on the basis of the agent’s location, since the agent would be a party to the transaction.

227. Another view was that draft article 5 (k) (v) should be deleted. It was observed that it would be inappropriate for an entire transaction to be referred to the law of the agent’s location, irrespective of whether the agent was a party to the transaction or merely performed administrative functions. In addition, it was pointed out that such an approach might result in the draft Convention often being inapplicable, to the extent that agents were located in a tax haven, which normally would not be a Contracting State. Moreover, it was said that the terms “authorized agent” and “trustee” were not universally understood. In response, it was observed that it might be premature to delete draft article 5 (k) (v) before the Working Group had an opportunity to discuss draft article 5 (k) as a whole. On that basis, the Working Group decided to retain draft article 5 (k) (v) within square brackets.

III. REPORT OF THE DRAFTING GROUP

228. The Working Group requested a drafting group established by the Secretariat to review the title, the preamble and draft articles 1 to 22, with a view to ensuring consistency between the various language versions.

229. At the close of its deliberations, the Working Group considered the report of the drafting group and adopted the title, the preamble and draft articles 1 to 22, as revised by the drafting group, as well as draft articles 23 and 24. The text of those revised draft articles, as well as of draft articles 23 and 24, as adopted by the Working Group, is reproduced in the annex to the present report. In line with its decision made after the preparation of the report of the drafting group (see para. 225), the Working Group decided that draft articles 1 (5) and 3 (2) and (3) should be deleted. It was agreed that, in the second sentence of draft article 2 (a), reference should be made to a creation of a security right being “deemed to be” a transfer of receivables, in order to reflect the fact that the Working Group was establishing a legal fiction. With regard to draft article 5 (c), it was decided that it should be made clear that an existing
IV. FUTURE WORK

230. It was stated that the Working Group should intensify its efforts to reach agreement on the meaning of the term "location" for the purposes of the draft Convention as a whole. In that connection, it was observed that, with regard to the location of the assignor and the assignee, a possible basis for agreement might be found in the notions of "chief executive office" or "place of central administration", while, with regard to the location of the debtor, reference could be made to the place most closely connected to the original contract. As to the provisions in chapter VI that related to mandatory rules and public policy issues, a note of caution was struck that their exception from the rules from which Contracting States could opt out might inadvertently give the impression that they were intended to apply not only to the private international law provisions of the draft Convention outside chapter VI, but also to the substantive law provisions of the draft Convention. It was observed that such a result would significantly reduce the certainty achieved by the draft Convention. With regard to the optional annex to the draft Convention, it was suggested that issues arising in that regard could be advanced before the next session of the Working Group by way of informal consultations.

231. It was noted that the next session of the Working Group was scheduled to take place at Vienna from 11 to 22 October 1999, those dates being subject to confirmation by the Commission at its thirty-second session, to be held at Vienna from 17 May to 4 June 1999.

V. RELATIONSHIP BETWEEN THE DRAFT CONVENTION AND THE UNIDROIT DRAFT CONVENTION ON INTERNATIONAL INTERESTS IN MOBILE EQUIPMENT

232. It was noted that the International Institute for the Unification of Private Law (Unidroit) was currently preparing, in cooperation with the International Civil Aviation Organization (ICAO) and other organizations, a convention on security interests (including conditional sales and leases) in mobile equipment of high value, such as aircraft, space equipment and railway rolling stock (hereinafter referred to as "the Unidroit draft"). It was also noted that the Unidroit draft was intended to remove obstacles to international trade created by the application of the law of the location of the equipment (lex situs), as a result of which a security right created in country A might not be enforceable in country B.

233. In addition, it was noted that one of the key features of the Unidroit draft was that it was divided into a base convention, which contained provisions applicable to a number of types of mobile equipment, and to protocols, which contained equipment-specific provisions. Moreover, it was noted that the base convention would enter into force only to the extent that an equipment protocol would enter into force. It was also noted that another key feature of the Unidroit draft was that it was based on equipment-specific international registries that would need to be established some time in the future for the Unidroit draft to apply. So far, an aircraft protocol had been prepared in cooperation with ICAO, while a space protocol and a railway rolling stock protocol were being prepared in cooperation with other organizations. Under the current draft aircraft protocol, three ratifications were required for the protocol to enter into force (although, in line with ICAO practice, the 1948 Geneva Convention on the International Recognition of Rights in Aircraft, which would be superseded by the aircraft protocol, required 20 ratifications).

234. The Unidroit draft would cover, inter alia, the creation of security interests in, as well as the outright assignment of, rights to payment or rights to performance by the obligor under a contract of sale or a lease of equipment (art. 1 and art. 41). In addition, the Unidroit draft would cover the assignment of security interests in equipment, which would result, under the current draft, in the transfer of the receivables arising under the contract of sale or lease of equipment to the transferee of the security right in equipment (art. 31). Moreover, the Unidroit draft would cover the question of priority in insurance proceeds payable in respect of the loss or physical destruction of equipment (art. 28.5).

235. It was noted that such an approach would create an overlap with the draft Convention being prepared by the Working Group. To the extent that the Unidroit draft would resolve assignment-related issues in a way other than the way in which those matters were resolved in the draft Convention, such an overlap could result in two conflicting regimes applying to the same matters. It was noted
that there were three ways in which such conflicts could be resolved, i.e. by excluding from the scope of the draft Convention the assignment of receivables arising from the sale or lease of equipment, by excluding from the Unidroit draft the assignment of receivables or by leaving conflicts to be dealt with by way of a provision governing the relationship of the draft Convention with other international texts. Such a provision could provide that the draft Convention superseded or gave way to the Unidroit draft. Alternatively, it could provide, along the lines of draft article 42, that a State, if interested in adopting both texts, should decide which text it wished to give precedence to.

236. It was noted that, if the assignment of receivables arising from the sale or lease of equipment were to be excluded from the scope of the draft Convention, on the assumption that the Unidroit draft would be widely adopted and would enter into force within a reasonable period of time (which depended on the establishment of equipment-specific international registries in the future), the assignment of those receivables would be covered by that text. The most notable results of such an approach would be that: the receivable secured by an accessory security right in equipment would be treated as an associated, accessory right following the security interest; the assignment of such receivables would be possible only with the consent of the debtor; priority with regard to those receivables would be determined on the basis of priority in time of registration in the relevant international registry; the equipment financier would be able to take advantage of the self-help remedies provided in the Unidroit draft (art. 9), as well as of the remedies foreseen in that text in the case of insolvency of the borrower (assignor of receivables), including the repossession of the encumbered equipment within 30 or 60 days after the opening of the insolvency proceedings (art. XI of the aircraft protocol).

237. If, on the other hand, the assignment of receivables arising from the sale or lease of equipment were to be excluded from the Unidroit draft, assuming that the draft Convention would be widely adopted, their assignment would be covered by the draft Convention. The most notable result of such an approach would be that priority in respect of those receivables would be determined in accordance with the law of the State of the assignor's location. If that State were a party to the Unidroit draft, priority would be determined in accordance with the order of priority in time of registration in the respective international registry. However, if the assignor were located in a State which was not a party to the Unidroit draft and that text applied on the basis that the equipment was registered in a national registry (e.g. aircraft registered with a national aviation authority; art. 4), two different priority rules could be applicable.

238. It was stated that, in determining how to address the conflict between the draft Convention and the Unidroit draft, the key question that would need to be answered was an empirical one, namely whether receivables arising from the sale or lease of equipment were part of equipment or receivables financing. In that connection, it was pointed out that, in aircraft financing transactions, rights associated with the sale or lease of aircraft (i.e. rights to payment as well as rights to performance) were inextricably linked with the aircraft in the sense that the financier would normally seek to obtain a security interest in the aircraft, as well as in the flow of income arising from the lease and in the rights relating to the maintenance of the encumbered aircraft. It was thus suggested that, in order to avoid affecting settled equipment financing practices, the assignment of receivables arising from the sale or lease of aircraft, and possibly similar mobile equipment, should be excluded from the draft Convention. Unlike receivables arising from the sale or lease of aircraft, receivables arising from the sale of airline tickets were said to be often used in receivables financing transactions, such as securitization, and, where combined with other receivables, could be excluded from the Unidroit draft.

239. While some support was expressed for that suggestion, the Working Group deferred final decision until its next session to allow time for consultations. It was observed that, in light of the broad scope of application of the base convention of the Unidroit draft, the exclusion of the assignment of receivables arising from the sale and lease of all types of mobile equipment could significantly reduce the benefit to be derived by States from the adoption of the draft Convention. On the other hand, it was stated that the impact of such an exclusion would not be so serious, since the Unidroit draft would affect at most a narrow range of receivables financing transactions, leaving the broad range of such transactions unaffected. It was observed, however, that the possibility of referring the assignment of receivables to the protocols or of the assignment of receivables being excluded altogether from the base convention of the Unidroit draft would also need to be considered. In addition, it was stated that the possibility of addressing the conflict between the draft Convention and the Unidroit draft by way of a provision dealing with conflicts between international texts would also need to be carefully studied.

ANNEX

[DRAFT CONVENTION ON ASSIGNMENT IN RECEIVABLES FINANCING]

[DRAFT CONVENTION ON ASSIGNMENT OF RECEIVABLES [IN INTERNATIONAL TRADE]]

Preamble

The Contracting States,

Reaffirming their conviction that international trade on the basis of equality and mutual benefit is an important element in the promotion of friendly relations among States,

Considering [that] problems created by [the] uncertainties as to the content and choice of legal regime applicable to assignments [of receivables] in international trade [constitute an obstacle to financing transactions],
Desiring to establish principles and adopt rules [relating to the assignment of receivables] that would create certainty and transparency and promote modernization of law relating to [assignments of receivables] [receivables financing] [including but not limited to assignments used in factoring, forfaiting, securitization, project financing, and refinancing,] while protecting existing [financing] [assignment] practices and facilitating the development of new practices,

Also desiring to ensure the adequate protection of the interests of the debtor in the case of an assignment of receivables,

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

Have agreed as follows:

CHAPTER I. SCOPE OF APPLICATION

Article 1. Scope of application

(1) This Convention applies to:

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

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

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

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

(3) The provisions of articles 29 to 33 apply [to assignments of international receivables and to international assignments of receivables as defined in this chapter independently of paragraphs (1) and (2) of this article] independently of the provisions of this chapter. However, the provisions of articles 29 to 31 do not apply if a State makes a declaration under article 42 bis.

(4) The annex to this Convention applies in a Contracting State which has made a declaration under article 43.

Article 2. Assignment of receivables

For the purposes of this Convention:

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

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

Article 3. Internationality

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

Article 4. Exclusions

[[1] This Convention does not apply to assignments:

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

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

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

[[2] This Convention does not apply to assignments listed in a declaration made under draft article 42 quater by the State in which the assignor is located, or with respect to the provisions of this Convention which deal with the rights and obligations of the debtor, by the State in which the debtor is located.]

CHAPTER II. GENERAL PROVISIONS

Article 5. Definitions and rules of interpretation

For the purposes of this Convention:

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

(b) a receivable is deemed to arise at the time when the original contract is concluded;

(c) "existing receivable" means a receivable that arises upon or before the conclusion of the contract of assignment; "future receivable" means a receivable that arises after the conclusion of the contract of assignment;

(d) "receivables financing" means any transaction in which value, credit or related services are provided for value in the form of receivables. Receivables financing includes factoring, forfaiting, securitization, project financing and refinancing;

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

(f) "notification of the assignment" means a communication in writing that reasonably identifies the assigned receivables and the assignee;

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

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

(i) “priority” means the right of a party in preference to another party;

(ii) [For the purposes of articles 24 and 25] an individual is located in the State in which it has its habitual residence; a corporation is located in the State in which it is incorporated; a legal person other than a corporation is located in the State in which its constitutive document is filed and, in the absence of a filed document, in the State in which it has its chief executive office.

(iii) [For the purposes of articles 1 and 3]

(i) the assignor is located in the State in which it has that place of business which has the closest relationship to the assignment;

(ii) the assignee is located in the State in which it has that place of business which has the closest relationship to the assignment;

(iii) the debtor is located in the State in which it has that place of business which has the closest relationship to the original contract;

(iv) in the absence of proof to the contrary, the place of central administration of a party is presumed to be the place of business which has the closest relationship to the relevant contract. If a party does not have a place of business, reference is to be made to its habitual residence;

(v) several assignors or assignees are located at the place in which their authorized agent or trustee is located].

Article 6. Party autonomy

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

Article 7. Principles of interpretation

(1) In the interpretation of this Convention, regard is to be had to its international character and to the need to promote uniformity in its application and the observance of good faith in international trade.

(2) Questions concerning matters governed by this Convention which are not expressly settled in it are to be settled in conformity with the general principles on which it is based or, in the absence of such principles, in conformity with the law applicable by virtue of the rules of private international law.

CHAPTER III. EFFECTS OF ASSIGNMENT

Article 8. Effectiveness of bulk assignments, assignments of future receivables, and partial assignments

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

(a) individually as receivables to which the assignment relates;

(b) in any other manner, provided that they can, at the time when the receivables arise, be identified as receivables to which the assignment relates.

(2) Unless otherwise agreed, an assignment of one or more future receivables is effective without a new act of transfer being required to assign each receivable when it arises.

Article 9. Time of assignment

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

Article 10. Contractual limitations on assignments

(1) An assignment of a receivable is effective notwithstanding any agreement between the initial or any subsequent assignor and the debtor or any subsequent assignee, limiting in any way the assignor’s right to assign its receivables.

(2) Nothing in this article affects any obligation or liability of the assignor for breach of such an agreement. A person who is not party to such an agreement is not liable under that agreement for its breach.

Article 11. Transfer of security rights

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

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

(3) Nothing in this article affects any obligation or liability of the assignor for breach of an agreement under paragraph (2). A person who is not a party to such an agreement is not liable under that agreement for its breach.

(4) The transfer of a possessory property right under paragraph (1) of this article does not affect any obligations of the assignor to the debtor or the person granting the property right with respect to the property transferred existing under the law governing that property right.

(5) Paragraph (1) of this article does not affect any requirement under rules of law other than this Convention relating to the form or registration of the transfer of any rights securing payment of the assigned receivable.

Article 12. Limitations relating to Governments and other public entities

Articles 10 and 11 do not affect the rights and obligations of a debtor, or of any person granting a personal or property right securing payment of the assigned receivable, if that debtor or person is a governmental department, agency, organ, or other unit, or any subdivision thereof, unless:
(a) the debtor or person is a commercial entity; or
(b) the receivable or the granting of the right arises from commercial activities of that debtor or person.)

CHAPTER IV. RIGHTS, OBLIGATIONS AND DEFENCES

Section I. Assignor and assignee

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

(1) The rights and obligations of the assignor and the assignee as between them arising from their agreement are determined by the terms and conditions set forth in that agreement, including any rules or general conditions referred to therein.

(2) The assignor and the assignee are bound by any usage to which they have agreed and, unless otherwise agreed, by any practices which they have established between themselves.

(3) In an international assignment, the assignor and the assignee are considered, unless otherwise agreed, to have impliedly made applicable to the assignment a usage which in international trade is widely known to, and regularly observed by, parties to the particular (receivables financing) practice.

Article 14. Representations of the assignor

(1) Unless otherwise agreed between the assignor and the assignee, the assignor represents at the time of the conclusion of the contract of assignment that:

(a) the assignor has the right to assign the receivable;
(b) the assignor has not previously assigned the receivable to another assignee; and
(c) the debtor does not and will not have any defences or rights of set-off.

(2) Unless otherwise agreed between the assignor and the assignee, the assignor does not represent that the debtor has, or will have, the financial ability to pay.

Article 15. Right to notify the debtor

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

(2) A notification of the assignment or payment instruction sent in breach of any agreement referred to in paragraph (1) of this article is not ineffective for the purposes of article 19 by reason of such breach. However, nothing in this article affects any obligation or liability of the party in breach of such an agreement for any damages arising as a result of the breach.

Article 16. Right to payment

(1) Unless otherwise agreed between the assignor and the assignee and whether or not a notification of the assignment has been sent:

(a) if payment with respect to the assigned receivable is made to the assignee, the assignee is entitled to retain whatever is received in respect of the assigned receivables;
(b) if payment with respect to the assigned receivable is made to the assignor, the assignee is entitled to payment of whatever has been received by the assignor.

(2) If payment with respect to the assigned receivable is made to another person over whom the assignee has priority, the assignee is entitled to payment of whatever has been received by such person.

(3) The assignee may not retain more than the value of its right in the receivable.

Section II. Debtor

Article 17. Principle of debtor-protection

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

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

(a) change the currency of payment specified in the original contract, or
(b) change the State specified in the original contract, in which payment is to be made, to a State other than that in which the debtor is located.

Article 18. Notification of the debtor

(1) A notification of the assignment and a payment instruction are effective when received by the debtor, if they are in a language that is reasonably expected to inform the debtor about their contents. It shall be sufficient if a notification of the assignment or a payment instruction is in the language of the original contract.

(2) A notification of the assignment or a payment instruction may relate to receivables arising after notification.

(3) Notification of a subsequent assignment constitutes notification of any prior assignment.

Article 19. Debtor's discharge by payment

(1) Until the debtor receives notification of the assignment, the debtor is entitled to discharge its obligation by paying in accordance with the original contract.

(2) After the debtor receives notification of the assignment, subject to paragraphs (3) to (8) of this article, the debtor is discharged only by paying the assignee or as otherwise instructed.

(3) If the debtor receives notification of more than one assignment of the same receivables made by the same assignor, the debtor is discharged by paying in accordance with the first notification received.

(4) If the debtor receives more than one payment instruction relating to a single assignment of the same receivables by the same assignor, the debtor is discharged by paying in accordance with the last payment instruction received from the assignee before payment.

(5) If the debtor receives notification of one or more subsequent assignments, the debtor is discharged by paying in accordance with the notification of the last of such subsequent assignments.
(6) If the debtor receives notification of the assignment from the assignee, the debtor is entitled to request the assignee to provide within a reasonable period of time adequate proof that the assignment has been made and, unless the assignee does so, the debtor is discharged by paying the assignor. Adequate proof includes, but is not limited to, any writing emanating from the assignor and indicating that the assignment has taken place.

(7) This article does not affect any other ground on which payment by the debtor to the person entitled to payment, to a competent judicial or other authority, or to a public deposit fund discharges the debtor.

(8) This article does not affect any ground on which the debtor may be discharged by paying a person to whom an invalid assignment has been made.

**Article 20. Defences and rights of set-off of the debtor**

(1) In a claim by the assignee against the debtor for payment of the assigned receivables, the debtor may raise against the assignee all defences or rights of set-off arising from the original contract of which the debtor could avail itself if such claim were made by the assignor.

(2) The debtor may raise against the assignee any other right of set-off, provided that it was available to the debtor at the time notification of the assignment was received.

(3) Notwithstanding paragraphs (1) and (2), defences and rights of set-off that the debtor could raise pursuant to article 10 against the assignor for breach of agreements limiting in any way the assignor’s right to assign its receivables are not available to the debtor against the assignee.

**Article 21. Agreement not to raise defences or rights of set-off**

(1) Without prejudice to the law governing the protection of the debtor in transactions made primarily for personal, family or household purposes in the State in which the debtor is located, the debtor may agree with the assignor in a signed writing not to raise against the assignee the defences and rights of set-off that it could raise pursuant to article 20. Such an agreement precludes the debtor from raising against the assignee those defences and rights of set-off.

(2) The debtor may not exclude:

(a) defences arising from fraudulent acts on the part of the assignee;

(b) defences based on the debtor’s incapacity.

(3) Such an agreement may only be modified by an agreement in a signed writing. The effect of such a modification as against the assignee is determined by article 22 (2).

**Article 22. Modification of the original contract**

(1) An agreement concluded before notification of the assignment between the assignor and the debtor that affects the assignee’s rights is effective as against the assignee and the assignee acquires corresponding rights.

(2) After notification of the assignment, an agreement between the assignor and the debtor that affects the assignee’s rights is ineffective as against the assignee unless:

(a) the assignee consents to it; or

(b) the receivable is not fully earned by performance and either modification is provided for in the original contract or, in the context of the original contract, a reasonable assignee would consent to the modification.

(3) Paragraphs (1) and (2) of this article do not affect any right of the assignor or the assignee for breach of an agreement between them.

**Article 23. Recovery of payments**

Without prejudice to the law governing the protection of the debtor in transactions made primarily for personal, family or household purposes in the State in which the debtor is located and the debtor’s rights under article 20, failure of the assignor to perform the original contract does not entitle the debtor to recover from the assignee a sum paid by the debtor to the assignor or the assignee.

**Article 24. Competing rights of several assignees**

(1) Priority among several assignees of the same receivables from the same assignor is governed by the law of the State in which the assignor is located.

(2) An assignee entitled to priority may at any time subordinate unilaterally or by agreement its priority in favour of any existing or future assignees.

**Article 25. Competing rights of assignee and creditors of the assignor or insolvency administrator**

(1) Priority between an assignee and the assignor’s creditors is governed by the law of the State in which the assignor is located.

(2) In an insolvency proceeding, priority between the assignee and the assignor’s creditors is governed by the law of the State in which the assignor is located.

(3) Notwithstanding paragraphs (1) and (2), the application of a provision of the law of the State in which the assignor is located may be refused by a court or other competent authority only if that provision is manifestly contrary to the public policy of the forum State.

(4) If an insolvency proceeding is commenced in a State other than the State in which the assignor is located, except as provided in this article, this Convention does not affect the rights of the insolvency administrator or the rights of the assignor’s creditors.

(5) If an insolvency proceeding is commenced in a State other than the State in which the assignor is located, any [non-consensual] [preferential] right or interest which under the law of the forum State would have priority over the interest of an assignee has such priority notwithstanding paragraph (2). [A State may deposit at any time a declaration identifying those [non-consensual] [preferential] rights or interests which have priority over the interests of an assignee notwithstanding application of the priority rule set out in paragraph (2).]

(6) An assignee asserting rights under this article has no less rights than an assignee asserting rights under other law.

**Article 26. Competing rights with respect to payments**

(1) If payment with respect to the assigned receivable is made to the assignee, the assignee has a property right in whatever is received in respect of the assigned receivable.

(2) If payment with respect to the assigned receivable is made to the assignor, the assignee has a property right in whatever is received in respect of the assigned receivable if:
Part Two. Studies and reports on specific subjects

(a) what is received is money, cheques, wire transfers, credit balances in deposit accounts or similar assets ("cash receipts");

(b) the assignor has collected the cash receipts under instructions from the assignee to hold the cash receipts for the benefit of the assignee; and

(c) the cash receipts are held by the assignor for the benefit of the assignee separately from assets of the assignor, such as in the case of a separate deposit account containing only cash receipts from receivables assigned to the assignee.

(3) With respect to the property rights referred to in paragraphs (1) and (2) of this article, the assignee has the same priority as it had in the assigned receivables.

(4) If payment with respect to the assigned receivable is made to the assignor and the requirements of paragraph (2) are not met, priority with respect to whatever is received is determined as follows:

(a) if what is received is a receivable, priority is governed by the law of the State in which the assignor is located;

(b) if what is received is an asset other than a receivable, priority is governed by the law of the State in which it is located.

(5) Paragraphs (3) to (5) of article 25 apply to a conflict of priority arising between an assignee and the insolvency administrator or the assignor’s creditors with respect to whatever is received.


(A/ CN.9/WG. II/ WP.102) [Original: English]

CONTENTS

INTRODUCTION ................................................. 146

DRAFT CONVENTION ON ASSIGNMENT
IN RECEIVABLES FINANCING .......................... 147

PREAMBLE ..................................................... 147

CHAPTER I. SCOPE OF APPLICATION ................. 148

Article 1. Scope of application ...................... 148

Article 2. Assignment of receivables ............... 151

Article 3. Internationality ......................... 152

Article 4. Exclusions .............................. 152

CHAPTER II. GENERAL PROVISIONS ............... 153

Article 5. Definitions and rules of interpretation 153

Article 6. Party autonomy .......................... 154

Article 7. Debtor’s protection ..................... 154

Article 8. Principles of interpretation ............ 154

CHAPTER III. FORM AND EFFECTS OF ASSIGNMENT 155

Article 9. Form of assignment ..................... 155

Article 10. Effect of assignment .................... 156

Article 11. Time of transfer of receivables ......... 156

Article 12. Contractual limitations to assignment 157

Article 13. Transfer of security rights ............ 158

CHAPTER IV. RIGHTS, OBLIGATIONS AND DEFENCES 159

Section I. Assignor and assignee ................. 159

Article 16. Right to notify the debtor ............ 159

Section II. Debtor ............................ 160
INTRODUCTION

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

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

3. At its twenty-sixth to twenty-eighth sessions (1993 to 1995), the Commission discussed three reports prepared by the Secretariat concerning certain legal problems in the area of assignment of receivables (A/CN.9/378/Add.3, A/CN.9/397 and A/CN.9/412). Having considered those reports, the Commission concluded that it would be both desirable and feasible to prepare a set of uniform rules, the purpose of which would be to remove obstacles to receivables financing arising from the uncertainty existing in various legal systems as to the validity of cross-border

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assignments (in which the assignor, the assignee and the debtor would not be in the same country) and as to the effects of such assignments on the debtor and other third parties.\(^3\)

4. At its twenty-fourth session (Vienna, 13-24 November 1995), the Working Group commenced its work by considering a number of preliminary draft uniform rules contained in a report of the Secretary-General entitled "Discussion and preliminary draft of uniform rules" (A/CN.9/412). At that session, the Working Group was urged to strive for a legal text aimed at increasing the availability of lower-cost credit (A/CN.9/420, para. 16).

5. At its twenty-ninth session (1996), the Commission had before it the report of the twenty-fourth session of the Working Group (A/CN.9/420). The Commission expressed appreciation for the work accomplished and requested the Working Group to proceed with its work expeditiously.\(^4\)

6. At its twenty-fifth and twenty-sixth sessions (New York, 8-19 July and Vienna, 11-22 November 1996), the Working Group continued its work by considering different versions of the draft uniform rules contained in the notes prepared by the Secretariat (A/CN.9/WG.II/WP.87 and A/CN.9/WG.II/WP.89 respectively). At those sessions, the Working Group adopted the working assumptions that the text being prepared would take the form of a convention (A/CN.9/432, para. 28) and would include private international law provisions (A/CN.9/434, para. 262).

7. At its thirty-first session (1997), the Commission had before it the reports of the twenty-fifth and twenty-sixth sessions of the Working Group (A/CN.9/432 and A/CN.9/434). The Commission noted that the Working Group had reached agreement on a number of issues and that the main outstanding issues included the effects of the assignment on third parties, such as the creditors of the assignor and the administrator in the insolvency of the assignor.\(^5\) In addition, the Commission noted that the draft Convention had aroused the interest of the receivables financing community and Governments, since it had the potential of increasing the availability of credit at more affordable rates.\(^6\)

8. At its twenty-seventh and twenty-eighth sessions (Vienna, 20-31 October 1997 and New York, 2-13 March 1998), the Working Group considered the notes prepared by the Secretariat (A/CN.9/WG.II/WP.93 and A/CN.9/WG.II/WP.96 respectively). At its twenty-eighth session, the Working Group adopted the substance of draft articles 14 to 16 and 18 to 22, and requested the Secretariat to prepare a revised version of draft article 17 (A/CN.9/447, paras. 161-164 and 68 respectively).

9. At its thirty-first session (1998), the Commission had before it the reports of the twenty-seventh and twenty-eighth sessions of the Working Group (A/CN.9/445 and A/CN.9/447). The Commission expressed appreciation for the work accomplished and requested the Working Group to proceed with its work expeditiously so as to complete its work in 1999 and submit the draft Convention to the Commission for adoption at its thirty-third session (2000).\(^7\)

10. At its twenty-ninth session (Vienna, 5-16 October 1998), the Working Group considered two notes prepared by the Secretariat (A/CN.9/WG.II/WP.96 and A/CN.9/WG.II/WP.98 respectively), as well as a note containing the report of a group of experts prepared by the Permanent Bureau of the Hague Conference on Private International Law (A/CN.9/WG.II/WP.99). At that session, the Working Group adopted the substance of the preamble and draft articles 1(1) and (2), 5(g) to (j), 18(5bis), 23 to 33 and 41 to 50 (A/CN.9/455, para. 17).

11. In order to facilitate the considerations of the Working Group, this note sets forth remarks on a number of draft articles. Where necessary, suggestions for alternative or additional provisions are made for consideration by the Working Group. Remarks to draft articles 1 to 13 relate to those provisions as they appear in document A/CN.9/WG.II/WP.96 (to be read in light of the remarks contained herein but also in document A/CN.9/WG.II/WP.98); remarks to draft articles 14 to 16 and 18 to 22 relate to those provisions as they appear in the annex to document A/CN.9/447; remarks to draft articles 17 and 17bis relate to those provisions as they appear in document A/CN.9/WG.II/WP.98; and remarks to draft articles 5(g) to (j), 18(5bis), 23 to 33 and 41 to 50 relate to those provisions as they appear in the annex to document A/CN.9/455.

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DRAFT CONVENTION ON ASSIGNMENT IN RECEIVABLES FINANCING

Preamble

The Working Group may wish to consider including in the preamble a reference to the principle of debtor-protection. Thus, the preamble would refer to both main principles of a modern assignment law, i.e. to the principle of facilitation of receivables financing and to the principle of debtor-protection. Language along the following lines may be considered: "Also desiring to ensure the adequate protection of the interests of the debtor in the case of an assignment of receivables" (as to the placement of draft article 7, see remarks to that article).

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\(^6\)Ibid., para. 256.

\(^7\)Ibid., Fifty-third Session, Supplement No. 17 (A/53/17), para. 231.
Chapter 1. Scope of application

Article 1. Scope of application

1. The issue of the meaning of the term "location" in draft article 1 remains pending. The Working Group has considered so far various suggestions, including the suggestion to refer to the place of incorporation or to the place of business with which the assignment is most closely connected (A/CN.9/455, para. 165; as to the location of the debtor, reference would need to be made to the place of business which is most closely connected to the original contract between the assignor and the debtor).

2. Assuming that the term "location" would have the same meaning for the purposes of both draft articles 1 and 3, an approach based on a combination of the place of incorporation and the relevant place of business, which would be meaningful only in the cases where the two places would not coincide, could result in bringing into the scope of the draft Convention purely domestic transactions (e.g. an assignment of receivables, where the assignor, the assignee and the debtor have their places of business in the same State, while the parent company of the assignee is incorporated in another State).

3. The main argument in favour of a place-of-incorporation approach is that, in view of the fact that it would result in reference being made to a single and easily determinable jurisdiction, it would provide certainty as to the application of the draft Convention, thus potentially having a beneficial impact on the availability and the cost of credit (A/CN.9/455, para. 27). While this approach was found to be acceptable in the context of draft articles 23 and 24, it has been objected to for the purpose of the scope provisions on the grounds that the place of incorporation is a fictitious place and referring to it in this context could inadvertently result in the application of the draft Convention to purely domestic transactions (A/CN.9/455, para. 164). An approach based on the place of incorporation could also lead to a situation in which the draft Convention would not apply to a clearly international transaction (e.g. an assignment of receivables from a branch office in country A to the parent corporation incorporated in country B, where also the assignor and the debtor are located).

4. In addition, it may be argued that use of the term "place of incorporation" may fail to promote its stated goal of achieving certainty, since this term is not universally understood in the same way and, unlike the place of business which normally appears on the letterhead of a corporation, is not readily available to third parties. Moreover, such an approach may inadvertently result in the non-application of the draft Convention to cases in which a corporation has its actual place of business in one or more places, while it is incorporated in a tax haven, which would typically not be a Contracting State. A reference to the place of incorporation, i.e. the nationality of a corporation, would also be inconsistent with the normal approach of focusing on the residence, not on the nationality, of persons (A/CN.9/WG.11/WP.99, part (3); see also para. 6 below).

5. In favour of a place-of-business approach it has been argued that it would provide sufficient certainty, since it is a well known term, used in a number of uniform laws and sufficiently explained in existing case law (A/CN.9/455, para. 164). Such an approach would also provide flexibility in that it would result in focusing in each case on the relevant place of business, i.e. the place of business which would be most closely connected with the relevant transaction (the assignment for the assignor and the assignee, and the original contract for the debtor). The main objection to this approach put forward so far is that it would be very difficult, in particular for third parties, to determine in each case where the relevant place of business would be, and that difficulty would have a negative impact on the availability and the cost of credit. In addition, it has been argued that, in order to avoid inconsistent results, the term "location", which was defined for the purpose of draft articles 23 and 24 by reference to the place of incorporation, should not be defined differently for the purpose of other provisions of the draft Convention (A/CN.9/455, para. 163). Moreover, it may be argued that in a variety of service-related transactions, in which services are provided by various branch offices of a corporation, it would be difficult and unnecessary to refer to the place of business of the branch offices that were involved in the transaction, while it would be easier and more sensible from a practical point of view to refer to the place of incorporation of the parent company. Reference to the place of business with the closest relationship to the assignment may also inadvertently result in a situation in which the various assignments of the same receivables by the assignor may be subject to different legal regimes, simply because the various assignments may be most closely connected with different jurisdictions.

6. In seeking a generally acceptable solution, the Working Group may wish to take into account that, in some legal systems, a corporation has the nationality of the State in which it has been incorporated (there can be only one such place). In those legal systems, a corporation's residence is determined according to the place where it has its central control and management (there can be more than one according to the purpose for which residence needs to be determined). The Working Group may also wish to take into account that, in other legal systems, reference is made to the seat of a corporation rather than to its nationality, i.e. the place in which its central administration or management takes place. In those legal systems, if a corporation is not incorporated under the law of the jurisdiction in which its central administration takes place, it does not exist as a corporation and the partners are personally liable (in any case, local transactions of a branch office are not made international by the fact that the parent corporation is foreign).

7. Thus, in trying to reach a generally acceptable compromise, the Working Group may wish to focus on the place of central administration. In fact, the place of central administration (in other words, the chief executive
8. The Working Group may wish to consider the following approach: for the purpose of determining the location of the assignor and the assignee, reference could be made to the place of business with the closest relationship to the assignment; for the purpose of determining the location of the debtor, reference could be made to the place of business with the closest relationship to the original contract; and a rebuttable presumption in favour of the place of the assignor’s central administration could be created (see draft article 5(k) below).

9. Such a provision would combine certainty with flexibility in that it would provide a presumption as to the meaning of the main point of reference (i.e. the relevant place of business), while allowing parties to rebut the presumption by showing that the transaction is most closely connected with another State. If the proposed provision were found to be acceptable, the Working Group may wish to consider whether its application should be extended to the draft Convention as a whole, i.e. to draft articles 9, 17bis, 19(2) (if reference is made to the law of the debtor’s location; see remarks to draft article 19 below), 20(1), 22 to 24, 29 to 33 and 46(3) as well.

10. The Working Group may also wish to consider the question whether parties to the assignment should be given a right to opt into the draft Convention. Such an opt-in approach, which would be in line with the principle of party autonomy (A/CN.9/WG.II/WP.98 draft article 1, remark 2), may not be appropriate when the rights of third parties are at stake. In line with this thinking, draft article 29 allows the assignor and the assignee to choose the law applicable to their relationship. Draft article 30 is also based on the assumption that, at least in the case of contractual receivables, the assignor and the debtor may choose the law governing their relationship (which may affect the assignee as the new creditor). Unlike draft articles 29 and 30, draft article 31 does not allow a choice of law with regard to issues of priority, since it would not be appropriate for the assignor and the assignee to affect with their agreement the rights of third parties. In addition, as a practical matter, it may not be easy for third parties to know whether the assignor has opted in or out of the draft Convention. Moreover, an opt-in or an opt-out approach could produce inconsistent results in the case of a chain of assignments, some of which may be subject to the draft Convention, while other assignments may be subject to different laws. Thus, if the assignor and the assignee were given a right to opt in or out of the draft Convention, such an opt-in or opt-out could have effects only as between themselves. This is the intended effect of draft article 6.

11. One way to allow the parties to opt in or out of the draft Convention may be a rule defining the term “location” as the place chosen by the parties. Such an approach, however, could still affect the rights of third parties. As to the assignor, this is obvious as the location of the assignor is decisive for the application of the draft Convention and for the determination of the law governing priority issues. The result would be the same even in the case of an opt-in or opt-out by the assignee and the debtor to the extent that, in view of draft article 3, a choice of location by the assignee may make international a purely domestic transaction and a choice of location by the debtor could make domestic an international transaction.

12. One way in which the Working Group may provide a degree of flexibility without undermining certainty in the application of the draft Convention could be to allow States to apply the draft Convention to additional practices (and/or to exclude in draft article 4 some of the practices covered in draft article 2; see draft article 1(7) and draft article 4, remark 4 below). However, an approach based on declarations by States may not be the most appropriate approach to law unification, since the draft Convention would have a different scope for different States. In addition, such an approach may not promote certainty in the application of the draft Convention, if the declarations are formulated in ambiguous terms (however, currently, the following draft articles provide for declarations: 42; 1(4) and 42bis; 1(7) and 42ter; 4(2) and 42quater; 1(5) and 43; and 24(5) and 44; see also draft article 9, remark 6 and draft article 12, remark 11).

13. The Working Group may also wish to address the question whether, for the draft Convention to apply in the case of multiple assignors or multiple debtors, all of them need to be located in a Contracting State (A/CN.9/WG.II/WP.98, draft article 3, remark 5).

14. Multiple assignors may be involved, for example, in an assignment by a consortium of contractors in a project financing context, or in an assignment by a limited partnership where the partners act as individuals. It may be that those situations could be better addressed by a rule which would refer to the location of the agent or trustee acting on behalf of the multiple assignors (A/CN.9/WG.II/WP.98, draft article 3, remark 6). The provision would apply only if, under the law applicable to the authority of the agent or trustee, the agent or trustee would be properly authorized to act on behalf of the multiple assignors (i.e. if the agent or trustee would be authorized to do more than to provide administrative services). This point could be usefully clarified in the commentary to the draft Convention.
15. Multiple assignors may be also involved in the case of one receivable owned partly or jointly and severally by several persons. However, in this case no special rule may be needed, if the Working Group agrees that each assignment of a part of a receivable or of a whole receivable jointly owned by several persons is a separate assignment which should meet the requirements of draft article 1(1) and (2).

16. Multiple debtors may be involved in the case of more than one receivable owed by several debtors, as well as in the case of one receivable owed partly or jointly and severally by several debtors. Cases involving several debtors of a single receivable may not need to be covered by a special rule to the extent that the part of a receivable or a whole receivable owed jointly and severally by several debtors would be a separate receivable in itself and the rule in draft article 1(2) would appropriately address it with the result that each debtor would need to be located in a Contracting State (as the issue of multiple parties arises also in the context draft article 3, it may be dealt by way of a provision that would apply to draft article 3 as well; see remarks to draft article 3 below).

17. The question of the scope or the purpose of the private international law rules of the draft Convention (Chapter VI), and the question of the relationship between the private international law priority provisions (draft articles 23 and 24) and the substantive law priority provisions (Chapter VII) also remain to be discussed.

18. Under paragraph (3), if the bracketed language is deleted, the private international law rules of the draft Convention would apply irrespective of whether the assignor or the debtor would be located in a Contracting State, or whether the law governing the receivable would be the law of a Contracting State. In addition, if the bracketed language is deleted, the private international law provisions of the draft Convention should apply independently of the other scope provisions contained in Chapter I, in particular of the definition of internationality contained in draft article 3 (see second set of bracketed language in draft article 1(4) below). The Working Group may also wish to consider moving this provision to Chapter VI and further elaborating on this matter in the commentary to the draft Convention.

19. In addition, the Working Group may wish to consider the possibility of allowing States to adopt only Chapter VI. It would appear that Chapter VI would be to a large extent compatible with existing international instruments dealing with related matters and, in addition, could be regarded as a welcome opportunity of resolving issues that are left unaddressed or are not fully addressed in such other instruments. Moreover, the Working Group may wish to consider the question of the hierarchy between the substantive and the private international law provisions of the draft Convention in the case of a Contracting State which has not made a reservation as to Chapter VI. The Working Group may wish to ensure that the application of the substantive law provisions of the draft Convention is considered before a Contracting State resorts to the application of the private international law provisions of the draft Convention.

20. At its twenty-ninth session, the Working Group agreed that Chapter VI should be subject to a reservation by States (ACN.9/455, para. 72 and draft article 1(4) below). It would appear, however, that this opt-out option should be limited to draft articles 29 to 31, since draft articles 32 and 33 should, for consistency reasons, apply to the private international law provisions that are outside Chapter VI (i.e. draft articles 1(2), 9, 17bis, 19(2) and 23 to 24; see also remarks to draft article 24(3), 32 to 33 and 42bis). In order to avoid that such an approach may be interpreted as subjecting the substantive law provisions of the draft Convention to rules of mandatory law or rules reflecting public policy of the forum State, thus undermining the certainty achieved by the draft Convention, the matter could be further explained in the commentary (on this matter, see also document ACN.9/WG.II/WP.98, draft article 22).

21. In paragraph (4), a reference should be included to the right of Contracting States to opt into Chapter VII (ACN.9/445, paras. 26 and 27 and ACN.9/455, para. 120). The second sentence of paragraph (4) may be deleted. A Contracting State opting into Chapter VII could still benefit from the private international law priority rules contained in draft articles 23 and 24. In addition, once it has considered its content, the Working Group may wish to consider the question of the appropriate place of Chapter VII in the text of the draft Convention (see remarks to Chapter VII below).

22. The Working Group may also wish to consider the question whether draft article 25, which deals with the scope of application of the draft Convention with regard to subsequent assignments, should be placed in the context of draft article 1 (ACN.9/455, para. 54). Paragraph (2) of draft article 25 may need to be revised so as to ensure that the subsequent assignee, who assigns the receivables assigned to him further is treated as the initial assignor, while the subsequent assignee, who receives the receivables previously assigned, is treated as the initial assignee.

23. Thus the Working Group may wish to consider the following reformulated version of draft article 1:

"(1) This Convention applies to:

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

(b) assignments of receivables by the initial or any other assignee to subsequent assignees ("subsequent assignments") provided that any prior assignment is governed by this Convention.

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

(2) This Convention applies to subsequent assignments as if the subsequent assignee who exercises its
right to assign were the initial assignor and as if the subsequent assignee to whom the assignment is made were the initial assignee.

“(3) This Convention does not affect the rights and obligations of the debtor unless the debtor is located in a Contracting State or the law governing the receivables is the law of a Contracting State.

“[4) The provisions of articles 29 to 33 apply to assignments of international receivables and to international assignments of receivables as defined in this chapter independently of paragraphs (1) and (3) of this article] [independently of the provisions of this chapter]. However, the provisions of articles 29 to 31 do not apply if a State makes a declaration under article 42bis.

“(5) Chapter VII applies in a Contracting State which has made a declaration under article 43.

“(6) [In the case of an assignment of more than one receivable by more than one assignor, this Convention applies if any assignor is located in a Contracting State.] In the case of an assignment of more than one receivable owed by more than one debtor, this Convention does not affect the rights and obligations of any debtor unless that debtor is located in a Contracting State or the law governing the receivable owed by that debtor is the law of a Contracting State.

“(7) This Convention applies to additional practices listed in a declaration made by a State under draft article 42ter”.

Article 2. Assignment of receivables

1. In addition to the questions identified in the remarks to draft article 2 contained in document A/CN.9/WG.II/WP.98, the Working Group may wish to consider the following questions: whether the definition of the term “assignment” also covers the agreement to assign; and whether the reference to consideration contained in the definition should be retained.

2. It should be recalled that at its twenty-seventh session the Working Group thought that “the formulation of paragraph (1) clarified sufficiently that both the contract of assignment and the resulting transfer of receivables were covered by the definition of ‘assignment’” (A/CN.9/445, para. 149). In reaching that conclusion, the Working Group had noted that, while in some legal systems the invalidity of the agreement to assign may invalidate the transfer, in other legal systems the invalidity of the agreement to assign may give rise to a claim against the assignee based on the principles of unjust enrichment (A/CN.9/WG.II/WP.93, draft article 2, remark 2).

3. Should the Working Group confirm the understanding that the definition contained in paragraph (1) covers the assignment as well as the agreement to assign, a number of provisions of the draft Convention should be reviewed in order to ensure that their application would produce the desired results if the agreement to assign and the assignment would not be concluded at the same time. For example, in its current formulation draft article 10 may not make it sufficiently clear that the assignment and not the agreement to assign produces the prescribed results, i.e. the transfer of property rights in the receivables. The text of the draft Convention would not need to be revised if the Working Group agrees that the reference to “transfer by agreement”, which is intended to ensure that only voluntary assignments (not assignments by operation of law) are covered, makes it sufficiently clear that the assignment is the main focus of the draft Convention. The commentary could explain that the draft Convention does not apply to agreements to assign, except where it expressly provides otherwise (e.g. draft articles 14-17).

4. The reference to consideration was originally intended to ensure that the draft Convention would not apply to gratuitous assignments. However, in view of the fact that the draft Convention deals only in exceptional cases with the financing contract or the agreement to assign, the reference to consideration may not be necessary in the definition of “assignment”. If this reference is deleted, in line with the goals of the draft Convention set out in the preamble, gratuitous assignments could be excluded in draft article 4.

5. In addition, the Working Group may wish to consider the question whether the draft Convention should apply not only to the assignment of rights to payment of money but also to the assignment of other contractual rights or even to the assignment of contracts (i.e. the assignment of rights and the delegation of obligations). In practice, often all rights arising under a contract are assigned, even though the assignee may be interested more in the rights to payment, including the rights to payment of damages for breach of contract, than in other rights. Covering the assignment of rights other than rights to payment would not interfere with the rights of the assignee to exclude those rights from the assignment so as to avoid additional risks and costs (e.g. the right to receive goods may entail product liability and maintenance or insurance costs). In addition, such an approach would result in a more comprehensive legal regime dealing with assignment. On the other hand, such an extension of the scope of the draft Convention may make it less acceptable to States. In any case, assignments of contractual rights should be clearly distinguished from assignments of contracts which involve not only the assignment of rights but also the delegation of obligations. Delegation of obligations may be regarded as a separate transaction, and leaving it outside the scope of the draft Convention may not negatively affect any financing practice (e.g. in the case of assignments of loans, it would seem that normally only the right of the assignor to receive payment of the amount lent to the borrower is assigned and not any obligation of the assignor to provide further credit).

6. The following reformulated version of draft article 2 may be considered:

“For the purposes of this Convention, ‘assignment’ means the transfer by agreement from one person (‘assignor’) to another person (‘assignee’) of the
assignor’s contractual right to payment of a monetary sum (‘receivable’) from a third person (‘the debtor’), including the creation of rights in receivables as security for indebtedness or other obligation.”

7. The Working Group may wish to address the question whether an explicit reference should be included in draft article 2 to conditional transfers of receivables. Normally, a conditional transfer would be regarded as a sale or a security device, depending, e.g. on whether the receivables are retransferred automatically to the seller in the case of debtor-default. However, in some legal systems conditional transfers are invalidated. Thus, their express recognition in the draft Convention may have a beneficial effect on those practices that take the form of a conditional transfer of receivables.

Article 3. Internality

1. The Working Group may wish to consider the question of the potential uncertainty as to the application of the draft Convention in the case of an assignment which relates to future receivables, resulting from the fact that their internationality would be determined under draft article 3 only at the time they arise (ACN.9/455, para. 162).

2. In addition, the Working Group may wish to address the question of a multiplicity of assignors, assignees or debtors in the context of draft article 3 (ACN.9/9/WG.II/WP.98, draft article 3, remarks 2.4) on the basis of the following provision:

“(2) In the case of an assignment of more than one receivable by more than one assignor, the assignment is international if any assignor and the assignee are located in different States. In the case of an assignment of more than one receivable to more than one assignee, the assignment is international if the assignor and any assignee are located in different States.

“(3) In the case of an assignment of more than one receivable owed to more than one creditor, the receivable is international if any assignor and the debtor are located in different States. In the case of an assignment of more than one receivable owed by more than one debtor, only that receivable is international in which the assignor and the debtor are located in different States.”

3. Alternatively, the issue of the location of multiple assignors and assignees may be dealt with by way of a provision that would refer to the location of their authorized agent or trustee and deal with the issue of location in general along the following lines (this provision would replace only the bracketed language in draft articles 1(7) and 3(2) and (3) above; it is tentatively formulated as subparagraph (k) of draft article 5):

“(k) For the purposes of articles 1 and 3:

“(i) the assignor is located in the State in which it has that place of business which has the closest relationship to the assignment;

“(ii) the assignee is located in the State in which it has that place of business which has the closest relationship to the assignment;

“(iii) the debtor is located in the State in which it has that place of business which has the closest relationship to the original contract;

“(iv) in the absence of proof to the contrary, the place of central administration of a party is presumed to be the place of business which has the closest relationship to the relevant contract. If a party does not have a place of business, reference is to be made to its habitual residence;

“(v) several assignors or assignees are located at the place in which their authorized agent or trustee is located.”

4. It should be noted that this provision is intended to apply in the case of an assignment of more than one receivable. The commentary may explain that each assignment of a part of one receivable or of a receivable jointly and severally owned by several persons is a separate assignment (see also draft article 1, remarks 15 and 16 above).

5. The Working Group may wish to consider whether a single definition of the term “location” would be preferable to one definition for the purposes of draft articles 23 and 24 and a different definition for the purposes of draft articles 1 and 3 (for arguments in favour of one definition, see ACN.9/455, para. 163). The meaning of the term “location” would need to be considered for the purposes of draft articles 9, 17bis, 19(2), 30(1), 22, 29 to 31 and 46(3) as well. In any case, the Working Group may wish to determine whether reference should be made to “the chief executive office” (as in draft article 5(j)), or to the “place of central administration” (as in new draft article 5(k) below).

Article 4. Exclusions

1. Depending on the decision of the Working Group as to the deletion of the reference to consideration in draft article 2, assignments made “without value, credit or related services being given or promised by the assignee” may need to be added to the list contained in draft article 4. In addition, subparagraph (e) may need to be revised along the following lines: “to the extent made by endorsement and delivery or only by delivery of a negotiable instrument”. Such a revision would reflect the fact that, with the exception of bearer instruments, which are transferred by delivery, negotiable instruments are transferred by endorsement and delivery (not “or”, as mentioned in subparagraph (e)).

2. The commentary may refer to the reason for this exclusion, i.e. to avoid conflicts with the law applicable to

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Footnote:

*For wording alternative to the bracketed wording in draft articles 3(2) and (3), see draft article 5(k) below."
negotiable instruments, such as bills of exchange, promissory notes and cheques, and in particular to avoid interfering with the priority scheme prevailing under both national and international negotiable-instrument law. For the same reason, certain other documents that may be regarded as payment instruments may also need to be excluded (e.g. bonds or preference shares under which there is an obligation for payment of regular dividends). Independent guarantees and stand-by letters of credit ("independent undertakings"; see article 3 of the United Nations Convention on Independent Guarantees and Stand-By Letters of Credit, hereinafter referred to as "the Guarantee and Standby Convention") may not need to be excluded altogether, as long as it is ensured that the guarantor/issuer, counter-guarantor or confirmor does not have to pay the assignee, unless it has consented to do so. Thus, this matter may be more appropriately addressed by way of a rule in draft article 12, which deals with contractual assignability of receivables, allowing the guarantor/issuer of an independent undertaking to discharge its obligation by paying the beneficiary (assignor). Such a rule would not interfere with statutory non-assignability of an independent undertaking, since statutory assignability is not addressed by the substantive law provisions of the draft Convention. Only draft article 30 provides for the law applicable to contractual and statutory assignability, on the understanding that application of the law governing the receivable may be refused by a court, if that law runs contrary to mandatory rules or rules reflecting public policy of the forum State.

3. As to the question whether the assignment of receivables from the buyer of a business to the institution financing the sale is excluded or not (A/CN.9/WG.II/ WP.98, draft article 4, remark 3), it may be sufficient to clarify in the commentary that, in the case of a sale of a business, only the assignment from the old to the new owner is excluded and not the assignment by the new owner to an institution financing the sale. In addition, the commentary may clarify that only the assignment of receivables is covered (e.g. the right to payment under a share) and not the assignment of other rights (e.g. voting rights flowing from a share).

4. Depending on the decision of the Working Group on the scope of the draft Convention in the context of draft article 2, the Working Group may wish to consider allowing States to exclude or include additional practices (see draft article 1(7) above and draft article 4(2) below). While, as already mentioned, such an approach might not be the most appropriate approach to law unification, it might make the draft Convention more acceptable to States and facilitate a decision by the Working Group to cover only contractual receivables, thus simplifying the text of the draft Convention (a number of provisions, e.g. draft articles 15 and 20, could not apply to assignments of tort receivables). Language along the following lines could be considered:

"(2) The Convention does not apply to assignments listed by a State in a declaration made under draft article 42quater."
7. Subparagraph (g), which is drawn from paragraph (d) of article 2 of the UNCITRAL Model Law on Cross-Border Insolvency, covers both voluntary and compulsory reorganization or liquidation of the assignor's assets. It may be noted that, in some systems, in the case of a voluntary reorganization of its assets the insolvent debtor may remain in control of the assets and there may not be an insolvency administrator. Thus, the Working Group may wish to consider revising draft article 24(2) so as to cover situations in which conflicts of priority may arise in the context of an insolvency proceeding in which there is no insolvency administrator (see draft article 24, remark 1).

8. The reference at the end of subparagraph (j) to "any other person" may need to be revised, since the reference to individuals, corporations and legal persons other than corporations covers every possible person. In order to cover legal persons other than corporations that do not have a constitutive document filed (e.g. partnerships), language along the following lines may be considered:

"...a legal person other than a corporation is located in the State in which its constitutive document is filed and, in the absence of a filed document, in the State in which it has its chief executive office."

9. As already mentioned, the Working Group may wish to consider adopting one definition of the term "location" for the purposes of the draft Convention as a whole (see draft article 3, remark 4 above).

10. The Working Group may wish to consider the following reformulated version of subparagraph (k) in document A/CN.9/WG.II/WP.96:

"(l) "Time of the assignment" means the time specified in an agreement between the assignor and the assignee and, in the absence of such an agreement, the time when the contract of assignment is concluded."

11. The Working Group may wish to consider the question whether the freedom of the parties to specify by agreement the time of the assignment should be limited (for a brief discussion of a previous version of this subparagraph, see A/CN.9/447, para. 30). The term "time of assignment" appears in draft articles 1(1), 9(1), 11(1) and 34.

Article 6. Party autonomy

1. The Working Group may wish to consider the following alternative formulation of draft article 6:

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

2. In the context of an agreement between the assignor and the assignee, "third parties" are the debtor, the assignor's creditors and the insolvency administrator. In the context of an agreement between the assignor and the debtor, "third parties" are the assignee, the assignor's creditors and the insolvency administrator. Agreements between the assignee and the debtor are not covered by the draft Convention.

Article 7. Debtor's protection

1. The Working Group may wish to consider including in the preamble a general reference to debtor-protection and to place draft article 7 at the beginning of Section II of Chapter III dealing with debtor-protection (see new draft article 17ter below).

2. The intended effect of paragraph (1) is that, with the exception of certain debtor-related matters expressly settled in the draft Convention (i.e. in draft articles 9-12 and 16-22), the rights and obligations of the debtor are left to the contract between the assignor and the debtor and the law governing this contract.

3. In order to align paragraph (2) with draft article 16(3) and to avoid an interpretation contrary to paragraph (2) that, apart from the country and the currency of payment, the assignee may change any other payment terms contained in the original contract, the Working Group may wish to revise paragraph (2) (see new draft article 17ter below).

4. The commentary may further clarify that no provision of the draft Convention is intended to address the question whether the debtor has an obligation to pay (capital or interest). The commentary could mention, for example, that notification in itself does not trigger the obligation of the debtor to pay, if payment is not yet due under the original contract. This matter remains an issue of the original contract even after notification of the assignment. The debtor may agree with the assignee to modify the payment obligation, but this matter is not covered by the draft Convention.

Article 8. Principles of interpretation

1. Paragraph (1) refers to the principle of good faith as an element to be taken into account in the interpretation of the draft Convention, but not of the contractual relationships of the parties involved in an assignment. While the principle of party autonomy would appropriately be applied to the contractual relationship between the assignor and the assignee or the assignor and the debtor, it could undermine the certainty achieved by the draft Convention if applied to the assignee-debtor or the assignee-third party relationship. For example, if the principle of good faith prevailing in the forum State were to apply to the assignee-debtor or the assignee-third party relationship: the debtor, who might have paid the assignee after notification, may have to pay again if, e.g. the debtor knew about a previous assignment; and the law applicable under draft article 24 might be disregarded if it does not respect the principle of good faith as it may be understood in the forum State.

2. As to the question whether the reference to general principles underlying the draft Convention relates to
substantive or to private international law principles, the Working Group may wish to consider whether this question could be settled by way of an explanation to be included in the commentary. The commentary could explain, for example, that draft article 8 applies only to the substantive provisions of the draft Convention and thus the reference to general principles should be understood as a reference to the substantive law principles underlying the draft Convention. In order to avoid any uncertainty, reference could be made, either in draft article 8 or in the commentary to the general principles embodied in the preamble.

3. If draft article 8 were to apply for filling gaps in the private international law provisions of the draft Convention, language along the following lines could be considered for addition to draft article 8:

“(2) ... by virtue of the private international law provisions of this Convention.

“(3) Questions concerning matters governed by articles 9, 17bis, 19(2), 23 to 24 and 29 to 33 which are not expressly settled in those articles are to be settled in conformity with the general principles on which they are based or, in the absence of such principles, in conformity with the law applicable by virtue of the rules of private international law of the forum State.”

4. The commentary could refer to a few principles underlying the private international law provisions of the draft Convention, such as the principle of party autonomy in the relationship between the assignor and the assignee (draft article 29), the principle of debtor-protection in the relationship between the assignee and the debtor (draft article 30) and the principle of certainty as to the rights of third parties (draft article 31).

Chapter III. Form and effects of assignment

Article 9. Form of assignment

1. Three different versions of paragraph (1) are set forth in document A/CN.9/WG.11/WP.96. Variant A has the advantage that it ensures adequate protection of third parties against the risk of the assignor acting in collusion with the assignee or any other person and affecting the order of priority. Another advantage of Variant A is that it requires a writing for the master agreement, not the assignment itself, thus avoiding raising the question of stamp duties, which are normally payable for the assignment, not the master agreement.

2. Yet another advantage of Variant A, as well as Variant B, is that it is formulated in a negative way, since it is intended to deal only with situations in which less than a written assignment, i.e. an oral assignment, is involved. If it were formulated in a positive way (e.g. "an assignment in writing is effective ..."), it could supplant national law requiring more than a written assignment (e.g. a notarized agreement, notification of the debtor or registration in a public registry). In such a case, the rights of third parties under national law requiring more than a written agreement would probably need to be preserved by including in draft article 9 language along the lines of the opening words of draft articles 10 and 11 (i.e. "subject to draft articles 23 and 24"). The only possible disadvantage of Variant A is that it may invalidate national practices in which no writing is necessary for the assignment to be effective. This disadvantage may be set aside by a rule along the lines of Variant B.

3. The scope of Variant C is different in that it deals with form in general (i.e. written form, notarial form, notification of the debtor or registration), leaving it to the law of the assignor’s location whether less or more than a written agreement would be required for an assignment to be effective. To the extent that Variant C covers the effectiveness of an assignment as against third parties, it appears overlapping with draft articles 23 and 24 (although it is consistent with those provisions).

4. The Working Group may thus wish to consider the following formulation of draft article 9, which combines Variants A and B:

“(1) An assignment in a form other than in writing is not effective [as against third parties], unless:

“(a) it is effected pursuant to a contract between the assignor and the assignee which is evidenced by a writing describing the receivables to which it relates; or

“(b) the law of the State in which the assignor is located at the time of the assignment provides otherwise.”

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

5. Thus, oral assignments would be effective if covered by a written master agreement or, in the absence of such a written agreement, if they would be effective under the law of the assignor’s location. The inclusion of the bracketed language in the opening words of paragraph (1) is intended to raise the question of the purpose of written form requirements. Written form may not be needed for the purpose of protecting the interests of the assignor and the assignee, since they can be left to take care of their own interests. Written form may not be needed for the purpose of debtor-protection either, since the draft Convention provides that, in the absence of a written notification, the debtor’s rights (i.e. the way in which the debtor can discharge its obligation, its defences and rights of set-off and its right to modify the original contract) are not affected. Written form, however, would be needed for the purpose of protecting the interests of third parties to the extent that it would preclude situations in which the assignor acting in collusion with the assignee or any other party could affect the order of priority.

6. Variants B and C, as well as the version mentioned above, are all intended to address the concern that a rule
along the lines of Variant A would invalidate certain practices for which no writing is required under national law. The ultimate way to address this concern might be to adopt a rule along the lines of Variant A and to allow States to enter a reservation in order to preserve practices based on oral assignments (see, however, draft article 1, remark 13).

Article 10. Effect of assignment

1. The opening words of draft articles 10 and 11 are intended to ensure that the rules as to the effectiveness of an assignment and the time of transfer of receivables do not unduly affect the rights of third parties (a reference to the provision dealing with priority in proceeds would need to be added). Without those words, draft article 10 could be read as validating the first assignment and invalidating any further assignment of the same receivables by the same assignor; and draft article 11 could be read as setting a rule for effectiveness of the assignment as against third parties, including the administrator in the insolvency of the assignor (e.g. receivables arising after the opening of an insolvency proceeding could be taken out of the insolvency estate or be subject to a security right, if the assignment had taken place before the opening of the insolvency proceeding).

2. However, the opening words may inadvertently result in the effectiveness of the assignment of future receivables or of bulk assignments being left altogether to the law applicable under draft articles 23 and 24. In order to avoid this unintended result, the Working Group may wish to consider including in the context of draft articles 23 and 24 a provision along the following lines: "Nothing in this Convention invalidates an assignment on the sole ground that it is an assignment of future receivables or receivables not specified individually or parts or undivided interests in receivables" (on this point, see also draft article 12, remark 8). As a result, the draft Convention would validate such assignments, as a matter of civil or commercial law, while leaving to other law specific challenges to their validity (e.g. the invalidation of an assignment made within the suspect period before the opening of an insolvency proceeding as a fraudulent or preferential transfer). Alternatively, the words "subject to articles 23 and 24" in draft articles 10 and 11 could be replaced by wording spelling out in detail their intended effect, or further explained in the commentary. The commentary may mention in particular that, as a result of those words, an effective first assignment does not invalidate any further assignment.

3. On the understanding that the definition of "assignment" contained in draft article 2 covers only the assignment (i.e. not the agreement to assign), draft article 10 does not need to be revised in order to ensure that only the assignment has the effect of transferring property rights in the receivables (on this matter, see draft article 2, remark 3). The words "to transfer" have been replaced by the words "to assign" in order to ensure that, in addition to outright transfers, draft article 10 includes the creation of security rights in receivables (the definition of "assignment" includes assignments by way of security). However, in view of the fact that the use of the words "to assign" is tautological ("an assignment ... assigns"), the Working Group may wish to delete the words "to assign the receivables to which it relates", on the understanding that the definition of assignment is sufficient to clarify the legal consequences of an effective assignment (i.e. the outright transfer of and the creation of security rights in receivables). The commentary could expressly refer to that understanding.

4. The Working Group may wish to consider reversing the order of paragraphs (1) and (2), in order to deal first with the effectiveness of assignments of future receivables and then with the effectiveness of bulk assignments.

5. Thus, the Working Group may wish to consider the following reformulated version of draft article 10:

"Subject to articles 23 and 24, an assignment of existing or future, one or more, receivables, and parts of, or undivided interests in, receivables is effective, if

(a) the receivables are specified individually as receivables to which the assignment relates; or

(b) the receivables can be identified as receivables to which the assignment relates, at the time agreed upon by the assignor and the assignee and, in the absence of such agreement, at the time when the receivables arise".

Article 11. Time of transfer of receivables

1. In view of the fact that only paragraph (1)(b) refers to party autonomy, paragraph (1)(a) may be read as precluding the assignor and the assignee from specifying the time of transfer of existing receivables. Such an interpretation would be inconsistent with draft article 6 and paragraph (1)(b). Draft article 6 may be sufficient in ensuring that parties may set the time of transfer of the receivables as long as they do not affect the rights of third parties and party autonomy in this regard may not need to be limited. Thus, it may not be necessary to refer to party autonomy in draft article 11.

2. If the new subparagraph (1) of draft article 5 (see draft article 5, remark 10 above) is retained and the scope of the draft Convention is limited to contractual receivables, the Working Group may wish to consider the following reformulated version of paragraph (1) of draft article 11:

"(1) Subject to articles 23 and 24,

(a) a receivable other than a future receivable is transferred at the time of the assignment;

(b) a future receivable is deemed to be transferred at the time of the assignment."
3. If new subparagraph (i) of draft article 5 is deleted, reference should be made in draft article 11 to the time of the conclusion of the contract of assignment.

Article 12. Contractual limitations to assignment

1. Draft article 12 overrides anti-assignment clauses and enables the assignee to collect directly from the debtor. The underlying policy is that it is more beneficial for everyone to reduce the transaction cost of examining contracts in order to ensure that they do not contain anti-assignment clauses rather than to protect the debtor from paying someone else.

2. However, in certain cases, there may be other policies or practices that may need to be preserved, e.g. the policy of Governments not to deal with certain parties or not to give up rights of set-off they may have against their suppliers of goods or services. It is also a generally accepted rule of independent-guarantee or standby-practice that the guarantor/issuer of an independent undertaking should not have to pay against its will a person other than the beneficiary (see, e.g. articles 10 and 11 of the Guarantee and Standby Convention). In addition, in loan-syndication practice an assignment is possible only if the terms of the loan agreement permit it. Moreover, in the case of securitization of mortgage loans, an assignment against the consumer-debtor may materially increase the burden of risk imposed on the consumer-debtor (if, e.g. the mortgage loan is assigned by the friendly local savings and loans bank to a foreign lender, who may be more aggressive in the collection of the outstanding amounts of the loan or in handling any variable interest rate).

3. Thus, the Working Group may wish to consider introducing certain exceptions to the rule contained in draft article 12 for assignments of receivables arising from deposit accounts, independent guarantees or stand-by letters of credit, transactions made for personal, household or family purposes, loan agreements or public procurement contracts (see also A/59/WG.II/WP.98, draft article 12, remark 1).

4. The effect of such exceptions would be that, in the case of an assignment made in violation of an anti-assignment clause, certain categories of debtors could discharge their obligations by paying the assignor, while a notification would not cut off their rights of set-off and would not limit their ability to modify the original contract without the consent of the assignee. Under such an approach, if the assignor is solvent, the assignee will be able to recover from the assignor in the case of debtor-default, while, if the assignor becomes insolvent, the assignee will have priority against the assignor and the assignor's creditors (for a brief discussion of this approach with regard to consumer-debtors, see A/9/445, para. 229 and A/9/432, para. 125).

5. On the other hand, while an approach based on a rule with certain exceptions may make the draft Convention more acceptable to States, once the approach taken in draft article 12 is accepted as the appropriate one, there would seem to be no substantive reason why powerful debtors, such as Governments and banks, should be exempted. The alternative would be to retain the rule set forth in draft article 12 without making exceptions, at least for powerful debtors, or to treat an assignment made in violation of an anti-assignment clause as ineffective as against any debtor and effective only as against the assignor and third parties other than the debtor. The latter approach may establish an appropriate balance between the need to facilitate receivables financing and the need to protect the interests of the debtor.

6. However, if such an approach were to be followed, the assignee would be deprived of the right to claim payment from the debtor. Such an approach, while suitable for some financing practices, would be inappropriate for other practices, such as factoring and asset-based lending, where the lender may structure the entire financing on the basis of collection from the debtors. In addition, in many legal systems, if payment is made to the assignor, the assignee would not always be entitled to be paid before unsecured creditors. For example, if the debtor pays the assignor before the opening of the insolvency proceeding, the assignee would have only a right ad personam. Only if payment is made after the opening of the insolvency proceeding, the assignee would have a right to be paid before unsecured creditors.

7. On the other hand, such an approach may be considered for the purpose of validating an assignment which may on its face be contrary to statutory prohibitions or, at least, to statutory prohibitions that do not constitute mandatory law (i.e. loi de police). Allowing the assignor to assign the proceeds of payment made by the debtor to the assignor would not be inconsistent with the policy of protecting the debtor. However, such an approach may be inconsistent with statutory prohibitions that are designed to protect the debtor (e.g. prohibitions relating to receivables owed by a Government), but with statutory prohibitions that are designed to protect the assignor (e.g. prohibition of the assignment of wages or pensions). For the purpose of a rule to be included in the draft Convention, there may be no way to determine whether a statutory prohibition is aimed at protecting the debtor or the assignor.

8. Unlike draft articles 10 and 11, draft article 12 is not subject to draft articles 23 and 24. As a result, an assignment made despite an anti-assignment clause is effective as against other assignees, the assignor's creditors and the administrator in the insolvency of the assignor. The fact that the law governing priority under draft article 23 and 24 cannot invalidate an assignment made in violation of an anti-assignment clause, may need to be clarified in the commentary or in the context of draft articles 23 and 24 by way of a provision along the following lines: "Nothing in this Convention invalidates an assignment on the sole ground that it is made despite an agreement between the assignor and the debtor limiting in any way the assignor's right to assign its receivables" (on this matter, see also draft article 10, remark 2).
9. The Working Group may also wish to consider the question whether draft article 26, which deals with agreements limiting assignments in the context of subsequent assignments, should be placed in the context of draft article 12 (A/CN.9/455, para. 54).

10. Thus, the Working Group may wish to consider the following reformulated version of draft article 12:

“(1) A receivable is transferred to the assignee notwithstanding any agreement between the assignor and the debtor, or, in the case of any subsequent assignment, between the initial or any subsequent assignor and the debtor or any subsequent assignee, limiting in any way the assignor’s right to assign its receivables.

“(2) Nothing in this article affects any obligation or liability of the assignor for breach of such an agreement. A person who is not party to such an agreement is not liable under that agreement for its breach.20

“(3) This article does not apply to assignments of receivables arising under loan agreements, deposit accounts, independent guarantees and stand-by letters of credit, contracts concluded for personal, household or family purposes, and public procurement contracts.”

11. As an alternative to paragraph (3), the Working Group may wish to consider making no exceptions to the rule contained in draft article 12 and allowing States to make a reservation. Under such an approach, each State would determine if and how it might wish to protect debtors in general or certain categories of debtors only.

12. In any case, draft article 12 in its present formulation would not address: the risk of cancellation of the original contract by the debtor for breach of an anti-assignment clause by the assignor; the risk that the assignee may be exposed to tortious liability; and the risk that an assignment may be set aside if, under notions of national law, it “would materially change the duty of the other party [the debtor], or increase materially the burden or risk imposed on him by his contract, or impair materially his chance of obtaining return performance” (art. 2-210 of the United States Uniform Commercial Code). While a rule invalidating anti-assignment clauses could resolve those problems, it might limit party autonomy with regard to the debtor to an unacceptable degree.

Article 13. Transfer of security rights

1. The thrust of this provision is that accessory security rights, whether personal or proprietary, follow the receivable which they secure. This is a generally accepted principle and one that is often of significant importance, since the value relied on by the lender extending credit to the assignor may be often not in the receivable but in the right securing the receivable.

2. The words “unless otherwise provided by law or by agreement between the assignor and the assignee” are intended to ensure that: if by law a security right is independent, it would not follow the assigned receivables; and parties may agree that an accessory security right would not follow automatically the assigned receivable and would be extinguished (e.g. a retention of title in goods or a mortgage would not follow the receivables, since the assignee may not wish to be exposed to product liability, in the case of goods, or to the cost of insuring and preserving the building, in the case of a mortgage). However, these words may not be sufficient in reflecting the intended meaning. Thus, the Working Group may wish to consider the formulation offered below, which attempts to further elaborate on the intended meaning of paragraph (1).

3. The reference to party autonomy may be deleted on the understanding that it is sufficiently dealt with in draft article 6. However, some reference to other law would need to be retained in order to address independent undertakings. As to such undertakings, the draft Convention could introduce an obligation of the assignor to transfer their proceeds to the assignee, on the assumption that such proceeds are transferable without the consent of the person obliged to pay. The value of a provision along those lines would be in the cause of action which the assignee would otherwise have against the assignor. The commentary could explain that, according to draft article 6, the assignor and the assignee could agree otherwise. Such an obligation could not be imposed on the assignor with regard to the right to demand payment under an independent undertaking, since normally the transfer of such a right would be subject to the consent of the person obliged to make payment.

4. In line with draft article 12, paragraphs (2) and (3) are intended to ensure that an agreement limiting the assignor’s right to transfer any security right does not invalidate their transfer. Such an agreement would in effect result in the case of an accessory security right in the right being extinguished, while, in the case of an independent security right, it would result in the right being not assignable. Paragraphs (2) and (3) are of importance, since, as already mentioned, in some practices the lender may be relying more on the security right rather than on the receivable.

5. The Working Group may wish to consider the following formulation of draft article 13:

“(1) A personal or property right securing payment of the assigned receivable is transferred to the assignee without a new act of transfer, unless it is by law [independent] [transferable only with a new act of transfer]. If such a right is by law [independent] [transferable only with a new act of transfer], the assignor is obliged to transfer the proceeds of this right to the assignee.

“(2) A right securing payment of the assigned receivable is transferred under paragraph (1) notwithstanding an agreement between the assignor and the debtor or other person granting the right, limiting in any way

20Draft article 12(2) has been aligned with draft article 26(2) (A/CN.9/455, para. 51).
the assignor’s right to assign the receivable or the right securing payment of the assigned receivable.

“(3) Nothing in this article affects any obligation or liability of the assignor for breach of an agreement under paragraph (2). A person who is not a party to such an agreement is not liable under that agreement for its breach.

“(4) Paragraph (1) of this article does not affect any requirement under rules of law other than this Convention relating to the form or registration of the transfer of any rights securing payment of the assigned receivable.”

Chapter IV. Rights, obligations and defences

Section I. Assignor and assignee

Article 16. Right to notify the debtor

1. Paragraph (1) provides that the assignor or the assignee or both may notify the debtor and request payment. However, after notification is given, the assignor is no longer the owner of the receivables, even if the assignor is still the payee. For that reason, after notification is received by the debtor, only the assignee should be able to notify the debtor and change or correct the instructions given to the debtor with the first notification. A rule along those lines, inserted in draft article 16(1) (see draft article 16 below), would appropriately supplement the rule proposed for draft article 18(4) (see draft article 18, remark 3 below, according to which in the case of several notifications relating to the same assignment, the debtor is discharged by paying the person or to the address identified in the last notification.

2. At its twenty-eighth session, the Working Group adopted the substance of draft article 16 without drawing a distinction between a notification and a request for payment. While some support was expressed at that session in favour of drawing such a distinction, that approach was objected to on a number of grounds, including the following: it unnecessarily formalized a distinction that eventually had practical importance in exceptional situations only, since assignees notifying debtors could not afford leaving any uncertainty as to whom the debtor should pay; it could inadvertently raise the cost of credit, if seen as encouraging parties to serve two “notifications”; one without and one with payment instructions; and would complicate the discharge of the debtor, since the debtor would have to know the legal consequences of each type of notification (A/CN.9/447, paras. 75-78).

3. However, the matter came up again in the context of draft articles 18(3) (in the context of a discussion as to whether the assignee could change or correct the payment instructions given to the debtor with the notification), 19(2) and 21(4) (in the context of a discussion as to whether a notification which does not identify the payee should bring about the legal consequences described in those draft articles). The lack of consensus as to the question whether a distinction should be drawn between different types of notifications (or, in other words, between a notification and a request for payment) for the purpose of attributing different legal consequences to them resulted in the addition of the bracketed language in draft articles 19(2) and 21(4) (A/CN.9/447, paras. 46, 74-76, 82-83, 99-100 and 135).

4. The “Proposal by the United States of America” (A/CN.9/WG.12/WP.100; hereinafter referred to as “the U.S. Proposal”) addresses this matter by drawing a distinction between different types of communications (i.e. a notification and a request for payment) and by attributing different legal consequences to each of those communications. Under the U.S. Proposal, unlike draft article 16(3) (now moved to draft article 5(f)), a notification does not need to identify the payee. As a result, a notification would not trigger a change in the way in which the debtor could discharge its obligation (draft article 18 as revised in the U.S. Proposal). It would, however, result in freezing the rights of set-off of the debtor and in limiting the right of the debtor to modify the original contract (if the U.S. Proposal were to be adopted, the bracketed language in draft articles 19(2) and 21(4) would not be necessary in order to achieve this result). In line with the approach of the U.S. Proposal to provide for different legal consequences, draft article 16(2) of the U.S. Proposal provides that a notification or a payment instruction given to the debtor in breach of an agreement between the assignor and the assignee “is not ineffective for the purposes of article 18 by reason of the breach”, which means, a contrario, that it is ineffective for the purposes of articles 19 and 21.

5. In deciding whether a distinction should be drawn between a notification and a payment instruction with a view to attributing different legal consequences to each of those communications, the Working Group may wish to determine whether the practices in which a bare notification is given without any payment instructions whatsoever, are sufficiently significant so as to dictate the rule for all cases. If the Working Group determines that in most practices some sort of payment instructions to the debtor (i.e. to pay the assignee or a third person, or to continue paying the assignor), would be an essential element of a notification, the Working Group may wish to determine whether: a special rule should be included in the draft Convention (essentially along the lines of the bracketed language in draft articles 19(2) and 21(4)) so as to accommodate certain exceptional practices where the notification does not contain any payment instruction; or whether such practices could be left outside the scope of the draft Convention.

6. In addition, the Working Group may wish to split draft article 16 into two provisions, one comprising paragraphs (1) and (2), which would deal with the right to notify the debtor and as such would be appropriately retained in Section I (rights and obligations of the assignor and the assignee), and another comprising paragraphs (4) and (5), which would deal with the rights of the debtor and should
be placed in Section II (rights and obligations of the debtor). The Working Group may also wish to consider the question whether draft article 28 dealing with notification of subsequent assignments should be placed in the context of draft article 16 (A/CN.9/455, para. 54). Thus, the Working Group might wish to consider a reformulated version of draft article 16 and a new article 17ter that would read along the following lines:

“(1) Unless otherwise agreed between the assignor and the assignee, the assignor or the assignee or both may send the debtor notification of the assignment and request that payment be made to the person or to the address identified in the notification. However, after notification is received by the debtor only the assignee may notify the debtor and request that payment be made to another person or address.

“(2) Notification of the assignment or request for payment made by the assignor or the assignee is not ineffective for the sole reason that it is in breach of an agreement referred to in paragraph (1) of this article. However, nothing in this article affects any obligation or liability of the party in breach of such an agreement for any damages arising as a result of the breach.”

Section II. Debtor

Article 17ter. Principle of debtor-protection

Paragraph (1) originates from paragraph (1) of draft article 7, while paragraph (2) is a new provision (see remarks to the preamble and to draft article 7).

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

“(2) With the exception of a change in the identity of the person to whom or for whose account or to the address of which the debtor is required to make payment, which may be effected by way of a notification of the assignment, nothing in this Convention affects the payment terms contained in the original contract without the consent of the debtor.”

Article 17quarter. Notification of the debtor

In order to avoid leaving any doubt as to the time the notification becomes effective, paragraph (1) restates the "receipt rule", which is already embodied in other provisions of the draft Convention (e.g. in draft article 18).

“(1) Notification of the assignment is effective when received by the debtor, if it is in any language that is reasonably designed to inform the debtor about the content of the notification. It shall be sufficient if notification of the assignment is in the language of the original contract.

“(2) Notification of the assignment may relate to receivables arising after notification.

“(3) Notification of a subsequent assignment constitutes notification of any prior assignment.”

Article 18. Debtor’s discharge by payment

1. In paragraph (1), the word “assignor” should be replaced by the words “in accordance with the original contract”, since the original contract may specify that payment should be made to a third person or to a bank account or post office box without any identification of the owner of the account or the post office box.

2. In order to align paragraph (3), dealing with several notifications relating to different assignments, with draft article 16(3) (moved to draft article 5(f)), the words “or to the account” should be deleted. The commentary could explain that the word “address” means a street address, account, post office box or the like (A/CN.9/434, paras. 184-185).

3. As paragraph (3) does not deal with changes or corrections of the notification (i.e. with several notifications relating to one and the same assignment), an additional provision would be needed. On the understanding that after the first notification is received by the debtor, only the assignee may give a second notification (draft article 16(1), second sentence), such a provision should provide that the debtor could be discharged only by paying the person identified in the last notification before payment (see draft article 18(4) below).

4. As to the question how the debtor receiving several notifications would know whether to pay the person identified in the first or in the last notification, it should be noted that reasonable debtors, if in doubt, would normally request from any assignee sufficient proof of the assignment (see draft article 18(6) below). Reasonable assignees would provide sufficient information to the debtor anyway. If such proof is not given, the debtor could be discharged by paying the assignor (for a discussion of this matter, see A/CN.9/455, paras. 63-66).

5. It would seem that the result aimed at in the U.S. Proposal would also be achieved if the language added in new draft article 16(1) is retained, new paragraph (4) is added in draft article 18 and the bracketed language in draft article 19(2) and 21(4) is also retained.

6. In addition, the Working Group may wish to consider whether paragraph (8), which appears within square brackets, should be retained. Paragraph (8) is intended to clarify that the draft Convention does not address the question whether the debtor may be discharged by paying a person who has received an invalid assignment (A/CN.9/455, paras. 55-58). If the Working Group decides to retain paragraph (8), it may wish to consider whether it is sufficient to cover the situation where it is not the assignment to the last assignee that is invalid, but a previous assignment.

7. The Working Group may also wish to consider the question whether draft article 27 dealing with multiple notifications in subsequent assignments should be placed in the context of draft article 18 (see draft article 18(5)
Thus, the Working Group may wish to consider draft article 18 on the basis of the following formulation:

“(1) Until the debtor receives notification of the assignment, it is entitled to discharge its obligation by paying in accordance with the original contract.

“(2) After the debtor receives notification of the assignment, subject to paragraphs (3) to (8) of this article, it is discharged only by paying the person or to the address identified in such notification.

“(3) If the debtor receives notification of more than one assignment of the same receivables made by the same assignor, the debtor is discharged by paying the person or to the address identified in the first notification received.

“(4) If the debtor receives more than one notification relating to a single assignment of the same receivables by the same assignor, the debtor is discharged by paying the person or to the address identified in the last notification received before payment.

“(5) If the debtor receives notification of one or more subsequent assignments, the debtor is discharged only by payment to the person or to the address identified in the notification of the last of such subsequent assignments received before payment.

“(6) If the debtor receives notification of the assignment from the assignee, the debtor is entitled to request the assignee to provide within a reasonable period of time adequate proof that the assignment has been made and, unless the assignee does so, the debtor is discharged by paying the assignor. Adequate proof includes, but is not limited to, any writing emanating from the assignor and indicating that the assignment has taken place.

“(7) This article does not affect any other ground on which payment by the debtor to the person entitled to payment, to a competent judicial or other authority, or to a public deposit fund discharges the debtor.

“(8) This article does not affect any ground on which the debtor may be discharged by paying a person to whom an invalid assignment has been made.”

Article 19. Defences and rights of set-off of the debtor

1. The Working Group may wish to consider the law applicable to the question when a right of set-off would be considered as being “available” (this matter was left open at the two previous sessions of the Working Group, see A/ CN.9/447, paras. 97-98 and A/CN.9/455, paras. 98-100). The main difficulty with determining the law applicable to matters relating to set-off is that they may be classified as procedural matters and subjected to the lex fori. This difficulty may be addressed to a large extent if reference were made to the law of the State of the debtor’s location, since the assignor or the assignee would normally initiate proceedings against the debtor in that State. However, if a dispute is brought before a court in a State other than the State of the debtor’s location (e.g. the State in which the debtor may have assets), a reference to the law of the State of the debtor’s location would not be helpful, since the court could classify the matter as a procedural one and apply its own law.

2. The Working Group may also wish to consider whether the bracketed language contained in paragraph (2) should be retained. The intention of the bracketed language is to ensure that a notification which does not identify the payee has the result of freezing the rights of set-off of the debtor (A/CN.9/447, para. 100). As already mentioned, if the Working Group were to adopt the U.S. Proposal with regard to draft article 16(3), the bracketed language could be deleted, since a notification would be a “notification” under the draft Convention even if it does not identify the payee.

Article 20. Agreement not to raise defences or rights of set-off

In order to avoid any uncertainty that might result from the use of the term “consumer” in draft articles 20 and 22, reference may be made to “the law governing the protection of the debtor in transactions made for personal, family or household purposes”. The Working Group may wish to consider whether paragraph (2)(c), which is drawn from article 30(1) of the United Nations Convention on International Bills of Exchange and International Promissory Notes and appears within square brackets, should be retained (for a discussion of this matter, see A/CN.9/447, paras. 110-119).

Article 21. Modification of the original contract

The Working Group may wish to decide whether paragraph (4), which appears within square brackets, should be retained. The bracketed wording is intended to ensure that a notification that does not identify the payee may limit the debtor’s right to modify the original contract without the consent of the assignee. As in draft article 19(2), this bracketed wording would not be needed, if the U.S. Proposal as to the minimum content of a notification were to be adopted by the Working Group, since in such a case a notification which would not identify the payee would be an effective notification for the purposes of draft articles 19 and 21.

Section III. Other parties

The title of this section may need to be changed to “other third parties” or “other parties”, since the debtor too is a third party to the assignment (the debtor is a party to the original contract with the assignor, but the draft Convention is not intended to cover this contract).

Article 23. Competing rights of several assignees

The Working Group may wish to decide whether the bracketed language contained in paragraph (2) should be
retained. If the bracketed language is deleted, the fact that subordination may take the form of a unilateral act or an agreement may be clarified in the commentary.

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

1. Paragraph (2) refers to priority between an assignee and the insolvency administrator. While such a formulation is known in those legal systems in which the insolvency administrator becomes the holder of the rights of the creditors, it may not be as appropriate for those legal systems in which the insolvency administrator merely exercises the rights of the creditors. In addition, in some reorganization proceedings, there may be no insolvency administrator. Thus, paragraph (2) may be reformulated along the following lines: "In an insolvency proceeding relating to the assets of the assignor, priority between the assignee and the assignor’s creditors is governed by the law of the State in which the assignor is located". Reference to the rights of the insolvency administrator is also made in paragraph (4). However, in this context the insolvency administrator may well be considered as having procedural rights separate from the substantive rights of the assignor’s creditors.

2. Draft article 24(3) would not be necessary if draft articles 32 and 33 were made applicable to the private international law provisions of the draft Convention that are outside Chapter VI (i.e. draft articles 1(2), 9, 17bis, 19(2) and 23 to 24; see also draft article 1, remark 20, Chapter VI, remark 2 and draft article 42bis below).

3. The Working Group may wish to consider the question whether, in order to ensure that draft article 24(2) does not override national rules creating super-priority rights, e.g. in favour of the State for taxes, a separate provision along the lines of paragraph (5) is required, or whether the matter is either already covered in paragraphs (3) and (4) or may be better addressed in the context of draft article 44.

4. In any case, requiring States to enumerate in a declaration non-consensual rights that would take precedence over the rights of an assignee might reduce the acceptability of the draft Convention to States, since any oversight or error in the declaration would result in such rights becoming subject to the rights of an assignee. In addition, certainty might not be served if, contrary to the expectations on which paragraph (5) is based, declarations are not sufficiently clear. Thus, if paragraph (5) is retained, the Working Group may wish to consider deleting the words "but only to the extent that such priority was specified by the forum State in an instrument deposited with the depositary prior to the time when the assignment was made". The commentary could explain that paragraph (5) is intended to preserve non-consensual rights or interests with priority under the law of the forum State.

Chapter V. Subsequent assignments

Should the Working Group decide to incorporate draft articles 25 to 28 in the provisions of the draft Convention dealing with the relevant issues in the context of an initial assignment (i.e. draft articles 1, 12, 18 and 17bis respectively), draft articles 25 to 28 may be deleted.

Chapter VI. Conflict of laws

1. If Chapter VI were to apply to the transactions to which the draft Convention is to apply under Chapter I, it could only serve to supplement the substantive provisions of the draft Convention by addressing matters that are governed but are not expressly settled in the draft Convention. In such a case, draft article 31 would need to be deleted, since it would be duplicating draft articles 23 and 24. On the other hand, if Chapter VI were to provide a second layer of harmonization with regard to transactions left to the law applicable outside the draft Convention, the opening words of draft articles 29 and 30 should be deleted, while draft article 31 should be retained without the opening words (see also draft article 1(3), remarks 17-19).

2. A reference should be included in draft articles 32 and 33 to those private international law provisions of the draft Convention that are outside Chapter VI (i.e. draft articles 1(2), 9, 17bis, 19(2) and 23 to 24; see draft article 1, remark 20, draft article 24, remark 2 above and draft article 42bis below).

Chapter VII. Alternative priority rules

The Working Group may wish to consider the contents as well as the placement of Chapter VII in the draft Convention. If Chapter VII is intended to operate as an autonomous model law, suggested to be incorporated by States in their domestic legislation, it may be more appropriate to be placed in an annex to the draft Convention. However, in such a case Chapter VII may need to be expanded. If, on the other hand, Chapter VII is intended to supplement or amend the draft Convention, it may be better placed in a protocol to the draft Convention. Alternatively, if it simply contains a provision describing the procedure for the amendment of the draft Convention, it could be placed in the chapter dealing with final provisions (as to the purpose of Chapter VII, see remarks to draft article 43 below).

Chapter VIII. Final provisions

Article 42. Conflicts with international agreements

Draft article 42 takes an approach that is different from the approach taken in other conventions prepared by UNCTITRAL in that, instead of giving precedence to other conventions dealing with matters covered in the draft
Convention, it allows States to decide to which convention
to give precedence. In the absence of a declaration, the
draft Convention prevails. This approach is intended to
address negative conflict situations, namely situations in
which different conventions dealing with the same matters
give way to each other and, as a result, uncertainty is
created as to which text applies. Conventions that deal
with matters covered by the draft Convention include the
Ottawa Convention and the Rome Convention.

Article 42bis. Application of Chapter VI

For the reasons already stated (see draft article 1, re-
mark 20; draft article 24, remark 2; and Chapter VI, remark
2 above), draft article 42bis should be revised as follows:
"A State may declare at any time that it will not be bound
by articles 29 to 31."

Article 42ter. Additional assignments covered
by the Convention

If the Working Group considers that States may wish
to apply the draft Convention to additional practices or to
exclude certain practices (see draft articles 1(7) and 4(2)
and remarks to those provisions), language along the fol-
lowing lines may be considered: "A State may declare at
any time that it will apply this Convention to additional
practices listed in a declaration."

Article 42quater. Other exclusions

"A State may declare at any time that it will not apply
the Convention to certain practices listed in a declara-
tion."

Article 43. Application of Chapter VII

The Working Group may wish to consider the question
of the purpose of Chapter VII. It may be noted that Chapter
VII may be used in one of the following ways: a State
could apply its domestic priority rules based on registra-
tion, but use the registration system foreseen by the draft
Convention; a State could apply the priority rules of
Section I, but use its own registration system; a State could
opt into both Sections I and II but only with regard to
assignments within the scope of the draft Convention; and
a State might introduce domestic rules based on Sections
I and II, to which draft articles 23 or 24 would point, and
apply them with regard to all assignments, within or
outside the scope of the draft Convention (A/CONF.9/455,
para. 122).

Article 44. Insolvency rules or procedures not
affected by this Convention

1. The Working Group may wish to consider whether
draft article 44 should be retained. Draft article 24(3)
may be sufficient in dealing with the matter. Under
draft article 24(3), the application of the law applicable to
priority issues may be refused by a court or other
competent authority if it is manifestly contrary to the
public policy of the forum State (A/CONF.9/455, paras. 136-
140).

2. In addition, while a generally formulated declaration
would fail to introduce the desired level of certainty as to
the application of the draft Convention, a requirement for
a specific declaration enumerating the substantive or
procedural rules of national insolvency law not affected by
the draft Convention may negatively affect the accept-
ability of the draft Convention to States (A/CONF.9/455,
para. 135).

Article 46. Application to territorial units

The Working Group may wish to consider the question
of the meaning of the term "location" in the context of
paragraph (3). If "location" were to be given the same
meaning as in draft articles 23 and 24, the draft Conven-
tion could apply in the case of a federally incorporated
business, whether or not it had any link (e.g. a place of
business) with a territorial unit to which the draft Conven-
tion applied. It may, therefore, be more appropriate to refer
to the place of business so that the draft Convention
would apply to a federally incorporated business with a place of
business in a territorial unit to which the draft Convention
would apply.

Article 47. Effect of declaration

Declarations may negatively affect the rights of third
parties extending credit on the basis of a certain legal
regime, particularly in the case of assignments of future
receivables. In order to protect the reasonable expectations
of third parties, a new paragraph (5) may be added that
would read: "A declaration or its withdrawal does not af-
fect the rights of parties with respect to assignments made
before the date at which the declaration or its withdrawal
takes effect."

Article 48. Reservations

Draft article 48 does not appear within square brackets,
since its formulation would not change even if additional
reservations were allowed in the draft Convention.

Article 50. Denunciation

For the same reasons mentioned under draft article 47
above, a new paragraph (3) should be added that would
read along the lines of article 90 of the United Nations
Convention on International Bills of Exchange and Inter-
national Promissory Notes: "The Convention remains ap-
licable to assignments made before the date at which the
denunciation takes effect."
II. ELECTRONIC COMMERCE


CONTENTS

INTRODUCTION ...................................................... 1-16

I. DELIBERATIONS AND DECISIONS ............................... 17

II. DRAFT UNIFORM RULES ON ELECTRONIC SIGNATURES ....... 18-172

CHAPTER I. SPHERE OF APPLICATION AND GENERAL PROVISIONS ..... 19

CHAPTER II. ELECTRONIC SIGNATURES .......................... 20-138
Section I. Electronic signatures in general ...................... 20-27
Article 1. Definitions ............................................. 20
Article 2. Effect of electronic signature ....................... 21-27
Section II. Enhanced[Secure] electronic signatures ............ 28-88
Article 3. Presumption of signing ................................ 28-39
Article 4. Presumption of attribution .......................... 40-53
Article 5. Presumption of integrity ............................ 54-63
Article 6. Predetermination of [enhanced][secure] electronic signature ...................... 64-75
Article 7. Liability for [enhanced][secure] electronic signature ........ 76-88

Section III. Digital signatures supported by certificates .... 89-138
Article 8. Contents of [enhanced][secure] certificate ........... 89-116
Article 9. Effect of digital signatures supported by certificates ... 117-138

CHAPTER III. CERTIFICATION AUTHORITIES AND RELATED ISSUES .... 139-172
Article 10. Undertaking upon issuance of certificate ........... 139-144
Article 11. Contractual liability .................................. 145-157
Article 12. Liability of the certification authority to parties relying on certificates ...................... 158-163
Articles 13 to 15 .................................................... 164-169
Article 16. Relations between parties relying on certificates and certification authorities ...................... 170-172

CHAPTER IV. FOREIGN ELECTRONIC SIGNATURES .............. 173
Articles 17 to 19 ..................................................... 173

III. PROPOSAL FOR FUTURE WORK IN THE FIELD OF ELECTRONIC COMMERCE .................................. 174-179

INTRODUCTION

I. The Commission, at its twenty-ninth session (1996), decided to place the issues of digital signatures and certification authorities on its agenda. The Working Group on Electronic Commerce was requested to examine the desirability and feasibility of preparing uniform rules on those topics. It was agreed that work to be carried out by the Working Group at its thirty-first session could involve the preparation of draft rules on certain aspects of the above-mentioned topics. The Working Group was requested to provide the Commission with sufficient elements for an informed decision to be made as to the scope of the uniform rules to be prepared. As to a more
precise mandate for the Working Group, it was agreed that the uniform rules to be prepared should deal with such issues as: the legal basis supporting certification processes, including emerging digital authentication and certification technology; the applicability of the certification process; the allocation of risk and liabilities of users, providers and third parties in the context of the use of certification techniques; the specific issues of certification through the use of registries; and incorporation by reference.\(^1\)

2. At its thirtieth session (1997), the Commission had before it the report of the Working Group on the work of its thirty-first session (A/CN.9/437). As to the desirability and feasibility of preparing uniform rules on issues of digital signatures and certification authorities, the Working Group indicated to the Commission that it had reached consensus as to the importance of, and the need for, working towards harmonization of law in that area. While it had not made a firm decision as to the form and content of such work, it had come to the preliminary conclusion that it was feasible to undertake the preparation of draft uniform rules at least on issues of digital signatures and certification authorities, and possibly on related matters. The Working Group recalled that, alongside digital signatures and certification authorities, future work in the area of electronic commerce might also need to address: issues of technical alternatives to public-key cryptography; general issues of functions performed by third-party service providers; and electronic contracting (A/CN.9/437, paras. 156 and 157).

3. The Commission expressed its appreciation for the work already accomplished by the Working Group at its thirty-first session, endorsed the conclusions reached by the Working Group, and entrusted the Working Group with the preparation of uniform rules on the legal issues of digital signatures and certification authorities (hereinafter referred to as “the Uniform Rules”).

4. With respect to the exact scope and form of the Uniform Rules, the Commission generally agreed that no decision could be made at this early stage of the process. It was felt that, while the Working Group might appropriately focus its attention on the issues of digital signatures in view of the apparently predominant role played by public-key cryptography in the emerging electronic-commerce practice, the Uniform Rules should be consistent with the media-neutral approach taken in the UNCITRAL Model Law on Electronic Commerce. Thus, the Uniform Rules should not discourage the use of other authentication techniques. Moreover, in dealing with public-key cryptography, the Uniform Rules might need to accommodate various levels of security and to recognize the various legal effects and levels of liability corresponding to the various types of services being provided in the context of digital signatures. With respect to certification authorities, while the of market-driven standards was recognized by the Commis-

5. The Working Group began the preparation of the Uniform Rules at its thirty-second session on the basis of a note prepared by the Secretariat (A/CN.9/WG.1IV/WP.73). The Secretariat was requested to prepare, on the basis of the deliberations and conclusions of the Working Group, a set of revised provisions, with possible variants, for consideration by the Working Group at a future session.

6. At its thirty-first session (1998), the Commission had before it the report of the Working Group on the work of its thirty-second session (A/CN.9/446). The Commission expressed its appreciation of the efforts accomplished by the Working Group in its preparation of draft Uniform Rules on Electronic Signatures. It was noted that the Working Group, throughout its thirty-first and thirty-second sessions, had experienced manifest difficulties in reaching a common understanding of the new legal issues that arose from the increased use of digital and other electronic signatures. It was also noted that a consensus was still to be found as to how those issues might be addressed in an internationally acceptable legal framework. However, it was generally felt by the Commission that the progress realized so far indicated that the draft Uniform Rules on Electronic Signatures were progressively being shaped into a workable structure.

7. The Commission reaffirmed the decision made at its thirty-first session as to the feasibility of preparing such Uniform Rules and expressed its confidence that more progress could be accomplished by the Working Group at its thirty-third session (New York, 29 June-10 July 1998) on the basis of the revised draft prepared by the Secretariat (A/CN.9/WG.1IV/WP.76). In the context of that discussion, the Commission noted with satisfaction that the Working Group had become generally recognized as a particularly important international forum for the exchange of views regarding the legal issues of electronic commerce and for the preparation of solutions to those issues.

8. The Commission noted that, at the close of the thirty-second session of the Working Group, a proposal had been made that the Working Group might wish to give preliminary consideration to undertaking the preparation of an international convention based on provisions of the Model Law and of the draft Uniform Rules. The Working Group had agreed that the topic might need to be taken up as an agenda item at the thirty-third session of the Working Group on the basis of more detailed proposals possibly to be made by interested delegations. However, the preliminary conclusion of the Working Group had been that the preparation of a convention should in any event be regarded as a project separate from both the preparation of

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the Uniform Rules and any other possible addition to the Model Law. Pending a final decision as to the form of the Uniform Rules, the suggestion to prepare a convention at a later stage should not distract the Working Group from its current task, which was to focus on the preparation of draft uniform rules on digital and other electronic signatures, and from its current working assumption that the Uniform Rules would be in the form of draft legislative provisions. It had been generally understood in the Working Group that the possible preparation of a draft convention should not be used as a means of reopening the issues settled in the Model Law, which might negatively affect the increased use of that already successful instrument (A/CN.9/446, para. 212).

9. The Commission noted that a specific and detailed proposal for the preparation of a convention had been submitted by a delegation to the Working Group for consideration at a future session (A/CN.9/WG.1V/WP.77). Diverging views were expressed in that respect. One view expressed was that a convention based on the provisions of the Model Law was necessary, since the UNCITRAL Model Law on Electronic Commerce might not suffice to establish a universal legal framework for electronic commerce. Owing to the nature of the instrument, the provisions of the Model Law were subject to variation by any national legislator that enacted them, thus detracting from the desired harmonization of the legal rules applicable to electronic commerce. The opposite view was that, owing to the rapidly changing technical background of electronic commerce, the matter did not easily lend itself to the rigid approach suggested by an international convention. It was pointed out that the Model Law was of particular value as a collection of principles, which could be enacted in domestic legislation through various formulations to accommodate the increased use of electronic commerce.

10. The prevailing view was that it would be premature to undertake the preparation of the suggested convention. Delegations of various countries indicated that law reform projects based on the provisions of the Model Law were currently under way in those countries. Concern was expressed that the preparation of an international convention based on the Model Law might adversely affect the widespread enactment of the Model Law itself which, only two years after its adoption by the Commission, was already being implemented in a significant number of countries. Moreover, it was generally felt that the Working Group should not be distracted from its current task, namely, the preparation of draft Uniform Rules on Electronic Signatures, as agreed by the Commission. Upon concluding that task, the Working Group would be welcome, in the context of its general advisory function with respect to the issues of electronic commerce, to make proposals to the Commission for future work in that area. It was suggested by the proponents of a convention that the matter might need to be further discussed at a future session of the Commission and in the context of the Working Group, possibly through informal consultations. It was recalled that, while possible future work might include the preparation of a convention, other topics had also been proposed, such as the issues of jurisdiction, applicable law and dispute settlement on the Internet.3

11. The Working Group on Electronic Commerce, which was composed of all the States members of the Commission, held its thirty-third session in New York from 29 June to 10 July 1998. The session was attended by representatives of the following States members of the Working Group: Australia, Austria, Brazil, Cameroon, China, Colombia, Egypt, Finland, France, Germany, Honduras, Hungary, Iran (Islamic Republic of), Italy, Japan, Lithuania, Mexico, Romania, Singapore, Spain, Thailand, Uganda, United Kingdom of Great Britain and Northern Ireland and the United States of America.

12. The session was attended by observers from the following States: Canada, the Czech Republic, the Democratic Republic of Congo, Denmark, Gabon, Indonesia, Ireland, Madagascar, the Netherlands, Panama, Poland, Portugal, the Republic of Korea, Saudi Arabia, Sweden, Switzerland, Tunisia and Turkey.

13. The session was attended by observers from the following international organizations: United Nations Development Programme (UNDP), World Intellectual Property Organization (WIPO), African Development Bank, European Commission, Organisation for Economic Co-operation and Development (OECD), Comité maritime international (CMI), European Law Student Association (ELSA) International, Grupo Latinoamericano de Abogados para el Comercio Internacional (GRULACI), Instituto Iberoamericano de Derecho Maritimo (INIDIE), International Association of Ports and Harbors (IAPH), International Bar Association (IBA), International Chamber of Commerce (ICC), Internet Law and Policy Forum (ILPF), Society for Worldwide Interbank Financial Telecommunications (SWIFT), and Union internationale des avocats (UIA).

14. The Working Group elected the following officers:

Chairman: Mr. Mads Bryde Andersen (Denmark)
Vice-Chairman: Mr. Pang Khiang Chau (Singapore)
Rapporteur: Mr. Jair Fernando Imbachi Ceron (Colombia)

15. The Working Group had before it the following documents: provisional agenda (A/CN.9/WG.1V/WP.75); a note by the Secretariat containing draft uniform rules on digital signatures, other electronic signatures, certification authorities and related legal issues (A/CN.9/ WG.1V/WP.76); and a note reproducing the text of a proposal by the United States of America for a draft international convention on electronic transactions (A/CN.9/ WG.1V/WP.77).

3Ibid., Fifty-third Session, Supplement No. 17 (A/53/17), paras. 209-211.
16. The Working Group adopted the following agenda:
   1. Election of officers.
   2. Adoption of the agenda.
   3. Legal aspects of electronic commerce: draft uniform rules on electronic signatures.
   4. Other business.
   5. Adoption of the report.

I. DELIBERATIONS AND DECISIONS

17. The Working Group discussed the issue of digital signatures, other electronic signatures, certification authorities and related legal issues on the basis of the note prepared by the Secretariat (A/CN.9/WG.IV/WP. 76). The deliberations and conclusions of the Working Group with respect to those issues are reflected in Part II below. The Secretariat was requested to prepare, on the basis of those deliberations and conclusions, a set of revised provisions, with possible variants, for consideration by the Working Group at a future session. A delegation proposed future work on a convention on electronic transactions. That proposal was discussed informally, as reflected in Part III below.

II. DRAFT UNIFORM RULES ON ELECTRONIC SIGNATURES

General remarks

18. At the outset, the Working Group generally agreed that the current structure of the Uniform Rules constituted an acceptable basis for discussion. However, the view was expressed that the combination of a general part on electronic signatures and a specific part with very detailed rules on digital signatures might cause problems in respect of the relationship and interplay between these two parts. It was pointed out that the Uniform Rules to a large extent, could accommodate the various types of electronic signatures that were gradually becoming available on the market. The Uniform Rules could play an important role in enabling the use of electronic signature techniques in an open environment, in creating confidence as to the use of those techniques and in avoiding discrimination among them. It was emphasized, however, that more clarity might be needed with respect to a number of issues, for example: the extent to which the Uniform Rules recognized party autonomy in the context of closed or semi-closed networks; the capability of the Uniform Rules to accommodate systems where certification authorities functioned as independent service providers and systems where parties would rely on a certificate issued by one of the parties; the adaptability of the Uniform Rules to specific techniques other than digital signatures; and the compatibility of the Uniform Rules with the existence of different degrees of security.

Chapter I. Sphere of application and general provisions

19. The Working Group decided to postpone its consideration of chapter I until it had completed its review of the substantive provisions of the Uniform Rules.

Chapter II. Electronic signatures

Section I. Electronic signatures in general

Article 1. Definitions

20. The Working Group decided to postpone its consideration of draft article 1 until it had completed its review of the substantive provisions of the Uniform Rules.

Article 2. Effect of electronic signature

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

"(1) With respect to a data message authenticated by means of an electronic signature [other than a secure electronic signature], the electronic signature satisfies any legal requirement for a signature if the electronic signature is as reliable as appropriate for the purpose for which the electronic signature was used, in the light of all the circumstances, including any relevant agreement.

"(2) Paragraph (1) applies whether the legal requirement referred to therein is in the form of an obligation or whether the law simply provides consequences for the absence of a signature.

"(3) Unless expressly provided elsewhere in [this Law], electronic signatures that are not [enhanced] [secure] electronic signatures are not subject to the regulations, standards, or licensing procedures established by ... [the State-specified organs or authorities referenced in article] or to the presumptions created by articles 4, 5 and 6.

"(4) The provisions of this article do not apply to the following: [...]"

Title

22. The view was expressed that the reference in the title of the draft article to the “effect of electronic signature” might be misleading. It was stated that, rather than focusing on the effects of electronic signatures, draft article 2 dealt with the circumstances under which an electronic signature would comply with the requirements of law, as referred to in article 7 of the Model Law. After discussion, it was agreed that the title of the draft article should read along the lines of “compliance with requirements of law”.
Paragraph (1)

23. The view was expressed that the wording of paragraph (1) should parallel exactly the wording used in article 7 of the Model Law. Accordingly, it was suggested that paragraph (1) should read as follows:

“(1) With respect to a data message authenticated by means of an electronic signature [other than a secure electronic signature], the electronic signature meets any requirement of law or evidence for a signature if the method used to apply the electronic signature is as reliable as was appropriate for the purpose for which the data message was generated or communicated, in the light of all the circumstances, including any relevant agreement.”

24. While support was expressed in favour of the suggested wording, it was pointed out that the reference to “any requirement of law or evidence” was inconsistent with the wording used in the Model Law. Article 7 of the Model Law referred to “where the law requires a signature”, which addressed both requirements of law and requirements of evidence. Any inconsistency between the Model Law and the Uniform Rules in that respect might create difficulties in the interpretation of both instruments. Subject to the deletion of the words “or evidence”, the Working Group adopted the suggested wording.

Paragraph (2)

25. The substance of paragraph (2) was found to be generally acceptable. For reasons of consistency with the terminology used in the Model Law, the Working Group agreed that the word “legal” should be deleted.

Paragraph (3)

26. The view was expressed that paragraph (3) was stating the obvious and should be deleted. The prevailing view, however, was that, since it could be expected that the vast majority of electronic signatures used in practice would not fall within the narrow category of “enhanced” or “secure” electronic signatures (which were being regulated in some countries), the Uniform Rules should make it abundantly clear that regulation applying to the higher level of “enhanced” or “secure” electronic signatures did not apply in general to all types of “electronic signatures”. After discussion, it was agreed that paragraph (3) should be maintained in the Uniform Rules for the purpose of clarity.

Paragraph (4)

27. The Working Group found the substance of paragraph (4) to be generally acceptable.

Section II. [Enhanced][Secure] electronic signatures

Article 3. Presumption of signing

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

“(1) A data message is presumed to have been signed [if] [as of the time] [an] [enhanced] [secure] electronic signature is affixed to the data message.

“(2) The provisions of this article do not apply to the following: [ ... ].”

Paragraph (1)

29. It was generally agreed that it was appropriate for the Uniform Rules to distinguish a narrow range of techniques that were capable of providing a high degree of reliability from “electronic signatures” in general. However, as a matter of drafting, doubts were expressed as to whether either of the words “enhanced” or “secure” electronic signature was acceptable. Although use of the word “secure” was acknowledged to be a term that was familiar in the context of electronic signatures, it was criticized on the ground that it introduced a subjective criterion and implied that signatures that did not fall within the category of “secure” were inherently insecure. The view was also expressed that “secure” might be interpreted as implying too much in terms of the “security” of the signature under draft article 3. Use of the term “enhanced” was said to be capable of referring to almost any attribute of a signature and was generally too uncertain, especially in relation to the concept of security of a signature. While the view was expressed that the word “enhanced” was almost meaningless in this context, the prevailing view was that, in the absence of a more appropriate term, which should be sought later, “enhanced” would be used. Suggestions for an alternative term included “qualified” and “certified”, but these did not receive support.

30. Another concern of a drafting nature was that draft article 3 concentrated upon the “affixing” of a signature, while the definition of an electronic signature in draft article 1(a) included the broader term “logically associated with a data message”. It was suggested that language parallel to that of draft article 1 should be included in draft article 3.

31. The view was expressed that the words “[as of the time]” the electronic signature was affixed to the data message should be deleted. In support of that view, it was stated that the time of signing of a data message was not the focus of draft article 3 and the inclusion of such a reference was likely to lead to uncertainty. In reply, it was stated that the time at which a data message was signed had important legal consequences, especially in the context of third parties, and should be retained in the text of the draft article. After discussion, the Working Group generally felt that the question of the time at which the data message had been signed should not be addressed in the context of draft article 3, but might need to be further considered at a later stage in the preparation of the Uniform Rules.

32. A concern was expressed that draft article 3 was insufficiently distinguished from draft article 4. It was pointed out that, in some legal systems, the question of whether or not a data message was signed could not be separated from the issue of attribution of the signature. It was suggested that this difficulty could be overcome by
combining draft articles 3 and 4. In reply, it was stated that, in other legal systems, the question of whether or not a data message had been signed, irrespective of the identity of the signer, could be important where the law required a signature, without indicating the identity of the signer, or where the sender’s identity was not at issue.

33. The discussion focused upon the question of whether draft article 3 should be deleted, retained in the form of a presumption, or redrafted to establish a substantive rule of law. The concern was expressed that a presumption should be capable of rebuttal and the act of signature would be difficult to rebut. In response, it was stated that the presumption raised evidentiary issues which could be rebutted by evidence relating to the intention of the signing party, or to the reliability or appropriateness of the medium used to sign the data message. By attaching the presumption to an enhanced electronic signature, the intention of the draft article was to distinguish the "enhanced" form of electronic signature from the more general form of electronic signature referred to in draft article 2. It was stated that by achieving that special status, the enhanced electronic signature could be regarded as having passed certain tests and should not therefore be subjected to the same level of inquiry as the more general form of electronic signature.

34. As an alternative, the Working Group was invited to consider a proposed new paragraph (1) as follows:

"Where the law requires a signature, that requirement is met by an enhanced electronic signature."

35. The discussion continued on the basis of that proposal. It was stated that the proposed text avoided the problems that might arise from the use of a presumption and recognized the principle of non-discrimination contained in article 5 of the Model Law. The purpose of the proposal was to establish a rule that an enhanced electronic signature met the requirement of article 7 of the Model Law that the method of authentication should be "as reliable as appropriate".

36. While support for the proposal was expressed, it was pointed out that it could only be properly considered in the context of the definition of what constituted "enhanced" electronic signature. It was suggested that the proposal should be retained in square brackets pending consideration of that definition. Some support was expressed for the suggestion that the language of the proposal should be more directly related to article 7 of the Model Law. It should make it clear that an enhanced electronic signature could be regarded as one that satisfied the requirements established by the Model Law for reliability and appropriateness, and could thus be regarded as functionally equivalent to a handwritten signature.

37. A further concern was that article 7 of the Model Law, by emphasizing the appropriateness of the method in the light of the circumstances for which it was used, established a test in which the substantive rule was tied to a flexible measure. The proposed text established, in contrast, a fixed test. The suggestion was made that words along the lines of "unless it is proved that the enhanced electronic signature does not fulfill the requirements set out in article 7 of the Model Law" should be added at the end of the proposed text to ensure flexibility. In response, it was pointed out that the purpose of the proposal was to move beyond the test of article 7 of the Model Law and to establish a rule that all legal requirements for a signature would be met by an enhanced electronic signature, without reference to the circumstances of each case. The addition of the suggested words would indicate that there were doubts about whether an enhanced electronic signature did meet all requirements for a signature, and should not be included.

38. After consideration, there was wide support for the substance of the proposed text, but the Working Group decided to retain it in square brackets pending consideration of the definition of [enhanced] electronic signature. It was also decided that words along the lines of "unless it is proved that the enhanced electronic signature does not fulfill the requirements of article 7 of the Model Law" should be added in square brackets for continuation of the discussion at a future session.

Paragraph (2)

39. The Working Group found the substance of paragraph (2) to be generally acceptable.

Article 4. Presumption of attribution

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

"(1) A[n] [enhanced] [secure] electronic signature is presumed to be that of the person by whom, or on whose behalf, it purports to have been used.

"Variant A

unless the purported signer establishes that the [enhanced] [secure] electronic signature was affixed without authorization.

"Variant B

provided that the relying party establishes that the security procedure or combination of security procedures used to verify the signature was

"(a) commercially reasonable under the circumstances;

"(b) applied by the relying party in a trustworthy manner; and

"(c) relied upon by the relying party reasonably and in good faith.

"(2) The provisions of this article do not apply to the following: [...]"

General remarks

41. Doubts were expressed regarding the usefulness and appropriateness of including a presumption of attribution
along the lines of draft article 4 in the draft Uniform Rules. It was stated that the matter dealt with under draft article 4 was relevant to general civil procedure and, as such, might not easily lend itself to harmonization by way of an international instrument. It was suggested that the question of attribution of electronic signatures should be left to applicable domestic law.

42. The prevailing view, however, was that an article along the lines of draft article 4 was needed. While some objections to the alternative variations of draft article 4 were expressed, it was widely felt not only that attribution might be essential for establishing the legal effect of a signature, but also that an article on attribution was important for establishing trust and certainty in the use of electronic signatures.

Paragraph (1)

43. Support was expressed in favour of retaining Variant A. Support was also expressed for a draft article which would include both Variant A and Variant B. It was pointed out that consideration of the variants as alternative texts was difficult because they were not true alternatives and dealt with different aspects of the presumption of attribution. Variant A dealt directly with the fact of signature and the questions of attribution and authorization of the signature, while Variant B established the grounds upon which the relying party could get the benefit of the presumption of attribution, notwithstanding that the signature might have been affixed without authorization.

44. In favour of retaining only Variant A, the view was expressed that it appropriately placed the burden of proof on the party most able to prove the fact of signature, namely, the signer, while the rules in Variant B relied upon a number of subjective standards that would be difficult to apply in practice. In addition, it was pointed out that Variant B unfairly imposed potential liability on the signer, notwithstanding that the signer might have proved, in satisfaction of the proviso in Variant A, that the signature was not authorized. In that context, the view was strongly expressed that a provision along the lines of Variant B would not be appropriate for transactions involving consumers. While the Working Group decided not to enter at that stage into a general debate as to whether the draft Uniform Rules should be applicable to consumer transactions, it was widely agreed that, in preparing the Uniform Rules, the Working Group should focus on transactions between commercial users of electronic communication techniques.

45. In support of retaining elements of Variant B in the Uniform Rules, it was stated that it was important, in the context of determining legal effect, for any party relying on the electronic signature to have to prove the matters set out in subparagraphs (a) to (c) before that party could claim the benefit of any presumption. The view was expressed that the requirements contained in Variant B were not properly located as part of a provision establishing a presumption. In this regard, it was suggested that the placement of Variant B might need to be reconsidered, not only in terms of its location in article 4, but also in terms of the relationship of article 4 to the definitions in draft article 1 and the substantive articles of the Uniform Rules. Subparagraph (c) of Variant B, for example, was noted as being of relevance to draft article 7 dealing with liability. There was some support for this suggestion, and it was agreed that it would be appropriate to reconsider the issues raised by Variant B in the context of the definition of [enhanced] electronic signature and the substantive provisions on liability. After discussion, the Working Group agreed that Variant B should be deleted.

46. As in the case of draft article 3, the drafting of draft article 4 in the form of a presumption was questioned, particularly in relation to whether it was a rebuttable presumption and the means by which it could be rebutted. The view was expressed that this should be made clear in the text of the article itself. It was pointed out that there might be a problem in establishing a general presumption applicable to all types of transactions, because such a presumption depended for its efficacy upon a number of variable factors, such as: the technical reliability of certain signatures; the expectation of the parties as to how certain signature devices were to be treated; and the nature of the transaction itself. In some types of transactions, for example, financial transactions, it might be appropriate to have a high level of responsibility attaching to the use of a signature without authorization. For low level transactions, such a high level of responsibility might not be appropriate.

47. There was also some concern expressed about whether the presumption should be structured to provide that rebuttal could be achieved simply by denial of the application of the signature, or whether it should also require proof of absence of authorization.

48. The focus of the article on the parties required to perform certain acts was criticized as being too narrow and specific. The requirement that it should be the relying party who must establish the requirements set out in subparagraphs (a) to (c) of Variant B was too narrow. Similarly, the requirement in subparagraph (b) that the security procedure must be applied by the relying party was too restrictive. The focus of the draft article should be on whether a security procedure was applied in a reasonable manner (irrespective of who applied it), or on what was required to be proved. The same criticism was made in respect of Variant A in relation to the requirement that the purported signer must establish the lack of authorization. It was generally agreed that the drafting of draft article 4 should be depersonalized to reflect these concerns.

49. The draft article was also criticized on the ground that it dealt with both authorization and attribution, two different concepts, which should be treated separately. The proposal was made that draft article 4 should focus upon the issue of authorization, rather than attribution. In reply, it was noted that paragraph (2) of article 13 of the Model Law included authorization in provisions dealing with attribution.
50. The drafting of draft article 4 gave rise to a number of concerns. One suggestion was that the draft Uniform Rules should respect the principles of technology and implementation neutrality, and that the drafting of Variant B did not accord with these principles. In particular, it was pointed out that the words “relying party” were generally understood to be specific to digital signature technology. Since the phrase was not defined in the context of the Uniform Rules, it needed to be made clear in draft article 4 that the meaning of “relying party” was not limited to the relying party in the situation of a certified digital signature, but could include a broader application. In view of the decision to delete Variant B, this proposal was not pursued. It was understood, however, that a text reflecting the substance of deleted Variant B might be proposed at a future meeting.

51. Additional suggestions were made to improve the drafting of draft article 4. One suggestion was that, instead of the word “used” in respect to the signature, wording along the lines of “created,” “originated” or “generated” should be adopted. That suggestion was accepted by the Working Group. Another suggestion was that the use of the phrase “a combination of security procedures” in the deleted Variant B would have been unnecessary because the use of different procedures would still result in the use of “a security procedure”. The Working Group agreed that that suggestion would need to be considered further in the context of other draft articles in which that phrase was used.

52. In order to reflect the suggestion made to depersonalize the text of draft article 4 and to expand the category of persons who could perform the required acts, the following text was proposed as an alternative to paragraph (1):

“An [enhanced] electronic signature is presumed to be that of the person by whom, or on whose behalf, it purports to have been generated, unless it is established that the [enhanced] electronic signature was applied neither by the purported signer nor by a person who had the authority to act on its behalf.”

After discussion, the Working Group adopted that reformulation of paragraph (1).

Paragraph (2)

53. The Working Group found the substance of paragraph (2) to be generally acceptable.

Article 5. Presumption of integrity

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

“(1) If the purported signer has used a security procedure which is capable of providing [reliable] evidence that a data message or any [enhanced] [secure electronic] electronic] signature thereon has not been changed since the time the security procedure was applied to the data message or to any signature, then it is presumed [in the absence of evidence to the contrary,] that the data message or the signature has not been changed.

“(2) The provisions of this article do not apply to the following: [...].”

Paragraph (1)

55. It was generally agreed, at the outset, that a provision along the lines of paragraph (1) was useful to clarify the ways in which the requirements of article 8 of the Model Law could be fulfilled. Various views were expressed and suggestions were made for possible improvement of paragraph (1).

56. The Working Group considered the question of whether draft article 5 should deal with both the integrity of the signature and the integrity of the data message. It was generally felt that the current wording of paragraph (1), which referred to the integrity of the data message “or any signature”, was unclear and might lead to erroneous interpretation, for example, as to whether verification of the integrity of the signature only would create any presumption as to the integrity of the message. The suggestion was made that draft article 5 should deal with the integrity of the signature and the integrity of the data message in separate provisions. Alternatively, it was suggested that draft article 5 should deal only with those security procedures that provided evidence as to the integrity of both the signature and the message. After discussion, however, it was generally agreed that the Uniform Rules should focus on the integrity of the message only.

57. With respect to the notion of “security procedure”, a concern was expressed that a definition might be needed to clarify the relationship between a security procedure and an electronic signature or an “enhanced” electronic signature. It was suggested that the notion of “enhanced security procedure” might need to be introduced to deal with issues of integrity of the message, as opposed to unqualified “security procedures” that might be appropriate for dealing with the issue of identity of the signer. It was generally agreed that the questions regarding the definition of “security procedure” and the level of security that would need to be reached to give rise to a presumption might be solved through the application of draft article 6, under which determination of what constituted an acceptable “security procedure” would be made by a declaration of a competent authority or by agreement of the parties.

58. As to whether the security procedure should be applied by the signer only, it was widely felt that the wording of paragraph (1) should be depersonalized. It was agreed that such a reformulation would more appropriately reflect situations (which were reported to be of considerable practical importance) where the security procedure would not be “applied” by the signer, but would suppose action on the part of both the signer and the relying party.

59. With respect to the words “capable of providing”, the view was expressed that paragraph (1) insufficiently
reflected the need for any security procedure to be applied properly and successfully in order to give rise to a presumption of integrity of the data message. To that effect, it was proposed that the words "is capable of providing reliable evidence" should be replaced by wording along the lines of "ensures", or "provides reliable evidence". Those suggested wordings were objected to on the grounds that it would be pointless to prescribe that evidence of integrity should be provided in order to give rise to a presumption of integrity. The aim of draft article 5 was precisely to establish that the use of certain security procedures (that might be recognized at an early stage through draft article 6, or at a later stage by a court under article 8 of the Model Law) should entail a presumption of integrity based on the recognition of the fact that such procedures were "capable" of verifying the integrity of the message. It was generally agreed, however, that draft article 5 should clarify that the presumption of integrity would only result if the security procedure had been successfully and properly applied.

60. As regards the words "in the absence of evidence to the contrary" between square brackets, a concern was expressed that such wording provided only a very weak presumption, since any evidence to the contrary would rebut the presumption. Compared to the presumption in draft article 4, draft article 5 provided a weaker presumption and the discrepancy might need to be addressed. A further concern was that, while draft article 5 was formulated as a rebuttable presumption, it contained no indication as to how the presumption might be rebutted. It was suggested that additional wording might need to be added to that effect to draft article 5. The prevailing view, however, was that, while it was appropriate for draft article 5 to establish a rule of evidence, it might be difficult to harmonize in more detail the level of the presumption and the means by which it could be rebutted. It was generally felt that those matters might be better dealt with by applicable domestic law outside the Uniform Rules.

61. With a view to reflecting the above-mentioned views and concerns, the following alternative formulations were proposed for paragraph (1):

"Variant A"

"Where a [trustworthy security procedure] [an enhanced electronic signature] is properly applied to a designated portion of a data message and indicates that the designated portion of the data message has not been changed since a specific point in time, it is presumed that the designated portion of the data message has not been changed since that time."

"Variant B"

"Where a security procedure is capable of showing [reliably] [with substantial certainty] that the designated portion of a data message has not been changed since a specific point in time, and a proper application of that procedure indicates that the data message has not been changed, it is presumed that [the integrity of the data message has been preserved] [the data message has not been changed] since that time."

62. While considerable support was expressed in favour of Variant B, the Working Group decided that both variants should be reflected in the revised draft of the Uniform Rules to be prepared by the Secretariat for continuation of the discussion at a later session. It was pointed out that, depending on the final decision as to the contents of paragraph (1), the placement of draft article 5 might need to be reconsidered. Should the text of paragraph (1) contain no reference to the notion of "enhanced electronic signature", the scope of draft article 5 would be broader and the provision might be more appropriately placed in section 1, which dealt with electronic signatures in general, or in a separate section of the Uniform Rules.

Paragraph (2)

63. The substance of paragraph (2) was found to be generally acceptable.

Article 6. Predetermination of [enhanced] [secure] electronic signature

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

"(1) A security procedure or a combination of security procedures satisfies the requirements of an [enhanced] [secure] electronic signature if it is so declared by ... [the organ or authority specified by the enacting State as competent to make such declaration ...]

"(2) As between the person signing a data message and any person relying on the signed message, a security procedure or a combination of security procedures is deemed to fulfil the requirements of an [enhanced] [secure] electronic signature if expressly so agreed by the parties.

"(3) The provisions of this article do not apply to the following: [...]."

General remarks

65. There was general support for the inclusion of an article along the lines of draft article 6 on the ground that predetermination of qualified security procedures would contribute to the certainty and trustworthiness of electronic signatures and electronic commerce generally. With respect to the issue of party autonomy as provided in paragraph (2), while there was widespread support for the principle of freedom of contract, there was a general view that this issue needed to be discussed in respect of the text as a whole, to determine which provisions could (and which could not) be varied by agreement. It was pointed out that, should the Working Group decide that the Uniform Rules should form part of the Model Law, the relationship of these Rules with article 4 of the Model Law would need to be considered and article 4 amended as necessary. The Working Group agreed to defer its discussion on the issue of mandatory and
non-mandatory provisions until it had completed its review of the substantive provisions of the Uniform Rules.

Paragraph (1)

66. Paragraph (1) was generally regarded as an acceptable means of assisting the predetermination of what constituted an [enhanced] electronic signature. A number of suggestions were made to clarify and improve the drafting.

67. The Working Group recalled that, in the context of the discussion of draft article 4, it had been agreed that the words “a security procedure” should be substituted for “a security procedure or combination of security procedures”.

68. It was observed that a declaration made under paragraph (1) without restraint could diminish trust and confidence in electronic commerce and that it would therefore be appropriate to require conformance to international standards, to the extent that they existed and were relevant. After discussion of this proposal, the Secretariat was asked to prepare appropriate text along the lines of “the declaration should be consistent with recognized international technical standards to the extent that they exist” for addition to paragraph (1).

69. It was widely felt that, given the far-reaching potential of a predetermination of [enhanced] electronic signature status, any declaration made under paragraph (1) should only be made by an organ or authority which was clearly in a position or authorized to make such a declaration, whether it be a public authority or a publicly-appointed private authority. In order to focus the draft article more clearly on how predetermination of [enhanced] status could occur, it was proposed that paragraph (1) should be redrafted to align the language with the heading by substituting “determination” for “declaration” and referring to the authority making the determination at the beginning of the provision along the following lines: “[The organ or authority specified by the enacting State as competent] may determine that a security procedure satisfies the requirements of an [enhanced] [secure] electronic signature”. Wide support was expressed in favour of that proposal.

Paragraph (2)

70. There was general support for the inclusion of a provision along the lines of paragraph (2) providing for party autonomy. It was pointed out that paragraph (2) allowed a flexible approach to the issue of predetermination of [enhanced] electronic signatures and also reflected the importance of party autonomy in the context of closed systems. There was some concern, however, that paragraph (2) might allow parties to agree to deviate from mandatory form requirements and that the provision should be limited to allowing party autonomy within the bounds of national law. In that regard, it was proposed that the words “to the extent permitted by law” should be added to the end of the paragraph, and that paragraph (3) should be deleted. In support of that proposal, it was pointed out that paragraph (3) required an enacting State to give careful consideration to possible exclusions, while the proposed language implemented existing restrictions and could include future restrictions in the general law. After discussion, the Working Group adopted that proposal.

71. As a matter of drafting, concern was expressed that, given the generally understood meaning of the phrase, use of the words “relying party” in paragraph (2) might be misinterpreted as referring to a party outside the contractual agreement affecting the determination of [enhanced] signature status. Such a misinterpretation would have the undesirable result that third parties could be adversely affected by that agreement. It was generally agreed that, as between themselves and for their own use, parties could agree on the effect of the security procedure they used, including that it was an [enhanced] electronic signature, but that the language of the paragraph needed to clarify that such an agreement could not affect persons who were not party to the agreement. It was pointed out that it was not the intention of the provision to allow a third party to be affected by an agreement between the signer and the addressee of the signed data message. Another view was that it needed to be indicated more clearly that the provision only applied in a commercial context and that the emphasis should be upon consenting parties, and not simply contracting parties.

72. A related concern was the relationship between article 7 of the Model Law, which was not subject to variation by agreement, and draft article 6. The effect of paragraphs (1) and (2), it was suggested, might lead parties to believe that, by agreeing on what constituted an [enhanced] electronic signature, they could avoid the requirements of article 7 as to what constituted a functional equivalent to a signature. The effect of paragraph (2), it was stated, should be that once a security procedure had satisfied the requirements for a signature under article 7 of the Model Law, parties could agree on what would constitute an [enhanced] electronic signature. It was also observed that, in addition to the situations envisaged by paragraphs (1) and (2), there could be a third possibility, namely, that a procedure not covered by either paragraph (1) or (2) could nevertheless satisfy the definition of an [enhanced] signature, for example, where so recognized by a court. That issue was not pursued in the discussion.

Proposed redrafting of draft article 6

73. A proposal was made for a revision of draft article 6, taking into account the redrafting that had been discussed and agreed in respect of paragraph (1). Pursuant to that proposal, paragraph (1) should be divided into two parts, the first dealing with determinations that security procedures would satisfy the requirements of an electronic signature, and the second addressing security procedures that would satisfy the integrity requirements of article 5. A new paragraph (2) would allow parties to determine the legal effect of their signatures. Language along the following lines was proposed:
"(1) [The organ or authority specified by the enacting State as competent] may determine:

"(a) that an electronic signature satisfies the requirements of article 1(b);

"(b) that a security procedure satisfies the requirements of article 5."

"(2) As between the person signing a data message and any person relying on the signed message, the parties may determine the effect of a signature or a security procedure if expressly agreed between the parties, subject to these Rules and applicable law."

74. The Working Group generally agreed with the proposed text, subject to some drafting changes. One proposal was that the words "these Rules and" should be placed within square brackets, pending future discussion regarding the issue of compliance with mandatory provisions of the Uniform Rules. That proposal was accepted and the Working Group agreed that discussion on the issue of which provisions of the Uniform Rules should be mandatory should be postponed, together with issues touching upon consumer law.

75. Some concern was expressed as to what the reference to parties determining "the effect" of the signature would mean. One objection was that parties could not agree on the legal effect that signatures would have, but could agree on how they should sign a data message. Another view was that the parties could agree as to the legal effect that a particular form of signature would have, but could not agree to confer legal status on a particular form of signature. Yet another view was that the provision in paragraph (2) should be limited to a single instance of the use of a particular signature. After discussion, it was agreed that the words "the effect" be placed in square brackets pending further discussion of what this phrase might mean. The Secretariat was requested to prepare a revised version of draft article 6 to reflect the above discussion.

Article 7. Liability for [enhanced][secure] electronic signature

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

"Variant A

"Where the use of an [enhanced][secure] electronic signature was unauthorized and the purported signer did not exercise reasonable care to avoid the unauthorized use of its signature and to prevent the addressee from relying on such a signature, the purported signer is liable to pay damages to compensate the relying party for harm caused, unless the relying party knew or should have known that the signature was not that of the purported signer.

"Variant B

"Where the use of an [enhanced][secure] electronic signature was unauthorized and the purported signer did not exercise reasonable care to avoid the unauthorized use of its signature and to prevent the addressee from relying on such a signature, the signature shall nevertheless be regarded as that of the purported signer, unless the relying party knew or should have known that the signature was not that of the purported signer."

77. It was suggested that the title of the draft article might need to be reworded to indicate that the focus of the provision was on the unauthorized use of the signature. Wording along the lines of: "Liability for unauthorized use of [enhanced][secure] electronic signature" was proposed.

78. As to the scope of the draft article, it was suggested that the rule on liability for unauthorized use of an enhanced signature should be expanded to apply to ordinary electronic signatures as well. Another suggestion was that draft article 7 should be restructured to distinguish the cases where: (a) the unauthorized use of the signature resulted from the criminal intervention of a hacker; (b) the signature was used by an unauthorized employee or former employee of the purported signer; or (c) the signature was used by an authorized employee, but for purposes outside the scope of the authorization.

79. It was stated by a number of delegations that, in order to avoid possible interference with the domestic law of contracts and the law of agency, the subject matter of draft article 7 should be left to applicable domestic law and draft article 7 should be deleted. However, this proposal did not receive sufficient support. Further discussion focused on Variants A and B.

Variant A

80. Strong support was expressed in favour of Variant A. It was pointed out that a provision along the lines of Variant A was necessary to make it clear that the purported signer could not repudiate its signature merely by indicating, under draft article 4, that the signature had been used without authorization. In addition to the lack of authorization referred to in draft article 4, the purported signer should demonstrate under draft article 7 that it had not been negligent in protecting its signature from unauthorized use. In that context, a concern was expressed that the allocation of the burden of proof under Variant A might not be appropriate. It was pointed out that, under Variant A, the relying party would be burdened with the need to prove that the purported signer had not exercised reasonable care to avoid the unauthorized use of its signature. It was suggested that the provision might need to be redrafted to the effect of reversing the burden of proof, so that the purported signer would have to prove that it had exercised reasonable care in protecting its electronic signature.

81. In support of Variant A, it was also pointed out that the provision appropriately focused on issues of liability, as opposed to Variant B, which might be excessively burdensome for the purported signer if it were to be interpreted
as tying strictly the purported signer to the contents of the message authenticated by means of an unauthorized signature.

82. However, objections were expressed against Variant A. One objection was that it might not be appropriate to create a standard of reasonable care with respect to emerging practices such as those of electronic signatures, which were developing in a rapidly changing technical environment and did not have a background of established usages or practices. In that context, a provision along the lines of Variant A might discourage the use of electronic signatures by setting too strict a standard. The mere reference to the notion of "liability" in a provision dealing with purported signers and relying parties might deter potential users from engaging into electronic signature practice. In that respect, Variant B, which avoided any reference to the notion of liability, might be more acceptable (see below, para. 84).

83. In response, it was observed that, in many countries, the standard of reasonable care established by Variant A was already applicable to electronic commerce as a generally applicable rule of conduct under domestic law. While the provisions of Variant A might be unnecessary in those countries, it was emphasized that international harmonization of the law with respect to that issue might be useful. While it would be unwise for the Uniform Rules to attempt to unify the law applicable to compensation for pure economic loss, or otherwise to interfere with the law of contractual or tortious liability, the Working Group should not shy away from providing clarity as to the basic rules of conduct to be followed by parties when using electronic signatures. It was also observed that the standard of reasonable care, as contained in Variant A, was sufficiently flexible to accommodate newly emerging practices of electronic commerce. Moreover, the standard of conduct set forth in Variant A might be less stringent than standards of conduct applicable under specific areas of domestic laws. Furthermore, it was pointed out that, far from discouraging the use of electronic signatures, the existence of known uniform standards of conduct was likely to generate increased confidence in the use of electronic commerce in general, provided that those standards of conduct were sufficiently reflective of industry practice.

**Variant B**

84. Limited support was expressed in favour of Variant B. It was stated that Variant B appropriately focused on attribution of enhanced electronic signatures in cases where the electronic signature was unauthorized, while leaving the question of liability to be dealt with by courts on the basis of domestic law. In that context, it was suggested that Variant B might be redrafted to limit its application in time, to include an element of foreseeability of the amount of damages that might result from the unauthorized use of the signature, and to make it clear that loss of expected profits would not fall within the scope of draft article 7. Alternatively, it was proposed that the wording of Variant B should be redrafted along the following lines:

"Where the use of an [enhanced] electronic signature was unauthorized and the purported signer did not exercise reasonable care to avoid the unauthorized use of its signature and to prevent the addressee from relying on such a signature, the signature shall nevertheless be regarded as authorized, unless the relying party knew or should have known that the signature was not authorized."

85. It was generally agreed that draft article 7 could be maintained in square brackets in the Uniform Rules for continuation of the discussion at a later session. It was generally agreed that the issue of liability of the purported signer for negligence in protecting its electronic signature might need to be reopened in the context of draft article 13(2), which contained an obligation to revoke a certificate if the private key had been compromised.

86. With a view to accommodating the various views and concerns that had been expressed with respect to Variants A and B, the following was suggested as a possible revision of draft article 7:

"Where (1) the use of an [enhanced] electronic signature was unauthorized; (2) the addressee reasonably relied on the signature in good faith to its detriment; and (3) the purported signer did not exercise reasonable care to avoid the unauthorized use of its signature and to prevent the addressee from relying on such signature, the signature shall be attributable to the purported signer for the purpose of allocating responsibility for the cost of restoring the parties to their position prior to the unauthorized use of the signature. The foregoing shall not apply to the extent that the addressee knew or should have known that the signature was unauthorized."

87. Alternatively, it was proposed that draft article 7 should read as follows:

"Where the use of a[n] [enhanced][secure] electronic signature was unauthorized and the purported signer did not exercise reasonable care to avoid the unauthorized use of its signature and to prevent the addressee from relying on such a signature, the purported signer may be held liable only for the cost of restoring the parties to their position before the unauthorized use of the signature, unless the relying party knew or should have known that the signature was not that of the purported signer."

88. After discussion, the Working Group decided that the various texts suggested as possible alternatives for draft article 7 should be included as possible variants in the revised version of the Uniform Rules to be prepared for consideration at a future session, together with the text of Variant A as set forth in the note by the Secretariat.

Section III. Digital signatures supported by certificates

**Article 8. Contents of [enhanced][secure] certificates**

89. The text of draft article 8 as considered by the Working Group was as follows:
"For the purposes of these Rules, a[n] [enhanced][secure] certificate shall, as a minimum:

"(a) identify the certification authority using it;

"(b) name or identify the [signer][subject of the certificate] or a device or electronic agent under the control of [the signer] [the subject of the certificate] [that person];

"(c) contain a public key which corresponds to a private key under the control of the [signer][subject of the certificate];

"(d) specify the operational period of the certificate;

"(e) be digitally signed or otherwise secured by the certification authority issuing it;

"(f) specify restrictions, if any, on the scope of the use of the public key;

"(g) identify the algorithm to be applied."

General remarks

90. At the outset of the discussion of draft article 8, concerns were expressed about the relationship between the article and the definition of an enhanced electronic signature in draft article 1(b). While the Working Group acknowledged that the definitions in draft article 1 of the Uniform Rules would need to be considered at a future session after the substantive articles had been finalized, it was agreed that the possible content of the definitions should be borne in mind in considering what the necessary elements of the substantive provisions might be.

91. Another concern related to the technology upon which the inclusion of draft article 8 in the Uniform Rules was based. It was pointed out that the draft article was based on three-party certification technology involving an independent certification authority in addition to the signer and addressee of a data message. In fact, what was currently developing in commercial usage was an emphasis upon two-party certification technology, and the view was expressed that the draft article might not be appropriate in that context. In that regard, a number of questions were raised as to whether inclusion of an article along the lines of draft article 8 would adversely affect two-party certification, whether it would be necessary to establish a similar rule for two-party certification, or whether two-party certification should be specifically excluded from the scope of draft article 8. In reply, it was stated that, while two-party certification was largely contractual, there were situations where a third party might rely on the signature and it might be important to secure the interests of that relying party. The view was expressed that, notwithstanding any apparent similarity in that case with the situation of a relying party in three-party certification, it would be difficult to draft a rule which applied to the different circumstances of two- and three-party certification. The application of draft article 8 to two-party certification and the need for a specific exclusion was widely felt to be an issue which should be pursued by the Working Group at a later stage.

92. Another concern related to technology was that, while the inclusion of a list of requirements to be met by the issuer of a certificate might add certainty to the use of digital signatures, the rapid development of technology was likely quickly to render such a detailed list irrelevant.

93. The view was expressed that it was not clear from the text of draft article 8 what the consequences would be where a certificate did not include all the information set forth in subparagraphs (a) to (g). The purpose of draft article 8 was to extend the definition of draft article 8 and how it related to draft articles 9 and 10. It was questioned whether draft article 8 was needed at all. It was pointed out that the obligations established by articles 9 and 10, which tied together the public and private keys and linked the two keys to identification of the signer, were central to the concept of an enhanced certificate supporting an enhanced signature and could not be considered separately from draft article 8. It was generally agreed that those issues were central to the inclusion of draft article 8 in the text and to the manner in which it should be formulated. A related concern was the relationship between draft article 8 and article 7 of the Model Law. In this regard, it was pointed out that it should not be assumed that, once draft article 8 was satisfied, the requirements of article 7 would be satisfied. It was also pointed out that some of the requirements of draft article 8, including subparagraphs (d) to (g), did not go to establishing the reliability of the signature, as required by the test in article 7 of the Model Law. The relationship between these articles was not finally resolved in the context of draft article 8, but the Working Group agreed that that question would need to be considered again in the context of discussion on draft articles 9 and 10.

94. A number of different views were expressed as to the possible consequences of a certificate failing to satisfy the requirements of draft article 8. One view was that the consequences of failing to satisfy the requirements of draft article 8 appeared to be that use of the certificate might be prohibited under the Uniform Rules and the remaining rules in section III of the Uniform Rules would not apply. It was stated that this was a serious penalty, which was out of proportion to the requirements of subparagraphs (a) to (g). Another view was that the failure of a certificate to meet the conditions set forth in subparagraphs (a) to (g) did not mean that the signature supported by the certificate would cease to be a digital signature, although it might cease to have enhanced status. Under that view, the signature would still be considered to be a digital signature and the rules covering digital signatures which were not supported by a certificate would apply. A contrary view was that, while the certificate would not qualify under section III of the Uniform Rules as a certificate which could support an enhanced signature, the signature could still qualify as an enhanced signature under draft article 1(b) of the Uniform Rules; the only difference would be that the shortcut provided by section III of the Uniform Rules would not be available and the elements of the definition in draft article 1(b) would have to be proved. Yet another view was that the consequences could include that the certificate was not a certificate for the purposes of the Uniform Rules or, alternatively, that it might still be a certificate, but that the issuer of the certificate might be
liable for misrepresentation if it were to represent that the certificate supported an enhanced signature. A related view was that a certification authority should not be able to escape liability under the Rules on the basis that it had not issued a certificate which qualified as an enhanced certificate. In such a situation, the certification authority should be treated as if it had issued an enhanced certificate. While the Working Group did not reach agreement on what the consequences of failure to comply with draft article 8 should be, it was agreed that it was not necessary to do so at this time, but that it would be important to consider this issue in the context of the remaining provisions of section III.

95. It was suggested that, because draft article 5 as revised by the Working Group included provisions applicable to certificates and signatures to be used for securing the integrity of the data message (as distinct from identification), this distinction should to be reflected in draft article 8. That proposal received little support.

96. As a matter of drafting, there was some support for use of the term "signer". A contrary view was that this term was not appropriate in the context of the issuing of a certificate, where the parties involved were the issuer and the subject of the certificate. Only where a certificate had been issued and the subject of the certificate actually signed something could it be said that there was a "signer". Another view was that use of the word "signer" would potentially exclude electronic agents. It was also pointed out that where there was an interloper, the actual signer was not the "signer" in the sense of being the subject of the certificate. It was suggested that the phrase “the subject of the certificate” would resolve the uncertainty associated with the use of "signer". It was agreed that the discussion on terminology might need to be reopened at a future session on the basis of the revised draft prepared by the Secretariat.

97. A suggestion was made that an additional requirement should be added after subparagraph (b) to cover attributes of a signer other than identity. The proposal was made that words to the effect of “identify a specific attribute [of the signer] such as address, authority to act on behalf of a company, or the existence of specific permits or licences” should be added in a new subparagraph (c). That proposal received little support.

Chapeau

98. As a matter of drafting, it was proposed that the words “and in the context of digital signatures” should be added after the word “Rules” in order to clarify the scope of the provision. Another proposal was that the chapeau should establish a positive obligation, binding on the issuer of the certificate, rather than a standard which established minimum criteria to be met for qualification as an enhanced certificate. In addition, it was suggested that draft article 8 should allow for variation by agreement between the parties. The following text was proposed:

“For the purposes of these Rules and in the context of digital signatures, the issuer of an [enhanced] certificate shall, at a minimum, include the following information in the certificate, in the absence of contrary agreement:"

99. While there was general support for the proposal to change draft article 8 from an impersonal standard to an obligation binding on the issuer, the reference to party autonomy was criticized on the same grounds as those discussed in the context of draft article 6 concerning the possible effect of any such agreement upon third parties. The view was also expressed that allowing variation by agreement in draft article 8 would give the article the effect of a default rule, rather than a minimum standard. It was pointed out in this regard that the original purpose of the draft article was to establish a minimum standard for the information to be included on the face of the certificate and that this would assist in harmonization of certification practices and build trust in electronic commerce. In response to these criticisms, it was proposed that the words "in the absence of contrary agreement" should be placed in square brackets pending further consideration of the issue of party autonomy.

100. Another proposal in relation to the sphere of application of draft article 8 was that it should apply to all certificates and that the reference to enhanced certificates should be deleted. In opposition to that proposal, it was stated that the only purpose of draft article 8 was to support enhanced signatures and the following text was proposed to reflect that scope:

“For the purposes of these Rules, a certificate issued to support an enhanced signature shall, at a minimum, include:"

Although that proposal did not receive support, these words were used in a subsequent proposal for a new draft article 8 (see below, para. 112).

101. Yet another suggestion, which related to the scope of draft article 8, was made to the effect that use of the word “issue” might cover only the handing out of the certificate to the subject of the certificate, involving a contractual relationship between the certification authority and the subject of the certificate, as opposed to disclosure by the certification authority of the information in the certificate to any relying third party. Such a provision could apply to any type of certificate, whether enhanced or not. To give effect to that proposal, the following text was proposed:

“A certification authority shall ensure that in disclosing to any party the information contained in a certificate at least the information in paragraph (2) shall be disclosed. The foregoing shall apply except to the extent that is otherwise expressly agreed between the certification authority and such party.”

102. As part of that proposal, it was stated that paragraph (2) should include subparagraphs (a) to (g) of draft article 8. Some support was expressed in favour of that inclusion,
and these words were used in a subsequent proposal for a new draft article 8 (see below, para. 114).

Subparagraph (a)

103. The Working Group agreed that the substance of the requirement contained in subparagraph (a) was generally acceptable.

Subparagraph (b)

104. It was pointed out that the phrase “device or electronic agent” was a new concept in these Rules and might need to be defined. In support of including these words, the view was expressed that the Uniform Rules needed to provide clearly for the situation where a system could be set in process by a user and then function by itself, including signing data messages and having a certificate issued to it.

Subparagraph (c)

105. One concern expressed in respect of subparagraph (c) was that the public key did not need to be referred to in the certificate as there were other means by which the relevant information could be made available. A proposal was made that the requirement could be changed to “identifying” rather than “containing” the public key.

Subparagraph (d)

106. Subparagraph (d) was criticized on the ground that the meaning of “operational period” was unclear. It was proposed that the words “specify the period during which the certificate may be used for verification of a digital signature” should be substituted. In opposition to that proposal, it was pointed out that the operational period of a certificate was the period during which a digital signature could be created validly. After a signature became invalid, the certificate could still be used to verify a signing which occurred before the time at which the signature became invalid. Retention of the current subparagraph (d) was generally agreed.

Subparagraph (e)

107. It was generally agreed that subparagraph (e) should be included in draft article 8. For reasons of clarity, and because signature of the certificate by the issuer was central to the validity of the certificate, it was suggested that the subparagraph should be included after draft subparagraph (a).

Subparagraph (f)

108. Discussion of subparagraph (f) focused upon the issue of incorporation by reference. Support was expressed in favour of retaining the subparagraph and removing the square brackets on the basis that the purpose of draft article 8 was to provide information to contracting and relying parties. The view was expressed that it was therefore essential that, if there were restrictions on the certificate, these should be made clear on the face of the certificate itself. In support of deleting subparagraph (f), it was pointed out that it might potentially include a very broad range of restrictions included in various other documents, such as a certification practice statement. Since such restrictions would need to be in human readable form to ensure accessibility to the user, rather than incorporated by reference to identifying codes, in some instances it might be technically infeasible to include a sufficiently large amount of information in the certificate in order to comply with this requirement.

109. In response to that criticism, it was suggested that, if restrictions were applicable to the certificate, it would be sufficient, as a minimum approach, for the certificate to simply “indicate” the existence of restrictions, rather than to specify the actual restrictions.

110. Another proposal was that an additional subparagraph should be added to subparagraph (f) to the effect that “In circumstances where restrictions are not stated in the certificate, the certificate may not be used to the detriment of third parties”. That proposal was not supported. Yet another proposal was that it should be possible to recognize a “short form certificate” provided that: the certificate itself indicated that it was a short form; the certificate stated where the remote information was; and the information was accessible to an inquiring party. That proposal received some support. After further discussion, the Working Group agreed that the issue of incorporation by reference raised a number of difficult issues that had already been discussed in the context of the formulation of article 5 bis of the Model Law. The view was expressed that article 5bis recognized that the issue of incorporation by reference could not be resolved in the context of electronic commerce until it had been resolved in the general law, and that such a resolution could not be achieved in this discussion. A contrary view was that, since article 5bis did not solve all issues related to incorporation by reference as it was only formulated in the negative, the issue needed to be secured in the Uniform Rules. After discussion, the Working Group agreed to leave the issue of incorporation by reference to be resolved according to national law.

Subparagraph (g)

111. Although some support was expressed in favour of retaining subparagraph (g), there was general agreement that it was not as important as subparagraphs (a) to (f).

Proposals for a new article 8

112. In response to criticisms that draft article 8 was too detailed and likely to be rendered irrelevant by the development of technology, the following text was proposed as a substitute for draft article 8:

“For the purposes of these Rules, an enhanced certificate shall, at a minimum, include, or [where technically
impractical] summarize and reference, information reasonable to satisfy [the applicable requirements of the relevant security procedure][its intended purpose]."

That proposal received little support.

113. Another proposal for a new draft article 8 was based on the view that the subparagraphs of the draft article were not of equal importance, and that there were two categories of elements, that is, those that should be mandatory and those where failure to comply did not necessarily lead to the loss of enhanced status, but rather to the loss of the ability to assert the enhanced status as against third parties. In support of that view, it was stated that subparagraphs (d) to (g) did not support the establishment of either the identification of the public and private keys and their functionality as a key pair, or the identification of the holder of the key pair, as required in draft articles 9 and 10. It was pointed out that these requirements might be difficult to satisfy with certain applications of certification practices. Subparagraphs (d) to (g) were therefore not essential requirements for an enhanced certificate. Subparagraphs (a) to (c), on the other hand, were stated to be essential to the purpose of draft article 8, formed the substance of draft articles 9 and 10 of the Uniform Rules, and indicated the linkage between draft article 8 and draft articles 9 and 10.

114. Yet another proposal based on the view that the subparagraphs of draft article 8 were not of equal importance was as follows:

“(1) In disclosing to any party the information in a certificate, a certification authority [or the subject of a certificate] shall ensure that such information shall include, at least, that which is set out in paragraph (2), except to the extent expressly otherwise agreed between the certification authority [or the subject, as the case may be] and such party.

"Variant A"

“(2) The information referred to in paragraph (1) shall be:

“(i) for all certificates, [(a) to (c) and (e) of draft article 8], and

“(ii) for [ ... ] certificates, [(d), (f), (g) of draft article 8].

"Variant B"

“(2) The information referred to in paragraph (1) shall be [(a) to (c) and (e) of draft article 8].

“(3) Certificates may also contain other information, including [(d), (f) and (g)]."

115. With respect to the type of certificate referred to in subparagraph (ii) of Variant A, agreement could not be reached. It was widely felt that the provision should neither refer to enhanced certificates, nor describe the certificate by reference to the signature supported. It was pointed out that subparagraphs (a) to (g) would require some redrafting. It was suggested that the words “certification authority” should be deleted and the words “certificate issuer” substituted.

116. The proposed revision of the drafting of draft article 8 set forth in paragraph 114 above was widely supported, with some preference being expressed for Variant B. After discussion, the Working Group agreed that, for the purposes of future discussion, a revised draft of article 8 should include: the above proposal (including Variants A and B of subparagraph (ii) and paragraph (3)) and the text set forth in document A/CN.9/WG.IV/WP.76.

Article 9. Effect of digital signatures supported by certificates

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

“(1) In respect of all or any part of a data message, where the originator is identified by a digital signature, the digital signature [is a[n] [enhanced][secure] electronic signature][satisfies the conditions in article 7 of the UNCITRAL Model Law on Electronic Commerce] if:

“(a) the digital signature was securely created during the operational period of a valid certificate and is securely verified by reference to the public key listed in the certificate; and

“(b) the certificate binds a public key to [the signer’s][a person’s] identity by virtue of the fact that:

"Variant A"

“(i) the certificate was issued by a certification authority licensed by ... [the enacting State specifies the organ or authority competent to license certification authorities and to promulgate regulations for the operation of licensed certification authorities]; or

“(ii) the certificate was issued by a certification authority accredited by a responsible accreditation body applying commercially appropriate and internationally recognized standards covering the trustworthiness of the certification authority’s technology, practices and other relevant characteristics. A non-exclusive list of bodies or standards that comply with this paragraph may be published by ... [the enacting State specifies the organ or authority competent to issue recognized standards for the operation of licensed certification authorities]; or

“(iii) the certificate was otherwise issued in accordance with commercially appropriate and internationally recognized standards. [ ]; or

“(iv) sufficient evidence indicates that the certificate [accurately] binds the public key to the [signer’s][subject’s] identity.]"
"[2] Where a data message is signed with a digital signature [created during the validity period of a certificate] that does not meet the requirements set forth in paragraph (1), the digital signature is regarded as a[n] [enhanced][secure] electronic signature if sufficient evidence indicates that the certificate accurately binds the public key to the identity of the [signer][subject of the certificate]."

"(3) The provisions of this article do not apply to the following: [ ... ]."

General remarks

118. The placement of the draft article in section III was questioned, and the suggestion was made that the order of draft article 8 and draft article 9 should be reversed, with the effects of a digital signature supported by a certificate to be introduced before specifying the content of that certificate.

Paragraph (1)

Opening words

119. It was recognized, at the outset, that the meaning and purpose of draft article 9 was dependent upon which words in square brackets in the opening words of paragraph (1) were retained. The view was expressed that the words containing a reference to article 7 of the Model Law would establish legal effect, while the words relating to an [enhanced] electronic signature would result in a statement of which digital signatures could be regarded as [enhanced] electronic signatures, provided that the requirements were met. General support was expressed in favour of retaining the words [is a n] [enhanced] electronic signature] without the square brackets in preference to the alternative words relating to article 7 of the Model Law.

Subparagraph (a)

120. The discussion focused on whether use of the word "securely" in subparagraph (a) was appropriate. In support of the retention of that word, it was recalled that it had been included in the Uniform Rules in order to reflect better the necessary trustworthiness of the digital signature process, which was essential to the concept of an [enhanced] electronic signature. It was suggested that the term "securely" could be deleted from subparagraph (a) if the opening words contained a reference to article 7 of the Model Law, because that reference to article 7 would imply the necessary level of trustworthiness. Since the Working Group had decided that the opening words of paragraph (1) should not refer to article 7 of the Model Law, the word "securely" should be retained in subparagraph (a) in order to ensure that the digital signature was secure, since not all digital signatures verifiable with reference to a certificate were necessarily secure, especially if there was uncertainty as to the accuracy of the identification of the signer or the public key. One proposal was that the term should not only be retained in subparagraph (a), but that it should be elaborated upon by addition of the following text:

"A digital signature is securely created and securely verified if it was generated using:

"(a) technical components for the generation and verification of the digital signature which would reliably reveal a forged digital signature and manipulated signed data and provided protection against unauthorized use of private signature keys;

"(b) technical components for the presentation of data to be signed which clearly indicate in advance the generation of digital signatures and enable identification of the data to which a digital signature applies; and

"(c) these technical components are adequately tested against current engineering standards."

121. In reply to that proposal, it was widely felt that the level of detail was too great for inclusion in the body of the Uniform Rules. However, explanations along the lines of the proposed text might be very useful in the context of a Guide to Enactment to the Uniform Rules.

122. Strong support was expressed in support of the deletion of the word "securely" in subparagraph (a). It was stated that use of the word introduced a new concept in relation to both creation and verification of a digital signature that was uncertain and ambiguous.

123. As a matter of drafting, a proposal was made that the text of subparagraph (a) should make it clear that both the creation of the signature and its verification should occur within the operational period of a certificate. A contrary view was that the operational period was only relevant to the verification of a digital signature and that subparagraph (a) should be revised by deleting the word "securely" in respect of verification and adding at the end of the subparagraph the words "and during the period in which verification is permitted to be made".

124. After discussion, the Working Group failed to achieve consensus with respect to the use of the word "securely" in subparagraph (a). It was decided that, in the variants of draft article 9 to be prepared for continuation of the discussion at a later session, retention and deletion of the word "securely" should be reflected as alternatives (see below, para. 133).

Subparagraph (b)

Opening words

125. The opening words of subparagraph (b) were found to be generally acceptable.

Subparagraphs (i) and (ii)

126. The substance of subparagraphs (i) and (ii) was found to be generally acceptable, although clarification as to the mandatory or other character of "licensed" and "accredited" was sought. It was stated that, while "licensed" suggested a mandatory, government-implemented scheme
for regulating certification authorities, and “accreditation” suggested a non-mandatory, voluntary scheme, such schemes were not central to the creation of a secure digital signature. Security should be assessed by reference to objective, qualitative criteria, rather than by focusing upon the process of creation of a secure signature. That view was not supported and retention of subparagraphs (i) and (ii) was agreed.

Subparagraph (iii)

127. A concern was expressed that the use of the word “otherwise” in draft subparagraph (iii) might not be sufficiently clear in its application, and it was proposed that the words in subparagraph (iii) should be stated at the beginning of each of subparagraphs (i) and (ii), along the following lines: “the certificate was issued in accordance with commercially appropriate and internationally recognized standards by a certification authority licensed by...”.

128. In support of retention of subparagraph (iii) in its present form, the view was expressed that, together with subparagraph (iv), the subparagraph established what might be described as a “long form” of proof which enabled satisfaction of the requirement that a public key be bound to a person’s identity in the event that the certificate was not issued in accordance with paragraph (1)(b)(i) or (1)(b)(ii) of draft article 9. In opposing the proposal to include the substance of subparagraph (iii) at the beginning of subparagraphs (i) and (ii), it was stated that that proposal would remove the “shortcuts”, provided by subparagraphs (i) and (ii), to the establishment of the binding of the public key to the signer’s identity, by requiring proof that the prescribed standards had been followed. If it were made clear that the process of licensing or accrediting a certification authority should be in accordance with appropriate standards of trustworthiness, it was unnecessary to restate this requirement in respect of the issue of certificates by those properly licensed or accredited bodies.

129. A concern of a drafting nature was that the reference to “commercially appropriate and internationally recognized standards” might not be appropriate and was likely to cause problems of interpretation in some languages. One proposal was that the term should be “commercially reasonable” and some reference should also be made to the origin of the standards by including the words “market-based”. Another proposal was that the words “usages and practices” should be substituted for “standards”. In opposing that proposal, it was pointed out that, since the word “usage” had a technical meaning in a number of legal systems which required that the usage be established over time and by means of wide use and support, it was inappropriate for use in the context of electronic commerce, where neither the Uniform Rules nor any other usage was sufficiently established to be applicable immediately. To resolve this difficulty, yet another proposal was made to include references to both “international technical standards” and “practices and usages”, and to describe the latter as “commercial usages and practices”.

130. With a view to reconciling the above-mentioned proposals, it was suggested that subparagraph (iii) should refer to a certificate issued “in accordance with international standards and commercial practices or usages widely known and regularly observed in the trade involved in the transaction”. It was widely felt that the suggested language might constitute an acceptable basis for continuation of the discussion. However, doubts were expressed as to whether the suggested language was fully consistent with other references to usages and practices (or to technical standards) that might exist in international texts in the field of international trade law. After discussion, it was agreed that the suggested language should be reflected between square brackets in the variants of draft article 9 to be prepared for consideration by the Working Group at a later stage.

Subparagraph (iv)

131. Support for the deletion of subparagraph (iv) was expressed on the grounds that it was unnecessary to state that the certificate binds the public key to the signer’s identity if evidence could be adduced to prove that fact, as this would ordinarly be the case, irrespective of any rule in draft article 9. In support of retaining subparagraph (iv), it was pointed out that, in the event that the binding of the public key was not achieved by the application of subparagraph (i) or (ii), which prescribed only very limited methods and might not be widely applicable, or subparagraph (iii) which might, at the outset, have a limited application in the field of electronic commerce, it was necessary to state how this could otherwise be proved. The purpose of subparagraph (iv) was therefore to balance subparagraphs (i), (ii) and (iii) and to ensure the flexibility of draft article 9.

Paragraph (2)

132. Support was expressed for the retention of paragraph (2) on the same grounds as stated in respect of subparagraph (iv). It was realized, however, that it might not be necessary to retain both subparagraph (1)(b)(iv) and paragraph (2), which served essentially the same purpose.

Proposal for new draft article 9

133. In order to reflect the differing proposals and suggestions made in respect of draft article 9, the following revised draft was proposed:

“(1) Variant A

“In respect of all or any part of a data message, where the originator is identified by a digital signature, the digital signature is an [enhanced] electronic signature if:

“(a) the digital signature was created during the operational period of a valid certificate and is [properly] verified by reference to the public key listed in the certificate;

“(b) the certificate purports to bind a public key to [the signer’s][a person’s] identity;
Part Two. Studies and reports on specific subjects

"(c) the certificate was issued for the purpose of supporting digital signatures which are [enhanced] electronic signatures; and

"(d) the certificate was issued:

"(i) by a certification authority licensed by ... [the enacting State specifies the organ or authority competent to license certification authorities and to promulgate regulations for the operation of licensed certification authorities]; or

"(ii) by a certification authority accredited by a responsible accreditation authority applying commercially appropriate and internationally recognized standards covering the trustworthiness of the certification authority’s technology, practices and other relevant characteristics. A non-exclusive list of bodies or standards that comply with this paragraph may be published by ... [the enacting State specifies the organ or authority competent to issue recognized standards for the operation of licensed certification authorities]; or

"(iii) in accordance with commercially appropriate and internationally recognized standards."

"Variant B

"In respect of all or any part of a data message, where the originator is identified by a digital signature, the digital signature is an [enhanced] electronic signature if:

"(a) the digital signature was [securely] created during the operational period of a valid certificate and is [properly] verified by reference to the public key listed in the certificate; and

"(b) the certificate binds a public key to the person’s identity according to procedures established by:

"(i) [the enacting State specifies the organ or authority competent to license certification authorities and to promulgate regulations for the operation of licensed certification authorities]; or

"(ii) a responsible accreditation authority applying commercially appropriate and internationally recognized standards covering the trustworthiness of the certification authority’s technology, practices and other relevant characteristics; or

"(iii) [international standards and commercial practices or usages widely known and regularly observed in the trade involved in the transaction]."

"(2) A digital signature that does not meet the requirements in paragraph (1) is regarded as an [enhanced] electronic signature if:

"(a) sufficient evidence exists to indicate that:

"(i) the certificate accurately binds the public key to the identity of the subject of the certificate; and

"(ii) the digital signature was properly created and verified using a secure and trustworthy procedure; or

"(b) it qualifies as an [enhanced] electronic signature under other provisions of these Rules."

134. In explanation of the proposal, it was stated that, in subparagraph (a) of Variant A, the term “properly” was intended to include the concept that the signature was created during the operational period of the certificate. Subparagraph (b) did not require proof that the certificate actually bound the public key to the signer’s identity, but that it should simply purport to do so. Subparagraph (d)(iii) was included in square brackets to reflect the earlier discussion concerning the inclusion of the reference to standards, practices and usages in subparagraphs (i) and (ii).

135. A concern was expressed that the use of the word “properly” in paragraph (1)(a) of the proposal was not sufficiently clear to ensure that verification ought to occur during the operational period of the certificate. The Secretariat was requested to insert appropriate language to reflect that concern.

136. After discussion, the Working Group agreed that Variants A and B above should be reflected by the Secretariat in the revised version of the Uniform Rules to be prepared for future discussion.

137. Having completed its review of Chapter II and prior to engaging into consideration of Chapter III of the Uniform Rules, the Working Group was invited by one delegation to reconsider the purpose of the Uniform Rules. It was stated that the purpose of the Uniform Rules should be to lay down some very basic principles of law in order to create a harmonized international common platform. In view of the fact that an instrument of the international character of the Uniform Rules could not be expected to be open to frequent revision, the Uniform Rules should not be aimed at creating standards and detailed rules as to digital signatures. Such detailed regulation would not be flexible enough to adapt to the rapidly developing techniques of electronic commerce. While it was appropriate for UNCITRAL to codify certain usages and practices of international trade, it should be borne in mind, when preparing the Uniform Rules, that such usages and practices did not currently exist with respect to electronic signatures, and that it would be illusory to attempt to deal in the Uniform Rules with the wide range of technical and commercial issues that might arise in connection with emerging digital signature practice. Such issues might be better dealt with by bodies such as ISO or the ICC. The scope of the Uniform Rules should be refocused to concentrate on the preparation of the basic legal framework within which all electronic signatures could be expected to develop. To that effect, the Uniform Rules might avoid any distinction between various levels
of signatures (e.g. the distinction between ordinary electronic signatures and [enhanced] electronic signatures), and be restructured in three parts as follows: (a) an introduction acknowledging the principle of party autonomy; (b) a set of rules dealing with the relationship between parties communicating with each other (based on the assumptions and liability provisions currently contained in the Uniform Rules); and (c) a set of provisions dealing with the liability of service providers that undertake to assist in the identification of parties in an electronic environment (also based on the liability provisions in the Uniform Rules). The Uniform Rules should not be concerned with certification authorities or other identification service providers, except to the extent necessary to provide basic guidance as to how such entities should perform the identification function. The Uniform Rules should avoid referring to the technical context (e.g. use of encryption techniques, reliance on a public-key infrastructure (PKI), signature dynamics or other biometric device). Instead, the Uniform Rules should provide a very general rule to the effect that identification service providers should be liable to persons who relied on the identification to the extent that such reliance was reasonable.

138. Support was expressed in favour of the idea that the Uniform Rules might need to be somewhat simplified and that they should continue focusing on provisions of general applicability in a media-neutral framework. Nevertheless, it was generally felt that the overall structure of the Uniform Rules was appropriate and did not need to be reconsidered at the current stage. In particular, the distinction between various levels of electronic signatures was adequate. It was pointed out that, as currently drafted, the Uniform Rules already reflected the intent to deal with the complex reality of electronic authentication through simple and general provisions. It was generally felt that the approach on which the Uniform Rules were based should be pursued further.

Chapter III. Certification authorities and related issues

Article 10. Undertaking upon issuance of certificate

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

"(1) By issuing a certificate, the certification authority undertakes [to any person who reasonably relies on the certificate] that:

"(a) the certification authority has complied with all applicable requirements of [these Rules];

"(b) all information in the certificate is accurate as of the date it was issued, [unless the certification authority has stated in the certificate that the accuracy of specified information is not confirmed];

"(c) to the certification authority’s knowledge, there are no known, material facts omitted from the certificate which would adversely affect the reliability of the information in the certificate; and

"(d) that if the certification authority has published a certification practice statement, the certificate has been issued by the certification authority in accordance with that certification practice statement."

"(2) By issuing a[n] [enhanced][secure] certificate, the certification authority makes the following additional undertakings in respect of the [signer][subject] identified in the certificate [to any person who reasonably relies on the certificate]:

"(a) that the public key and private key of the [signer][subject] identified in the certificate constitute a functioning key pair; and

"(b) that at the time of issuing the certificate, the private key is:

"(i) that of the [signer][subject] identified in the certificate; and

"(ii) corresponds to the public key listed in the certificate."

Paragraph (1)

140. Various views were expressed as to the need for, and the scope of, paragraph (1) of draft article 10. One view was that paragraph (1) (and possibly draft article 10 in its entirety) should be deleted, as it was unnecessary and went into too much detail. It was stated that, in particular, the standard of care contained in paragraph (1) with respect to all certificates was unnecessarily complex and could be summarized as a duty placed on the certification authority to act reasonably and in good faith. Thus, paragraph (1) merely stated the obvious and could be either deleted or reflected in other provisions of the Uniform Rules. It was stated in reply that, irrespective of its content and location, the provision of a standard of conduct was necessary as a logical step to allow the operation of the provisions of the Uniform Rules dealing with the liability of the certification authority. It was pointed out that the relationship between draft article 10 and draft articles 11 and 12 might need to be clarified to the effect of ensuring that failure to comply with the requirements of draft article 10 would entail liability of the certification authority. The suggestion was made that the contents of draft article 10 could be merged with draft article 12. In the context of that discussion, a further suggestion was that, alongside provisions dealing with the liability of certification authorities, the Uniform Rules might need to provide more detailed guidance as to the standard of care to be met by the relying parties. Another suggestion was that the standard of care for both certification authorities and relying parties might need to be reformulated on the basis of an obligation to act reasonably.

141. Another view was that specific elements listed under paragraph (1) were necessary with respect to all types of certificates. Paragraph (1) should thus be retained, subject to the possible deletion of subparagraphs (b) and (d), the subject matter of which could be dealt with through party autonomy. As a matter of drafting, it was suggested that, should the Uniform Rules contain requirements for all
certificates, these should be made subject to international practice and established usage. Another suggestion was that the words "by issuing a certificate" should be revised in order to make it clear that the standard of conduct contained in the provision covered both the "issuing" of the certificate to its client by the certification authority and the "disclosing" of information with respect to the certificate to any relying party by the certification authority. In the context of that discussion, it was realized that the question of whether the signer or subject of a certificate was to be considered as a relying party was still unresolved. With respect to subparagraph (c), the view was expressed that the provision might need to spell out more clearly the facts which should not be omitted from the certificate. Alternatively, it was suggested that the liability of the issuer of the certificate should be limited to guaranteeing the reliability of the information relevant to the purpose for which the certificate was issued, to the exclusion of other information that might be contained in the certificate. To that effect, it was suggested that the words "for its intended use" should be inserted at the end of subparagraph (c).

142. A widely held view was that the scope of draft article 10 should be limited to cover only a limited range of certificates, and possibly only those certificates that were issued for the purposes of [enhanced] electronic signatures. It was stated that prescribing a mandatory standard of conduct for all certificates might not be appropriate in view of the numerous types (and uses) of certificates that might develop beyond those needed for enhanced electronic signatures and beyond the scope of the Uniform Rules. It was suggested that the contents of paragraph (2) might need to be reconsidered to include in the opening words a general reference to the obligation of the certification authority to act reasonably.

Paragraph (2)

143. As a matter of drafting, it was suggested that subparagraph (b)(i) should read along the lines of "corresponds to the [signer][subject] identified in the certificate". Such a formulation would avoid the certification authority becoming inadvertently involved in issues regarding ownership of the key.

144. After discussion, the Working Group decided to postpone its decision on draft article 10 until it had completed its review of draft article 12. It was agreed that, for continuation of the discussion at a future session, the Secretariat should prepare a revised version of draft article 10, limited in scope as suggested above.

Article 11. Contractual liability

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

"Variant A"

"(1) As between a certification authority issuing a certificate and the holder of that certificate [or any other relying party having a contractual relationship with the certification authority], the rights and obligations of the parties [and any limitation thereon] are determined by their agreement [subject to applicable law]."

"[(2) Subject to article 10, a certification authority may, by agreement, exempt itself from liability for any loss [resulting from reliance on the certificate][due to defects in the information listed in the certificate, technical breakdowns or similar circumstances. However, the clause which limits or excludes the liability of the certification authority may not be invoked if exclusion or limitation of contractual liability would be grossly unfair, having regard to the purpose of the contract].]

"[(3) The certification authority is not entitled to limit its liability if it is proved that the loss resulted from the act or omission of the certification authority done with intent to cause damage or recklessly and with knowledge that damage would probably result.]

"Variant B"

"In accordance with applicable law, the rights and obligations of a certification authority, of a [signer][subject] identified in a certificate, and of any other party shall be governed by the agreement or agreements entered into by those parties to the extent that the agreement or agreements deal with those rights and obligations and any limitations thereon."

"Variant C"

"Where agreements are entered into by a certification authority, a [signer][subject] identified in a certificate, or any other party, the rights and obligations of those parties and any limitation thereon which are dealt with in the agreements shall be governed by the agreements in accordance with to the extent permitted by applicable law."

General remarks

146. At the outset of the discussion, doubt was expressed as to the need for an article on contractual liability in the Uniform Rules. With specific reference to draft article 11, it was pointed out that paragraph (1) of Variant A, as well as Variant B and Variant C, referred simply to the application of domestic law, a result which would be achieved without the inclusion of a provision such as draft article 11 in the Uniform Rules. These provisions were characterized as "place holders" which simply reminded readers of the Uniform Rules that, in respect of issues of contractual liability, reference should be made to applicable law. The provisions did not attempt to establish any substantive rule or impose obligations in respect of that issue. It was also pointed out that paragraphs (2) and (3) of Variant A could not be characterized in this way and did provide substantive rules on issues of unfairness and wilful misconduct. These issues, however, were generally contentious, both domestically and internationally, as they touched upon consumer protection concerns.
147. A contrary view was that draft article 11 was of use as an introduction to draft article 12. In dealing with rules of liability other than contractual liability, draft article 12 did not provide for party autonomy or otherwise for limitation of liability by contract. In order to clarify that the Uniform Rules were not intended to exclude the possibility of parties agreeing to limit liability in their contract, it was suggested that it might be necessary to include a provision along the lines of draft article 11.

148. Another view was that, since the purpose of UNCITRAL was to harmonize and unify the rules of international trade law, it was important to seek agreement on substantive principles of liability for inclusion in the Uniform Rules. In the same context, it was pointed out that some legal systems might not recognize variation of liability by agreement, and that leaving the issue to be resolved according to domestic law therefore might not serve the interests of facilitating electronic commerce.

149. The prevailing view was that a provision along the lines of draft article 11 should be maintained in the Uniform Rules. The discussion focused on Variants A, B and C of draft article 11. A concern which applied to each variant was the use of the phrase “subject to applicable law”. One view was that in legal systems that did not recognize the right of parties to vary liability by agreement, the inclusion of the words “subject to applicable law” would result in an excessively narrow application of the Uniform Rules. Conversely, deletion of those words would result in an unlimited ability to limit or exclude liability. For those reasons, it was suggested that the Working Group should carefully consider the use of those words in draft article 11. A proposal was made that contractual liability, to the extent that a provision was required, could be dealt with in the context of article 12, with the inclusion of a provision dealing with party autonomy.

Variant A

150. Variant A was widely supported, subject to general concerns expressed as to the meaning, in particular, of paragraph (2).

Paragraph (1)

151. One concern expressed in respect of paragraph (1) was that it was limited in scope to specific relationships between specified parties to a particular contract, rather than including all contracting parties. Subject to that concern, the substance of paragraph (1) was found to be generally acceptable and it was agreed that it could be adopted as the basis of further discussion.

Paragraph (2)

152. The view was expressed that, by providing a rule on grossly unfair conduct, paragraph (2) raised an issue that might be difficult to understand in the context of a number of legal systems. The Working Group was reminded that paragraph (2) was inspired by the UNIDROIT Principles on International Commercial Contracts (Article 7.1.6) as an attempt to provide a uniform standard for assessing the general acceptability of exemption clauses. The reference to the limitation or exemption of liability being “grossly unfair” suggested a flexible approach to exemption clauses, with the aim of promoting a broader recognition of limitation and exemption clauses than would otherwise be the case if the Uniform Rules were to refer merely to the law applicable outside the Uniform Rules (A/CN.9/WG.1V/ WP.73, para. 64). While some support was expressed in favour of including the standard in the terms developed by UNIDROIT, which was known and understood in a number of legal systems, a number of proposals were made to improve the drafting and more clearly reflect the principle at issue. One proposal was that language that described the principle should be substituted for the words “grossly unfair”. Another proposal was that the principle should be interpreted in the Uniform Rules in the same way as the UNIDROIT provision and explanatory material should be included in a Guide to Enactment. The Secretariat was requested to consider the redrafting of paragraph (2) to reflect the proposals made in respect of the standard of “grossly unfair” limitations and exclusions.

153. Another concern related to the use of the words “Subject to article 10” at the beginning of paragraph (2). It was pointed out that, since the Working Group had not reached agreement on draft article 10, it was difficult to understand what the use of those words in paragraph (2) of draft article 11 would mean. It was agreed that those words should be placed in square brackets until article 10 could be further discussed.

154. With respect to the words in square brackets in paragraph (2), there was general support for retaining the words “resulting from reliance on the certificate” without square brackets, and for deleting the words “due to defects in the information listed in the certificate, technical breakdowns or similar circumstances”. There was also general agreement that the last sentence of paragraph (2) should be retained, with amendments as follows: “However, the clause which limits or excludes the liability of the certification authority may not be invoked to the extent that exclusion or limitation of contractual liability would be grossly unfair, having regard to the purpose of the contract and other relevant circumstances.” Inclusion of the words “and other relevant circumstances” was proposed on the basis that assessment of what constituted a grossly unfair limitation or exclusion would always have to be considered by reference to all of the surrounding circumstances, not simply to the contract which contained such limitation or exclusion.

155. The Working Group decided that paragraphs (1) and (2) of Variant A should be retained, subject to revision to reflect the above-mentioned suggested changes.

Paragraph (3)

156. The proposal was made that paragraph (3) could be deleted on the basis that the standard of intent to cause harm, or wilful or reckless conduct would be covered by paragraph (2). That proposal was generally accepted.
Variants B and C

157. Some support was expressed in favour of retaining Variant C as a possible alternative to Variant A. It was stated that, since Variant C was based on a mere reference to applicable law, it would not run the risk of conflicting with any applicable rule of contractual liability. After discussion, it was generally felt that, for the above-mentioned reasons, Variant A should be preferred. No support was expressed in favour of Variant B. After discussion, the Working Group decided that both Variants B and C should be deleted.

Article 12. Liability of the certification authority to parties relying on certificates

158. The text of draft article 12 as considered by the Working Group was as follows:

“(1) Subject to paragraph (2), where a certification authority issues a certificate, it is liable to any person who reasonably relies on that certificate for:

“(a) errors in the certificate, unless the certification authority proves that it or its agents have taken [all reasonable] [commercially reasonable] measures [that were appropriate for the purpose for which the certificate was issued, in the light of all circumstances] to avoid errors in the certificate;

“(b) failure to register revocation of the certificate, unless the certification authority proves that it or its agents have taken [all reasonable] [commercially reasonable] measures [that were appropriate for the purpose for which the certificate was issued, in the light of all circumstances] to register the revocation promptly upon receipt of notice of the revocation]; and

“(c) the consequences of not following:

“(i) any procedure set forth in the certification practice statement published by the certification authority; or

“(ii) any procedure set forth in applicable law.

“(2) Reliance on a certificate is not reasonable to the extent that it is contrary to the information contained [or incorporated by reference] in the certificate [or in a revocation list] [or in the revocation information]. [Reliance is not reasonable, in particular, if:

“(a) it is contrary to the purpose for which the certificate was issued;

“(b) it exceeds the value for which the certificate is valid; or

“(c) [...].]”

General remarks

159. While the substance of draft article 12 was found to be generally acceptable, some delegations expressed the view that it would be preferable not to have a specific rule on the liability of a certification authority to relying parties. The Working Group agreed that draft articles 10, 11 and 12 would need to be considered together at a future meeting to ensure that obligations imposed upon certification authorities corresponded with the liability rules established by the Uniform Rules and to ensure that issues of party autonomy were properly resolved. It was also suggested that consistency of approach between the three draft articles should be ensured, particularly as to whether the focus of the provisions should be upon the accuracy of the result to be achieved or upon the procedure to be followed.

Paragraph (1)

Subparagraph (a)

160. A number of suggestions of a drafting nature were made. It was agreed that the words “all reasonable” in square brackets should be retained without brackets and that the remaining bracketed text should be deleted. It was proposed that subparagraph (a) should include a reference to “omissions” from the certificate in addition to errors, and that the reference to the requirement that the certification authority should prove that it had taken reasonable measures to avoid errors or omissions should be deleted. The following text was proposed: “(a) errors or omissions in the certificate which result from the certification authority’s failure to have taken all reasonable measures to avoid errors or omission in the certificate”. Another proposal was that the order of the text should be reversed to focus upon the certification authority’s failure to take reasonable care and to introduce the concept of allowing the certification authority to take remedial action to correct errors or inaccuracies in the certificate. The following text was proposed: “(a) for failure to take all reasonable measures to avoid or correct errors or inaccuracies in the certificate”. One concern with that proposal was that the reference to omissions would have meaning only in the context of a duty to include specified information on the certificate, where failure to do so would give rise to liability for its omission. This would be relevant in the context of draft articles 8 and 10, and would need to be aligned with those draft articles. Another concern was that the proposal to reverse the order of subparagraph (a) and delete the words relating to the certification authority’s obligation to prove that it took all reasonable measures would effectively reverse the burden of proof in the subparagraph. While addition of a reference to omissions was accepted, it was generally agreed that the burden of proof should not be reversed in this way.

Subparagraph (b)

161. It was suggested that subparagraph (b) should be deleted on the ground that it was too detailed. However, it was generally agreed that deletion of subparagraph (b) would be acceptable only if the substance of the subparagraph were included in a revised and broader version of subparagraph (a). It was agreed that, pending
future discussion on the alignment of draft articles 8, 10 and 12, subparagraph (b) should be retained in the Uniform Rules. As a matter of drafting, it was decided that the words “all reasonable” should be retained without brackets and that the remaining text in square brackets should be deleted.

Subparagraph (c)

162. Concern was expressed at the inclusion of a provision along the lines of subparagraph (ii) of subparagraph (c) on the basis that it could be difficult for a certification authority to know what the applicable law might be in a given instance. In support of deletion of subparagraph (c) (ii), it was stated that the reference to “any procedure” set forth in a certification practice statement or in applicable law might be too broad, since not all such procedures were aimed at protecting relying parties, and the scope of draft article 12 should be limited to the liability of certification authorities to such relying parties. It was generally agreed that subparagraph (ii) should be deleted. It was decided that subparagraph (i), which dealt with the liability of the certification authority for failure to comply with its own certification practice statement, should be retained.

Paragraph (2)

163. Suggestions were made to clarify the drafting of paragraph (2). One proposal was that subparagraph (a) should be amended as follows: “it is for a purpose contrary to the purpose for which the certificate was issued”. Similarly, subparagraph (b) should be amended as follows: “it is in respect of a transaction, the value of which exceeds the value for which the certificate is valid”. Another suggestion was that the text should make it clear that reliance on a certificate would not be reasonable under paragraph (2) “to the extent” that it was not founded upon either the purpose for which the certificate was issued or the value for which the certificate was valid. It was generally agreed that the drafting of paragraph (2) would need to be revised to reflect those suggestions.

Articles 13 to 15

164. For lack of sufficient time, the Working Group had only a preliminary discussion of draft articles 13, 14 and 15. The text of draft articles 13, 14 and 15 as considered by the Working Group was as follows:

Article 13. Revocation of certificate

“(1) During the operational period of a certificate, the certification authority that issued the certificate must revoke the certificate in accordance with the policies and procedures governing revocation specified in the applicable certification practice statement or, in the absence of such policies and procedures, promptly upon receiving:

“(a) a request for revocation by the [signer] [subject] identified in the certificate, and confirmation that the person requesting revocation is the [rightful] [signer] [subject], or is an agent of the [signer] [subject] with authority to request the revocation;

“(b) reliable evidence of the [signer’s] [subject’s] death if the [signer] [subject] is a natural person;

“(c) reliable evidence that the [signer] [subject] has been dissolved or has ceased to exist, if the [signer] [subject] is a corporate entity.

“(2) The [signer] [subject] in relation to a certified key pair is under an obligation to revoke, or to request revocation of, the corresponding certificate where the [signer] [subject] knows that the private key has been lost, compromised or is in danger of being misused in other respects. If the [signer] [subject] fails to revoke, or to request revocation of, the certificate in such a situation, the [signer] [subject] is liable to any person relying on a message as a result of the failure by the [signer] [subject] to undertake such revocation.

“(3) Regardless of whether the [signer] [subject] identified in the certificate consents to the revocation, the certification authority that issued a certificate must revoke the certificate promptly upon acquiring knowledge that:

“(a) a material fact represented in the certificate is false;

“(b) the certification authority’s private key or information system was compromised in a manner affecting the reliability of the certificate; or

“(c) the [signer’s] [subject’s] private key or information system was compromised.

“(4) Upon effecting the revocation of a certificate under paragraph (3), the certification authority must notify the [signer] [subject] and relying parties in accordance with the policies and procedures governing notice of revocation specified in the applicable certification practice statement, or in the absence of such policies and procedures, promptly notify the [signer] [subject] and promptly publish notice of the revocation if the certificate was published, and otherwise disclose the fact of revocation upon inquiry by a relying party.

“(5) [As between the [signer] [subject] and the certification authority] the revocation is effective from the time when it is [received] [registered] by the certification authority.

“(6) As between the certification authority and any other relying party, the revocation is effective from the time it is [registered] [published] by the certification authority.]”

Article 14. Suspension of certificate

“During the operational period of a certificate, the certification authority that issued the certificate must suspend the certificate in accordance with the policies and procedures governing suspension specified in the applicable
certification practice statement or, in the absence of such policies and procedures, promptly upon receiving a request to that effect by a person whom the certification authority reasonably believes to be the [signer] [subject] identified in the certificate or a person authorized to act on behalf of that [signer] [subject]."

Article 15. Register of certificates

"(1) Certification authorities shall keep a publicly accessible electronic register of certificates issued, indicating the time when any individual certificate expires or when it was suspended or revoked.

"(2) The register shall be maintained by the certification authority.

"Variant A

for at least [30] [10] [5] years

"Variant B

for ... [the enacting State specifies the period during which the relevant information should be maintained in the register]

after the date of revocation or expiry of the operational period of any certificate issued by that certification authority.

"Variant C

in accordance with the policies and procedures specified by the certification authority in the applicable certification practice statement."

General remarks

165. A number of concerns were expressed about the need for including draft articles 13 to 15 in the Uniform Rules. The suggestion was made that all three articles could be deleted on the grounds that: they were too specific, detailed and limited in their application; they were based on broad assumptions as to how certain models might or might not work in practice; and they were unlikely to be widely adopted. However, it was widely accepted in the Working Group that it would be premature to delete those draft articles without further discussion.

166. A number of delegations felt that draft articles 13 and 14 dealt with issues that it might be important to include in the Uniform Rules, depending upon how issues left open by the Working Group at its current session might eventually be dealt with in the Uniform Rules. The view was generally expressed that the draft articles should be simplified and possibly reduced to a single article, or incorporated with other articles in section III of chapter II. It was proposed that, as it was clear that certification authorities were needed for digital signatures, these three articles should be limited in their application to digital signatures and the Uniform Rules rearranged to reflect that limitation. A related proposal was that it would be important to examine how commercial practices with respect to signatures other than digital signatures were developing, in order to see how the structure of the Uniform Rules should be arranged.

167. As to the substance of the draft articles, the view was expressed that draft articles 13 and 14 dealt with primary obligations of a certification authority and that it was necessary to resolve what those obligations should be before issues of liability could be resolved. In respect of draft article 13, it was suggested that the article provided an opportunity to ensure that a balance was reached in the Uniform Rules between the obligations imposed on the certification authority and those applicable to the signer or subject of the certificate.

168. The view was expressed that draft article 15 raised difficult issues of data privacy and could be deleted. Another difficulty raised was that draft article 15 might be unworkable in some certification systems. In support of retention, it was pointed out that draft article 15 was related to the liability of the certification authority under draft article 12 and would need to be further considered in the context of consideration of draft article 12.

169. The Working Group agreed that draft articles 13, 14 and 15 should be retained between square brackets for future consideration. The Secretariat was requested to review the drafting to reflect the views expressed and to explore the possibility of simplifying those draft articles.

Article 16. Relations between parties relying on certificates and certification authorities

170. The text of draft article 16 as considered by the Working Group was as follows:

"[(1) A certification authority is only allowed to request such information as is necessary to identify the [signer] [subject of the certificate].

"(2) Upon request, the certification authority shall deliver information about the following:

"(a) the conditions under which the certificate may be used;

"(b) the conditions associated with the use of digital signatures;

"(c) the costs of using the services of the certification authority;

"(d) the policy or practices of the certification authority with respect to the use, storage and communication of personal information;

"(e) the technical requirements of the certification authority with respect to the communication equipment to be used by parties relying on certificates;

"(f) the conditions under which warnings are given to parties relying on certificates by the certification authority in case of irregularities or faults in the functioning of the communication equipment;

"(g) any limitation of the liability of the certification authority;
“(h) any restrictions imposed by the certification authority on the use of the certificate; and

“(i) the conditions under which the [signer] [subject] is entitled to place restrictions on the use of the certificate.

“(3) The information listed in paragraph (1) shall be delivered to the [potential] [signer] [subject] before a final agreement of certification is concluded. That information may be delivered by the certification authority by way of a certification practice statement.

“(4) Subject to a [one-month] notice, the [signer] [subject] may terminate the agreement for connection to the certification authority. Such notice of termination takes effect when received by the certification authority.

“(5) Subject to a [three-month] notice, the certification authority may terminate the agreement for connection to the certification authority. Such notice of termination takes effect when received.”

171. There was general agreement that article 16 should be deleted on the grounds that it dealt with pre-contractual matters which should be left to the parties to a certification contract to resolve as between themselves. While some of the issues covered might be useful as a statement of best practice for certification authorities, the view was expressed that such issues were inappropriate for inclusion in the Uniform Rules, but could be included in an explanatory guide.

172. One concern related to the question of certification practice statements referred to in paragraph (3). The view was expressed that certification practice statements were an important element of the relationship between certification authorities, signers and relying parties, and that all certification authorities should be placed under an obligation to issue a certification practice statement. It was agreed that the issue should be further discussed by the Working Group at a later session in the context of draft articles 10, 11 and 12.

Chapter IV. Foreign electronic signatures

Articles 17 to 19

173. For lack of sufficient time, the Working Group postponed its consideration of draft articles 17 to 19 to a future session.

III. PROPOSAL FOR FUTURE WORK IN THE FIELD OF ELECTRONIC COMMERCE

174. During the current session of the Working Group, informal consultations were held with respect to the proposal for the preparation of a draft international convention on electronic transactions (see A/CN.9/WG.19/ WP.77). A delegation described the goal of the proposal.

It was explained that the proposal sought to accomplish two goals: (a) to remove paper-based obstacles to electronic transactions by adopting provisions from the Model Law; and (b) to address certain electronic authentication issues (to the extent that those issues were not already covered by the current work on the draft Uniform Rules) in a manner which, while accommodating different domestic law approaches that might be adopted, would still ensure that private contractual stipulations dealing with the authentication of electronic transactions were widely recognized and enforced. It was noted that the text of the proposal had been drafted for discussion purposes and was not cast in convention language.

175. With respect to paper-based obstacles, the proposal addressed issues concerning electronic transactions generally. It would include adoption of basic elements of the Model Law; for example, a contract formed electronically should not be denied validity or enforceability on the sole ground that it had been formed electronically. That portion of the convention would also define the characteristics of a valid electronic writing and original document and support the admission of electronic evidence. It would also recognize the acceptability of electronic signatures for legal and commercial purposes. It was felt by the proponents of the convention that there was a great deal of international consensus about these provisions, although it was reported that, in the context of informal consultations, a number of delegations had expressed interest in retaining flexibility in implementing these provisions in their own laws.

176. One delegation provided an oral report to the Working Group about various additional issues that had been informally discussed during a number of delegations. It was reported that an informal view had been expressed that the possible preparation of a convention should not involve reopening discussion as to the contents of the Model Law. The proposal for a convention should rather be regarded as a suggestion for further promoting the Model Law. It was also reported that there had been some discussion about the extent to which the provisions of the Model Law should be incorporated into the proposed convention. It was further reported that a view had been expressed that the entire Model Law should be annexed to the convention. Another view that was reported was that certain provisions of the Model Law might be less appropriate in the context of a convention. One idea that was reported was the possibility of adapting the wording of the draft convention so that States parties would undertake to implement the principles contained in the appropriate provisions of the Model Law.

177. With respect to the portion of the convention dealing with electronic authentication, it was reported that a number of issues had been discussed informally. A delegation had emphasized that, in addressing electronic authentication issues, the proposed convention should preserve the freedom of countries to adopt different approaches in domestic law. The convention was to preserve the freedom of countries to adopt different approaches in domestic law. The convention should also make it clear that, notwithstanding the precise nature of any statutory framework governing electronic authentication, the terms of an agreement (including closed-system agreements) between parties should be enforced to
the maximum extent possible. It was reported that the view had been expressed that the need to strike a balance between wide recognition of party autonomy, on the one hand, and the willingness of States to ensure preservation of their domestic legislative and regulatory framework, on the other hand, might be one of the crucial issues to be solved.

178. Other issues had been informally discussed in connection with the rest of the provisions concerning authentication. In addition to technology and implementation neutrality, the proposed convention provided that parties should be permitted to try to prove that their transactions were valid, whether or not the authentication technology or business method they used had been specifically addressed by legislation or regulation. Finally, the proposed convention called on States to take a non-discriminatory approach to authentication mechanisms as implemented in other countries. It was reported that there had been some discussion about this provision as a principle of commercial law and its relationship to principles of international trade policy.

179. It was agreed that informal discussions might be continued with respect to the proposed convention before and during the next session of the Working Group.

(A/CN.9/WG.IV/WP.76) [Original: English]

CONTENTS

INTRODUCTION ......................................................... 1-8

I. GENERAL REMARKS .............................................. 9-11

II. DRAFT PROVISIONS ON DIGITAL SIGNATURES, OTHER ELECTRONIC SIGNATURES, CERTIFICATION AUTHORITIES AND RELATED LEGAL ISSUES ......................................................... 12-50

CHAPTER I. SPHERE OF APPLICATION AND GENERAL PROVISIONS .............................................. 12-15

CHAPTER II. ELECTRONIC SIGNATURES ......................... 16-38

Section I. Electronic signatures in general ....................... 16-21

Article 1. Definitions ............................................. 16-20

Article 2. Effect of electronic signature ....................... 21

Section II. [Enhanced][Secure] electronic signatures .......... 22-30

Article 3. Presumption of signing ............................... 22-23

Article 4. Presumption of attribution ........................... 24

Article 5 Presumption of integrity .............................. 25-26

Article 6. Pre-determination of [enhanced][secure] electronic signature .............................................. 27

Article 7. Liability for [enhanced][secure] electronic signature .............................................. 28-30

Section III. Digital signatures supported by certificates ........ 31-38

Article 8. Contents of [enhanced][secure] certificate ............. 31

Article 9. Effect of digital signatures supported by certificates ........ 32-38
## INTRODUCTION

1. The Commission, at its twenty-ninth session (1996), decided to place the issues of digital signatures and certification authorities on its agenda. The Working Group on Electronic Commerce was requested to examine the desirability and feasibility of preparing uniform rules on those topics. It was agreed that work to be carried out by the Working Group at its thirty-first session could involve the preparation of draft rules on certain aspects of the above-mentioned topics. The Working was requested to provide the Commission with sufficient elements for an informed decision to be made as to the scope of the uniform rules to be prepared. As to a more precise mandate for the Working Group, it was agreed that the uniform rules to be prepared should deal with such issues as: the legal basis supporting certification processes, including emerging digital authentication and certification technology; the applicability of the certification process; the allocation of risk and liabilities of users, providers and third parties in the context of the use of certification techniques; the specific issues of certification through the use of registries; and incorporation by reference.1

2. At its thirtieth session (1997), the Commission had before it the report of the Working Group on the work of its thirty-first session (A/CN.9/437). As to the desirability and feasibility of preparing uniform rules on issues of digital signatures and certification authorities, the Working Group indicated to the Commission that it had reached consensus as to the importance of, and the need for, working towards harmonization of law in that area. While it had not made a firm decision as to the form and content of such work, it had come to the preliminary conclusion that it was feasible to undertake the preparation of draft uniform rules at least on issues of digital signatures and certification authorities, and possibly on related matters. The Working Group recalled that, alongside digital signatures and certification authorities, future work in the area of electronic commerce might also need to address: issues of technical alternatives to public-key cryptography; general issues of functions performed by third-party service providers; and electronic contracting (A/CN.9/437, paras. 156-157). With respect to the issue of incorporation by reference, the Working Group concluded that no further study by the Secretariat was needed, since the fundamental issues were well known and it was clear that many aspects of battle-ofts and adhesion contracts would need to be left to applicable national laws for reasons involving, for example, consumer protection and other public-policy considerations. The Working Group was

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of the opinion that the issue should be dealt with as the first substantive item on its agenda, at the beginning of its next session (A/CN.9/437, para. 155).

3. The Commission expressed its appreciation for the work already accomplished by the Working Group at its thirty-first session, endorsed the conclusions reached by the Working Group, and entrusted the Working Group with the preparation of uniform rules on the legal issues of digital signatures and certification authorities (hereinafter referred to as “the Uniform Rules”).

4. With respect to the exact scope and form of the Uniform Rules, the Commission generally agreed that no decision could be made at this early stage of the process. It was felt that, while the Working Group might appropriately focus its attention on the issues of digital signatures in view of the apparently predominant role played by public-key cryptography in the emerging electronic-commerce practice, the Uniform Rules should be consistent with the media-neutral approach taken in the UNCITRAL Model Law on Electronic Commerce. Thus, the Uniform Rules should not discourage the use of other authentication techniques. Moreover, in dealing with public-key cryptography, the Uniform Rules might need to accommodate various levels of security and to recognize the various legal effects and levels of liability corresponding to the various types of services being provided in the context of digital signatures. With respect to certification authorities, while the value of market-driven standards was recognized by the Commission, it was widely felt that the Working Group might appropriately envisage the establishment of a minimum set of standards to be met by certification authorities, particularly where cross-border certification was sought.3

5. The Working Group began the preparation of the Uniform Rules at its thirty-second session on the basis of a note prepared by the Secretariat (A/CN.9/WG.IV/ WP.73). The Secretariat was requested to prepare, on the basis of the deliberations and conclusions of the Working Group, a set of revised provisions, with possible variants, for consideration by the Working Group at a future session (for the report on the work of that session, see A/CN.9/446). With respect to incorporation by reference, the Working Group adopted the text of a draft provision, decided that it should be presented to the Commission for review and possible insertion as a new article 5bis of the UNCITRAL Model Law on Electronic Commerce and requested the Secretariat to prepare an explanatory note to be added to the Guide to Enactment of the Model Law (A/CN.9/446, para. 24).

6. This note contains the revised draft provisions prepared pursuant to the deliberations and decisions of the Working Group and also pursuant to the deliberations and decisions of the Commission at its thirtieth session, as reproduced above. In particular, the draft provisions are based on the working assumption adopted by the Working Group that its work in the area of digital signatures would take the form of draft statutory provisions (A/CN.9/437, para. 27). They are also intended to reflect the decision made by the Working Group at its thirty-first session that possible uniform rules in the area of digital signatures should be derived from article 7 of the UNCITRAL Model Law on Electronic Commerce (hereinafter referred to as “the Model Law”) and should be considered as setting out a manner in which a reliable method could be used “to identify a person” and “to indicate that person’s approval” of the information contained in a data message.

7. In the preparation of this note, the Secretariat was assisted by a group of experts, comprising both experts invited by the Secretariat and experts designated by interested governments and international organizations.

8. In line with the applicable instructions relating to the stricter control and limitation of United Nations documents, the explanatory remarks to the draft provisions have been kept as brief as possible. Additional explanations will be provided orally at the session.

1. GENERAL REMARKS

9. The purpose of the Uniform Rules, as reflected in the draft provisions set forth in part II of this note, is to facilitate the increased use of electronic signatures in international business transactions. Drawing on the many legislative instruments already in force or currently being prepared in a number of countries, these draft provisions aim at preventing disharmony in the legal rules applicable to electronic commerce by providing a set of standards on the basis of which the legal effect of digital signatures and other electronic signatures may become recognized, with the possible assistance of certification authorities, for which a number of basic rules are also provided.

10. Focused on the private-law aspects of commercial transactions, the Uniform Rules do not attempt to solve all the questions that may arise in the context of the increased use of electronic signatures. In particular, the Uniform Rules do not deal with aspects of public policy, administrative law, consumer law or criminal law that may need to be taken into account by national legislators when establishing a comprehensive legal framework for electronic signatures.

11. Based on the Model Law, the Uniform Rules are intended to reflect in particular: the principle of media-neutrality; an approach under which functional equivalents of traditional paper-based concepts and practices should not be discriminated against; and extensive reliance on party autonomy. They are intended for use both as minimum standards in an “open” environment (i.e. where parties communicate electronically without prior agreement) and as default rules in a “closed” environment (i.e. where parties are bound by pre-existing contractual rules and procedures to be followed in communicating by electronic means).

II. DRAFT PROVISIONS ON DIGITAL SIGNATURES, OTHER ELECTRONIC SIGNATURES, CERTIFICATION AUTHORITIES AND RELATED LEGAL ISSUES

Chapter I. Sphere of application and general provisions

12. In considering the draft provisions proposed for inclusion in the Uniform Rules, the Working Group may wish to consider more generally the relationship between the Uniform Rules and the Model Law. In particular, the Working Group might wish to make proposals to the Commission as to whether uniform rules on digital signatures should constitute a separate legal instrument or whether they should be incorporated in an extended version of the Model Law, for example as a new part III of the Model Law.

13. If the Uniform Rules are prepared as a separate instrument, it is submitted that they will need to incorporate provisions along the lines of articles 1 (Sphere of application), 2(a),(c) and (e) (Definitions of “data message”, “originator” and “addressee”), 3 (Interpretation), 7 (Signature) and 13 (Attribution of data messages) of the Model Law. While those articles are not reproduced in this note, it should be noted that the draft provisions of the Uniform Rules have been prepared by the Secretariat based on the assumption that such provisions would form part of the Uniform Rules. With respect to the sphere of application of the Uniform Rules, it should be borne in mind that, under article 1 of the Model Law, transactions involving consumers, while not the focus of the Uniform Rules, would not be excluded from their sphere of application unless the law applicable to consumer transactions in the enacting State conflicted with the Uniform Rules.

14. As to the question of party autonomy, a mere reference to article 4 (Variation by agreement) of the Model Law may not suffice to provide a satisfactory solution, in view of the fact that article 4 establishes a distinction between those provisions of the Model Law that may be freely varied by contract and those provisions that should be regarded as mandatory unless variation by agreement is authorized by the law applicable outside the Model Law. With respect to electronic signatures, the practical importance of "closed" networks makes it necessary to provide wide recognition of party autonomy. However, public policy restrictions on freedom of contract, including laws protecting consumers from overreaching contracts of adhesion, may also need to be taken into consideration. The Working Group may thus wish to include in the Uniform Rules a provision along the lines of article 4(1) of the Model Law to the effect that, except as otherwise provided by the Uniform Rules or other applicable law, electronic signatures and certificates issued, received or relied upon in accordance with procedures agreed among the parties to a transaction are given the effect specified in the agreement. In addition, the Working Group might consider establishing a rule of interpretation to the effect that, in determining whether a certificate, an electronic signature or a data message verified with reference to a certificate, is sufficiently reliable for a particular purpose, all relevant agreements involving the parties, any course of conduct among them, and any relevant trade usage should be taken into account.

15. In addition to the above-mentioned provisions, the Working Group may wish to consider whether a preamble should clarify the purpose of the Uniform Rules, namely to promote the efficient utilization of digital communication by establishing a security framework and by giving written and digital messages equal status as regards their legal effect.

Chapter II. Electronic signatures

Section I. Electronic signatures in general

Article 1. Definitions

For the purposes of these Rules:

(a) "Electronic signature" means data in electronic form in, affixed to, or logically associated with, a data message, and [that may be] used to [identify the signers of the data message and indicate the signer's approval of the information contained in the data message][satisfy the conditions set forth in article 7(1)(a) of the UNCTRAL Model Law on Electronic Commerce];

(b) "[Enhanced][Secure] electronic signature" means an electronic signature which [is created and][as of the time it was made] can be verified through the application of a security procedure or combination of security procedures that ensures that such electronic signature:

(i) is unique to the signer [for the purpose for][within the context in] which it is used;

(ii) can be used to identify objectively the signer of the data message;

(iii) was created and affixed to the data message by the signer or using a means under the sole control of the signer; [and]

(iv) was created and is linked to the data message to which it relates in a manner such that any change in the data message would be revealed.

(c) Variant A

"Digital signature" means an electronic signature created by transforming a data message using a message digest function, and encrypting the resulting transformation with an asymmetric cryptosystem using the signer's private key, such that any person having the initial untransformed data message, the encrypted transformation, and the signer's corresponding public key can [accurately] determine:

(i) whether the transformation was created using the private key that corresponds to the signer's public key; and
(ii) whether the initial data message has been altered since the transformation was made.

**Variant B**

"Digital signature" is a cryptographic transformation (using an asymmetric cryptographic technique) of the numerical representation of a data message, such that any person having the data message and the relevant public key can determine:

(i) that the transformation was created using the private key corresponding to the relevant public key; and

(ii) that the data message has not been altered since the cryptographic transformation.

(d) "Certification authority" means any person who, or entity which, in the course of its business, engages in issuing [identity] certificates in relation to cryptographic keys used for the purposes of digital signatures. [This definition is subject to any applicable law which requires a certification authority to be licensed, to be accredited, or to operate in a manner specified in such law.]

(e) "[Identity] certificate" means a data message or other record which is issued by a certification authority and which purports to confirm the identity [or other significant characteristic] of a person or entity who holds a particular key pair.

(f) "[Enhanced][Secure] certificate" means a[n identity] certificate issued for the purpose of supporting [enhanced][secure] electronic signatures.

(g) "Certification practice statement" means a statement published by a certification authority that specifies the practices that the certification authority employs in issuing and otherwise handling certificates.

(h) "Signer" means the person by whom, or on whose behalf, [an electronic signature is used][data is used as an electronic signature].

References

A/CN.9/446, paras. 27-46 (draft article 1), 62-70 (draft article 4), 113-131 (draft article 8), 132 and 133 (draft article 9);

A/CN.9/WG.IV/WP.73, paras. 16-27, 37-38, 50-57, and 58-60;

A/CN.9/437, paras. 29-50 and 90-113 (draft articles A, B and C); and

A/CN.9/WG.IV/WP.71, paras. 52-60.

Remarks

**Definitions of “electronic signature” and “[enhanced]/[secure] electronic signature”**

16. Pursuant to the decision made by the Working Group at its thirty-second session (A/CN.9/446, para. 30), the definition of “electronic signature” refers to article 7 of the Model Law. Depending on the decision to be made with respect to the relationship between the Uniform Rules and the Model Law, the provisions of article 7(1)(a) of the Model Law may need to be stated in full.

17. The distinction between a broad notion of “electronic signature” and a narrower category (provisionally called “enhanced” or “secure” electronic signature) has been maintained with a view to emphasizing the differences in the legal status of two types of procedures. On the one hand, a wide range of unspecified authentication techniques (labelled as “electronic signatures”) could obtain legal recognition as a legally significant signature, provided that they met the reliability test set forth in article 7(1)(b) of the Model Law, which would need to be established after the electronic signature had been used, and would typically require the intervention of a judge, arbitrator, or other trier of fact. On the other hand, a number of authentication techniques designated through administrative procedures to be defined by each enacting State or as a result of express agreement between the parties would enjoy advance recognition as functional equivalents to hand-written signatures.

**Definition of “digital signature”**

18. The category of “digital signatures” is not defined as a subset of “enhanced” electronic signatures. This is intended to reflect the fact that, although in most situations “digital” techniques (with or without reliance on certification authorities) would be used to produce the legal effects envisaged for the more “secure” category of electronic signatures, such techniques could also be used in a less specific context. The definition of “digital signature” is thus intended to emphasize the media-neutral character of the Uniform Rules.

**Definition of “certification authority”**

19. The Uniform Rules do not contain any requirement as to the standards to be met by certification authorities before they are allowed to operate. The issue was discussed by the Working Group at previous sessions and is also dealt with in draft article 19. Should it be seen as necessary to provide guidance to enacting States, either in the text of the Uniform Rules or in a guide to enactment, attention might be given to the following example of a possible provision:

Certification authorities must:

(a) possess the reliability necessary for offering certification services;

(b) employ personnel who possess the expert knowledge, experience, and qualifications necessary for the offered services;

(c) use trustworthy systems and generally acknowledged hardware and software adequate for the type of service and degree of security offered;
(d) have sufficient financial resources to operate in conformity with [these Rules];

(e) record all relevant information concerning [an] [enhanced][secure] certificate for an appropriate period of time, in particular to be able to provide evidence of certification in the context of a lawsuit. Such recording may be done electronically;

(f) publish all relevant information concerning the proper and secure use of certification services and establish procedures for complaints and dispute settlement; and

(g) publish with regard to the services available to the public, all relevant information concerning used procedures and applied practices, the terms and conditions of the contracts, in particular the liability obligations they undertake, as well as the complaints and dispute settlement procedures they apply; publication shall be accessible in an appropriate and easy manner.

Definitions of “[identity] certificate” and “[enhanced][secure] certificate”

20. The definitions in subparagraphs (e) and (f) draw on the suggestion made at the thirty-second session of the Working Group to distinguish the cases where digital signatures were used for the purposes of international trade transactions with the intent to sign (i.e. to identify the signer and link the signer with the information being signed) from other uses of digital signatures, e.g. to establish the level of authority of a person (“authority certificates”) (see A/CN.9/446, para. 72). While the provisions contained in Chapter III of the Uniform Rules deal mostly with digital signature techniques as a means of establishing pre-determined equivalency with hand-written signatures, the Working Group may wish to discuss the extent to which digital signature techniques should be dealt with in other contexts. Should the Uniform Rules focus on digital signatures as equivalent to hand-written signatures, there might be no need to distinguish between “certificates”, “identity certificates” and “[enhanced] secure certificates”. It may be recalled that any lower-security use of digital signatures could also be covered by the general provisions of draft article 2.

Article 2. Effect of electronic signature

(1) With respect to a data message authenticated by means of an electronic signature [other than a secure electronic signature], the electronic signature satisfies any legal requirement for a signature if the electronic signature is as reliable as appropriate for the purpose for which the electronic signature was used, in the light of all the circumstances, including any relevant agreement.

(2) Paragraph (1) applies whether the legal requirement referred to therein is in the form of an obligation or whether the law simply provides consequences for the absence of a signature.

(3) Unless expressly provided elsewhere in [this Law], electronic signatures that are not [enhanced][secure] electronic signatures are not subject to the regulations, standards, or licensing procedures established by ... [the State-specified organs or authorities referenced in article] or to the presumptions created by articles 4, 5 and 6.

(4) The provisions of this article do not apply to the following: [...]..

References

A/CN.9/446, paras. 27-46 (draft article 1).

Remarks

21. Draft article 2 is intended to deal with the legal effect of electronic signatures that do not meet the requirements set forth for the recognition of the “enhanced” or “secure” status. Consistent with the mandate received from the Commission and with views expressed at the thirty-second session of the Working Group (see A/CN.9/446, paras. 4 and 45), the purpose of the draft article is to ensure the media-neutrality of the Uniform Rules, to make it clear that the use of low-security authentication techniques is not prohibited, and to provide appropriate recognition of party autonomy, without allowing parties to derogate from mandatory rules of law relating to signatures. Paragraphs (1), (2) and (4) merely restate provisions contained in article 7 of the Model Law. Paragraph (3) addresses the distinction to be drawn between the legal effects of electronic signatures in general, as opposed to “enhanced” or “secure” authentication techniques.

Section II. [Enhanced][Secure] electronic signatures

Article 3. Presumption of signing

(1) A data message is presumed to have been signed [if][as of the time] [an][enhanced][secure] electronic signature is affixed to the data message.

(2) The provisions of this article do not apply to the following: [...].

References

A/CN.9/446, paras. 47 and 48 (draft article 2) and 49-61 (draft article 3); A/CN.9/WG.1/WP.73, paras. 28-36; and A/CN.9/437, paras. 43, 48 and 92.

Remarks

22. The draft article creating a presumption that a data message is to be regarded as “signed” if it is authenticated by a secure electronic signature has been redrafted pursuant to a view expressed at the thirty-second session that the relationship between the definition of a secure electronic signature and the presumptions flowing from the use of such secure electronic signature needed to be clarified (see A/CN.9/446, para. 34).
23. The Uniform Rules contain no definition of "signature" and no indication of any specific legal effects attached to any such "signature". Under draft article 3, the legal effect of a signature is to be determined by reference to domestic law outside the Uniform Rules.

Article 4. Presumption of attribution

(1) [A[n] [enhanced][secure] electronic signature is presumed to be that of the person by whom, or on whose behalf, it purported to have been used,

Variant A

unless the purported signer establishes that the [enhanced][secure] electronic signature was affixed without authorization.

Variant B

provided that the relying party establishes that the security procedure or combination of security procedures used to verify the signature was

(a) commercially reasonable under the circumstances;

(b) applied by the relying party in a trustworthy manner; and

(c) relied upon by the relying party reasonably and in good faith.

(2) The provisions of this article do not apply to the following: [ ... ].

References

A/CN.9/446, paras. 47 and 48 (draft article 2);
A/CN.9/WG.1V/WP.73, paras. 28-32; and
A/CN.9/437, paras. 43, 48 and 92.

Remarks

25. The previous draft of the Uniform Rules referred to verification of the integrity of the data message as an element of the definition of a "secure electronic signature". It has been brought to the attention of the Secretariat that verification of the integrity of the data message might be performed through separate procedures. Moreover, it is conceivable that certain authentication techniques would achieve the high level of security required under the definition of "enhanced" electronic signatures without verifying the integrity of the data message.

26. Should the Working Group find it more appropriate, the provisions of draft articles 3, 4 and 5 might be reworded to establish legal effects instead of presumptions.

Article 6. Pre-determination of [enhanced][secure] electronic signature

(1) A security procedure or a combination of security procedures satisfies the requirements of an [enhanced][secure] electronic signature if it is so declared by ...[the organ or authority specified by the enacting State as competent to make such declaration...].

(2) As between the person signing a data message and any person relying on the signed message, a security procedure or a combination of security procedures is deemed to fulfill the requirements of an [enhanced][secure] electronic signature if expressly so agreed by the parties.

(3) The provisions of paragraph (2) do not apply to the following: [ ... ].

References

A/CN.9/446, paras. 37-45 (draft article 1); and
A/CN.9/WG.1V/WP.73, para. 27.

Remarks

27. As opposed to unqualified "electronic signatures" dealt with in draft article 2, [enhanced] [secure] electronic signatures under draft article 6 present the advantage that, either through compliance with applicable regulations, or directly by contract, commercial parties can achieve certainty as to the legal effect of any given signing technique in advance of using that technique. The Working Group may wish to discuss whether limitations to party autonomy in that respect should be dealt
with by the Uniform Rules or simply left to domestic law under paragraph (3) (see above, para. 14).

Article 7. Liability for [enhanced][secure] electronic signature

Variant A

Where the use of a(n) [enhanced][secure] electronic signature was unauthorized and the purported signer did not exercise reasonable care to avoid the unauthorized use of its signature and to prevent the addressee from relying on such a signature, the purported signer is liable [to pay damages to compensate the relying party] for harm caused, unless the relying party knew or should have known that the signature was not that of the purported signer.

Variant B

Where the use of a(n) [enhanced][secure] electronic signature was unauthorized and the purported signer did not exercise reasonable care to avoid the unauthorized use of its signature and to prevent the addressee from relying on such a signature, the signature shall nevertheless be regarded as that of the purported signer, unless the relying party knew or should have known that the signature was not that of the purported signer.

References

A/CN.9/446, paras. 49-61 (draft article 3);
A/CN.9/WG.IV/WP.73, paras. 33-36;
A/CN.9/437, paras. 118-124 (draft article E); and
A/CN.9/WG.IV/WP.71, paras. 64 and 65.

Remarks

28. At its thirty-second session, the Working Group discussed whether the Uniform Rules should deal only with the attribution of secure electronic signatures (or digital signatures) or whether it should also address the issue of liability of the purported signer to the relying parties. It was emphasized that, in establishing the link between the electronic signature and the purported signer, the Uniform Rules should also create an incentive for the use of digital signatures by properly allocating liability for the loss caused to the relying party through the failure of the purported signer to exercise reasonable care and avoid the unauthorized use of its signature (see A/CN.9/446, para. 51).

29. The Working Group may wish to discuss the link between the Uniform Rules and article 13 of the Model Law. While article 13 of the Model Law deals with the attribution of the data message, the issue of attribution of an electronic signature is addressed in the definition of “[enhanced][secure] electronic signature” and in draft article 4.

30. Variant A limits the purported signer’s liability to damages proved by the relying party, which may be computed on a tortious or contractual basis, depending on the circumstances. Variant B makes the purported signer liable for the contents of the data message.

Section III. Digital signatures supported by certificates

Article 8. Contents of [enhanced][secure] certificate

For the purposes of these Rules, a(n) [enhanced][secure] certificate shall, as a minimum:

(a) identify the certification authority issuing it;
(b) name or identify the [signer][subject of the certificate] or a device or electronic agent under the control of [the signer][the subject of the certificate][that person];
(c) contain a public key which corresponds to a private key under the control of the [signer][subject of the certificate];
(d) specify the operational period of the certificate;
(e) be digitally signed or otherwise secured by the certification authority issuing it;
(ff) specify the restrictions, if any, on the scope of use of the public key; [and]
(g) identify the algorithm to be applied.

References

A/CN.9/446, paras. 113-131 (draft article 8);
A/CN.9/WG.IV/WP.73, paras. 50-57;
A/CN.9/437, paras. 98-113 (draft article C); and
A/CN.9/WG.IV/WP.71, paras. 18-45 and 59 and 60.

Remarks

31. At its thirty-second session, the Working Group did not decide whether, as a matter of drafting, the Uniform Rules should refer to “the subject of the certificate” or specifically indicate that the subject should be a “person”. With a view to improving the readability of the Uniform Rules, the term “signer” has been used consistently, while the term “subject” has also been kept for comparison. While the Uniform Rules could accommodate a reference to the notion of “person”, extensive redrafting would be required to avoid ambiguity as to which person is intended to be covered. The definition of “signer” under draft article 1(h) indicates that the signer should be a “person”.

Article 9. Effect of digital signatures supported by certificates

(1) In respect of all or any part of a data message, where the originator is identified by a digital signature, the digital signature [is a(n) [enhanced][secure] elec-
tronic signature][satisfies the conditions in article 7 of the UNCITRAL Model Law on Electronic Commerce] if:

(a) the digital signature was securely created during the operational period of a valid certificate and is securely verified by reference to the public key listed in the certificate; and

(b) the certificate binds a public key to [the signer’s][a person’s] identity by virtue of the fact that:

(i) the certificate was issued by a certification authority licensed by ... [the enacting State specifies the organ or authority competent to license certification authorities and to promulgate regulations for the operation of licensed certification authorities]; or

(ii) the certificate was issued by a certification authority accredited by a responsible accreditation body applying commercially appropriate and internationally recognized standards covering the trustworthiness of the certification authority’s technology, practices and other relevant characteristics.

A non-exclusive list of bodies or standards that comply with this paragraph may be published by ... [the enacting State specifies the organ or authority competent to issue recognized standards for the operation of licensed certification authorities]; or

(iii) the certificate was otherwise issued in accordance with commercially appropriate and internationally recognized standards[.]; or

(iv) sufficient evidence indicates that the certificate [accurately] binds the public key to the [signer’s][subject’s] identity.

[(2) Where a data message is signed with a digital signature [created during the validity period of a certificate] that does not meet the requirements set forth in paragraph (1), the digital signature is regarded as a[n] [enhanced][secure] electronic signature if sufficient evidence indicates that [the certificate] accurately binds the public key to the identity of the [signer][subject of the certificate].]

(3) The provisions of this article do not apply to the following: [...].

References
A/CN.9/446, paras. 71-84 (draft article 5);
A/CN.9/WG.1IV/WP.73, paras. 39-44; and
A/CN.9/437, paras. 43, 48 and 92.

Remarks
32. The opening words of paragraph (1) reflect the decision made by the Working Group at its thirty-second session (see A/CN.9/446, para. 76).

33. Digital signatures, if properly implemented, should constitute secure electronic signatures. However, a question is to determine when the implementation of a digital signature has been done in a manner such that it is entitled to secure status. Not all digital signatures verifiable with reference to a certificate are secure, especially where there is uncertainty as to whether the identification or authentication of the signer or the public key is accurate. The primary factors that determine whether a digital signature is secure include: (1) whether the certification authority has properly identified the signer; (2) whether the certification authority has properly authenticated the signer’s public key; (3) whether the signer’s private key has been compromised; and (4) whether the process is trustworthy (e.g. whether the public key algorithm and the key length used are appropriate).

34. Paragraph (1) sets forth two basic criteria for determining when a digital signature qualifies as a secure electronic signature. The first criterion requires that the signature be created during the operational period of a valid certificate and be verified by reference to the public key listed in the certificate. The operational period of a certificate normally begins at the time it is issued and ends upon the earlier of expiration, revocation or suspension.

35. The second step involves providing assurance that the certificate itself accurately identifies a person as the signer in relation to a private key corresponding to the public key specified in the certificate. The trustworthiness of the certificate may be assessed by reference to standards, procedures, and other requirements specified by authorities recognized in the enacting State. Such standards may be established through accreditation of certification authorities by third parties, the voluntary licensing of certification authorities, or otherwise require compliance with rules adopted by the enacting State.

36. Alternatively, under paragraph (2), if a court or other trier of fact determines, as a matter of evidence, that the information stated in the certificate is in fact true, then the trustworthiness of the certificate is obvious. At this stage, however, the trier of fact is required to determine on a case-by-case basis whether the certificate was issued by a certification authority that properly identified the signer and authenticated the signer’s public key.

37. Consistent with the “dual approach” taken by the Working Group, draft article 9 is intended to provide as much latitude as possible for making a determination as to the trustworthiness of a certificate issued by a certification authority. This flexibility is particularly important in light of the fact that the use of digital signatures is new and the models for its use as well as its regulation have not yet fully developed. Thus, it is important to facilitate the increased use of digital signatures in electronic commerce, while at the same time establishing the standards necessary to make a presumptive determination as to the reliability of a digitally-signed message.

38. It is also important to note that while one of the options set forth in draft article 9 includes a judicial determination of the accuracy of a certificate, the other option presumes the accuracy of a certificate if it was
issued by a certification authority accredited by the enacting State or if it otherwise meets certain standards established by the enacting State. In such a case, a judicial finding of accuracy is not required in order to qualify for a secure electronic signature status. The second option may be helpful to persons engaging in electronic commerce, who would know in advance of acting in reliance on a communication whether such action can be enforced. However, the presumption of accuracy may be rebutted by showing that a certificate issued by such an accredited certification authority is, in fact, not accurate or reliable (see A/CN.9/WG.IV/WP.73, paras. 39-44).

Chapter III. Certification authorities and related issues

Article 10. Undertaking upon issuance of certificate

(1) By issuing a certificate, the certification authority undertakes [to any person who reasonably relies on the certificate] that:

(a) the certification authority has complied with all applicable requirements of [these Rules];

(b) all information in the certificate is accurate as of the date it was issued [unless the certification authority has stated in the certificate that the accuracy of specified information is not confirmed];

(c) to the certification authority’s knowledge, there are no known, material facts omitted from the certificate which would adversely affect the reliability of the information in the certificate; and

(d) that if the certification authority has published a certification practice statement, the certificate has been issued by the certification authority in accordance with that certification practice statement.

(2) By issuing a[n] [enhanced][secure] certificate, the certification authority makes the following additional undertakings in respect of the [signer][subject] identified in the certificate [to any person who reasonably relies on the certificate]:

(a) that the public key and private key of the [signer][subject] identified in the certificate constitute a functioning key pair; and

(b) that at the time of issuing the certificate, the private key is:

(i) that of the [signer][subject] identified in the certificate; and

(ii) corresponds to the public key listed in the certificate.

References

A/CN.9/446, paras. 134-145 (draft article 10);
A/CN.9/WG.IV/WP.73, paras. 61-63;
A/CN.9/437, paras. 51-73 (draft article H); and
A/CN.9/WG.IV/WP.71, paras. 70-72.

Remarks

39. Draft article 10 relies on a distinction between [enhanced][secure] certificates and a broader category of certificates. Depending on the decision to be made by the Working Group regarding the extent to which the Uniform Rules should deal with digital signatures as used for purposes other than establishing predetermined equivalency with hand-written signatures, that distinction may not be needed (see above, para. 20).

Article 11. Contractual liability

Variant A

(1) As between a certification authority issuing a certificate and the holder of that certificate [or any other relying party having a contractual relationship with the certification authority], the rights and obligations of the parties [and any limitation thereon] are determined by their agreement [subject to applicable law].

(2) Subject to article 10, a certification authority may, by agreement, exempt itself from liability for any loss [resulting from reliance on the certificate][due to defects in the information listed in the certificate, technical breakdowns or similar circumstances. However, the clause which limits or excludes the liability of the certification authority may not be invoked if exclusion or limitation of contractual liability would be grossly unfair, having regard to the purpose of the contract].

(3) The certification authority is not entitled to limit its liability if it is proved that the loss resulted from the act or omission of the certification authority done with intent to cause damage or recklessly and with knowledge that damage would probably result.

Variant B

In accordance with applicable law, the rights and obligations of a certification authority, of a [signer][subject] identified in a certificate, and of any other party shall be governed by the agreement or agreements entered into by those parties to the extent that the agreement or agreements deal with those rights and obligations and any limitations thereon.

Variant C

Where agreements are entered into by a certification authority, a [signer][subject] identified in a certificate, or any other party, the rights and obligations of those parties and any limitation thereon which are dealt with in the agreements shall be governed by the agreements in accordance with and to the extent permitted by applicable law.
Part Two. Studies and reports on specific subjects

References
A/CN.9/446, paras. 146-154 (draft article 11); A/CN.9/WG.IV/WP.73, paras. 64-65; A/CN.9/437, paras. 51-73 (draft article 11); and A/CN.9/WG.IV/WP.71, paras. 70-72.

Remarks
40. Prior to considering the variants proposed for draft article 11, the Working Group may wish to discuss the question of whether draft article 11 should be retained as part of the Uniform Rules. At the thirty-second session of the Working Group, it was stated that the draft article dealt with matters that were better left to the contract and to the applicable law. In particular, it was observed that there might be no need to restate the principle of party autonomy, which was covered by article 4 of the Model Law; and that other matters dealt with in the draft article were interfering with national law on matters which might not lend themselves to unification. While leaving the issues of contractual liability to the contract and to the law applicable outside the Uniform Rules was found to be an acceptable alternative, the prevailing view was that it was worth trying to achieve a degree of unification on this important matter (see A/CN.9/446, para. 148).

Article 12. Liability of the certification authority to parties relying on certificate

(1) Subject to paragraph (2), where a certification authority issues a certificate, it is liable to any person who reasonably relies on that certificate for:

(a) errors in the certificate, unless the certification authority proves that it or its agents have taken [all reasonable][commercially reasonable] measures [that were appropriate for the purpose for which the certificate was issued, in the light of all circumstances] to avoid errors in the certificate;

(b) failure to register revocation of the certificate, unless the certification authority proves that it or its agents have taken [all reasonable][commercially reasonable] measures [that were appropriate for the purpose for which the certificate was issued, in the light of all circumstances] to register the revocation promptly upon receipt of notice of the revocation; and

(c) the consequences of not following:

(i) any procedure set forth in the certification practice statement published by the certification authority; or

(ii) any procedure set forth in applicable law.

(2) Reliance on a certificate is not reasonable to the extent that it is contrary to the information contained [or incorporated by reference] in the certificate [or in a revocation list] [or in the revocation information]. [Reliance is not reasonable, in particular, if:

(a) it is contrary to the purpose for which the certificate was issued;

(b) it exceeds the value for which the certificate is valid; or

(c) […].]

References
A/CN.9/446, paras. 155-173 (draft article 12); A/CN.9/WG.IV/WP.73, paras. 66 and 67; A/CN.9/437, paras. 51-73 (draft article 11); and A/CN.9/WG.IV/WP.71, paras. 70-72.

Remarks
41. Draft article 12 reflects the decision made by the Working Group at its thirty-second session (A/CN.9/446, para. 173). At that session, the view was expressed that draft article 12 should apply only to certification authorities issuing identity certificates.

General remark regarding draft articles 13 to 16

42. At its previous session, for lack of sufficient time, the Working Group postponed its consideration of draft articles 13 to 16 to a future session (see A/CN.9/446, para. 174). Subject to editing, aimed mostly at ensuring the consistency of the various provisions included in the revised text of the Uniform Rules, the text of draft articles 13 to 16 in this note is substantially identical to the text of those articles as set forth in document A/CN.9/WG.IV/WP.73.

Article 13. Revocation of certificate

(1) During the operational period of a certificate, the certification authority that issued the certificate must revoke the certificate in accordance with the policies and procedures governing revocation specified in the applicable certification practice statement or, in the absence of such policies and procedures, promptly upon receiving:

(a) a request for revocation by the [signer][subject] identified in the certificate, and confirmation that the person requesting revocation is the [rightful][signer][subject], or is an agent of the [signer][subject] with authority to request the revocation;

(b) reliable evidence of the [signer’s][subject’s] death if the [signer][subject] is a natural person; or

(c) reliable evidence that the [signer][subject] has been dissolved or has ceased to exist, if the [signer][subject] is a corporate entity.

(2) The [signer][subject] in relation to a certified key pair is under an obligation to revoke, or to request revocation of, the corresponding certificate where the [signer][subject] knows that the private key has been lost, compromised or is in danger of being misused in other
respects. If the [signer][subject] fails to revoke, or to request revocation of, the certificate in such a situation, the [signer][subject] is liable to any person relying on a message as a result of the failure by the [signer][subject] to undertake such revocation.

(3) Regardless of whether the [signer][subject] identified in the certificate consents to the revocation, the certification authority that issued a certificate must revoke the certificate promptly upon acquiring knowledge that:

(a) a material fact represented in the certificate is false;
(b) the certification authority’s private key or information system was compromised in a manner affecting the reliability of the certificate; or
(c) the [signer’s][subject’s] private key or information system was compromised.

(4) Upon effecting the revocation of a certificate under paragraph (3), the certification authority must notify the [signer][subject] and relying parties in accordance with the policies and procedures governing notice of revocation specified in the applicable certification practice statement, or, in the absence of such policies and procedures, promptly notify the [signer] [subject] and promptly publish notice of the revocation if the certificate was published, and otherwise disclose the fact of revocation upon inquiry by a relying party.

(5) [As between the [signer][subject] and the certification authority,] the revocation is effective from the time it is [received] [registered] by the certification authority.

(6) As between the certification authority and any other relying party, the revocation is effective from the time it is [registered] [published] by the certification authority.

References

A/CN.9/446, para. 174 (draft article 13);
A/CN.9/WG.IV/JP.WP.73, para. 68;
A/CN.9/437, paras. 125-139 (draft article F); and
A/CN.9/WG.IV/JP.WP.71, paras. 66 and 67.

Remarks

43. Draft article 13 is intended to reflect the various views expressed at the thirty-first session of the Working Group by setting forth a default standard governing revocation of certificates. At all times, however, a certification authority can avoid the default standard by establishing procedures governing revocation in its certification practice statement, and following those procedures. As regards the time of effectiveness of a revocation, the Working Group may wish to decide whether a distinction should be drawn between the situation of the signer and that of any other relying party (see A/CN.9/437, para. 130).

Article 14. Suspension of certificate

During the operational period of a certificate, the certification authority that issued the certificate must suspend the certificate in accordance with the policies and procedures governing suspension specified in the applicable certification practice statement or, in the absence of such policies and procedures, promptly upon receiving a request to that effect by a person whom the certification authority reasonably believes to be the [signer][subject] identified in the certificate or a person authorized to act on behalf of that [signer][subject].

References

A/CN.9/446, para. 174 (draft article 14);
A/CN.9/WG.IV/JP.WP.73, para. 69; and
A/CN.9/437, paras. 133-135 (draft article F).

Remarks

44. At its thirty-first session, the Working Group decided that the Uniform Rules should contain a provision on suspension of certificates (see A/CN.9/437, paras. 133 and 134). As regards the time of effectiveness of a suspension, the Working Group may wish to decide whether provisions should be added along the lines of the principles in paragraphs (4) and (5) of draft article 13.

Article 15. Register of certificates

(1) Certification authorities shall keep a publicly accessible electronic register of certificates issued, indicating the time when any individual certificate expires or when it was suspended or revoked.

(2) The register shall be maintained by the certification authority


Variant B for ... [the enacting State specifies the period during which the relevant information should be maintained in the register]

after the date of revocation or expiry of the operational period of any certificate issued by that certification authority.

Variant C in accordance with the policies and procedures specified by the certification authority in the applicable certification practice statement.

References

A/CN.9/446, para. 174 (draft article 15);
A/CN.9/WG.IV/JP.WP.73, paras. 70 and 71;
A/CN.9/437, paras. 140-148 (draft article G); and
A/CN.9/WG.IV/JP.WP.71, paras. 68 and 69.

Remarks

45. At the thirty-first session of the Working Group, no objection of principle was raised to including in the Uniform Rules a provision on registration of certificates (see A/CN.9/437, para. 142). The proper maintenance of a widely accessible register (sometimes referred to as a
"repository") featuring, in particular, a certificate revocation list (CRL) may be regarded as an important element in establishing the trustworthiness of digital signatures. When dealing with the ways in which such registers and CRLs should be maintained by certification authorities, the Working Group may wish to consider whether relying parties should be under an obligation to verify the status of the certificate by consulting the relevant register or CRL before they could rely on the validity of the certificate.

46. More generally, the Working Group may wish to discuss whether the Uniform Rules, in establishing minimum standards for the operation of certification authorities, should also deal with the rights and obligations of parties relying on certificates.

Article 16. Relations between parties relying on certificates and certification authorities

(1) A certification authority is only allowed to request such information as is necessary to identify the signer[subject of the certificate].

(2) Upon request, the certification authority shall deliver information about the following:
   (a) the conditions under which the certificate may be used;
   (b) the conditions associated with the use of digital signatures;
   (c) the costs of using the services of the certification authority;
   (d) the policy or practices of the certification authority with respect to the use, storage and communication of personal information;
   (e) the technical requirements of the certification authority with respect to the communication equipment to be used by parties relying on certificates;
   (f) the conditions under which warnings are given to parties relying on certificates by the certification authority in case of irregularities or faults in the functioning of the communication equipment;
   (g) any limitation of the liability of the certification authority;
   (h) any restrictions imposed by the certification authority on the use of the certificate; and
   (i) the conditions under which the signer[subject] is entitled to place restrictions on the use of the certificate.

(3) The information listed in paragraph (1) shall be delivered to the potential signer[subject] before a final agreement of certification is concluded. That information may be delivered by the certification authority by way of a certification practice statement.

(4) Subject to a [one-month] notice, the signer[subject] may terminate the agreement for connection to the certification authority. Such notice of termination takes effect when received by the certification authority.

(5) Subject to a [three-month] notice, the certification authority may terminate the agreement for connection to the certification authority. Such notice of termination takes effect when received.

References
A/CN.9/446, para. 174 (draft article 16);
A/CN.9/WG.IV/WP.73, para. 72;
A/CN.9/437, paras. 149 and 150 (draft article J); and
A/CN.9/WG.IV/WP.71, para. 76.

Remarks
47. At its thirty-first session, the Working Group noted that the various elements listed in draft article 15 should be placed in square brackets, to be considered by the Working Group at a later stage (see A/CN.9/437, para. 150).

Chapter IV. Foreign electronic signatures

Article 17. Provision of services by foreign certification authorities

(1) Variant A: Foreign persons/entities may become locally established as certification authorities or may provide certification services from another country without a local establishment if they meet the same objective standards and follow the same procedures as domestic entities and persons that may become certification authorities.

Variant B: Subject to the laws of the enacting State, a foreign person/entity may:
(a) become locally established as a certification authority; or
(b) provide certification services with out being established locally if it meets the same objective standards and follows the same procedures as domestic entities and persons that may become certification authorities.

Variant C: Foreign persons/entities may not be denied the right to become locally established or to provide certification services solely on the grounds that they are foreign if they meet the same objective standards and follow the same procedures as domestic entities and persons that may become certification authorities.

(2) Variant X: The rule stated in paragraph (1) does not apply to the following: [...].

Variant Y: Exceptions to the rule stated in paragraph (1) may be made to the extent required by national security.]
References

A/CN.9/446, paras. 175-188 (draft article 17);  
A/CN.9/WG.IV/WP.73, para. 73;  
A/CN.9/437, paras. 74-89 (draft article 1); and  
A/CN.9/WG.IV/WP.71, paras. 73-75.

Remarks

48. By allowing foreign entities to become established as certification authorities, draft article 17 merely states the principle that foreign entities should not be discriminated against, provided that they meet the standards set forth for domestic certification authorities. While that principle may be generally accepted, it may be of particular relevance to express it with respect to certification authorities, since certification authorities might be expected to operate without necessarily having a physical establishment or other place of business in the country in which they operate.

Article 18. Endorsement of foreign certificates by domestic certification authorities

Variant A: Certificates issued by foreign certification authorities may be used for digital signatures on the same terms as certificates subject to these Rules if they are recognized by a certification authority operating under ... [the law of the enacting State], and that certification authority guarantees, to the same extent as its own certificates, the correctness of the details of the certificate as well as the certificate being valid and in force.

Variant B: Certificates issued by foreign certification authorities may be used for digital signatures on the same terms as certificates subject to these Rules on the basis of an appropriate guarantee provided by a certification authority operating under ... [the law of the enacting State].

References

A/CN.9/446, paras. 189-195 (draft article 18);  
A/CN.9/WG.IV/WP.73, para. 74;  
A/CN.9/437, paras. 74-89 (draft article 1); and  
A/CN.9/WG.IV/WP.71, paras. 73-75.

Remarks

49. Draft article 18 enables a domestic certification authority to guarantee, to the same extent as its own certificates, the correctness of the details of the foreign certificate, and to guarantee that the foreign certificate is valid and in force. It refers to the matters referred to as “cross-certification” at the thirty-first session of the Working Group. Draft article 18 essentially contains a provision on the allocation of liability to the domestic certification authority in the event that the foreign certificate is found to be defective (see A/CN.9/437, paras. 77-78).

Article 19. Recognition of foreign certificates

Variant A

(1) Variant X: Certificates issued by foreign certification authorities shall not be precluded from having the same recognition as certificates issued by domestic certification authorities on the ground that they have been issued by foreign certification authorities.

Variant Y: Certificates issued by a foreign certification authority are recognized as legally equivalent to certificates issued by certification authorities operating under ... [the law of the enacting State] if the practices of the foreign certification authority provide a level of reliability at least equivalent to that required of certification authorities under these Rules. [Such recognition may be made through a published determination of the State or through bilateral or multilateral agreement between or among the States concerned.]

(2) Signatures and records complying with the laws of another State relating to digital or other electronic signatures are recognized as legally equivalent to signatures and records complying with these Rules if the laws of the other State require a level of reliability at least equivalent to that required for such records and signatures under ... [the law of the enacting State]. [Such recognition may be made by a published determination of the State or through bilateral or multilateral agreement with other States.]

(2)[3] Digital signatures that are verified by reference to a certificate issued by a foreign certification authority shall [be][not be precluded from being] given effect [by courts and other finders of fact] if the certificate is as reliable as is appropriate for the purpose for which the certificate was issued, in light of all the circumstances.

(3)[4] Notwithstanding the preceding paragraph, Government agencies and parties to commercial and other transactions may specify that a particular certification authority, class of certification authorities or class of certificates must be used in connection with messages or signatures submitted to them.

Variant B

(1) Certificates issued by a foreign certification authority are recognized as legally equivalent to certificates issued by certification authorities operating under [the law of the enacting State] if the practices of the foreign certification authority provide a level of reliability at least equivalent to that required of certification authorities under these Rules.

[2] The determination of equivalence described in paragraph (1) may be made by a published determination of the State or through bilateral or multilateral agreement with other States.]

(3) In the determination of equivalence, regard shall be had to the following factors:
(a) financial and human resources, including existence of assets within jurisdiction;
(b) trustworthiness of hardware and software systems;
(c) procedures for processing of certificates and applications for certificates and retention of records;
(d) availability of information to the [signers][subjects] identified in certificates and to potential relying parties;
(e) regularity and extent of audit by an independent body;
(f) the existence of a declaration by the State, an accreditation body or the certification authority regarding compliance with or existence of the foregoing;
(g) susceptibility to the jurisdiction of courts of the enacting State; and
(h) the degree of discrepancy between the law applicable to the liability of the certification authority and the law of enacting State.

Variant C

A foreign certification authority is considered reliable [in the enacting State] for the purpose of a certificate it issues to support signatures in relation to data messages if, in issuing such a certificate, the certification authority complies with, and is subject at least to the same liabilities as those imposed by these Rules and any domestic licensing regime applicable to a certificate of that type.

Variant D

(1) A foreign certification authority is considered reliable [in the enacting State] for the purpose of a certificate it issues to support signatures in relation to data messages if, in issuing such a certificate, the certification authority provides a level of reliability [at least] equivalent to that [required] of domestic certification authorities issuing such certificates.

(2) In assessing a certification authority’s level of reliability, regard shall be had to the following factors:
(a) financial and human resources, including existence of assets within the jurisdiction;
(b) trustworthiness of hardware and software systems;
(c) procedures for processing of certificates and applications for certificates and retention of records;
(d) availability of information to the [signers][subjects] identified in certificates and to potential relying parties;
(e) regularity and extent of audit by an independent body;
(f) the existence of a declaration by the State, an accreditation body or the certification authority regarding compliance with or existence of the foregoing;
(g) susceptibility to the jurisdiction of courts of the enacting State; and
(h) the degree of discrepancy between the law applicable to the liability of the certification authority and the law of enacting State.

References
A/CN.9/446, paras. 196-207 (draft article 19);
A/CN.9/WG.IV/WP.73, para. 75;
A/CN.9/437, paras. 74-89 (draft article 1);
A/CN.9/WG.IV/WP.71, paras. 73-75.

Remarks
50. Draft article 19 refers to the matters referred to as "cross-border recognition" at the thirty-first session of the Working Group (see A/CN.9/437, paras. 77 and 78). Variant A is based on a suggestion for a combination of paragraphs (1) and (2) made at the thirty-second session of the Working Group (see A/CN.9/446, paras. 197-204). Variant B provides an illustrative list of criteria to be taken into account in assessing the reliability of foreign certificates. Variants C and D focus on the recognition of the foreign certification authorities. It may be noted that, should the Working Group decide to include in the Uniform Rules criteria to be met by domestic certification authorities (see above, para. 19), there might be no need to provide for such criteria in draft article 19.

C. Working paper submitted to the Working Group on Electronic Commerce at its thirty-third session: proposal by the United States of America: note by the secretariat
(A/CN.9/WG.IV/WP.77) [Original: English]

1. At the close of the thirty-second session of the Working Group, the proposal was made that the Working Group might wish to give preliminary consideration to undertaking the preparation of an international convention based on provisions of the Model Law and of the Uniform Rules. It was agreed that the topic might need to be taken up as an agenda item at the next session of the Working Group on the basis of more detailed proposals possibly to be made by interested delegations. However, the preliminary conclusion of the Working Group was that the preparation of a convention should in any event be regarded as a project separate from both the preparation of the Uniform Rules and any other possible addition to the Model Law. Pending a final decision as to the form of the Uniform
Rules, the suggestion to prepare a convention at a later stage should not distract the Working Group from its current task, which was to focus on the preparation of draft uniform rules on digital and other electronic signatures, and from its current working assumption that the Uniform Rules would be in the form of draft legislative provisions. It was generally understood that the possible preparation of a draft convention should not be used as a means of reopening the issues settled in the Model Law, which might negatively affect the increased use of that already successful instrument (A/69/446, para. 212).

2. Following the thirty-second session of the Working Group, the Secretariat received from the delegation of the United States of America a proposal for a draft international convention on electronic transactions, together with the text of a "United States Government Non-paper on Electronic Transactions" that explains the rationale and purpose of the proposed convention. The text of that proposal and the corresponding "non-paper" are reproduced in the annex to this note as they were received by the Secretariat.

ANNEX
Draft international convention on electronic transactions

Chapter I
Proposed goal of Chapter I: To set forth any necessary definitions. To be developed after Chapters II and III.

Chapter II
Proposed goal of Chapter II: In order to implement the legal rules articulated in the second section, as set forth below, it may be necessary for States to review their existing and proposed legislation to ensure that it is appropriately tailored to electronic transactions. In order to facilitate such review and adoption on a harmonized basis, the following general obligations are proposed as the framework states should use to support electronic transactions on a global basis.

Possible language

II. General obligations

To encourage the free flow of electronic transactions and to avoid the creation of barriers to these transactions, subject to overriding public policy, the Contracting States hereby agree as follows:

Modification of Existing Rules and Minimal Adoption of New Rules—States shall make only those changes to their laws that are necessary to support the use of electronic transactions. Existing rules should be modified and new rules adopted only in cooperation with the private sector and where necessary.

Contracting States recognize that parties to a transaction may determine the method of authentication for that transaction. Recognizing that parties may make this determination and recognizing that this determination should have the legal effect intended by the parties, the Contracting States agree as follows:

Party Autonomy—Parties to a transaction should be permitted, to the maximum extent possible, to determine by contract the appropriate technological and business methods of authentication with the assurance that those means will be recognized as legally binding, whether or not those technological and business means are specifically addressed by legislation or regulation. The terms of any agreement (including closed systems) between parties governing their transaction should be enforced without regard to any statutory framework governing electronic authentication.

Further, Contracting States recognize that cryptography is not the sole means of proving the source or existence of a message. Recognizing that parties may establish the source or existence of a message in different ways, Contracting States agree as follows:

All Authentication Technologies and Business Methods May Be Evidence of Authenticity—Where the law requires evidence of the authenticity or integrity of a message, a party shall be permitted to use any authentication technology or business method, whether or not such authentication technology or business method has been specifically addressed by legislation or regulation.

Electronic Authentication methods should not be "locked in" through legislative fiat but rather should allow for changing applications for existing and future technologies. Therefore, the Contracting States agree that:

Technology Neutrality—Any rules should neither require nor hinder the use or development of authentication technologies. States should anticipate that authentication methods will change over time and avoid legislation that might preclude innovation or new applications. States should avoid laws that intentionally or unintentionally drive the private sector to adopt only one particular technology for electronic authentication to the exclusion of other viable authentication methods.

Authentication technologies may be implemented and used by businesses in ways that were not originally envisaged when legislation was passed. Recognizing that technology may be used for purposes such as establishing age or authority, which may go beyond verifying identity and achieving non-repudiation, and recognizing that business models for authentication may not use third parties, the Contracting States agree that:

Implementation Neutrality—Any rules should neither require nor hinder the use or development of new or innovative business applications or implementation models.

To remove barriers to the free flow of electronic transactions and to avoid the creation of new barriers, subject to overriding public policy, the Contracting States agree that:

Non-Discrimination—States shall accord to providers and users of authentication technologies and business methods of another State treatment no less favourable than it accords in like circumstances to its own providers and users of authentication technologies and business methods.
Avoid Unnecessary Barriers to Trade—States should enhance the flow of cross-border electronic transactions and not create unnecessary barriers to trade.

Chapter III

Proposed goal of Chapter III: To recognize the acceptability of electronic signatures for legal and commercial purposes, define the characteristics of a valid electronic writing and an original document, support the admission of electronic evidence and the electronic retention of records. These provisions would be drawn from the enabling provisions of the UNCITRAL Model Law on Electronic Commerce.

Possible language

III. Specific obligations

Contracting States recognize the work of the United Nations Commission on International Trade Law and the importance of establishing its governing provisions on a uniform, international basis. Contracting States also recognize information is increasingly generated, stored, sent, received or otherwise processed electronically, rather than in a paper-based form. Recognizing these important business practices, the Contracting States hereby agree on the following:

Legal Recognition of Data Messages

Information shall not be denied legal effect, validity or enforceability solely on the grounds that it is in the form of a data message. [Source Model Law on Electronic Commerce, article 5.]

Formation and Validity of Contracts

(1) In the context of contract formation, unless otherwise agreed by the parties, an offer and the acceptance of an offer may be expressed by means of data messages. Where a data message is used in the formation of a contract, that contract shall not be denied validity or enforceability on the sole ground that a data message was used for that purpose.

(2) The provisions of this article do not apply to the following ... [limited exception]. [Source: Model Law on Electronic Commerce, article 11.]

Contracting States recognize that the formal requirements that currently exist under many legal regimes may constitute insurmountable barriers to the conduct of electronic transactions on an international basis. As a result, there is a paramount need for ensuring that electronically transmitted messages are allowed to satisfy these formal requirements subject to overriding public policy. Therefore, the Contracting States agree as follows:

Writing

(1) Where the law requires information to be in writing, that requirement is met by a data message if the information contained therein is accessible so as to be usable for subsequent reference.

(2) Paragraph (1) applies whether the requirement therein is in the form of an obligation or whether the law simply provides consequences for the information not being in writing.

(3) The provisions of this article do not apply to the following ... [limited exception]. [Source: Model Law on Electronic Commerce, article 6.]

Signature

(1) Where the law requires a signature of a person, that requirement is met in relation to a data message if:

(a) a method is used to identify that person and to indicate that person's approval of the information contained in the data message; and

(b) that method is as reliable as was appropriate for the purpose for which the data message was generated or communicated, in the light of all the circumstances, including any relevant agreement.

(2) Paragraph (1) applies whether the requirement therein is in the form of an obligation or whether the law simply provides consequences for the absence of a signature.

(3) The provisions of this article do not apply to the following ... [limited exception]. [Source: Model Law on Electronic Commerce, article 7.]

Original

(1) Where the law requires information to be presented or retained in its original form, that requirement is met by a data message if:

(a) there exists a reliable assurance as to the integrity of the information from the time when it was first generated in its final form, as a data message or otherwise; and

(b) where it is required that information be presented, that information is capable of being displayed to the person to whom it is to be presented.

(2) Paragraph (1) applies whether the requirement therein is in the form of an obligation or whether the law simply provides consequences for the information not being in writing.

(3) For the purposes of subparagraph (a) of paragraph (1):

(a) the criteria for assessing integrity shall be whether the information has remained complete and unaltered, apart from the addition of any endorsement and any change which arises in the normal course of communication, storage and display; and

(b) the standard of reliability required shall be assessed in the light of the purpose for which the information was generated and in the light of all the relevant circumstances.

(4) The provisions of this article do not apply to the following ... [limited exception]. [Source: Model Law on Electronic Commerce, article 8.]

The Contracting States recognize that the inability of parties to prove the existence of electronic transactions in the event of dispute...
and formal judicial proceedings may itself be an inhibition to the conduct of electronic transactions. To ensure the legal equivalence of electronic documents with paper-based ones, the Contracting States agree that:

Admissibility and Evidential Weight of Data Messages

(1) In any legal proceedings, nothing in the application of the rules of evidence shall apply so as to deny the admissibility of a data message in evidence:

(a) on the sole ground that it is a data message; or,

(b) if it is the best evidence that the person adducing it could reasonably be expected to obtain, on the grounds that it is not in its original form.

(2) Information in the form of a data message shall be given due evidential weight. In assessing the evidential weight of a data message, regard shall be had to the reliability of the manner in which the data message was generated, stored or communicated, to the reliability of the manner in which the integrity of the information was maintained, to the manner in which its originator was identified, and to any other relevant factor. [Source: Model Law on Electronic Commerce, article 9.]

Contracting States further recognize that requirements for record retention, which exist both as a matter of law and business practice, may prove to be obstacles for electronic transactions. The Contracting States agree, therefore, that:

Retention of Data Messages

(1) Where the law requires that certain documents, records or information be retained, that requirement is met by retaining data messages, provided that the following conditions are satisfied:

(a) the information contained therein is accessible so as to be usable for subsequent reference; and

(b) the data message is retained in the format in which it was generated, sent or received, or in a format which can be demonstrated to represent accurately the information generated, sent or received; and

(c) such information, if any, is retained as enables the identification of the origin and destination of a data message and the date and time when it was sent or received.

(2) An obligation to retain documents, records or information in accordance with paragraph (1) does not extend to any information the sole purpose of which is to enable the message to be sent or received.

(3) A person may satisfy these requirement referred to in paragraph (1) by using the services of any other person, provided that the conditions in subparagraphs (a), (b) and (c) of paragraph 1 are met. [Source: Model Law on Electronic Commerce Article 10.]

United States Government Non-Paper on Electronic Transactions

To encourage electronic transactions, the United States supports both a domestic and global uniform legal framework that recognizes, facilitates, and enforces electronic transactions worldwide.

I.

The United Nations Commission on International Trade Law (UNCITRAL) has completed work on a Model Law on Electronic Commerce that supports the commercial use of international contracts in electronic commerce. The Model Law establishes rules and norms that define the characteristics of a valid electronic writing and an original document, provides for the acceptability of electronic signatures for legal and commercial purposes, and supports the admission of computer evidence. It also validates and recognizes contracts formed through electronic means, setting default rules for contract formation and the governance of electronic contract performance.

While many countries, including the United States, are using the Model Law as a basis for updating their commercial laws, many countries are not. The Government of the United States supports the adoption of the enabling principles that are contained in the Model Law through a binding international agreement as a start to defining an international set of uniform commercial principles for electronic commerce.

II.

On the international level, a number of countries are considering or have enacted digital signature legislation to specifically address authentication methods including digital signatures. Recently, UNCITRAL began work in the authentication area, specifically including digital signatures, and is currently considering model statutory provisions.

Since UNCITRAL began its work last year, new models for the implementation and use of digital signature technology have emerged. The expanding array of authentication methods and the complexity of their commercial use raise concerns about fashioning detailed legal rules at this point in such areas as, for example, certificate authorities and liability. In the United States, most states that have considered digital signature legislation recently have rejected statutory enactments setting forth specific rules for digital signatures, opting instead for more generalized enabling and supporting legislation that supports the use of digital signatures and other authentication technologies, but which otherwise does not impose liability or licensing schemes.

This new legislative approach reflects important evolutionary market changes. In particular, the market appears unlikely to settle on one universal authentication mechanism or model of implementation in the near future. Parties appear headed toward a choice between different types of authentication regimes, depending on the nature of the transaction and upon the prior relationship, if any, among the parties to the transaction. For example, a large company may choose one authentication method for the electronic system used to procure goods from suppliers, but a different method for on-line purchases by its customers.

Like other aspects of electronic commerce, authentication methods and technologies are developing rapidly. In the area of digital signatures, the technology is being implemented in ways that are different from the public key infrastructures envisaged when the first digital signature legislation was passed. For example, digital signatures may be used for purposes such as establishing age or authority, which may go beyond verifying identity and achieving nonrepudiation. In addition, much of its use is in closed rather than in open systems. There is also recognition that digital signatures are being used for a great number of business purposes apart from those originally envisaged; for example, minimal value certificates are already being issued on a wide-scale basis.
The US Government supports the development of structures that will support a variety of authentication methods and technologies as well as a variety of implementation models. Fashioning rules that would govern digital signature technology or any other single authentication technology, to the exclusion of other authentication approaches, would inhibit rather than encourage the growth of electronic commerce. Nevertheless, the US Government recognizes the valuable dialogue supported by UNCITRAL on these issues.

The US Government believes that UNCITRAL should consider giving priority attention to an International Convention on Electronic Transactions. The Convention would remove paper-based obstacles to electronic transactions, and address electronic authentication issues.

III.

UNCITRAL should work towards a binding Convention on electronic transactions that would have two elements:

Part A: General obligations—These would include: minimal modification to existing legal rules and minimal adoption of new rules; technology and implementation neutrality; a non-discriminatory approach toward authentication technologies and business applications from other countries; the avoidance of unnecessary barriers to trade. In addition:

Party Autonomy—Parties to a transaction should be permitted, to the maximum extent possible, to determine by contract the appropriate technological and business methods of authentication with the assurance that those means will be recognized as legally binding, whether or not those technological and business means are specifically addressed by legislation or regulation. The terms of any agreement (including closed systems) between parties governing their transaction should be enforced without regard to any statutory framework governing electronic authentication.

All Authentication Technologies and Business Methods May Be Evidence of Authenticity—Where the law requires evidence of the authenticity or integrity of a message, a party shall be permitted to use any authentication technology or business method to try to prove authenticity, whether or not such authentication technology or business method has been specifically addressed by legislation or regulation. (As with the authentication of physical documents, a party denying the agreement could introduce evidence disputing its authenticity or integrity and the issue would be resolved by the trier of fact.)

Part B: Adoption of Key Elements of the Model Law on Electronic Commerce—Enabling provisions drawn from the provisions of the UNCITRAL Model Law on Electronic Commerce would define an international set of uniform commercial principles for electronic commerce. The Convention would recognize the acceptability of electronic signatures for legal and commercial purposes, define the characteristics of a valid electronic writing and an original document and support the admission of electronic evidence and the retention of electronic records.

CONTENTS

INTRODUCTION ............................................................. 1-14
I. DELIBERATIONS AND DECISIONS .................................. 15

II. DRAFT UNIFORM RULES ON ELECTRONIC SIGNATURES .......... 16-122
A. GENERAL REMARKS .................................................. 16-21
B. CONSIDERATION OF DRAFT ARTICLES ............................ 22-119
   Article A. Definitions .............................................. 22-52
   Article E. Freedom of contract .................................. 53-64
   Article F. Obligations of signature holder ...................... 65-98
   Article G. Reliance on enhanced electronic signatures ........ 99-107
   Article H. Obligations of an information certifier ............ 108-119
C. FURTHER ITEMS TO BE CONSIDERED .............................. 120-122

INTRODUCTION

1. The Commission, at its twenty-ninth session (1996), decided to place the issues of digital signatures and certification authorities on its agenda. The Working Group on Electronic Commerce was requested to examine the desirability and feasibility of preparing uniform rules on those topics. It was agreed that the uniform rules to be prepared should deal with such issues as: the legal basis supporting certification processes, including emerging digital authentication and certification technology; the applicability of the certification process; the allocation of risk and liabilities of users, providers and third parties in the context of the use of certification techniques; the specific issues of certification through the use of registries; and incorporation by reference.¹

2. At its thirtieth session (1997), the Commission had before it the report of the Working Group on the work of its thirty-first session (A/CN.9/437). The Working Group indicated to the Commission that it had reached consensus as to the importance of, and the need for, working towards harmonization of law in that area. While no firm decision as to the form and content of such work had been reached, the Working Group had come to the preliminary conclusion that it was feasible to undertake the preparation of draft uniform rules at least on issues of digital signatures and certification authorities, and possibly on related matters. The Working Group recalled that, alongside digital signatures and certification authorities, future work in the area of electronic commerce might also need to address: issues of technical alternatives to public-key cryptography; general issues of functions performed by third-party service providers; and electronic contracting (A/CN.9/437, paras. 156-157).

3. The Commission endorsed the conclusions reached by the Working Group, and entrusted the Working Group with the preparation of uniform rules on the legal issues of digital signatures and certification authorities (hereinafter referred to as “the Uniform Rules”).

4. With respect to the exact scope and form of the Uniform Rules, the Commission generally agreed that no decision could be made at this early stage of the process. It was felt that, while the Working Group might appropriately focus its attention on the issues of digital signatures in view of the apparently predominant role played by public-key cryptography in the emerging

5. The Working Group began the preparation of the Uniform Rules at its thirty-second session on the basis of a note prepared by the Secretariat (A/CN.9/WG.1/WP.73).

6. At its thirty-first session (1998), the Commission had before it the report of the Working Group on the work of its thirty-second session (A/CN.9/446). The Commission expressed its appreciation of the efforts accomplished by the Working Group in its preparation of draft Uniform Rules on Electronic Signatures. It was noted that the Working Group, throughout its thirty-first and thirty-second sessions, had experienced manifest difficulties in reaching a common understanding of the new legal issues that arose from the increased use of digital and other electronic signatures. It was also noted that a consensus was still to be found as to how those issues might be addressed in an internationally acceptable legal framework. However, it was generally felt by the Commission that the progress realized so far indicated that the draft Uniform Rules on Electronic Signatures were progressively being shaped into a workable structure.

7. The Commission reaffirmed the decision made at its thirty-first session as to the feasibility of preparing such Uniform Rules and expressed its confidence that more progress could be accomplished by the Working Group at its thirty-third session (New York, 29 June-10 July 1998) on the basis of the revised draft prepared by the secretariat (A/CN.9/WG.1/WP.76). In the context of that discussion, the Commission noted with satisfaction that the Working Group had become generally recognized as a particularly important international forum for the exchange of views regarding the legal issues of electronic commerce and for the preparation of solutions to those issues.\footnote{Ibid., Fifty-second Session, Supplement No. 17 (A/52/17), paras. 249-251.}


9. The Working Group on Electronic Commerce, which was composed of all the States members of the Commission, held its thirty-fourth session in Vienna from 8 to 19 February 1999. The session was attended by representatives of the following States members of the Working Group: Argentina, Australia, Austria, Brazil, Burkina Faso, Cameroon, China, Colombia, Egypt, Finland, France, Germany, Honduras, Hungary, India, Iran (Islamic Republic of), Italy, Japan, Mexico, Nigeria, Paraguay, Romania, Russian Federation, Singapore, Spain, Thailand, United Kingdom of Great Britain and Northern Ireland, and the United States of America.

10. The session was attended by observers from the following States: Angola, Belarus, Belgium, Bolivia, Canada, Croatia, Cuba, the Czech Republic, Georgia, Guatemala, Indonesia, Ireland, Kuwait, Lebanon, Morocco, the Netherlands, New Zealand, Poland, Portugal, the Republic of Korea, Saudi Arabia, Slovakia, South Africa, Sweden, Switzerland, Turkey, and Uruguay.


12. The Working Group elected the following officers:

Chairman: Mr. Jacques GAUTHIER (Canada, elected in his personal capacity)
Vice-Chairman: Mr. PANG Khang Chau (Singapore)
Rapporteur: Mr. Louis-Paul ENOUGA (Cameroon)

13. The Working Group had before it the following documents: provisional agenda (A/CN.9/WG.1/WP.78); two notes by the Secretariat containing revised draft uniform rules on electronic signatures (A/CN.9/WG.1/WP.79 and 80); and the note by the Secretariat prepared for the thirty-third session of the Working Group (A/CN.9/WG.1/WP.76), for continuation of the discussion on the issues of recognition of foreign electronic signatures (draft articles 17 to 19).
14. The Working Group adopted the following agenda:
   1. Election of officers.
   2. Adoption of the agenda.
   3. Legal aspects of electronic commerce: draft uniform rules on electronic signatures.
   4. Other business.
   5. Adoption of the report.

I. DELIBERATIONS AND DECISIONS

15. The Working Group discussed the issue of electronic signatures on the basis of the notes prepared by the Secretariat (A/CN.9/WG.14/WP.76, 79 and 80). The deliberations and conclusions of the Working Group with respect to those issues are reflected in section II below. The Secretariat was requested to prepare, on the basis of those deliberations and conclusions, a set of revised provisions with possible variants, for consideration by the Working Group at a future session.

II. DRAFT UNIFORM RULES ON ELECTRONIC SIGNATURES

A. General remarks

16. At the outset, the Working Group exchanged views on current developments in regulatory issues arising from electronic commerce, including adoption of the UNCITRAL Model Law on Electronic Commerce, electronic signatures and public key infrastructure (hereinafter referred to as ‘‘PKI’’) issues in the context of digital signatures. These reports, at the governmental, inter-governmental and non-governmental levels, confirmed that addressing electronic commerce legal issues had become increasingly recognized as important for the facilitation and implementation of electronic commerce and the removal of barriers to trade. It was reported that several countries had introduced recently, or were about to introduce, legislation either adopting the Model Law or addressing related electronic commerce facilitation issues. A number of these legislative proposals also dealt with electronic-(or in some cases, specifically digital-) signature issues. Other countries had established policy working groups, a number in close association with private sector interests, which were working on the need for legislative changes to facilitate electronic commerce, actively considering adoption of the Model Law and preparing necessary legislation, working on electronic signature issues including the establishment of public key infrastructures or other projects on closely related matters.

17. The Working Group commenced its consideration of the Uniform Rules by recalling the desirability and feasibility of preparing rules on electronic signatures and the need to work towards harmonization of the law in that area (see above, para. 7). It was pointed out that a number of references had been made to work being undertaken on specifically digital signatures and the diversity of laws appearing on this particular signature technique underlined the importance of harmonization. It was also pointed out that while the principles of technology neutrality and media neutrality underpinned the Model Law, in the draft Uniform Rules which addressed a number of different signature techniques, following these principles created a tension. While there was general agreement that consistency between the Model Law and the Uniform Rules should be ensured, it was recognized that drafting provisions which attributed specific legal effects to these various types of signature techniques required a balance which might be difficult to achieve. It was suggested that the Uniform Rules should focus upon uses of signatures, which might include looking specifically at issues of functional equivalence for an ‘‘enhanced’’ or high-level signature; the consequences of the use of various signature techniques on the parties involved, including the conduct of those parties (rather than trying to establish a link between any specific legal consequence and the use of any specific electronic signature technique); and issues of cross-border recognition.

18. The view was expressed that the relationship between article 7 of the Model Law and the draft Uniform Rules needed to be further clarified. The necessity and desirability of building upon article 7 were questioned and it was pointed out that providing a single shortcut to satisfaction of the very flexible requirement in article 7(1)(b) that the method of identification used be ‘‘as reliable as appropriate for the purpose for which it was used’’ might prove difficult. Reference was made to the diversity of the matters listed in the Guide to Enactment (see para. 58 of the Guide to Enactment of the UNCITRAL Model Law on Electronic Commerce) as relevant to any consideration of the purpose for which the method was used. It was recalled that the Working Group had considered this issue on a number of occasions in its previous deliberations and the current draft of the Uniform Rules left this issue to be resolved. A further concern was expressed that considering a rule on what types of signature techniques might satisfy the requirement in article 7 might lead to a rule which could be construed as having a very narrow sphere of application in relation to commercial transactions (which generally were not required to satisfy any particular rules of law as to form of transactions).

19. The question of what form the draft Uniform Rules might take was raised and the importance of considering the relationship of the form to the content was noted. Different approaches were suggested as to what the form might be, which included contractual rules, legislative provisions, or guidelines for States considering enacting legislation on electronic signatures. The relationship of the Uniform Rules, as legislative provisions, to the Model Law was also raised in the context of the consideration of form. It was recognized that the discussion in the Working Group on the use of various signature techniques had been particularly helpful in advancing understanding of the relevant issues and that the Working Group documents provided a good outline of the basic concepts. Pending a final decision as to the relationship between the Uni-
form Rules and the Model Law, overall preference was expressed in the Working Group for dealing with the Uniform Rules as a separate instrument.

20. With respect to the scope of the Uniform Rules, it was generally felt that consumers should not be dealt with specifically in the Uniform Rules. Nevertheless, since there might be cases where the Uniform Rules might prove to be useful to consumers, the suggestion was made that the formulation set out in footnote ** to article 1 of the Model Law could be adopted. A further suggestion was that, in any event, the scope of consumer transactions covered by the Uniform Rules should be limited to commercial transactions as described in footnote *** to article 1 of the Model Law (for continuation of the discussion, see below, paras. 56 and 70).

21. The Working Group was of the view that the draft of the Uniform Rules contained in document A/CN.9/WG.IV/WP.80 (in this report referred to as WP.80) constituted a more acceptable basis for discussion than that contained in document A/CN.9/WG.IV/WP.79 (in this report referred to as WP.79). It was pointed out that it might be helpful for the Working Group to consider WP.79 once it had completed its consideration of WP.80 in order to gauge whether there were any further issues which might need to be addressed.

B. Consideration of draft articles

Article A. Definitions

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

“For the purposes of these Rules:

“(a) 'Electronic signature' means data in electronic form in, affixed to, or logically associated with, a data message, and [that may be] used to [identify the signature holder in relation to the data message and indicate the signature holder's approval of the information contained in the data message].

“(b) 'Enhanced electronic signature' means an electronic signature which [is created and] can be verified through the application of a security procedure or combination of security procedures that ensures that such electronic signature:

“(i) is unique to the signature holder [for the purpose for][within the context in] which it is used;

“(ii) can be used to identify objectively the signature holder in relation to the data message;

“(iii) was created and affixed to the data message by the signature holder or using a means under the sole control of the signature holder.

“(c) 'Signature holder' means a person by whom, or on whose behalf, an enhanced electronic signature can be created and affixed to a data message.

“(d) 'Information certifier' means a person or entity which, in the course of its business, engages in [providing identification services] [certifying information] which [are][is] used to support the use of enhanced electronic signatures”.

Subparagraph (a)—Definition of “electronic signature”

23. Approaching the issue of the definition of electronic signature from a broad perspective, it was suggested that such a definition was superfluous, since the concept of electronic signature was well known and understood. Another view was that the term “signature” should not be used, since it suggested that a definition of the legal concept of a signature was being provided, whilst the Uniform Rules were merely aimed at regulating the use of certain types of technology. Electronic signature, like digital signature, was a technical concept and should not be used as a legal term indicating legal effect. Yet another view was that no definition was needed since the notion of “electronic signature” was sufficiently explained in article 7 of the Model Law.

24. In response, it was pointed out that “electronic signature” could not be merely a technical term, since it did not refer to any particular signature technique, but was intended to provide a link between a variety of techniques and the legal notion of a signature. As to whether article 7 of the Model Law sufficiently covered the matter of the definition of a “signature” in an electronic environment, it was pointed out that article 7 did not contain a definition. Article 7 was geared towards providing a functional-equivalence rule for a range of situations where technical devices were used to produce substitutes for traditional hand-written signatures. It was widely felt that the need for the definition of “electronic signature” should be addressed in terms of the structure of WP.80. It was pointed out that a definition was needed both because an electronic signature was given legal effect in draft article B, and in order to be able to construct a definition of enhanced electronic signature. After discussion, it was generally agreed that a definition of “electronic signature” should be included. However, a view was expressed that a definition was not necessary because no legal effect would be attached to it see below, para. 48).

25. Various suggestions were made as to how the definition of “electronic signature” might be improved. One suggestion, which was widely supported, was that the square brackets should be removed from the words “that may be”. It was generally felt that the definition should not cover only the case where an electronic signature was effectively used, but also point to its availability as a technical signing device.

26. Another suggestion was that the use of the term “approval” was too subjective and conducive to uncertainty as it depended on the intentions of the signer at the time of signing. It was suggested that a more objective wording should be used and the following text was proposed as an alternative, based upon a draft directive of the European Parliament and Council on a common framework for electronic signatures:

“Electronic signatures means data in electronic form attached to, or logically associated with, other
electronic data and which serves as a method of authentication."

27. In response to that suggestion, it was pointed out that the use of the word "approval" did not necessarily imply any assessment of the subjective intent of the signer with respect, for example, to the contractual or other legal effects of the message. Instead, it was limited to associating the signer with the message, which was a necessary element of most existing definitions of any type of signature, as illustrated by the use of the notion of "approval" in article 7 of the Model Law. The suggested alternative was not adopted by the Working Group.

28. With a view to reflecting some of the views and concerns that had been expressed in the discussion, it was suggested that the elements necessary to define an electronic signature might be expressed more clearly along the following lines:

"Electronic signature" means data in electronic form which:

"(a) is included in, attached to or logically associated with a data message;

"(b) is provided by a signer as a means of identifying himself;

"(c) is used by a signer to indicate his approval of the information in the date message; and

"(d) can be used to verify that identification".

29. It was pointed out that the suggested changes were intended to clarify: firstly, that while the data constituting the electronic signature should be provided as a means of identifying the signer, the actual use of the data for that purpose might not occur until some time after the signature had been created; and second, that verification could be done by the recipient, the signer or by a third party, but that verification of the means of identification had to be possible. However, in the light of earlier comments about the word "approval", a suggestion was made to delete subparagraph (c).

30. While some support was expressed in favour of the suggested text, doubts were expressed about the need for subparagraph (d). Subparagraph (d) implied the possible involvement of third parties in the verification of the signature and was thus outside the scope of the actual signature. In addition, subparagraph (d) might not be needed in the context of the general category of electronic signature, since that category might include types of signature where verification would have little meaning.

31. It was suggested that, in order to align the definition in WP.80 with article 7 of the Model Law, the words "electronic form in, affixed to, or logically associated with, a data message, and" should be replaced with "any method in relation to a data message" as follows:

"Electronic signature means any method in relation to a data message that may be used to [identify the signature holder in relation to the data message and indicate the signature holder’s approval of the information contained in the data message]."

32. After discussion, the Working Group decided that the definition contained in subparagraph (a) should be retained with all square brackets removed. It was also decided that, for continuation of the discussion at a later stage, an alternative draft should be prepared, based on the above-suggested wording (see above, para. 31), which referred to the use of a "method" along the lines of article 7 of the Model Law.

Subparagraph (b)—Definition of “enhanced electronic signature”

33. It was suggested that the notion of “enhanced electronic signature” should be replaced by that of “certified electronic signature”, which was said to be more in line with digital signature practice. While support was expressed in favour of the proposal, it was generally felt that the notion of “enhanced” signature was preferable since the intervention of a third party to certify the signature would not be necessary in all instances.

34. With a view to better expressing the idea that the enhanced electronic signature should be both unique as a signature and singular to the signer, a proposal was made to replace subparagraph (b) by the following:

"Enhanced electronic signature means an electronic signature in respect of which it can be shown, through the use of a security procedure, that:

"(i) it was unique in the context in which it was used; and

"(ii) it was not used by any person other than the signer”.

35. Some support was expressed in favour of the proposal. However, doubts were expressed as to whether the elements of the definition contained either in the new proposal or in the original subparagraphs (i) to (iii) did create any difference in substance between an “electronic signature” and an “enhanced electronic signature”. With a view to expressing the specific character of an “enhanced electronic signature”, it was suggested that additional language should be introduced in subparagraph (b) along the lines of subparagraph (b)(iv) contained in WP.79 as follows:

“(iv) was created and is linked to the data message to which it relates in a manner such that any change in the data message would be revealed”.

36. Strong support was expressed in favour of the suggested addition, which was said to provide a necessary (and otherwise missing) link between the enhanced signature and the information contained in the data message. It was stated that applying an “enhanced electronic signature” should make any subsequent alteration of the message more difficult, much in the same way as the use of a handwritten signature made it more difficult to alter the contents of a paper document. In addition, it was pointed out that, although the function described in subparagraph (iv) was similar to the "hash function" offered by digital
signatures, any other signature technique (e.g. authentication techniques based on signature dynamics) should be capable of offering the same level of reliability as to the integrity of the message. A guarantee as to the integrity of the message was needed, particularly in view of the ease with which undetectable changes could be made to documents in electronic form.

37. It was objected, however, that not all electronic signatures providing a high degree of security would perform the function referred to in subparagraph (iv), which was said to be typical of certain types of digital signatures only. As to a possible parallel between the hash function and the handwritten signature, it was pointed out that a handwritten signature as such did not offer much certainty as to the non-alteration of the document. With respect to the difference between an “electronic signature” under subparagraph (a) and an “enhanced” signature under subparagraphs (b)(i) to (iii), it was stated that only the “enhanced” signature inherently involved the use of security procedures which could provide highly objective assurances as to the identity of the signer. The view was expressed that such an identification function should be considered separately from the function of verifying the integrity of the message, which might be needed only where the law required an original document. As a matter of drafting, it was stated that the wording of subparagraph (iv) might lend itself to misinterpretation, particularly if the provision that any alteration in the data message should be “revealed” were to be read as implying that the exact nature of the alteration would be spelled out. It was proposed that, should subparagraph (iv) be retained, language based on the text of article 8(1)(a) of the Model Law (e.g. “provides reasonable assurance as to the integrity of the message”) should be used.

38. A concern was expressed that introducing subparagraph (iv) in the definition of “enhanced electronic signature” might raise questions as to the consistency of the Uniform Rules with article 8 of the Model Law. While article 8 provided that integrity should be guaranteed “from the time when [the information] was first generated in its final form”, subparagraph (iv) would require integrity only as of the time when the signature was applied. It was stated in response that the definition of “enhanced electronic signature” was not aimed at dealing with the functional equivalence between a data message and an original document for all legal purposes. Rather, that definition was meant to ensure that an enhanced electronic signature could reliably identify a given message as the message which had been sent.

39. After discussion, the Working Group decided that a text along the lines of the suggested subparagraph (iv) should be added between square brackets to the text of subparagraph (b) or, as an alternative, to the text proposed in para. 34 above, for continuation of the discussion after the Working Group had reviewed the substantive provisions of the draft Uniform Rules. It was felt that the definition of “enhanced electronic signature” might need to be reconsidered, together with the general architecture of the Uniform Rules, once the purpose of dealing with two categories of electronic signatures had been clarified, particularly as regards the legal effects of both types of electronic signatures. It was suggested that it might be justified to deal with electronic signatures offering a high degree of reliability only if the Uniform Rules were to provide a functional equivalent to specific uses of handwritten signatures (e.g. deeds under seal, signatures certified by witnesses, and other types of certified signatures). However, it was also suggested that international unification or harmonization of such specific uses of handwritten signatures might be particularly difficult, while presenting little relevance to the vast majority of international commercial transactions. If, for those reasons, such specific form requirements were to remain outside the scope of the Uniform Rules, the additional benefit to be expected from using an “enhanced electronic signature” as opposed to a mere “electronic signature” might need to be further clarified, possibly in the context of draft article B. The Working Group agreed that discussion as to that issue might need to be reopened at a later stage.

Subparagraph (c)—Definition of “signature holder”

40. While general support was expressed for the substance of subparagraph (c), a question was raised as to whether the definition of “signature holder” should simply replace the definition of “signer” as contained in WP.79. It was suggested that, while the signature holder and the signer would, in most instances, be the same person, the two concepts might need to be used for distinguishing the act of signing from the mere possession of a signature device. While the discussion focused on the definition of “signature holder”, it was widely felt that the discussion might need to be reopened at a later stage regarding the possible definition of “signer”.

41. Various views were expressed as to the exact formulation of subparagraph (c). One view was the definition should not cover only situations where an “enhanced electronic signature” was used but should extend to situations where signature devices were used in the context of mere “electronic signatures”. To the extent the “signature holder” might be granted rights and obligations under draft articles E, F and G, there was no reason why the same rights and obligations should not be attributed to users of “electronic signatures” in general. A note of caution was struck, however, about burdening all users of electronic signatures with the obligations created for the signature holder under those articles. For example, under the laws of certain countries, the mere typewriting of the name of the signer at the bottom of an electronic mail message might be sufficient as a “signature”. However, it might not be appropriate to provide that the signer should protect such “signatures” to the same extent the “signature holder” should protect the “signature device” containing a private key in a public-key infrastructure (PKI) environment. It was generally agreed that the matter would need to be further discussed in the context of draft articles E to G.

42. A widely shared view was that subparagraph (c) should apply only to the “rightful” holder of the signature device, as a person whose rights and obligations were being dealt with in subsequent articles of the Uniform
Rules. Any person coming into possession of a signature device through fraud should not be protected by the Uniform Rules.

43. A concern was expressed that the words “on whose behalf” might raise questions regarding the law of agency and representation of legal entities, which the Uniform Rules should not interfere with. In response, it was observed that similar wording had been introduced in the definition of “originator” under the Model Law, on the assumption that any implication concerning agency should be settled by reference to the law applicable outside the Model Law. It was generally felt that the same assumption should be made under the Uniform Rules (see below, para. 90).

44. Another concern was that the notion of “signature holder” might be inconsistent with the notion of “originator” under the Model Law. It was stated in response that, while the signature holder and the originator might be the same person, it was still justified to maintain two definitions, in view of their distinct purposes. The notion of originator was used to determine the person to whom the message was attributable, whereas the signature holder had to be identified to determine who owed obligations for managing a signature device.

45. As a matter of drafting, it was suggested that the notion of “signature device holder” would be more appropriate, although admittedly more cumbersome, than the notion of “signature holder”.

46. With a view to addressing some of the views and concerns that had been expressed, it was suggested that alternative wording for subparagraph (c) might be considered along the following lines:

“Signatory” means a person who rightfully holds a signature creation device and acts either for himself or the entity he represents.

47. The Working Group did not conclude its deliberations with respect to subparagraph (c). In the context of the discussion of the definition of “signature holder” the view was expressed that the scope of the definition (as the scope of the draft Uniform Rules in general) was too broad and that, as a consequence, the individual rules contained therein were too general to provide any meaningful answer to the difficulties that were encountered in practice with respect to public-key infrastructures (PKI) in the context of which digital signatures were used (for continuation of the discussion, see below, para. 66).

48. The Working Group engaged in a general discussion of the scope of the Uniform Rules. In view of various remarks and concerns expressed at earlier stages in the discussion, it was suggested that the concepts of both electronic signature and enhanced electronic signature should not be used in the Uniform Rules since they were not in fact “signatures”, but rather techniques that enabled the identification of the sender of a data message and identification of the message that was sent. Accordingly, there was no rationale for using the term “signature” to describe such techniques, and in fact to do so could create confusion as the term “signature” carried with it meanings closely associated with its use in the paper environment and with the legal effects of its use in that environment (see above, paras. 23-24). It was suggested that article 7 of the Model Law provided a rule which dealt sufficiently with the functional equivalent of signatures in the paper and electronic environments in so far as such a rule was needed. Formulating a rule which indicated which signature techniques would satisfy the test in article 7 was not appropriate in view of these factors and in view of the difficulties associated with trying to ensure that technologies which had not yet been developed might be brought within the scope of such a provision. In addition, a view was expressed that adopting a single rule to indicate which signature technique would satisfy article 7 of the Model Law would be inappropriate in the light of the diversity of the concept of “signature” in the different legal traditions.

49. Another suggestion was that the Working Group should consider technologies which had been developed and which were being used in commercial transactions, such as digital signature techniques within a public key infrastructure (PKI). Once rules on PKI had been agreed, it would be possible to consider whether such rules could have a wider application. On that basis, it was proposed that the Working Group should not proceed to consider draft A to D of WP.80, but should focus upon draft articles F to H of WP.80 in the context of PKI (see above, para. 4).

50. That suggestion was widely supported, although some concerns were expressed that the focus on PKI might be too narrow and likely to discriminate against technologies other than PKI. It was suggested that draft articles A to D should not be dismissed without further consideration, but that discussion could be deferred until after draft articles F to H had been reviewed. It was pointed out that draft article B, in particular, might serve an important function in defining the scope of application of articles F to H. In addition, it was suggested that article E, which dealt with the principle of party autonomy, would be important to any consideration of the obligations of the parties in articles F to H. A further suggestion was that the question of cross-border recognition of foreign digital signatures and certificates, as discussed in draft articles 17 to 19 of document A/CN.9/ WG.IV/WP.76 should also be considered in the context of rules on PKI. It was also noted that WP.79 could serve as a useful reference in determining whether there were other issues (in addition to draft articles E to H and issues of cross-border recognition) that could be considered in the context of rules on PKI.

51. The Working Group generally agreed to continue its consideration of these issues on the basis that it would focus first upon rules for PKI as reflected in draft articles E to H of WP.80, with the possibility of considering the extension of those rules once they were agreed; that issues of media neutrality and the legal effects of PKI would not be further pursued at this stage but kept in mind for continuation of the discussion at a later stage; and that cross-border recognition issues would be added to the topics to be considered. It was recognized that since WP.80 had not been drafted with this focus in mind, the document should
only be viewed as a starting point for discussion. As to the form of the Uniform Rules, while no final decision could be made at this stage, the Working Group adopted as a working assumption that the provisions being prepared would be legal rules with commentary, and not merely guidelines (for continuation of the discussion, see below, para. 72).

52. The Working Group proceeded next with a discussion of the substance of draft articles E to G.

Article E. Freedom of contract

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

"A signature holder and any person who may rely on the electronic signature of the signature holder may determine that as between themselves the electronic signature is to be treated as an enhanced electronic signature".

54. As the Working Group was to consider the question of party autonomy in the context of PKI, it was felt that the focus of draft article E might be too narrow and that a broader consideration of the issue was required. While it was generally agreed that commercial parties should have the freedom to contract and allocate risk between or among themselves, some limits might need to be stated, for example, in relation to consumer protection or other public policy issues.

55. To facilitate discussion of a broader concept of party autonomy, the following text was proposed:

"(1) These Rules are intended only for commercial relationships and shall not be applied so as to conflict with any law concerned with the protection of consumers.

(2) By agreement, whether express or implied, commercial parties are free to deviate from or modify any aspect of these Rules.

(Commentary would say that 'None of the provisions of these Rules is mandatory'). (Commentary would say that this autonomy provision relates only to these Rules, it does not affect ordre public or mandatory laws applicable to contracts such as provisions relating to unconscionable contracts.)

(3) None of the provisions of these Rules shall be applied so as to exclude, restrict, or discriminate against any alternative form of electronic signature [that meets the requirements of article 7 of the Model Law on Electronic Commerce] [that is applied to a data message and is as reliable as was appropriate for the purpose for which the data message was generated or communicated, in the light of all the circumstances, including any relevant agreement]."

56. There was general support for an article along the lines of the proposal. As a matter of drafting, it was suggested that the reference to consumers in paragraph 1 of the draft article should be aligned with the language of footnote** to article 1 of the Model Law as follows: "This Law does not override any rules of law intended for the protection of consumers" (see above, para. 20, and below, para. 70). Another drafting suggestion was that the second square-bracketed language in proposed paragraph (3) should be deleted, as the reference to article 7 of the Model Law was the more appropriate alternative and, in order to align the drafting to article 7, the words "electronic signature" should be deleted and the word "method" substituted. A further suggestion was that the heading "Party Autonomy" should replace the heading of draft article E. There was general support for these drafting proposals.

57. It was suggested that the reference to agreement between the parties did not address the issue of possible detriment to third parties not involved in the agreement with sufficient clarity. To ensure that any agreement between the parties could not have effects on third parties, it was proposed that words to the effect that the parties were free to agree to certain effects "as between themselves" should be adopted from draft article E. That suggestion was widely supported.

58. Some concern was expressed as to the meaning of paragraph (3) and its relationship to paragraphs (1) and (2). It was pointed out that while paragraphs (1) and (2) clearly related to the issue of party autonomy, paragraph (3) introduced a different principle, i.e. that of non-discrimination. Without further considering the content of such a provision at this stage, it was proposed that paragraph (3) should be included as a separate article. That proposal was widely supported. As to the meaning of paragraph (3), it was suggested that such a provision was not needed, since the purpose of the draft rules would not be to give a benefit to any particular technique, even though focusing upon PKI. It was widely felt, however, that, pending a final decision by the Working Group as to whether the Uniform Rules would deal with any specific legal consequence of using digital and other electronic signatures, a provision along the lines of the proposed paragraph (3) was useful.

59. A further concern with the proposed article was that, when considered in the context of draft article F which covered obligations in both contract and tort, the proposed article on party autonomy might allow the parties to agree to modify the law of tort. It was pointed out in response that, in commercial relationships, the parties should be free to modify those obligations and, for example, accept higher or lower levels of liability than would otherwise be the case under the general law of tort.

60. In order to reflect the various views and concerns expressed in the discussion, an amended proposal was made as follows:

"(1) These Rules shall apply only to commercial relationships and shall not be applied so as to override any law intended for the protection of consumers.

(2) By agreement, whether express or implied, among themselves commercial parties are free to deviate from or modify any aspect of these Rules."
“(Commentary would say that ‘None of the provisions of these Rules is mandatory.’) (Commentary would say that this autonomy provision relates only to these Rules, it does not affect ordre public or mandatory laws applicable to contracts, such as provisions relating to unconscionable contracts.) (Commentary may address significance of phrase ‘among themselves’.)

“(3) None of the provisions of these Rules shall be applied so as to exclude, restrict, or discriminate against any alternative method [of signature] that meets the requirements of article 7 of the Model Law on Electronic Commerce.”

61. There was wide support for the substance of the revised proposal. However, a suggestion was made that the principle of party autonomy could be expressed more succinctly. Some doubt was also expressed as to whether the rules should be limited to commercial relations, as indicated in paragraph (1) of the proposal, or whether draft articles F to H might also be useful in the context of consumers. One suggestion was that the rules should apply equally to consumers and commercial parties, provided mandatory law for the protection of consumers was not affected. A view was expressed that the reference to mandatory law or ordre public should be transferred from the commentary and set out explicitly in the text of the proposed rule.

62. With a view to addressing some of the concerns raised in connection with proposed paragraphs (1) and (2), language along the following lines was proposed:

“These Rules shall only apply insofar as parties have not agreed otherwise, and they shall not override any mandatory law or ordre public.”

Some support was expressed for the substance of that proposal.

63. It was observed that, in order to reach a proper understanding of the scope of an article on party autonomy, it might be important to consider the nature of draft articles F to H. One view was that the draft articles were intended to be default or gap-filling rules which would apply when the parties had not made any agreement on the issues covered. Another view was that the draft articles would apply unless the parties agreed otherwise. Strong support was expressed in favour of the view that draft articles F to H should perform the function of gap-filling rules.

64. After discussion, the Working Group concluded that both the detailed proposal and the concise proposal for a new article on party autonomy addressed the same principle. The Working Group agreed that, for continuation of the discussion at a future session, the revised article on party autonomy should: address the preservation of consumer protection laws; focus on commercial relationships as defined in footnote ** to article 1 of the Model Law; ensure the freedom of parties to agree between themselves; and preserve mandatory laws. The Working Group agreed that these principles on party autonomy would form a satisfactory basis for considering draft articles F to H and that the discussion on party autonomy could be resumed at a later stage in the light of the discussion on those draft articles. As to the need for a provision on non-discrimination, which had been raised in the proposal for a more detailed article on party autonomy, no decision was made. It was agreed that further consideration of that principle should be deferred until after draft articles F to H had been reviewed.

Article F. Obligations of signature holder

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

“(1) A signature holder is obliged to:

“(a) Exercise due care to avoid unauthorized use of its signature;

“(b) Notify [appropriate persons] [as soon as possible] in the event its signature is compromised and could be used to create unauthorized enhanced electronic signatures;

“(c) Ensure that all material representations or statements made by the signature holder to information certifiers and relying parties are accurate and complete to the best of the signature holder’s knowledge and belief.

“(2) A signature holder shall be responsible for the consequences of its failure to fulfill the obligations in paragraph (1).”

General remarks

66. As a provisional conclusion of its deliberations over the definition of “signature holder” in draft article A (see above, paras. 40-47), the Working Group considered whether the “signature holder” should be the subject of the obligations stated in draft article F. It was recalled that, since the notion of “signature” was used as a reference to a technical device and not to the legal notion of a signature, the use of the term “signature holder” might lend itself to misinterpretation. It was suggested that the term “device holder” should be preferred. It was also recalled that, in view of the decision of the Working Group to consider first the issues of PKI before possibly extending the scope of the Uniform Rules to cover also other electronic signature techniques, the use of established PKI terminology might be more appropriate. It was thus suggested that terms such as “subscriber” or “key holder” might be preferable. While there was general agreement for replacing the term “signature holder” by more suitable wording, no final decision was made as to what such a more suitable wording might be. It was decided that the use of the terms “device holder”, “signature device holder”, “key holder” and “subscriber”, all of which were used as synonymous during the discussion, might need to be reconsidered, and defined at a later stage.

67. In the context of that discussion, it was pointed out that the notions of “key holder” and “subscriber” might correspond to different periods in the life-cycle of a key pair. It was suggested that, while the key pair would typically be created prior to application for a certificate, the Uniform Rules should only apply to keys
and key holders as of the time an identity certificate was issued (or requested) to allow for the practical use of the keys. Support was expressed in favour of that suggestion. The prevailing view, however, was that, while the duties of the key holder should only arise with respect to those key pairs that were effectively protected by a certificate (i.e. at the time when the certificate was issued), the duty of the key holder to protect such certified keys against misuse should retroact to the time of creation of the key pair.

68. With respect to the general reference to PKI and PKI terminology, the view was expressed that the interplay of relationships between three distinct types of parties (i.e. key holders, certification authorities and relying parties) corresponded to one possible PKI model, but that other models were conceivable, e.g. where no independent certification authority was involved. That view was generally accepted by the Working Group. It was generally felt, however, that one of the main benefits to be drawn from focusing on PKI issues was to facilitate the structuring of the Uniform Rules by reference to three functions (or roles) with respect to key pairs, namely, the key issuer (or subscriber) function, the certification function and the relying function. It was generally agreed that those three functions were common to all PKI models. It was also agreed that those three functions should be dealt with irrespective of whether they were in fact served by three separate entities or whether two of those functions were served by the same person (e.g. where the certification authority was also the relying party). In addition, it was widely felt that focusing on the functions typical of PKI and not on any specific model might make it easier to develop a fully media-neutral rule at a later stage (for continuation of the discussion, see below, para. 109).

69. The Working Group then discussed who the subject of the obligations stated in draft article F might be. It was widely felt that only the “rightful” holder of the key should be considered. In addition, it was generally agreed that only a key holder who was aware that it was in possession of a key pair, and who had shown an intent to use the key should be made subject to obligations. Reference was made to the holding of a credit card as similar to the holding of a key pair. However, it was realized that other types of situations also needed to be considered. For example, a prospective buyer might receive from a merchant a key pair to be used for securing possible transactions with that merchant. Such a key pair could be sent through electronic messaging, without the recipient of the message being aware of the issuance and attribution of that key pair. There was general agreement that, in such a case, the recipient of the key pair should not fall under any definition of “key holder” and that it should be subject to no obligations under the Uniform Rules. It was pointed out that the notion of “reasonable care” might sufficiently address this situation since no “reasonable care” could be expected as to the key pair from the unaware holder.

70. In the context of the discussion as to who the subject of the obligations stated in draft article F might be, the Working Group examined the consequences of its earlier decision to deal with the issues of consumer protection laws by way of a provision similar to footnote ** to article I of the Model Law. The view was expressed that (at least under the laws of a limited number of countries), even where a key holder had expressed an intent to use a key pair, the obligations established in draft article F might be regarded as too harsh if the key holder were to be regarded as a consumer. While it was generally felt that, in a large number of countries, the general duty of care expressed in draft article F would also apply to consumers, the Working Group reaffirmed its decision not to embark on the preparation of specific consumer law for electronic commerce. It was recalled that, under that decision, however, consumers would not be excluded from the scope of the Uniform Rules, and it would be for each enacting State to make a determination as to the need for exclusion of specific categories of key users from the application of the Rules (for previous discussion, see above, paras. 20 and 56).

71. The Working Group proceeded with a discussion concerning the person or persons to whom the various obligations established in draft article F were owed by the key holder. The view was expressed that those obligations were owed to either the certification authority or any other party who might rely on a digital signature in the context of contractual relationships with the key holder. The prevailing view, however, was that the obligations of the key holder were owed to any party who might reasonably rely on a digital signature, irrespective of whether or not that party was linked to the key holder by a contractual relationship. While the relationships between the key holder and either a certification authority or an independent key issuer would typically be contractual in nature, the relationship between the key holder and relying parties might be either contractual in the context of a commercial transaction, or based on tort. In view of their general nature, it was suggested that the “obligations” spelled out in draft article F would be more accurately described as “duties” of the key holder. The Working Group took note of that suggestion. It was generally agreed that the text of the Uniform Rules should make it clear that the obligations of the key holder should be owed to any party who reasonably relied on the use of a key and suffered a loss as a result of the keyholder’s failure to fulfil its obligations. It was also agreed that, for the purpose of draft article F, the notion of “party who reasonably relied” on the use of a key should include certification authorities.

72. In the context of the general discussion of draft article F, a view was expressed that the current focus of the Uniform Rules on the establishment of a set of prescriptive provisions of a legislative nature was overly ambitious (see above, paras. 19 and 51). Accordingly, it was suggested that issues currently addressed in the Uniform Rules might be more easily solved if the purpose and nature of the entire project was reconsidered. Two possible alternatives to the current project were proposed. One alternative was to limit the contents of the Rules to a general model legislative provision, the effect of which would be to provide the broadest possible recognition of party autonomy. The remainder of the issues currently dealt with under the Uniform Rules might then be dealt with by way of a legal guide geared towards assisting parties with the structuring
of their contracts regarding the issues of electronic signatures. Another alternative was to deal with the entire set of issues addressed in the Uniform Rules by way of a legislative guide, possibly accompanied by illustrative provisions. While it was pointed out that the current working assumption regarding the preparation of model legislative provisions accompanied by a legislative guide might, in practice, differ little from the latter proposed alternative, the greatly prevailing view was that the Working Group should pursue its task (the importance of which was reaffirmed, although some delegations questioned its feasibility) on the basis of the current working assumption (see above, para. 51). It was observed that, where appropriate, the Working Group might consider introducing optional formulations in the text of the Uniform Rules.

Paragraph (1)

Subparagraph (a)

73. It was widely felt that additional elements should be inserted alongside the notion of “avoiding unauthorized use of the key”. It was suggested that the key holder should be under an obligation to: avoid misuse of the key; and exercise due care in retaining control of the key and control of the information contained in the signature device or used in conjunction with the signature device to create the digital signature. It was generally agreed that the notion of “control” of the key and of the information contained therein was essential, particularly for determining the time as of which the key holder should come under the obligations spelled out in the draft article F. In particular in those situations where the control of the key was transferred among several successive holders of the key, draft article F should make it clear that only the person who was in control of the key was under an obligation to protect that key.

74. In connection with the discussion as to who was in control of the key, a question was raised as to whether, at any given point in time, there could be more than one holder of the same key. It was proposed that wording might be added to paragraph (1) along the following lines: “If [there are joint holders]more than one person has control of the key, the duties under paragraph (1) are joint and several”. The Working Group took note of the proposal and decided that it should be reflected in the revised draft of the Uniform Rules to be prepared for continuation of the discussion at a later session.

75. With respect to the words “exercise due care”, it was observed that draft article F reflected the assumption that the responsibility of the key holder was based on a standard of due diligence (also referred to as “liability for negligence”) rather than on the notion of strict liability.

Subparagraph (b)

76. There was general support for a rule along the lines of subparagraph (b). It was pointed out that the words in square brackets indicated two important matters to be clarified: the persons to be notified and the time at which notification should occur.

77. On the first issue, one suggestion was that any reference to the parties to be notified should not be included, or at least that they should not be specified, as a number of different bodies might be relevant where certification authority functions were distributed. It was proposed that this issue should be further considered at a later time when it would be clear what the scope of the duties covered in the rules and the persons to whom they applied was resolved. At that time, a specific reference to the relevant persons could be included in this article. For the same reasons, it was suggested that the term “appropriate persons” should be maintained.

78. On the question of the time at which notice was required to be given, it was suggested that “without undue delay” should be adopted, as it was well understood and widely used in a number of jurisdictions and provided an appropriately flexible standard.

79. A related question was raised as to the time at which the duty to notify arose. One possibility expressed was that it arose at least as early as the time at which there was actual knowledge of the compromise of the key, but it was suggested that it could arise before that time if it could be established that the key holder ought to have known or should have known that the key was compromised. Another view was that the duty to notify arose when the key holder had “adequate grounds for suspicion” or a “reasonable suspicion” that the key was compromised or that the key was or might have been compromised. It was questioned whether there was a difference between the knowledge test in the first proposal and the question of the fact of compromise in the second. Differing views were expressed as to whether these standards were the same or achieved the same result, or whether the result in each case was desirable. In regard to the latter point, one view was that apportioning responsibility on the basis that the key “might have been compromised” placed too heavy a burden on the key holder and might discourage use of the technology. After discussion, the Working Group generally agreed that both of these standards should be included in a revised draft of subparagraph (b) for future consideration.

80. It was suggested that the rule contained in subparagraph (b), if it essentially dealt with a question of negligence, should be supplemented by a rule dealing with apportionment of risk. If risk were to be considered, it would be necessary to decide when the risk was transferred from the key holder—when notice was given, when the notice was received or when action was taken on the notice. It was pointed out in response that issues of transfer of risk were different from rules on proper and reasonable conduct, which were based on the concept of fault. The concept of risk was important where there was no question of fault. The two types of rules should be kept separate, as liability could not be equated with risk. It was noted that subparagraph (a) established a duty to take care of the key which, under paragraph (2), could lead to liability in the event that care had not been taken. Subparagraph (b) was important in that event, as it provided a means by which the key holder could mitigate the
effects of the failure to take care by giving notice of the compromise of the key. In the context of liability, it was also pointed out that it might be important to consider the basis of any relationship between the parties, whether contractual or not and the content of that contract. There was general support for the formulation of a rule based on fault.

81. The question was raised as to whether the Working Group might want to consider dealing with the legal effects of the failure to take care of the key. One view was that as this issue had proven very difficult to reach consensus on in the past, it should not be considered here. Another suggestion was that WP.79 dealt with issues of effects in greater detail and would provide a useful starting point for considering these questions further. A further view was that the detail of liability should not be dealt with beyond the content of paragraph (2), which had yet to be discussed.

82. As a matter of drafting, it was suggested that the words “and could be used to create unauthorized enhanced electronic signatures” was not needed, since it was clear what the signature device could be used for and it did not need to be stated.

83. The Working Group agreed that a future draft of subparagraph (b) should reflect the changes discussed: notice should be given “without undue delay”; the two standards of “knew or ought to have known” and “is or might have been compromised” should be included in square brackets as alternative texts; and the words “and could be used to create unauthorized enhanced electronic signatures” should be deleted.

Subparagraph (c)

84. It was suggested that the words “to information certifiers and relying parties” should be deleted on the grounds that while representations to these parties were probably the ones which should be covered, it was conceivable that there might be representations to other relevant parties. The focus of the article should be upon the obligation for the information be accurate and complete, regardless of to whom the information was provided. In response to this suggestion, it was pointed out that removing the words referring to information certifiers and relying parties might mean that the obligation was unlimited, when the focus should actually be upon representations which related to the process of identification. It was proposed that the words “and that are material to the issuance of the certificate” be added after “representations and statements”.

85. Another suggestion on the issue of an objective test was that the words “which are relevant in the process of issuing a certificate or which are included in the certificate” should be added after “representations or statement”. It was pointed out that such a test limited subparagraph (c) to statements made by the key holder or the person who applied for a certificate, and would not be relevant in cases where a key holder did not apply for a certificate. It was not intended, however, that those words should be interpreted in such a way as to make the person applying for a certificate liable for representations which might be stated incorrectly in the certificate, or which otherwise were not based upon information provided by the applicant for a certificate. In such cases, the information certifier would have a corresponding obligation under draft article H with respect to the content of the certificate. A key holder would be liable, however, on a narrow construction of the obligation, to a relying party where the relying party suffered loss or damage as a result of misleading or false information provided by the key holder and included in the certificate. Opposing the limitation of the subparagraph to the certification process, the view was expressed that the obligation in subparagraph (c) should be general and include the provision of information under subparagraph (b).

86. A further proposal on the scope of subparagraph (c) was that the subparagraph should be divided into two parts. Representations made to a relying party could be covered by the general obligation as to completeness and accuracy, while representations which were made to an information certifier for the purposes of obtaining a certificate could form a separate subparagraph. In the case of the information provided to the information certifier, the connection between the obligation in this draft article and that in draft article H(1)(b) (which imposed an obligation in respect of information to be certified) was highlighted.

87. Some concern was expressed as to the persons to whom the obligations in paragraph (1) should apply. It was pointed out that it might not be appropriate to consider the whole of article F as establishing duties for the same person, as the subparagraphs of the current draft referred to different concepts. Subparagraph (a), for example, referred to both information and the device on which that information was stored and the way in which it was used. It may be that the obligation applied to a wider class of persons than just the key holder. Subparagraph (c), on the other hand, referred to information in the form of representations made to certain persons for the purpose of obtaining a certificate. These differences might need to be treated separately in any revision of the obligations in paragraph (1) of draft article F.

88. In relation to the knowledge and belief of the key holder at the time of making representations, it was pointed out that such a test was unnecessarily subjective and weak, and might result, for example, in a reduced level of responsibility where the key holder was reckless or stupid. What was required was objective language which made it clear that this was not an intended consequence of the subparagraph. One suggestion was that the words “to the best of the signature holder’s knowledge and belief” should be replaced by a reference to a due diligence standard; the opening words of the subparagraph could be “Exercise due diligence in ensuring that...”. With respect to the words “accurate and complete”, a view was expressed that the reference to a “complete” statement was superfluous since, in some jurisdictions, the concept of “completeness” was already included in the concept of “accuracy”. That view was noted by the Working Group.
of “completeness” was already included in the concept of “accuracy”. That view was noted by the Working Group.

89. On the issue of terminology, the Working Group again discussed the meaning of a number of different terms, including signature holder, device holder, key holder and signature device, signature creation device, signature verification device (see above, paras. 40-47). It was proposed, in terms of a definition, that “key holder” should refer to the person by whom, or on whose behalf, the signature was attached to the data message, adopting the drafting of subparagraph (c) of article A of WP.80, a definition which recognized the concept of agency. As to the device or signature being used, the Working Group generally agreed that it was not the device that was used to create the key that was being discussed, but rather the device that was used to create the signature.

90. The Working Group considered the desirability of including agency within the concept of a key holder (for previous discussion, see above, para. 43). The general view was that agency should not be covered in the Uniform Rules, as it would be difficult to reach agreement on principles of agency and inclusion of that concept would make the scope of draft article F too broad. Where a situation of agency might be involved, such as in an employee using a signature device for a corporation, this article would have the effect that, without prejudice to corporation law, the signature of the employee would be regarded as that of the corporation, which was effectively the “key holder”. The Working Group reaffirmed its earlier decision that issues of agency should be resolved under applicable law.

91. A suggestion of a drafting nature was that the term “material” was not appropriate in some jurisdictions and should therefore not be used. Another suggestion of a drafting nature was that, since the obligation under subparagraph (c) preceded the obligation under subparagraph (a) in time, the order of these two subparagraphs should be reversed.

92. After discussion, the Working Group agreed that the scope of subparagraph (c) should be limited to looking at the key holder’s obligations in the context of the certification process; the key holder should ensure that representations were accurate and complete; the reference to “knowledge and belief” should be replaced by the opening words “exercise due diligence in ensuring”; the words “which are relevant in the process of issuing a certificate or which are included in the certificate” should be introduced to qualify “representations and statements”, but it should be made clear that the key holder would only be liable for such statements when they were properly included in the certificate and not for mistakes or inaccuracies introduced by the information certifier; the reference to the “information certifiers and relying parties” should be removed; the order of subparagraphs (a) and (c) should be reversed; the concept of agency should not be dealt with in this article.

Paragraph (2)

93. Some support was expressed in favour of retaining draft paragraph (2) in its present form without amendment. Concerns were expressed, however, that the Uniform Rules should refer to the legal consequences of failure to fulfil the obligations set forth in draft paragraph (1). One means of addressing these consequences was to include a specific reference to national or applicable law, while a second solution was to promote harmonization by exploring possible consequences and drafting a uniform rule which should address the issue of damages, but not bind the key holder to the consequences of use of the signature device, particularly since questions of authorization and intention might arise. However, another view was that the data message should be attributed to the key holder (see below, paras. 97 and 104). In order to place the focus of paragraph (2) on damages rather than upon consequences, it was proposed that the words “The key holder is responsible for damage and injury resulting from the failure to fulfil the obligations in paragraph (1)” should be adopted. As another means of addressing the legal consequences of failure to fulfil the obligations set forth in draft paragraph (1), it was proposed that draft article 7 of WP.79 be considered, or perhaps an article along the lines of article 74 of the United Nations Convention on the International Sale of Goods. For the purposes of considering this proposal further, the following wording based on article 74 was suggested:

“Liability of the key holder may not exceed the loss which the key holder foresaw or ought to have foreseen at the time of its failure in the light of facts or matters of which the key holder knew or ought to have known to be possible consequences of the key holder’s failure to fulfil the obligations in paragraph (1).”

94. In response to this proposal based on article 74 of the United Nations Sales Convention, concern was expressed that the liability which might arise in the context of a contract for the sale of goods was not the same as liability that might arise from the use of a signature and could not be quantified in the same way. While it might be possible to foresee the damage that could arise from the breach of a contract for sale of goods, the same test could not apply in the case of the use of a particular signature technique. It was stated in that context that, under the Uniform Rules, the use of a particular signature technique should not result in any particular limitation of liability (or in any other competitive advantage over users of traditional hand-written signatures) being established to the benefit of users of electronic technology. Another view was that the test of foreseeability of damage was an internationally accepted standard which might prove to be useful in the context of signatures and facilitate the drafting of a uniform rule. A further view was that if an article on damages were to be considered, it may be necessary to distinguish between damage that arose as the result of action by the key holder which failed to meet the standard required by draft paragraph (1) and damage that arose because the key holder failed to take any action, that is between direct and indirect damage.
95. It was suggested that the duties of the key holder in article F should be analysed in terms of the parties or classes of parties to whom the duty was owed; the information certifier on one hand and a group of potential relying parties on the other. It was clear that the relationship between the key holder and the information certifier would be a contractual relationship which would be governed by the applicable law. Some doubt was expressed as to the appropriateness of applying a rule on foreseeability or remoteness of damage to such a contractual relationship. In terms of the group of relying parties, it was suggested that it might be appropriate to establish a rule that determined which relying parties might foreseeably suffer damage and the type of damage for which the key holder would be liable. Doubts were expressed as to whether article 74 of the United Nations Sales Convention captured both of these concepts and whether, in any event, it would be appropriate to have a single foreseeability rule which covered the obligations set forth in subparagraphs (a) to (c) of draft paragraph (1). It was also pointed out that draft article G dealt with issues relating to the relying party and would have to be taken account of in any article dealing with the consequences of failure on the part of the key holder to observe the obligations in draft article F.

96. To clarify the scope of application of draft paragraph (2), it was proposed that the reference to the "consequences of failing to fulfil the obligations in paragraph (1)" should be deleted, in order to avoid any uncertainty as to what the inclusion of those words might mean and to avoid considerations of whether the obligation being breached was contractual. It was also pointed out that the phrase "the consequences" might suggest that all possible consequences were under consideration and did not convey any idea as to the remoteness of those possible consequences. Deletion of these words was widely supported.

97. A further concern was expressed that if draft articles F and G were read together they could lead to a legal effect other than liability, namely attribution. It was suggested that, at the very least, a rule or a rebuttable presumption on attribution of the signature was required in order to remove uncertainty. While there was some agreement that such an article might be useful and would add to the level of trust in electronic commerce, it was pointed out that difficulties were certain to arise in the context of article 13 of the Model Law which dealt with attribution of a data message. It was generally agreed that attribution should not be considered in the context of draft article F (see below, para. 104).

98. After discussion, the Working Group agreed that, as there was both support for retaining paragraph (2) in its present form, with suggested amendments and for exploring a rule on consequences, possibly based on article 74 of the United Nations Sales Convention, a revised draft of paragraph (2) dealing with both possibilities should be included in future working papers for consideration by the Working Group. Such a provision should be limited in its application to the duties to be included in a revised version of paragraph (1) of draft article F.

Article G. Reliance on enhanced electronic signatures

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

"A person is entitled to rely on an enhanced electronic signature, provided it takes reasonable steps to determine whether the enhanced electronic signature is valid and has not been compromised or revoked".

100. Some concerns were expressed that the form in which the article was drafted was not appropriate. It was pointed out that the question that should be considered was not whether the relying party was entitled to rely upon the signature, but rather whether anyone seeking to rely on the signature might have to do before reliance could be regarded as reasonable. In that regard, it would be important to indicate the situations where it would be unreasonable to rely upon the signature. In order to reflect that change of emphasis, the following words were proposed:

"(1) A person is not entitled to rely on a certificate or a signature supported by a certificate to the extent that it is not reasonable to do so.

(2) In determining whether reliance is reasonable, regard shall be had to:

(a) any restrictions placed upon the certificate;

(b) the nature of the underlying transaction that the certificate or signature was intended to support;

(c) whether the relying party has taken appropriate steps to determine the reliability of the signature or the certificate;

(d) any agreement or trade usage or course of dealing which the relying party has with the information certifier or subscriber".

101. Support was expressed in favour of that proposal. To clarify what was intended by the reference to the underlying transaction in subparagraph (b), it was observed that situations might arise where it might not be sufficient to rely only on the use of a technique of identification and some other form of identification or checking might be needed. The example was given of a situation where a bank might want further confirmation that a transaction that might be considered unusual for a particular customer was in fact that customer's transaction, in addition to the use of an appropriate identification technique. Some concern was expressed that the factors stated in subparagraphs (a) to (d) might be too general and, in the context of the Working Group's assumption that PKI was being addressed, it might be helpful to make a specific reference to the need to check the validity or reliability of the certificate. For that purpose, it was suggested that the words "including reference to a certificate revocation list where relevant" could be added to subparagraph (c).

102. It was suggested that in addition to the factors set forth in subparagraphs (a) to (d) of the proposal, reference also should be made to whether the relying party knew or ought to have known that the key had been compromised or revoked or, as an alternative, that it was
not reasonable to rely on the signature or the certificate. To introduce additional flexibility in the proposed text, a further suggestion was made to add the words “if appropriate” in paragraph (2) after the words “regard shall be had”. Both of those proposals received some support.

103. Some support was also expressed for retaining draft article G in its current formulation or deleting it altogether. It was pointed out that constructing an article along the lines of the proposed text would suggest the establishment of requirements or conditions for reliance on enhanced signatures. The consequences of such requirements, when considered in the context of article 13 of the Model Law, might create a situation in which it would be easier to rely on a relatively insecure electronic signature than on the more secure enhanced signature. This might have the effect of making the more secure form of signature more difficult to use. Another view was that some connection should be drawn between reliance upon the signature and article 13 of the Model Law, in particular paragraphs (3) and (4). A further view was that the current formulation of draft article G expressed a more positive policy as to whether relying parties were entitled to be confidant in the use of this type of signature. Nevertheless, it was felt that some precautions might need to be taken by a relying party and a further proposal along the following lines was made:

“A person is entitled to rely on an enhanced electronic signature provided it takes reasonable measures to verify the validity of the signature according to the standards agreed with the key holder or to verify the information provided by the information certifier.”

That proposal did not receive support.

104. Concern was expressed that the Working Group might be trying to build into draft article G legal effects that were included in draft articles B and C, but which it had been decided should not be considered at this stage. Formulating draft article G as an entitlement to rely might presume certain legal effects, while establishing what ought to be done in order to rely avoided addressing the issue of what legal effect the signature might have. It was stated that, since draft articles F, G, and H focused upon rules of conduct for parties within a PKI, it was not appropriate for legal effects to be included. As to the question of attribution as raised by article 13 of the Model Law (see above, para. 97), it was observed that, while article 13 was generally limited in its scope to the situation where there was a contractual relationship between the originator and addressee of the data message, these Uniform Rules were intended to have a broader sphere of reference. It was also pointed out that formulating draft article G as a series of steps that should be considered in order to determine whether reliance was reasonable was not inconsistent with the requirement in article 13 for reasonable care, nor did it establish legal effect in terms of the validity of the signature. On the latter point, it was noted that draft article F as revised by the Working Group also did not address legal effect or validity of the signature and the form of these two draft articles was therefore consistent.

105. An opposing view was that formulating draft article G as an entitlement added a benefit that was not available under the Model Law, regardless of whether the specific legal effect was spelled out in other articles. It was proposed that the approach of establishing an entitlement to rely could be combined with the steps to be considered in determining whether reliance was reasonable as follows: “(1) A person is entitled to rely on a certificate or a signature supported by a certificate to the extent that it is reasonable to do so”. A second paragraph would then set out the matters to be considered as previously proposed, with an additional category covering “all other relevant factors”.

106. As a matter of drafting, it was noted that the words “reliance” and “enhanced” were not commonly used in some languages or legal systems and a more appropriate word might need to be sought.

107. After discussion, the Working Group agreed that both formulations of draft article G (see above, paras. 100 and 105) should be included in a revised article G for future consideration; that the references to “all other relevant factors” and to whether the relying party knew or ought to have known that the key had been compromised or revoked or, as an alternative, that it was not reasonable to rely on the signature or the certificate should be included; and that the words “if appropriate” should be added to paragraph (2) as discussed.

Article H. Obligations of an information certifier

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

“(1) An information certifier is obliged to:

“(a) act in accordance with the representations it makes with respect to its practices;

“(b) take reasonable steps to determine accurately the identity of the signature holder and any other facts or information that the information certifier certifies;

“(c) provide reasonably accessible means which enable a relying party to ascertain:

“(i) the identity of the information certifier;

“(ii) the method used to identify the signature holder;

“(iii) any limitations on the purposes for which the signature may be used; and

“(iv) whether the signature is valid and has not been compromised.

“(d) Provide a means for signature holders to give notice that an enhanced electronic signature has been compromised.

“(e) Ensure that all material representations or statements the information certifier makes are accurate and complete to the best of it’s knowledge and belief;

“(f) Utilize trustworthy systems and procedures in performing its services.
“(2) An information certifier shall be responsible for the consequences of its failure to fulfil the obligations in paragraph (1)”.

General remarks

109. The view was expressed that the possibility of stating opinions regarding the duties and liability of a certification authority was largely conditioned by the definition of a certification authority. In particular, a decision would need to be made as to whether the functions of a certification authority could be performed by a person or entity that was also a party to the underlying transaction for the purpose of which a certificate might be used (a working assumption currently adopted by the Working Group) or whether the certification authority should, in all instances, be independent from the parties (a situation akin to that of a notary public in a number of civil law countries). After discussion, the Working Group decided to continue its deliberation of the matter on the basis of the working assumption made at that session (see above, para. 68). While the Working Group did not discuss the definition of “certification authority” as such, it was generally agreed that the words “in the course of its business” in the definition of “information certifier” in draft article A, should not be interpreted as implying that certification-related activities should be the exclusive business activities of a certification authority. A view was also expressed that there might be a need to differentiate between an entity that issued certificates merely as an incidental part of its business and an entity that engaged in the business of issuing certificates (whether exclusively or in addition to other business activities which the entity might carry on). A further view was that, given the important role played by certification authorities and the responsibilities that might flow from that important role, both for certification authorities and for relying parties, the Uniform Rules should clarify the status of certification authorities. After discussion, it was agreed that the issues of the definition, role and status of certification authorities would need to be discussed further at a future session.

Paragraph (1)

110. The discussion focused on whether the list of duties contained in paragraph (1), irrespective of what those specific duties might be, should be exhaustive or not. Strong support was expressed in favour of the view that paragraph (1) should be worded in terms of an open-ended, illustrative, list of duties. Language along the following lines was suggested as opening words for paragraph (1): “Without limiting the generality of the certification authority’s obligation of due diligence, a certification authority is obliged, inter alia, to ...”. It was stated that, while such a formulation might appear to be burdensome for the certification authority, it would in fact be consistent with the general rule that would currently apply to certification authorities in many legal systems. It was also stated that a broad statement regarding the obligations of the certification authority in paragraph (1) might be compensated by exemptions from liability, to be established under paragraph (2) or under draft article E. In that respect, it was suggested that the attention of the Working Group might appropriately focus on the ways in which contractual clauses exempting the liability of the certification authority might be extended beyond the contractual sphere. In response, it was stated that, even within the contractual sphere, limitations should be placed on the ability of certification authorities to limit their liability, for example where such limitation would be grossly unfair. The Working Group agreed that the question of contractual and other limitations to the liability of the certification authority would need to be further discussed at a future session.

111. Another view was that paragraph (1) should be phrased in terms of an exhaustive list of duties. It was stated that, under the law of certain countries, the certification authority might not be under a general duty of due diligence. The various obligations of the certification authority should thus be spelled out in detail to determine the exact scope of its liability. A further justification for that view was that the Uniform Rules should deal only with the performance of certification authority functions and should not restate general principles of tort law which might be applicable to all persons engaging in whatever types of activities. Under that view, since “certification-authority function” was an ascertainable concept, the Uniform Rules should only deal with activities within such certification-authority functions, and should not be open-ended. It was agreed that both views should be reflected in the revised text that would be prepared for continuation of the discussion at a future session.

112. As to the substance of the specific duties listed in subparagraphs (a) to (f), general support was expressed. Various suggestions were made as to how the expression of those duties might be improved. One suggestion was that the duty to identify the signature holder under subparagraph (b) might be superfluous, as a mere illustration of the more general duty to ensure the accuracy of material representations under subparagraph (e). It was generally felt, however, that subparagraph (b) was useful to enhance clarity. Another suggestion was that subparagraph (b) should contain an additional obligation to state in the certificate the identity of the key holder.

113. Yet another suggestion was that, among its basic duties, the certification authority should be under an obligation to operate a certificate revocation list (CRL). It was suggested that the following words should be added to subparagraph (d): “and ensure the operation of a prompt and immediate revocation service”. Support was expressed in favour of that suggestion. It was pointed out, however, that the obligation to operate a CRL might be appropriate for high-value transactions and certificates (i.e. for those “enhanced electronic signatures” that were intended to produce legal effect) but would be overly burdensome (and contrary to existing practice) if it were to be imposed with respect to all certificates (including “cheap certificates” used in the context of significant numbers of digital signatures). In that connection, it was recalled that one of the main difficulties of the current project was to establish a workable criterion for distinguishing between the
higher level of transactions (for which a high level of security was sought, through stringent requirements on certificates and certification authorities, possibly with the view of producing specific, pre-determined, legal effects) and the bulk of lower-level uses of digital signatures and certificates (where the production of legal effects as to “signature” was largely irrelevant, and the main policy requirement was not to interfere with party autonomy). The view was expressed that, while no such workable criterion might be found, limiting the scope of the Uniform Rules to the commercial sphere (i.e. excluding consumer transactions) might provide an acceptable solution.

114. Further suggestions were made for reflecting additional elements in the list of duties established under paragraph (1) as follows: an obligation to provide information as to the revocation and suspension of certificates; in subparagraph (e), language mirroring a similar provision in draft article F; and in subparagraph (f), language expressing the obligation of the certification authority to utilize trustworthy human resources in performing its services. The following text was proposed for insertion in paragraph (1)(c): “that the person who is named in the certificate holds [held at the relevant time] the private key corresponding to the public key”; and “that the keys are a functioning key pair”.

Paragraph (2)

115. With respect to the general provision concerning the liability of the certification authority for failure to fulfil the duties established under paragraph (1), it was widely felt that it would be appropriate to create a uniform rule beyond merely referring to the applicable law. As to what the contents of such a rule might be, it was suggested that it should establish a general liability for negligence, subject to possible contractual exemptions, and subject to the certification authority exonerating itself from liability by demonstrating that it had fulfilled the obligations under paragraph (1). The following text was proposed as a substitute for paragraph (2):

“(2) Subject to paragraph (3), a certification authority shall be liable for damage suffered by either:

“(a) a party who has contracted with the certification authority for the provision of a certificate; or

“(b) any person who relies on a certificate issued by the certification authority, if the damage has been caused as a result of the certificate being incorrect or defective.

“(3) A certification authority shall not be liable under paragraph (2):

“(a) if, and to the extent, it included in the certificate’s information a statement limiting the scope or extent of its liability to any person; or

“(b) if it proves that it [was not negligent] took all reasonable measures to prevent the damage”.

116. While support was expressed in favour of the proposal, strong objections were raised on the grounds that adopting the proposed language would amount to establishing a strict liability standard for “any damage”, and that imposing a strict liability standard on certification authorities might significantly jeopardize the increased use of electronic commerce. With respect to the text of proposed subparagraph (3)(a), doubts were expressed as to whether information included in the certificate to the effect of the liability of the certification authority with respect to that certificate could apply equally to contractual and tortious liability. In that context, the Working Group was urged to attempt to base any meaningful distinction in the Uniform Rules on the notions of contractual and tortious liability, since the contents of these notions might vary significantly from country to country. Furthermore, a view was expressed that the clause limiting the liability of the certification authority ought not to be invoked to the extent that exclusion or limitation of liability would be grossly unfair. That view was supported by some delegations.

117. Support was also expressed in favour of maintaining the current structure of paragraph (2), in connection with an exhaustive list of duties under paragraph (1).

118. In connection with the discussion of the duties of the certification authority, a question was raised as to who would bear the risk of a loss resulting from reliance on an unreliable (e.g. a compromised or revoked) certificate when all parties had been diligent under draft articles F, G and H of the Uniform Rules. One suggestion was that, through the suggested negative formulation of draft article G, the relying party would bear that residual risk. It was pointed out that, in practice, reliance on means of communication such as telephone or telecopy already placed the residual risk on the relying party. Another suggestion was that provisions should be introduced in draft article H of the effect that the residual risk should be borne by the certification authority. Yet another suggestion was that the Uniform Rules should be silent on that point and leave it to the courts to determine which party should bear that risk, in view of all relevant circumstances.

119. After discussion, the Working Group did not adopt a final decision on the contents of draft article H. The Secretariat was requested to prepare variants reflecting the various views expressed, for continuation of the debate at a later session.

C. Further items to be considered

120. The Working Group proceeded to list the items which, for lack of time, had not been considered at that session but should be further discussed in the context of possible additions to the Uniform Rules. The view was expressed that, in its future deliberations of the Uniform Rules, the Working Group might wish to give consideration to introducing an article to establish that certificates should not be discriminated against on the basis of the place at which they were issued. The following text was proposed: “In determining whether, or the extent to which, a certificate is legally effective, no regard shall be had to where the certificate was issued,
nor in which State the issuer had its place of business". The Working Group took note of that proposal.

121. Other items for future consideration included the following issues: cross-border recognition of certificates; legal effect of electronic signatures; attribution of electronic signatures; relationship between the Uniform Rules and the Model Law; definition and minimum qualities of certification authorities; possible incompatibility of functions of certification authorities with the performance of any other function in the same transaction; and revocation and suspension of certificates.

122. It was noted that the next session of the Working Group was scheduled to take place at Vienna from 6 to 17 September 1999, those dates being subject to confirmation by the Commission at its thirty-second, to be held at Vienna, from 17 May to 4 June 1999. A suggestion was made on behalf of a number of delegations that the duration of future sessions of the Working Group should be limited to one week and that this matter should be fully discussed at the thirty-second session of the Commission. The suggestion was noted by the Working Group as a matter that could only be decided upon by the Commission.

E. Working paper submitted to the Working Group on Electronic Commerce at its thirty-fourth session: draft Uniform Rules on Electronic Signatures: note by the secretariat
(A/CN.9/WG.1V/WP.79) [Original: English]

CONTENTS

INTRODUCTION ................................................................. 1-11

I. GENERAL REMARKS ...................................................... 12-14

II. DRAFT PROVISIONS ON DIGITAL SIGNATURES, OTHER ELECTRONIC SIGNATURES, CERTIFICATION AUTHORITIES AND RELATED LEGAL ISSUES ................................................................. 15-53

CHAPTER I. SPHERE OF APPLICATION AND GENERAL PROVISIONS ................................................................. 15-20

CHAPTER II. ELECTRONIC SIGNATURES .................................... 21-48

Section I. Electronic signatures in general .................................. 21-23

Article 1. Definitions ...................................................... 21

Article 2. Compliance with requirements of law .......................... 22-23

Section II. [Enhanced] electronic signatures ............................. 24-44

Article 3. ........................................................................ 24-30

Article 4. Presumption of attribution of [enhanced] electronic signature ................................................................. 31-33

Article 5. Presumption of integrity .......................................... 34-37

Article 6. Predetermination of [enhanced] electronic signature ...... 38-41

Article 7. Liability for unauthorized use of [enhanced] electronic signature ................................................................. 42-44

Section III. Digital signatures supported by certificates ................. 45-48

Article 8. Contents of [enhanced] certificates ............................ 45-46

Article 9. Effect of digital signatures supported by certificates ....... 47-48
CHAPTER III. CERTIFICATION AUTHORITIES AND RELATED ISSUES

<table>
<thead>
<tr>
<th>Article</th>
<th>Paragraph</th>
</tr>
</thead>
<tbody>
<tr>
<td>10.</td>
<td>Undertaking upon issuance of [enhanced] certificate</td>
</tr>
<tr>
<td>11.</td>
<td>Contractual liability</td>
</tr>
<tr>
<td>12.</td>
<td>Liability of the certification authority to parties relying on certificates</td>
</tr>
<tr>
<td></td>
<td>General remark regarding draft articles 13 to 15</td>
</tr>
<tr>
<td>13.</td>
<td>Revocation of certificate</td>
</tr>
<tr>
<td>14.</td>
<td>Suspension of certificate</td>
</tr>
<tr>
<td>15.</td>
<td>Register of certificates</td>
</tr>
</tbody>
</table>

INTRODUCTION

1. The Commission, at its twenty-ninth session (1996), decided to place the issues of digital signatures and certification authorities on its agenda. The Working Group on Electronic Commerce was requested to examine the desirability and feasibility of preparing uniform rules on these topics. It was agreed that the uniform rules to be prepared should deal with such issues as: the legal basis supporting certification processes, including emerging digital authentication and certification technology; the applicability of the certification process; the allocation of risk and liabilities of users, providers and third parties in the context of the use of certification techniques; the specific issues of certification through the use of registries; and incorporation by reference.1

2. At its thirtieth session (1997), the Commission had before it the report of the Working Group on the work of its thirty-first session (A/CN.9/437). The Working Group indicated to the Commission that it had reached consensus as to the importance of, and the need for, working towards harmonization of law in that area. While no firm decision as to the form and content of such work had been reached, the Working Group had come to the preliminary conclusion that it was feasible to undertake the preparation of draft uniform rules at least on issues of digital signatures and certification authorities, and possibly on related matters. The Working Group recalled that, alongside digital signatures and certification authorities, future work in the area of electronic commerce might also need to address: issues of technical alternatives to public-key cryptography; general issues of functions performed by third-party service providers; and electronic contracting (A/CN.9/437, paras. 156-157).

3. The Commission endorsed the conclusions reached by the Working Group, and entrusted the Working Group with the preparation of uniform rules on the legal issues of digital signatures and certification authorities (hereinafter referred to as “the Uniform Rules”).

4. With respect to the exact scope and form of the Uniform Rules, the Commission generally agreed that no decision could be made at this early stage of the process. It was felt that, while the Working Group might appropriately focus its attention on the issues of digital signatures in view of the apparently predominant role played by public-key cryptography in the emerging electronic-commerce practice, the Uniform Rules should be consistent with the media-neutral approach taken in the UNCTRAL Model Law on Electronic Commerce (the Model Law). Thus, the Uniform Rules should not discourage the use of other authentication techniques. Moreover, in dealing with public-key cryptography, the Uniform Rules might need to accommodate various levels of security and to recognize the various legal effects and levels of liability corresponding to the various types of services being provided in the context of digital signatures. With respect to certification authorities, while the value of market-driven standards was recognized by the Commission, it was widely felt that the Working Group might appropriately envisage the establishment of a minimum set of standards to be met by certification authorities, particularly where cross-border certification was sought.2

5. The Working Group began the preparation of the Uniform Rules at its thirty-second session on the basis of a note prepared by the Secretariat (A/CN.9/WG.IV/WP.73).

6. At its thirty-first session (1998), the Commission had before it the report of the Working Group on the work of its thirty-second session (A/CN.9/446). The Commission expressed its appreciation of the efforts accomplished by the Working Group in its preparation of draft Uniform Rules on Electronic Signatures. It was noted that the Working Group, throughout its thirty-first and thirty-second sessions, had experienced manifest difficulties in

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reaching a common understanding of the new legal issues that arose from the increased use of digital and other electronic signatures. It was also noted that a consensus was still to be found as to how those issues might be addressed in an internationally acceptable legal framework. However, it was generally felt by the Commission that the progress realized so far indicated that the draft Uniform Rules on Electronic Signatures were progressively being shaped into a workable structure.

7. The Commission reaffirmed the decision made at its thirty-first session as to the feasibility of preparing such Uniform Rules and expressed its confidence that more progress could be accomplished by the Working Group at its thirty-third session (New York, 29 June-10 July 1998) on the basis of the revised draft prepared by the Secretariat (A/CN.9/WG.1V/WP.76). In the context of that discussion, the Commission noted with satisfaction that the Working Group had become generally recognized as a particularly important international forum for the exchange of views regarding the legal issues of electronic commerce and for the preparation of solutions to those issues.


9. This note contains the revised draft provisions prepared pursuant to the deliberations and decisions of the Working Group and also pursuant to the deliberations and decisions of the Commission at its thirty-first session, as reproduced above. They are intended to reflect the decisions made by the Working Group at its thirty-third session.

10. In the preparation of this note, the Secretariat was assisted by a group of experts, comprising both experts invited by the Secretariat and experts designated by interested governments and international organizations.

11. In line with the applicable instructions relating to the stricter control and limitation of United Nations documents, the explanatory remarks to the draft provisions have been kept as brief as possible. Additional explanations will be provided orally at the session.

I. GENERAL REMARKS

12. The purpose of the Uniform Rules, as reflected in the draft provisions set forth in part II of this note, is to facilitate the increased use of electronic signatures in international business transactions. Drawing on the many legislative instruments already in force or currently being prepared in a number of countries, these draft provisions aim at preventing disharmony in the legal rules applicable to electronic commerce by providing a set of standards on the basis of which the legal effect of digital signatures and other electronic signatures may become recognized, with the possible assistance of certification authorities, for which a number of basic rules are also provided.

13. Focused on the private-law aspects of commercial transactions, the Uniform Rules do not attempt to solve all the questions that may arise in the context of the increased use of electronic signatures. In particular, the Uniform Rules do not deal with aspects of public policy, administrative law, consumer law or criminal law that may need to be taken into account by national legislators when establishing a comprehensive legal framework for electronic signatures.

14. Based on the Model Law, the Uniform Rules are intended to reflect in particular: the principle of media-neutrality; an approach under which functional equivalents of traditional paper-based concepts and practices should not be discriminated against; and extensive reliance on party autonomy. They are intended for use both as minimum standards in an “open” environment (i.e. where parties communicate electronically without prior agreement) and as default rules in a “closed” environment (i.e. where parties are bound by pre-existing contractual rules and procedures to be followed in communicating by electronic means).

II. DRAFT PROVISIONS ON DIGITAL SIGNATURES,
OTHER ELECTRONIC SIGNATURES,
CERTIFICATION AUTHORITIES
AND RELATED LEGAL ISSUES

Chapter I. Sphere of application and general provisions

15. In considering the draft provisions proposed for inclusion in the Uniform Rules, the Working Group may wish to consider more generally the relationship between the Uniform Rules and the Model Law. In particular, the Working Group might wish to make proposals to the Commission as to whether uniform rules on digital signatures should constitute a separate legal instrument or whether they should be incorporated in an extended version of the Model Law, for example as a new part III of the Model Law.

16. If the Uniform Rules are prepared as a separate instrument, it is submitted that they will need to incorporate provisions along the lines of articles 1 (Sphere of application), article 2 (definitions as required), 3 (Interpretation) and 4 (Variation by agreement) of the Model Law. While those articles are not reproduced in this note, it should be noted that the draft provisions of the Uniform Rules have been prepared by the Secretariat on the assumption that such provisions would be included in the Uniform Rules. With respect to the sphere of application of the Uniform
Rules, it should be borne in mind that, if an article along the lines of article 1 of the Model Law is included, transactions involving consumers would not be excluded from their sphere of application unless the law applicable to consumer transactions in the enacting State conflicted with the Uniform Rules.

17. As to the question of party autonomy, a mere reference to article 4 (Variation by agreement) of the Model Law may not suffice to provide a satisfactory solution. Article 4 establishes a distinction between those provisions of the Model Law that may be freely varied by contract and those provisions that should be regarded as mandatory unless variation by agreement is authorized by the law applicable outside the Model Law. With respect to electronic signatures, the practical importance of "closed" networks makes it necessary to provide wide recognition of party autonomy. However, public policy restrictions on freedom of contract, including laws protecting consumers from overreaching contracts of adhesion, may also need to be taken into consideration. The Working Group may thus wish to include in the Uniform Rules a provision along the lines of article 4(1) of the Model Law to the effect that, except as otherwise provided by the Uniform Rules or other applicable law, electronic signatures and certificates issued, received or relied upon in accordance with procedures agreed among the parties to a transaction are given the effect specified in the agreement. In addition, the Working Group might consider establishing a rule of intepretation to the effect that, in determining whether a certificate, an electronic signature or a data message verified with reference to a certificate, is sufficiently reliable for a particular purpose, all relevant agreements involving the parties, any course of conduct among them, and any relevant trade usage should be taken into account.

18. In addition to the above-mentioned provisions, the Working Group may wish to consider whether a preamble should clarify the purpose of the Uniform Rules, namely to promote the efficient utilization of electronic communication by establishing a security framework and by giving written and electronic messages equal status as regards their legal effect.

19. At its thirty-third session, the Working Group expressed doubts as to the appropriateness of using the terms "enhanced" or "secure" to describe signature techniques that were capable of providing a higher degree of reliability than "electronic signatures in general" (A/CN.9/454, paras. 29). The Working Group concluded that, in the absence of a more appropriate term, "enhanced" should be retained. For those reasons, "enhanced" is included in this revision of the Uniform Rules in square brackets.

20. In discussing the relationship between these Uniform Rules and article 7 of the Model Law, the Working Group may wish to consider whether these Rules should be limited in their application to situations where there are legal form requirements or where the law provides for consequences in the absence of certain conditions, such as writing or a signature. It should be recalled that what is meant by form requirements was discussed in the preparation of the Model Law. Paragraph 68 of the Guide to

Enactment of the Model Law notes that the use of the phrase "the law" in the Model Law is to be understood as encompassing not only statutory or regulatory law, but also judicially-created law and other procedural law. Thus the phrase "the law" also covers rules of evidence. Where the law does not stipulate a requirement for a particular condition, but provides for consequences in the absence of the condition, for example writing or signature, this is also to be included within the concept of "the law" as used in the Model Law.

Chapter II. Electronic signatures

Section I. Electronic signatures in general

Article 1. Definitions

For the purposes of these Rules:

(a) "Electronic signature" means data in electronic form in, affixed to, or logically associated with, a data message, and [that may be] used to [identify the signer of the data message and indicate the signer's approval of the information contained in the data message][satisfy the conditions set forth in article 7(1)(a) of the UNCITRAL Model Law on Electronic Commerce];

(b) "[Enhanced] electronic signature" means an electronic signature which [is created and][as of the time it was made] can be verified through the application of a security procedure or combination of security procedures that ensures that such electronic signature:

(i) is unique to the signer [for the purpose for][within the context in] which it is used;

(ii) can be used to identify objectively the signer of the data message;

(iii) was created and affixed to the data message by the signer or using a means under the sole control of the signer; [and]

(iv) was created and is linked to the data message to which it relates in a manner such that any change in the data message would be revealed.

(c) Variant A

"Digital signature" means an electronic signature created by transforming a data message using a message digest function, and encrypting the resulting transformation with an asymmetric cryptosystem using the signer's private key, such that any person having the initial untransformed data message, the encrypted transformation, and the signer's corresponding public key can [accurately] determine:

(i) whether the transformation was created using the private key that corresponds to the signer's public key; and
(ii) whether the initial data message has been altered since the transformation was made.

Variant B

“Digital signature” is a cryptographic transformation (using an asymmetric cryptographic technique) of the numerical representation of a data message, such that any person having the data message and the relevant public key can determine:

(i) that the transformation was created using the private key corresponding to the relevant public key; and

(ii) that the data message has not been altered since the cryptographic transformation.

(d) “Certification authority” means any person who, or entity which, in the course of its business, engages in issuing [identity] certificates in relation to cryptographic keys used for the purposes of digital signatures. [This definition is subject to any applicable law which requires a certification authority to be licensed, to be accredited, or to operate in a manner specified in such law.]

(e) “[Identity] certificate” means a data message or other record which is issued by a certification authority and which purports to confirm the identity [or other significant characteristic] of a person or entity who holds a particular key pair.


(g) “Certification practice statement” means a statement published by a certification authority that specifies the practices that the certification authority employs in issuing and otherwise handling certificates.

(h) “Signer” means the person by whom, or on whose behalf, [an electronic signature is used][data is used as an electronic signature].

References

A/CN.9/454, para. 20;
A/CN.9/WG.IV/76, paras. 16-20;
A/CN.9/446, paras. 27-46 (draft article 1), 62-70 (draft article 4), 113-131 (draft article 8), 132 and 133 (draft article 9);
A/CN.9/WG.IV/WP.73, paras. 16-27, 37 and 38, 50-57, and 58-60;
A/CN.9/437, paras. 29-50 and 90-113 (draft articles A, B and C); and
A/CN.9/WG.IV/WP.71, paras. 52-60.

Remarks

21. At its previous session, for lack of sufficient time, the Working Group postponed its consideration of draft article 1 to a future session (see A/CN.9/454, para. 19). With the exception of the deletion of the word “secure” in relation to electronic signatures, the text of draft article 1 in this note is identical to the text of that draft article as set forth in A/CN.9/WG.IV/76.

Article 2. Compliance with requirements of law

(1) With respect to a data message authenticated by means of an electronic signature [other than an [enhanced] electronic signature], the electronic signature meets any requirement of law for a signature if the method used to affix the electronic signature is as reliable as was appropriate for the purpose for which the data message was generated or communicated, in the light of all the circumstances, including any relevant agreement.

(2) Paragraph (1) applies whether the requirement referred to therein is in the form of an obligation or whether the law simply provides consequences for the absence of a signature.

(3) Unless expressly provided elsewhere in [this Law], electronic signatures that are not [enhanced] electronic signatures are not subject to the regulations, standards, or licensing procedures established by ... [the State-specified organs or authorities referenced in draft article 6] or to the presumptions created by articles 3, 4 and 5.

(4) The provisions of this article do not apply to the following: [...].

References

A/CN.9/454, paras. 21-27;
A/CN.9/WG.IV/WP.76, para. 21; and
A/CN.9/446, paras. 27-46 (draft article 1).

Remarks

22. The purpose of draft article 2 is to confirm the connection between article 7 of the Model Law and the Uniform Rules. Draft article 2(1) includes the appropriate recognition of party autonomy. The Working Group may wish to consider whether the words included in square brackets in draft article 2(1) ["other than an enhanced electronic signature"] should be retained as they suggest that an enhanced electronic signature does not meet the requirement of article 7 of the Model Law. This appears to contradict the effect of Variant B of draft article 3.

23. Draft article 2(2) is included for consistency with article 7 of the Model Law and for the reasons noted above in relation to the meaning of the phrase “the law”. Draft article 2(3) makes it clear that rules applying to higher levels of “enhanced” or “secure” electronic signatures, such as those relating to possible licensing schemes for certification authorities or other possible regulation for digital signatures for example, do not apply in general to all types of “electronic signatures".
Section II. [Enhanced] electronic signatures

Article 3.

Variant A

Article 3. Compliance of [enhanced] electronic signature with requirements of law

(1) Where the law requires a signature, that requirement is met by an [enhanced] electronic signature, unless it is proved that the [enhanced] electronic signature does not fulfill the requirements of article 7 of the Model Law.

(2) Paragraph (1) applies whether the requirement referred to is in the form of an obligation or whether the law simply provides consequences for the absence of a signature.

(3) The provisions of this article do not apply to the following: [ ...

Variant B

Article 3. Presumption of signing

(1) A data message is presumed to have been signed if an [enhanced] electronic signature is affixed to or logically associated with the data message.

(2) The provisions of this article do not apply to the following: [ ... ].

Variant C

Article 3. Consequences arising from the use of an [enhanced] electronic signature

(1) Where consequences in law would arise from the use of a signature, those consequences arise from an [enhanced] electronic signature.

(2) The provisions of this article do not apply to the following: [ ...

References

A/CN.9/454, paras. 28-39;
A/CN.9/WG.IV/WP.76, paras. 22 and 23;
A/CN.9/446, paras. 47 and 48 (draft article 2) and 49-61 (draft article 3);
A/CN.9/WG.IV/WP.73, paras. 28-36; and
A/CN.9/437, paras. 43, 48 and 92.

Remarks

Variant A

24. Variant A provides a rule for enhanced electronic signatures that is a shortcut to satisfying the requirements of article 7 of the Model Law. This variant of draft article 3 and draft article 2 establish the basis of the Uniform Rules. Firstly, draft article 2 restates the principle of article 7 of the Model Law that an electronic signature can satisfy a requirement of law for a signature provided that it meets certain conditions. Second, Variant A of draft article 3 provides that an [enhanced] electronic signature does meet those conditions and a shortcut to satisfying the requirement of article 7 is established.

25. The provision which confirms that the phrase “the law” applies whether the requirement is in the form of an obligation or whether the law simply provides consequences for the absence of a particular condition has been repeated in paragraph (2) of Variant A, to ensure that the meaning of the phrase “the law” is consistent between with the draft Uniform rules and the Model Law.

26. If the words in square brackets in draft Variant A are retained, draft Variant A provides a qualified shortcut to satisfying the requirements of article 7 of the Model Law, as proof may be introduced that the requirements of article 7 are not satisfied. The Working Group may wish to consider whether those words should be retained in draft article 3.

Variant B

27. The purpose of Variant B is to create a presumption that a data message can be regarded as “signed” if it is authenticated by an enhanced electronic signature. As such, this presumption treats the “signing” of a message as being distinct from the question of the identification of the signer. Such a presumption may be important where there is no formal requirement for a signature, as set out in article 7 of the Model Law, but where the existence of a signature on a data message may be important for some other purpose, or in cases where the law requires that a message be signed without specifying the identity of the signer or where the signer’s identity is not at issue.

28. As currently drafted, Variant B may apply to situations additional to those contemplated by article 7. The Working Group may wish to consider whether these two arms of article 7 (i.e. where there is a requirement of law for a signature or where consequences are specified in the absence of a signature) catch all situations where a signature could be used and have legal effect. If they do not, a provision along the lines of Variant B may be useful. In such circumstances, Variant B may be retained together with Variant A, as Variant B will deal with additional circumstances.

29. The reference in the previous draft of article 3 to the time at which the signature was affixed has been deleted, but the Working Group may wish to consider whether this concept may need to be included elsewhere in the draft Uniform Rules.

Variant C

30. The purpose of this variant is to establish in the Uniform Rules a clear principle of non-discrimination, as reflected in article 5 of the Model Law. The provision is intended to ensure that where the use of signature gives rise to legal consequences, irrespective of a formal requirement for a signature, those consequences will be the same for handwritten and electronic signatures. The effect of this variant is very close to that of Variant B, as both
rely on domestic law to provide the consequences where a message is signed (Variant B) or a signature has been used (Variant C).

**Article 4. Presumption of attribution of [enhanced] electronic signature**

(1) An [enhanced] electronic signature is presumed to be that of the person by whom, or on whose behalf, it purports to have been generated, unless it is established that the [enhanced] electronic signature was applied neither by the purported signer nor by a person who had the authority to act on its behalf.

(2) The provisions of this article do not apply to the following: [...].

**References**

A/CN.9/454, paras. 40-53;
A/CN.9/WG.IV/WP.76, paras. 24;
A/CN.9/446, paras. 49-61 (draft article 3);
A/CN.9/WG.IV/WP.73, paras. 33-36;
A/CN.9/437, paras. 118-124 (draft article E); and
A/CN.9/WG.IV/WP.71, paras. 64 and 65.

**Remarks**

31. Draft article 4 provides a presumption of attribution for [enhanced] electronic signatures, and provides two cases where the presumption does not apply. As such, it deals with issues addressed in article 13 of the Model Law, although there are some differences in its drafting. Draft article 4, for example, is in the form of a rebuttable presumption of attribution. On the other hand, article 13(2) of the Model Law is in the form of a deeming provision, and article 13(3) establishes a rule entitling the addressee to act on the attribution of the data message. Draft article 4 deals with attribution of a signature, while article 13 of the Model Law is concerned with attribution of the data message. The tests for attributing the signature in draft article 4 are slightly different to the criteria used in article 13 of the Model Law for attributing the data message.

32. The Working Group may wish to consider the relationship between draft article 4 and article 13 of the Model Law and in particular, whether there is any legal need for a distinction to be drawn between attribution of the message and attribution of the signature on that message. It should be borne in mind that for technical reasons, it may not be possible for such a distinction to be made. It may be that attribution of a signature should follow attribution of a data message, or vice versa and only one rule on attribution is needed.

33. Another aspect of draft article 4 is that it deals with unauthorized use of the electronic signature. In that respect it overlaps with issues covered by article 13 of the Model Law. Draft article 4, for example, provides that the presumption of attribution does not apply in two instances—where the signature was applied neither by the purported signer nor by a person authorised by the purported signer. Article 13, on the other hand, provides that notwithstanding that the message was unauthorized, the addressee may regard the data message as being that of the purported originator. The Working Group may wish to consider the need for including a new rule on the unauthorized use of signatures in these Uniform Rules and the relationship of such a rule to draft article 7 on liability.

**Article 5. Presumption of integrity**

(1) **Variant A**

Where [a trustworthy security procedure] [an enhanced electronic signature] is properly applied to a designated portion of a data message and indicates that the designated portion of the data message has not been changed since a specific point in time, it is presumed that the designated portion of the data message has not been changed since that time.

(2) The provisions of this article do not apply to the following: [...].

**References**

A/CN.9/454, paras. 54-63;
A/CN.9/WG.IV/WP.76, paras. 25 and 26;
A/CN.9/446, paras. 47 and 48 (draft article 2);
A/CN.9/WG.IV/WP.73, paras. 28-32; and
A/CN.9/437, paras. 43, 48 and 92.

**Remarks**

34. Draft article 5 has been revised in accordance with the decision of the Working Group at its thirty-third session (A/CN.9/454, paras. 54-63). The revised draft purports to establish a presumption as to integrity of the data message. In order to establish the presumption both variants of the draft article appear to require that the security procedure or signature must actually have been applied with a result which shows that there has been no change to the message. Once this evidence is available, little value could be attached to a presumption to that effect. The Working
Group may wish to consider whether the draft article should be drafted as a presumption or as a substantive rule of law.

35. One of the alternatives provided in Variant A is based upon the application of the signature as indicating integrity. The Working Group may wish to consider whether both the application and the verification of that signature (and the use of the hash function or message digest) should be included or whether the application of a security procedure is a preferable formulation.

36. Draft article 5(1) of both Variants A and B makes a direct connection between the signing of a message and the integrity of that message, a connection which may not always be useful or necessary. In some cases, the integrity function is an integral part of the type of electronic signature technology used (as may be the case with particular types of [enhanced] electronic signatures), and a presumption as to integrity simply states what is a direct result of the use of that technology. In other cases, the signature technology used may not be capable of satisfying a requirement for integrity, even though in all other respects such a signature may be considered to be an [enhanced] electronic signature. In addition, there will be cases where it may be necessary to prove the integrity of a message which is not signed. For such cases, a rule establishing a direct connection between integrity and signature may not be useful.

37. Where integrity is required in order to show that a message is an original, article 8 of the Model Law is relevant. The Working Group may wish to consider whether a presumption as to integrity should be included in these Rules as a substantive rule, whether the integrity function should be included in the definition of [enhanced] electronic signature and the relationship between this draft article and article 8 of the Model Law.

Article 6. Predetermination of [enhanced] electronic signature

(1) [The organ or authority specified by the enacting State as competent] may determine:

(a) that an electronic signature is [an [enhanced] electronic signature] [satisfies the requirements of article 7 of the Model Law];

(b) that a security procedure satisfies the requirements of article 5.

(2) Any determination made under paragraph (1) should be consistent with recognized international technical standards.

(3) [Subject to [these Rules and] applicable law] parties may agree that an electronic signature is to be treated among themselves:

(a) as an [enhanced] electronic signature;

(b) as satisfying the requirements of article 7 of the Model Law.

References

A/CN.9/454, paras. 64-75
A/CN.9/WG.IV/WP.76, para. 27.
A/CN.9/446, paras. 37-45 (draft article 1); and
A/CN.9/WG.IV/WP.73, para. 27.

Remarks

38. The previous version of draft article 6(1) referred to the signature as satisfying the requirements of draft article 1(b) (the definition of [enhanced] electronic signature). This revision of draft article 6 allows for a determination that an electronic signature is an [enhanced] electronic signature or, as an alternative possibility, that the electronic signature satisfies the requirements of article 7, thereby establishing a clear shortcut. If an electronic signature is an [enhanced] electronic signature under Variant A of draft article 3, there is no need to state that it satisfies the requirements of article 7, since this is clear from its [enhanced] status.

39. The revised version of draft article 6(1)(b) agreed to at the thirty-third session of the Working Group (A/CN.9/454, para. 73) refers to the “requirements of article 5”. As revised at the same session (A/CN.9/454, para. 61) draft article 5 no longer establishes requirements for integrity. The Working Group may wish to reconsider the inclusion of a reference to draft article 5 in draft article 6(1)(b).

40. In draft article 6(2) the words “to the extent that they exist” have been deleted on the basis that they are not necessary in the context of a Model Law. To the extent that such standards exist, States enacting the Uniform Rules should be encouraged to observe them and a note to this effect could be included, for example, in a guide to enactment.

41. The language of draft article 6(3) has been revised to reflect the concern expressed at the thirty-third session of the Working Group (A/CN.9/454, para. 71) that, while party autonomy should be respected, any agreement between parties as to the use of an electronic signature should not operate to affect third parties. The revision also addresses concerns (A/CN.9/454, para. 75) as to the use of the phrase “determine the effect of a signature” (emphasis added) and what that might mean in different legal systems. Draft paragraph (3) adopts the drafting of paragraph (1), providing the determination of [enhanced] status as an alternative to a determination that the signature meets the requirements of article 7 of the Model Law.

Article 7. Liability for unauthorized use of [enhanced] electronic signature

Variant A

Where the use of an [enhanced] electronic signature was unauthorized and the purported signee did not exercise reasonable care to avoid the unauthorized use of its signature and to prevent the addressee from relying on such a signature,
Variant X the signature is nevertheless regarded as authorized, unless the relying party knew or should have known that the signature was not authorized.

Variant Y the purported signer may be held liable only for the cost of restoring the parties to their position before the unauthorized use of the signature, unless the relying party knew or should have known that the signature was not that of the purported signer.

Variant Z the purported signer is liable [to pay damages to compensate the relying party] for harm caused, unless the relying party knew or should have known that the signature was not that of the purported signer.

Variant B

(1) Where:

(a) the use of an [enhanced] electronic signature was unauthorized;

(b) the purported signer did not exercise reasonable care to avoid the unauthorized use of its signature and to prevent the addressee from relying on such signature; and

(c) the addressee reasonably relied on the signature in good faith to its detriment the signature is [attributed] [attributable] to the purported signer for the purpose of allocating responsibility for the cost of restoring the parties to their position prior to the unauthorized use of the signature.

(2) Paragraph (1) shall not apply to the extent that the addressee knew or should have known that use of the signature was unauthorized.

Variant C

(1) Where an [enhanced] electronic signature is affixed to a data message and:

(a) the use of the [enhanced] electronic signature was unauthorized;

(b) the purported signer did not exercise reasonable care to avoid the unauthorized use of its signature; and

(c) the addressee reasonably relied on the signature in good faith to its detriment, the data message shall be attributed to the purported signer unless it [is not just and equitable] [would be manifestly unfair] to do so, having regard to the purposes for which the data message was used and other relevant circumstances.

(2) [Where subparagraphs (a), (b) and (c) of paragraph (1) apply, and the data message is not attributed to the purported signer under paragraph (1)] [Where the data message is not attributed to the purported signer under paragraph (1) on the grounds of manifest unfairness], the purported signer is nevertheless liable for the cost of restoring the addressee to the position it occupied prior to the use of the unauthorized signature.

(3) Paragraph (1) shall not apply:

(a) to the extent that the addressee knew or should have known, had it exercised reasonable care, that the signature was not that of the purported signer;

(b) where the addressee received notice from the purported signer that the signature was not that of the purported signer and the addressee had a reasonable time to act accordingly.

(4) It would be manifestly unfair to attribute an unauthorized signature to a purported signer under paragraph (1) if:

(a) to do so would cause hardship to the purported signer out of proportion to the loss suffered by the addressee;

(b) [.....]

References

A/CN.9/454, paras. 76-88;
A/CN.9/WG.1V/WP.76, paras. 28-30;
A/CN.9/446, paras. 49-61 (draft article 3);
A/CN.9/WG.1V/WP.73, paras. 33-36;
A/CN.9/437, paras. 118-124 (draft article E); and
A/CN.9/WG.1V/WP.71, paras. 64 and 65.

Remarks

42. Draft article 7 has been revised to include a number of different variants as discussed by the Working Group at its thirty-third session (A/CN.9/454, paras. 76-88). As currently drafted, Variants A and B both raise issues which are covered by article 13 of the Model Law, in particular under article 13(3). It should be noted, however, that article 13 of the Model Law deals with attribution of a data message, while draft article 7 deals with unauthorized use of a signature.

43. The way in which the issue of attribution is treated in draft article 7 is slightly different from the treatment under article 13. For example, under article 13(4)(a) and (b), where there is an unauthorized message within the meaning of article13(3)(b), the receiving party can rely upon the message, provided it has not received notice of the lack of authorization, or it should have known that the message was unauthorized. Article 13 does not specify that the purported signer can raise the defence that it acted reasonably to protect the signature (i.e. by preventing access to a method used by the signer to identify the data message as its own), which it can do under Variant B(b) of draft article 7. In addition, article 13 does not address the issue of the relying party acting in good faith to its detriment; in contrast, it is clear that Variant B(c) of draft article 7 of the Uniform Rules is based upon the detriment suffered by the addressee and the idea of restitution.

44. The focus of article 13 of the Model Law and draft article 7 of the Uniform Rules is different. Article 13 focuses upon attribution of the message while draft article 7 establishes a rule of liability for attribution of the
signature. The Working Group may wish to recall the decision to be made under draft article 4 as to whether there is a legal need for a distinction to be drawn between attribution of the message and attribution of the signature (see above, para. 32). The relationship between the two draft articles may need to be considered to ensure that there is no confusion, in cases of a signed data message, as to which provision should be used to attribute the data message. One means of avoiding the potential for confusion would be to provide a specific rule applicable to cases in which the data message is signed with an [enhanced] electronic signature, as in Variant C of draft article 7. In addition to the grounds of manifest unfairness, draft article 7(3) repeats the two instances provided by article 13 where the message cannot be attributed to the purported signer, while draft article 7(4) provides some guidance as to what may constitute manifest unfairness. The Working Group may like to consider other situations which might constitute manifest unfairness in the context of attribution.

Section III. Digital signatures supported by certificates

Article 8. Contents of [enhanced] certificates

Variant A
(1) For the purposes of these Rules, an [enhanced] certificate shall, as a minimum:

(a) identify the certification authority issuing it;

(b) name or identify the [signer][subject of the certificate] or a device or electronic agent under the control of [the signer] [the subject of the certificate] [that person];

(c) contain a public key which corresponds to a private key under the control of the [signer][subject of the certificate];

(d) specify the operational period of the certificate;

(e) be digitally signed or otherwise secured by the certification authority issuing it;

(f) specify restrictions, if any, on the scope of the use of the public key;

(g) identify the algorithm to be applied.

Variant B
(1) In disclosing to any party the information in a certificate, a certification authority [or the subject of a certificate] shall ensure that such information shall include, at least, that which is set out in paragraph (2), except to the extent expressly otherwise agreed between the certification authority [or the subject, as the case may be] and such party.

Variant X (2) The information referred to in paragraph (1) shall include:

(a) for all certificates,

(i) the identity of the certification authority using it;

(ii) the public key which corresponds to a private key under the control of the [signer][subject of the certificate];

(iii) the digital or other signature of the certification authority issuing the certificate [the information];

(b) for [ ... ] certificates,

(i) the operational period of the certificate;

(ii) the restrictions, if any, applicable to the scope of the use of the public key;

(iii) the identity of the algorithm to be applied.

Variant Y (2) The information referred to in paragraph (1) shall include:

(a) the identity of the certification authority using [the certificate][the information];

(b) the name or identity of the [signer][subject of the certificate] or a device or electronic agent under the control of [the signer] [the subject of the certificate] [that person];

(c) the public key which corresponds to a private key under the control of the [signer] [subject of the certificate];

(d) the digital or other signature of the certification authority issuing the certificate [the information];

(3) Certificates may also include other information, including:

(a) the operational period of the certificate;

(b) the restrictions, if any, applicable to the scope of the use of the public key;

(c) the identity of the algorithm to be applied.

References
A/CN.9/454, paras. 89-116;
A/CN.9/WG.IV/WP.76, para. 31;
A/CN.9/446, paras. 113-131 (draft article 8);
A/CN.9/WG.IV/WP.73, paras. 50-57;
A/CN.9/437, paras. 98-113 (draft article C); and
A/CN.9/WG.IV/WP.71, paras. 18-45 and 59 and 60.

Remarks
45. In view of the speed at which technology is changing and the development of forms of certification not based
upon the three-party model (signer, relying party and certification authority), concern was expressed at the thirty-third session of the Working Group as to the appropriateness of including in these Rules a single provision dealing with the content of certificates (A/CN.9/454, paras. 90-97). This revision of draft article 8 includes the two variants which the Working Group agreed (A/CN.9/454, para 116) would provide the basis for future discussion.

46. Variant B reflects a concern that the issuing of a certificate might cover only the handing out of a certificate to the subject of the certificate, involving a contractual relationship, as opposed to disclosure of the information in the certificate to any relying third party. Variant B establishes an obligation to disclose certain information on a certificate, but this is not linked to any obligation to include that information in a certificate as a prerequisite to disclosure. Where any information is not included in a certificate, problems could arise if there is nevertheless an obligation to disclose such information. The Working Group may wish to consider whether it would be preferable to establish a provision which sets out the minimum information to be included in the certificate and a separate provision dealing with the obligation of disclosure.

Article 9. Effect of digital signatures supported by certificates

(1) In respect of all or any part of a data message, where the originator is identified by a digital signature, the digital signature is an [enhanced] electronic signature if:

**Variant A**

(a) the digital signature was created during the operational period of a valid certificate and is [properly] verified [during the operational period of a valid certificate] by reference to the public key listed in the certificate;

(b) the certificate purports to bind a public key to [the signers] [a person’s] [the originator’s] identity;

(c) the certificate was issued for the purpose of supporting digital signatures which are [enhanced] electronic signatures; and

(d) the certificate was issued:

(i) by a certification authority licensed by ... [the enacting State specifies the organ or authority competent to license certification authorities and to promulgate regulations for the operation of licensed certification authorities]; or

(ii) by a certification authority accredited by a responsible accreditation authority applying commercially appropriate and internationally recognized standards covering the trustworthiness of the certification authority’s technology, practices and other relevant characteristics. A non-exclusive list

of bodies or standards that comply with this paragraph may be published by ... [the enacting State specifies the organ or authority competent to issue recognized standards for the operation of licensed certification authorities]; or

(iii) in accordance with commercially appropriate and internationally recognized standards.

**Variant B**

(a) the digital signature was [securely] created during the operational period of a valid certificate and is [properly] verified [during the operational period of a valid certificate] by reference to the public key listed in the certificate; and

(b) the certificate binds a public key to [the person’s] [the originator’s] [...] identity according to procedures established by:

(i) [the enacting State specifies the organ or authority competent to license certification authorities and to promulgate regulations for the operation of licensed certification authorities]; or

(ii) a responsible accreditation authority applying commercially appropriate and internationally recognized standards covering the trustworthiness of the certification authority’s technology, practices and other relevant characteristics; or

(iii) [international standards and commercial practices or usages widely known and regularly observed in the trade involved in the transaction].

(2) A digital signature that does not meet the requirements in paragraph (1) is regarded as an [enhanced] electronic signature if:

(a) sufficient evidence exists to indicate that:

(i) the certificate accurately binds the public key to the identity of the [subject of the certificate] [...]; and

(ii) the digital signature was properly created and verified [during the operational period of a valid certificate] using a trustworthy security procedure; or

(b) it qualifies as an [enhanced] electronic signature under other provisions of these Rules.

References

A/CN.9/454, paras. 117-138;
A/CN.9/WG.1IV/WP.76, paras. 32-38;
A/CN.9/446, paras. 71-84 (draft article 5);
A/CN.9/WG.1IV/WP.73, paras. 39-44; and
A/CN.9/437, paras. 43, 48 and 92
Remarks

47. Draft article 9 has been revised to reflect the decision of the Working Group at its thirty-third session (A/CN.9/454, para 136) that Variants A and B should be included in the text for future discussion. It sets out conditions that have to be met in order for a digital signature to be considered an [enhanced] electronic signature. [Enhanced] electronic signature is generally defined in draft article 1(b) as a signature which meets certain conditions. The Working Group may wish to consider whether the conditions in draft article 9 are additional to the general conditions of the definition, or intended to clarify and elaborate those conditions. The current version of draft article 9(2)(b), however, provides that a digital signature can be considered to be an [enhanced] electronic signature even if it does not meet the requirements of draft article 9(1), provided it qualifies as an [enhanced] electronic signature under other provisions of the Rules. This would include qualifying under the definition in draft article 1. If draft article 9 is not clearly drafted as an elaboration of the conditions set out in draft article 1, the Rules will establish two different standards for what is to be considered an [enhanced] electronic signature.

48. The Working Group may wish to consider draft article 9 in the context of draft article 1, with a particular focus on digital signature technology. The draft article could deal specifically, for example, with how a digital signature could satisfy the requirements of draft article 1(b) (i) to (iii).

Chapter III. Certification authorities and related issues

Article 10. Undertaking upon issuance of [enhanced] certificate

(1) By issuing an [enhanced] certificate, the certification authority undertakes [to any person who reasonably relies on the [enhanced] certificate] that:

(a) the certification authority has complied with all applicable requirements of [these Rules];

(b) all information in the [enhanced] certificate is accurate as of the date it was issued, [unless the certification authority has stated in the [enhanced] certificate that the accuracy of specified information is not confirmed];

(c) to the certification authority’s knowledge, there are no known, material facts omitted from the [enhanced] certificate which would adversely affect the reliability of the information in the [enhanced] certificate; and

(d) that if the certification authority has published a certification practice statement, the [enhanced] certificate has been issued by the certification authority in accordance with that certification practice statement.

(2) By issuing an [enhanced] certificate, the certification authority makes the following additional undertakings in respect of the [signer][subject] identified in the [enhanced] certificate [to any person who reasonably relies on the [enhanced] certificate]:

(a) that the public key and private key of the [signer][subject] identified in the [enhanced] certificate constitute a functioning key pair; and

(b) that at the time of issuing the [enhanced] certificate, the private key:

(i) corresponds to the [signer][subject] identified in the [enhanced] certificate; and

(ii) corresponds to the public key listed in the [enhanced] certificate.

References

A/CN.9/454, paras. 139-144;
A/CN.9/WG.IV/WP.76, para. 39;
A/CN.9/446, paras. 134-145 (draft article 10);
A/CN.9/WG.IV/WP.73, paras. 61-63;
A/CN.9/437, paras. 51-73 (draft article H); and
A/CN.9/WG.IV/WP.71, paras. 70-72.

Remarks

49. Draft article 10 reflects the decision made by the Working Group at its thirty-third session (A/CN.9/454, paras. 140-144), although the Working Group agreed that this article would need to be considered in the future in conjunction with draft articles 11 and 12.

50. The revised draft of article 10 is limited in its application to [enhanced] electronic signatures on the basis that prescribing a mandatory standard for all types of certificates may not be appropriate in view of the numerous types and uses of certificates that may develop.

Article 11. Contractual liability

(1) As between a certification authority issuing a certificate and the holder of that certificate [or any other relying party having a contractual relationship with the certification authority], the rights and obligations of the parties [and any limitation thereon] are determined by their agreement [subject to applicable law].

(2) [Subject to article 10], a certification authority may, by agreement, exempt itself from liability for any loss resulting from reliance on the certificate. However, the clause that limits or excludes the liability of the certification authority may not be invoked to the extent that exclusion or limitation of contractual liability would [be grossly unfair] [be inherently unfair and lead to an
evident imbalance between the parties] [unjustifiably give one party an excessive advantage], having regard to the purpose of the contract and other relevant circumstances.

References
A/CN.9/454, paras. 145-157;
A/CN.9/WG.IV/WP.76, para. 40;
A/CN.9/446, paras. 146-154 (draft article 11);
A/CN.9/WG.IV/WP.73, paras. 64 and 65;
A/CN.9/437, paras. 51-73 (draft article H); and
A/CN.9/WG.IV/WP.71, paras. 70-72.

Remarks
51. Draft article 11 reflects the decision of the Working Group at its thirty-third session (A/CN.9/454, para. 149) to maintain an article along the lines of draft article 11 in the Uniform Rules. Concern was expressed at the session that the term “grossly unfair” would not be understood in all legal systems (A/CN.9/454, para. 152). The Working Group was reminded that paragraph (2) was inspired by the UNIDROIT Principles on International Commercial Contracts (Article 7.1.6) as an attempt to provide a uniform standard for assessing the general acceptability of exemption clauses. The reference to the limitation or exemption of liability being “grossly unfair” suggested a flexible approach to exemption clauses, with the aim of promoting a broader recognition of limitation and exemption clauses than would otherwise be the case if the Uniform Rules were to refer merely to the law applicable outside the Uniform Rules (A/CN.9/WG.IV/WP.73, para. 64). Additional words in square brackets have been included in order to better explain the term “grossly unfair”. These words are taken from the explanatory material to article 7.1.6 of the UNIDROIT Principles.

Article 12. Liability of the certification authority to parties relying on certificates

(1) Subject to paragraph (2), where a certification authority issues a certificate, it is liable to any person who reasonably relies on that certificate for:

(a) errors in or omissions from the certificate, unless the certification authority proves that it or its agents have taken all reasonable measures to avoid errors in or omissions from the certificate;

(b) failure to register revocation of the certificate, unless the certification authority proves that it or its agents have taken all reasonable measures to register the revocation promptly upon receipt of notice of the revocation; and

(c) the consequences of not following any procedure set forth in the certification practice statement published by the certification authority.

(2) Reliance on a certificate is not reasonable to the extent that it is contrary to the information contained [or incorporated by reference] in the certificate [or in a revocation list] [or in the revocation information]. [Reliance is not reasonable, in particular, if [to the extent to which] it is:

(a) for a purpose contrary to the purpose for which the certificate was issued;

(b) in respect of a transaction, the value of which exceeds the value for which the certificate is valid; or

(c) [...]”

References
A/CN.9/454, paras. 158-163;
A/CN.9/WG.IV/WP.76, para. 41;
A/CN.9/446, paras. 155-173 (draft article 12);
A/CN.9/WG.IV/WP.73, paras. 66 and 67;
A/CN.9/437, paras. 51-73 (draft article H); and
A/CN.9/WG.IV/WP.71, paras. 70-72.

Remarks
52. At its thirty-third session the Working Group agreed that draft articles 10, 11 and 12 would need to be considered together at a future meeting to ensure that obligations imposed upon certification authorities corresponded with the liability rules established by the Uniform Rules (A/CN.9/454, para. 159), but that draft article 12 should be retained and revised to reflect a number of drafting changes. These drafting changes have been made in this revision of draft article 12.

General remarks regarding draft articles 13-15

53. For lack of sufficient time, the Working Group had only a preliminary discussion of draft articles 13, 14 and 15 (A/CN.9/454, paras. 164-169). Some concerns were expressed about the level of detail of these draft articles and the technical assumptions upon which they were based. It was proposed at the Working Group that these draft articles should only be applicable to digital signatures and that, since they dealt with primary obligations of a certification authority, the substance of those obligations should be resolved before issues of liability could be considered. It was agreed that the draft articles should be retained in square brackets for future consideration.

[Article 13. Revocation of certificate

“(1) During the operational period of a certificate, the certification authority that issued the certificate must revoke the certificate in accordance with the policies and
procedures governing revocation specified in the applicable certification practice statement or, in the absence of such policies and procedures, promptly upon receiving:

“(a) a request for revocation by the [signer] [subject] identified in the certificate, and confirmation that the person requesting revocation is the [rightful] [signer] [subject], or is an agent of the [signer] [subject] with authority to request the revocation;

“(b) reliable evidence of the [signer’s] [subject’s] death if the [signer] [subject] is a natural person; or

“(c) reliable evidence that the [signer] [subject] has been dissolved or has ceased to exist, if the [signer] [subject] is a corporate entity.

“(2) The [signer] [subject] in relation to a certified key pair is under an obligation to revoke, or to request revocation of, the corresponding certificate where the [signer] [subject] knows that the private key has been lost, compromised or is in danger of being misused in other respects. If the [signer] [subject] fails to revoke, or to request revocation of, the certificate in such a situation, the [signer] [subject] is liable to any person relying on a message as a result of the failure by the [signer] [subject] to undertake such revocation.

“(3) Regardless of whether the [signer] [subject] identified in the certificate consents to the revocation, the certification authority that issued a certificate must revoke the certificate promptly upon acquiring knowledge that:

“(a) a material fact represented in the certificate is false;

“(b) the certification authority’s private key or information system was compromised in a manner affecting the reliability of the certificate; or

“(c) the [signer’s] [subject’s] private key or information system was compromised.

“(4) Upon effecting the revocation of a certificate under paragraph (3), the certification authority must notify the [signer] [subject] and relying parties in accordance with the policies and procedures governing notice of revocation specified in the applicable certification practice statement, or in the absence of such policies and procedures, promptly notify the [signer] [subject] and promptly publish notice of the revocation if the certificate was published, and otherwise disclose the fact of revocation upon inquiry by a relying party.

“(5) [As between the [signer] [subject] and the certification authority,] the revocation is effective from the time when it is [received] [registered] by the certification authority.

“(6) As between the certification authority and any other relying party, the revocation is effective from the time it is [registered] [published] by the certification authority.”

[Article 14. Suspension of certificate

“During the operational period of a certificate, the certification authority that issued the certificate must suspend the certificate in accordance with the policies and procedures governing suspension specified in the applicable certification practice statement or, in the absence of such policies and procedures, promptly upon receiving a request to that effect by a person whom the certification authority reasonably believes to be the [signer] [subject] identified in the certificate or a person authorized to act on behalf of that [signer] [subject].”

[Article 15. Register of certificates

(1) Certification authorities shall keep a publicly accessible electronic register of certificates issued, indicating the time when any individual certificate expires or when it was suspended or revoked.

(2) The register shall be maintained by the certification authority.

Variant A for at least [30] [10] [5] years

Variant B for ... [the enacting State specifies the period during which the relevant information should be maintained in the register] after the date of revocation or expiry of the operational period of any certificate issued by that certification authority.

Variant C in accordance with the policies and procedures specified by the certification authority in the applicable certification practice statement.]

CONTENTS

<table>
<thead>
<tr>
<th>CONTENTS</th>
<th>Paragraphs</th>
</tr>
</thead>
<tbody>
<tr>
<td>INTRODUCTION</td>
<td>1-6</td>
</tr>
<tr>
<td>DRAFT ARTICLES ON ELECTRONIC SIGNATURES</td>
<td>7-24</td>
</tr>
<tr>
<td>Article A. Definitions</td>
<td>7-10</td>
</tr>
<tr>
<td>Article B. Compliance with requirements for signature</td>
<td>11-12</td>
</tr>
<tr>
<td>Article C. Compliance with requirements for original</td>
<td>13-14</td>
</tr>
<tr>
<td>Article D. Determination of enhanced electronic signature</td>
<td>15</td>
</tr>
<tr>
<td>Article E. Freedom of contract</td>
<td>16-17</td>
</tr>
<tr>
<td>Article F. Obligations of the signature holder</td>
<td>18-19</td>
</tr>
<tr>
<td>Article G. Reliance on enhanced electronic signatures</td>
<td>20-21</td>
</tr>
<tr>
<td>Article H. Obligations of an information certifier</td>
<td>22-24</td>
</tr>
</tbody>
</table>

INTRODUCTION

1. The Commission, at its thirtieth session, in May 1997, entrusted the Working Group on Electronic Commerce with the preparation of uniform rules on the legal issues of digital signatures and certification authorities. With respect to the exact scope and form of such uniform rules, it was generally agreed at that session that no decision could be made at such an early stage of the process. In addition, it was felt that, while the Working Group might appropriately focus its attention on issues of digital signatures in view of the apparently predominant role played by public-key cryptography in the emerging electronic-commerce practice, the uniform rules to be prepared should be consistent with the media-neutral approach taken in the UNCITRAL Model Law on Electronic Commerce (hereinafter referred to as "the Model Law"). Thus, the uniform rules should not discourage the use of other authentication techniques. Moreover, in dealing with public-key cryptography, those uniform rules might need to accommodate various levels of security and to recognize the various legal effects and levels of liability corresponding to the various types of services being provided in the context of digital signatures. With respect to certification authorities, while the value of market-driven standards was recognized by the Commission, it was widely felt that the Working Group might appropriately envisage the establishment of a minimum set of standards to be met by certification authorities, in particular where cross-border certification was sought.\(^1\)

2. At its thirty-first session, in June 1998, the Commission had before it the report of the Working Group on the work of its thirty-second session (A/CN.9/446). The Commission expressed its appreciation of the efforts accomplished by the Working Group in its preparation of draft uniform rules on electronic signatures. It was noted that the Working Group, throughout its thirty-first and thirty-second sessions, had experienced manifest difficulties in reaching a common understanding of the new legal issues arising from the increased use of digital and other electronic signatures. It was also noted that a consensus was still to be found as to how those issues might be addressed in an internationally acceptable legal framework. However, it was generally felt by the Commission that the progress achieved so far indicated that the draft uniform rules on electronic signatures were progressively being shaped into a workable structure. The Commission reaffirmed the decision made at its thirty-first session as to the feasibility of preparing such uniform rules\(^2\) and expressed its confidence?

\(^2\)Ibid., paras. 249 and 250.
that more progress could be accomplished by the Working Group at its thirty-third session (New York, 29 June-10 July 1998) on the basis of the revised draft prepared by the Secretariat (A/CN.9/WG.IV/ WP.76). In the context of that discussion, the Commission noted with satisfaction that the Working Group had become generally recognized as a particularly important international forum for the exchange of views regarding the legal issues of electronic commerce and for the preparation of solutions to those issues.¹


4. This note contains draft articles, a number of which are based on those contained in document A/CN.9/ WG.IV/ WP.79, which could be considered by the Working Group in combination with, or as alternatives to, draft articles 1-15 of the revised draft Uniform Rules.

5. The purpose of this note is to facilitate discussion in the Working Group by providing draft articles based on the key elements of Chapters II and III of the revised draft Uniform Rules contained in document A/CN.9/WG.IV/ WP.79, together with three draft articles which address the difficulties encountered by the Working Group in its discussions of the issues of liability. As such, these three articles draw upon a number of obligations of parties to signature transactions already set out in Chapters II and III of the revised draft Uniform Rules. The terminology and definitions of the draft Uniform Rules as set out in document A/CN.9/ WG.IV/ WP.79, have been revised as necessary.

6. In the preparation of this note, the Secretariat was assisted by a group of experts, comprising both experts invited by the Secretariat and experts designated by interested governments and international organizations.

**DRAFT ARTICLES ON ELECTRONIC SIGNATURES**

**Article A. Definitions**

For the purposes of these Rules:

(a) “Electronic signature” means data in electronic form in, affixed to, or logically associated with, a data message, and [that may be] used to [identify the signature holder in relation to the data message and indicate the signature holder's approval of the information contained in the data message].

(b) “Enhanced electronic signature” means an electronic signature which [is created and] can be verified through the application of a security procedure or combination of security procedures that ensures that such electronic signature:

(i) is unique to the signature holder [for the purpose for][within the context in] which it is used;

(ii) can be used to identify objectively the signature holder in relation to the data message;

(iii) was created and affixed to the data message by the signature holder or using a means under the sole control of the signature holder.

(c) “Signature holder” means a person by whom, or on whose behalf, an enhanced electronic signature can be created and affixed to a data message.

(d) “Information certifier” means a person or entity which, in the course of its business, engages in [providing identification services] [certifying information] which [are] [is] used to support the use of enhanced electronic signatures.

**Remarks**

7. While reflecting decisions reached by the Working Group at its thirtieth session that, consistent with media neutrality in the Model Law, the Uniform Rules should not discourage the use of any technique that would provide a “method as reliable as appropriate” as an alternative to handwritten and other paper-based signatures in compliance with article 7 of the Model Law, this document builds upon a broad definition of electronic signatures to focus more specifically upon signatures that provide a higher level of trustworthiness by reference to a set of criteria which, once met, would entail legal effects.

8. The definitions of “electronic signature” and “enhanced electronic signature” are intended to cover all techniques that might be applied to provide the functional equivalent of a handwritten signature, as understood in article 7 of the Model Law.

9. The term “signature holder” has been adopted in this draft to overcome problems which were identified with the use of the phrase “signer” i.e. that the natural meaning of the word implies that a signature has already been created, whereas in these draft articles, for example, the signature holder has certain obligations to protect its enhanced electronic signature, irrespective of whether it actually affixes it to a data message. This would be the same situation as that of the holder of a credit card or cash card where the personal identification number (PIN) should be protected, irrespective of whether or not the card was ever used.

10. “Information certifier” replaces the more specific term “certification authority”, which is generally understood in

the context of digital signatures only, to make it clear that the draft Uniform Rules should also apply to signature
technologies that may not be specifically digital signa-
tures, but which may nevertheless utilize similar functions
to those characteristic of digital signatures.

Article B. Compliance with requirements for
signature

(1) Where the law requires a signature of a person, that
requirement is met in relation to a data message if an
electronic signature is used which is as reliable as was
appropriate for the purpose for which the data message was
generated or communicated, in the light of all the circum-
cstances, including any relevant agreement.

(2) Where the law requires a signature of a person, that
requirement is met in relation to a data message if an
enhanced electronic signature is used.

(3) Paragraphs (1) and (2) apply whether the requirement
referred to therein is in the form of an obligation or whether
the law simply provides consequences for the absence of
a signature.

(4) The provisions of this article do not apply to the fol-
lowing: [...].

Remarks

11. The purpose of draft article B is to confirm the con-
nection with article 7 of the Model Law. Paragraph (1)
restates the principle of article 8 of the Model Law that an
electronic signature can satisfy a requirement of law for a
signature provided that it meets certain conditions. Para-
graph (2) provides that an enhanced electronic signature
does meet those conditions and establishes a shortcut to
satisfying the requirement of article 7.

12. Paragraphs (3) and (4) are included for consistency
with article 7 of the Model Law.

Article C. Compliance with requirements
for original

(1) Where the law requires information to be presented or
retained in its original form, that requirement in relation to
a data message if an electronic signature is used which
provides a reliable assurance as to the integrity of the
information from the time when it was first generated in its
final form, as a data message or otherwise.

(2) Where the law requires information to be presented or
retained in its original form, that requirement in relation to
a data message if an enhanced electronic signature is used.

(3) Paragraphs (1) and (2) apply whether the requirement
referred to therein is in the form of an obligation or whether
the law simply provides consequences for the absence of
a signature.

(4) The provisions of this article do not apply to the fol-
lowing: [...].

Remarks

13. The purpose of draft article B is to confirm the con-
nection with article 8 of the Model Law. Paragraph (1)
restates the principle of article 8 of the Model Law that an
electronic signature can satisfy a requirement of law for an
original provided that it meets certain conditions. Para-
graph (2) provides that an enhanced electronic signature
does meet those conditions and establishes a shortcut to
satisfying the requirement of article 8.

14. Paragraphs (3) and (4) are included for consistency
with article 7 of the Model Law.

Article D. Determination of enhanced
electronic signature

(1) [The organ or authority specified by the enacting
State as competent] may determine that an electronic sig-
nature is an enhanced electronic signature.

(2) Any determination made under paragraph (1) should
be consistent with recognized international standards.

Remarks

15. The purpose of draft article D is to make it clear that
an enacting State may designate an organ or authority that
will have the power to make determinations on what spe-
cific technologies may qualify as an enhanced electronic
signature. The purpose of paragraph (2) is to encourage
States to ensure that determinations made under paragraph
(1) conform with international standards where applicable,
thus facilitating harmonization of practices with respect to
enhanced electronic signatures and cross-border use and
recognition of signatures.

Article E. Freedom of contract

A signature holder and any person who may rely on the
electronic signature of the signature holder may determine
that as between themselves the electronic signature is to be
treated as an enhanced electronic signature.

Remarks

16. Draft article D recognizes the importance of party
autonomy in the use of enhanced electronic signatures,
while ensuring that any agreement as to what may be
treated as an enhanced electronic signature will not operate
to affect any person not a party to that agreement (i.e. third
parties).

17. This draft article is intended to be consistent with the
approach to party autonomy taken in the Model Law, and
in particular in article 4. The Model Law provides that
while certain articles (those in Chapter II) are to be
regarded as mandatory, they can nevertheless be modified by agreement to the extent that that would be permitted by national law. Similarly, draft article E is not intended to allow parties to modify form requirements where this is not permitted by national law.

Article F. Obligations of the signature holder

(1) A signature holder is obliged to:

(a) Exercise due care to avoid unauthorized use of its signature;

(b) Notify [appropriate persons] [as soon as possible] in the event its signature is compromised and could be used to create unauthorized enhanced electronic signatures;

(c) Ensure that all material representations or statements made by the signature holder to information certifiers and relying parties are accurate and complete to the best of the signature holder’s knowledge and belief.

(2) A signature holder shall be responsible for the consequences of its failure to fulfill the obligations in paragraph (1).

Remarks

20. Draft article G takes the principle of article 13(3) of the Model Law that a party relying upon a data message or, in this case an enhanced electronic signature, is only entitled to do so in certain circumstances. Such a party is not entitled to rely on a signature where it could have found out, had it taken reasonable steps, that the signature had been compromised and was no longer valid, or if the party knew or should have known that representations with respect, for example to the authorization of the signature, were not valid. For the purposes of this draft article, it is assumed that validity includes the concept of authorization of the signature.

21. Taking reasonable steps might include, for example, checking information made available by an information certifier as to the validity or otherwise of signatures it has certified, or verifying a signature using a procedure agreed with the signature holder or that was reasonable in the circumstances.

Article H. Obligations of an information certifier

(1) An information certifier is obliged to:

(a) act in accordance with the representations it makes with respect to its practices;

(b) take reasonable steps to determine accurately the identity of the signature holder and any other facts or information that the information certifier certifies;

(c) provide reasonably accessible means which enable a relying party to ascertains:

(i) the identity of the information certifier;

(ii) the method used to identify the signature holder;

(iii) any limitations on the purposes for which the signature may be used; and

(iv) whether the signature is valid and has not been compromised.

(d) Provide a means for signature holders to give notice that an enhanced electronic signature has been compromised.

(e) Ensure that all material representations or statements the information certifier makes are accurate and complete to the best of it’s knowledge and belief;

(f) Utilize trustworthy systems and procedures in performing its services.

(2) An information certifier shall be responsible for the consequences of its failure to fulfill the obligations in paragraph (1).

Remarks

22. Like draft article F, draft article H establishes minimum standards that an information certifier is obliged to
observe in conducting its business, including certifying information with respect to the identification of the signature holder, providing information on the continuing validity of signatures including notification where that signature is compromised, and in its dealings with signature holders and relying parties. The draft article includes the key obligations that generally could be expected to apply to any person in the business of an information certifier in the context of enhanced electronic signatures.

23. The draft article establishes that the information certifier is responsible for the consequences of not observing these obligations, but leaves it up to national law to determine what these consequences would be. Paragraph (3) provides that the information certifier, like the relying party, is not entitled to rely upon representations that is knows or should know are not true.

24. As in the case of draft article F, this article, which leaves it up to national law to determine the consequences of not observing these obligations, is unlikely to foster the development of harmonized rules on electronic signatures. The Working Group may wish to consider a rule along the lines of draft article 7 of the Uniform Rules (see A/CN.9/WG.1 IV/WP.79), which more specifically provides for what these consequences might be.
III. PRIVATELY FINANCED INFRASTRUCTURE PROJECTS

Draft chapters of a legislative guide on privately financed infrastructure projects: Report of the Secretary-General
(A/CN.9/458 and Add.1-9) [Original: English]

A/CN.9/458

I. INTRODUCTION

1. At its twenty-ninth session, in 1996, after consideration of the note by the Secretariat on build-operate-transfer (BOT) projects (A/CN.9/424), the United Nations Commission on International Trade Law decided to prepare a legislative guide to assist States in preparing or modernizing legislation relevant to those projects. The Commission requested the Secretariat to review issues suitable for treatment in such a legislative guide and to prepare draft materials for consideration by the Commission.

2. At its thirtieth session, in 1997, the Commission considered an annotated table of contents setting out the topics proposed for inclusion in the legislative guide (A/CN.9/438, annex). The Commission also considered initial drafts of chapters I, "Scope, purpose and terminology of the Guide" (A/CN.9/438/Add.1), II, "Parties and phases of privately financed infrastructure projects" (A/CN.9/438/Add.2), and V, "Preparatory measures" (A/CN.9/438/Add.3), of the guide. After an exchange of views on the nature of the issues to be discussed and possible methods for addressing them in the guide, the Commission generally approved the line of work proposed by the Secretariat, as contained in those documents. The Commission requested the Secretariat to seek the assistance of outside experts, as required, in the preparation of future chapters and invited Governments to identify experts who could be of assistance to the Secretariat in that task.

3. At its thirty-first session, in 1998, the Commission had before it revised versions of the earlier chapters, as well as initial drafts of additional chapters, which had been prepared by the Secretariat with the assistance of outside experts and in consultation with other international organizations. The documents included a revised table of contents (A/CN.9/444) and a draft of the introduction to the legislative guide (A/CN.9/444/Add.1), which combined, with amendments, the contents of documents A/CN.9/438/Add.1 and 2. Further documents included initial drafts of chapters I, "General legislative considerations" (A/CN.9/444/Add.2); II, "Sector structure and regulation" (A/CN.9/444/Add.3); III, "Selection of the concessionaire" (A/CN.9/444/Add.4); and IV, "Conclusion and general terms of the project agreement" (A/CN.9/444/Add.5), which incorporated some of the contents of document A/CN.9/438/Add.3. The Commission considered various specific suggestions concerning the draft chapters, as well as proposals for changing the structure of the legislative guide and reducing the number of chapters. The Commission requested the Secretariat to continue the preparation of future chapters, with the assistance of outside experts, for submission to the Commission at its thirty-second session.

4. Pursuant to that request, the Secretariat has changed the overall structure of the legislative guide, combined some of its chapters, revised the documents considered by the Commission at its thirty-first session and prepared initial drafts of the remaining chapters, with the assistance of outside experts and in consultation with other international organizations. The complete draft of the legislative guide is contained in addenda 1-9 to the present document (A/CN.9/458/Add.1-9).

II. PROPOSED STRUCTURE AND CONTENTS OF THE LEGISLATIVE GUIDE

Introduction and background information on privately financed infrastructure projects

5. An earlier draft of the introduction was contained in document A/CN.9/444/Add.1. A revised draft, which takes into account suggestions made at the thirty-first session of the Commission,4 is contained in an addendum to the present document (A/CN.9/458/Add.1).

6. In preparing the revised introduction, the Secretariat paid particular attention to the suggestion made at the thirty-first session of the Commission that some portions of

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Ibid., paras. 23-49.
the introduction were lengthy and could usefully be reduced, in particular those which anticipated to some extent issues that would be discussed in more detail in the substantive chapters.  

7. The revised introduction incorporates some of the contents of former chapter II, “Sector structure and regulation” (A/CN.9/444/Add.3), pursuant to the Commission’s decision, at its thirty-first session, to move the substance of the discussion on competition and sector structure, then contained in sections A, “Market structure and competition”, and B, “Legislative measures to implement sector reform”, of that chapter to the introductory part of the guide.  

Chapter I. General legislative considerations

8. An earlier draft of chapter I was contained in document A/CN.9/444/Add.2. A revised draft, which takes into account suggestions made at the thirty-first session of the Commission, is contained in an addendum to the present document (A/CN.9/458/Add.2).

9. Section D of draft chapter I incorporates the substance of some portions of former chapter II, “Sector structure and regulation” (A/CN.9/444/Add.3), that dealt with organizational and administrative matters pertaining to the functioning of regulatory bodies.

10. Document A/CN.9/444/Add.2 contained, in its sections B and C, a discussion on the possible impact of other areas of legislation on the successful implementation of privately financed infrastructure projects and the possible relevance of international agreements entered into by the host country for domestic legislation on those projects. That discussion has been moved to draft chapter VII, “Governing law” (A/CN.9/458/Add.8).

Chapter II. Project risks and government support

11. An initial draft of chapter II (previously numbered chapter V) is contained in an addendum to the present document (A/CN.9/458/Add.3).

12. Section B of draft chapter II provides an overview of the main risks encountered in privately financed infrastructure projects and a brief discussion of common contractual solutions for risk allocation. Section C sets out policy considerations the Government may wish to take into account when designing the level of direct government support that may be provided to infrastructure projects and discusses some additional support measures that have been used in government programmes to promote private investment in infrastructure development, without advocating the use of any of them in particular. Lastly, sections D and E outline guarantees and support measures that may be provided by international and bilateral financial institutions.

Chapter III. Selection of the concessionaire

13. An earlier version of this chapter was contained in document A/CN.9/444/Add.4. A revised draft, which takes into account suggestions made at the thirty-first session of the Commission, is contained in an addendum to the present document (A/CN.9/458/Add.4).

14. In preparing the revised version of chapter III, the Secretariat paid particular attention to the suggestion made at the thirty-first session of the Commission that the chapter should elaborate further on the fact that competitive procedures typically used for the procurement of goods, construction or services were not entirely suitable for privately financed infrastructure projects. The Secretariat has endeavoured to avoid the use of terminology that in some legal systems is normally used in connection with procurement methods for the acquisition of goods, construction and services. Extensive revisions were made, in particular, to the sections dealing with pre-selection criteria, the contents of the final requests for proposals, evaluation criteria, procedures for opening and evaluating proposals, direct negotiations, unsolicited proposals and review procedures. The revised draft chapter also includes a new subsection dealing with measures to enhance transparency in direct negotiations.

Chapter IV. The project agreement

15. An earlier version of this chapter was contained in document A/CN.9/444/Add.5. A revised draft, which takes into account suggestions made at the thirty-first session of the Commission, is contained in an addendum to the present document (A/CN.9/458/Add.5).

Chapter V. Infrastructure development and operation

16. An initial draft of chapter V is contained in an addendum to the present document (A/CN.9/458/Add.6). The draft chapter combines issues previously proposed for discussion in separate chapters.  

17. Issues discussed in the draft chapter include legal issues relating to subcontracting and the construction phase (previously proposed for inclusion in a separate chapter entitled “Construction phase”); conditions of operation of the infrastructure facility, level and quality of services, tariff structure and price adjustment provisions (previously proposed for inclusion in a separate chapter entitled “Operational phase”); provisions and remedies in the event of default or breach of the project agreement, provisions dealing with changes in conditions and unforeseen events, performance guarantees and insurance obligations of the concessionaire (previously proposed for inclusion in a separate chapter entitled “Delays, defects and other failures to perform”).

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1Ibid., paras. 32 and 47.
2Ibid., paras. 101 and 102.
3Ibid., paras. 50-95.
4Ibid., paras. 123-175.
5Ibid., para. 129.
6Ibid., paras. 176-201.
7See A/CN.9/444, paras. 21-24.
18. In line with the Commission's decision at its thirty-first session to move the substance of the discussion on regulatory issues that was contained in section C of former chapter II, "Sector structure and regulation" (A/CN.9/444/Add.3), to a future chapter dealing with the operational phase,\textsuperscript{12} draft chapter V contains a section dealing with a number of regulatory issues such as general duties of public-service providers and price control measures.

\textit{Chapter VI. End of project term, extension and termination}

19. An initial draft of chapter VI (previously numbered chapter IX) is contained in an addendum to the present document (A/CN.9/458/Add.7).

20. Section B deals with the question of whether and under what circumstances the project agreement may be extended. Section C considers circumstances that may authorize the termination of the project agreement prior to the expiry of its term. Lastly, section D deals with provisions for the winding-up of the project, including the transfer of project assets and the compensation to which either party may be entitled in the event of termination of the project agreement.

\textit{Chapter VII. Governing law}

21. An initial draft of chapter VII (previously numbered chapter X) is contained in an addendum to the present document (A/CN.9/458/Add.8).

22. Section B of the draft chapter deals with the choice of law or laws governing the project agreement and other contracts entered into by the concessionaire during the life of the project. Section C points out a few selected aspects of the laws of the host country that, without necessarily being directly involved with privately financed infrastructure projects, may have an impact on their implementation. Section D indicates the possible relevance of a number of international agreements for the implementation of privately financed infrastructure projects in the host country. The substance of sections C and D was previously contained in an earlier version of chapter I, "General legislative considerations" (A/CN.9/444/Add.2).

\textbf{Chapter VIII. Settlement of disputes}

23. An initial draft of chapter VIII (previously numbered chapter XI) is contained in an addendum to the present document (A/CN.9/458/Add.9).

24. Section B of the draft chapter deals with mechanisms for the settlement of disputes between the concessionaire and the contracting authority. Section C deals with disputes between the concessionaire and other parties, such as its contractors, suppliers, lenders and customers. Lastly, section D deals with conciliation and similar methods of solving disputes.

\textbf{III. CONCLUSIONS}

25. The Commission may wish to note that the proposed timetable for the thirty-second session of the Commission, as set out in the provisional agenda (A/CN.9/453), provides for the first eight days of the session to be devoted to a discussion of the subject of privately financed infrastructure projects. It is suggested that the Commission use that period for an in-depth consideration of the draft chapters, in particular the revised structure of the legislative guide, whether the draft chapters cover the relevant issues, whether statements made adequately address the practical needs of privately financed infrastructure projects and whether the advice given is appropriate. The Commission may wish to consider whether the legislative recommendations, as currently formulated, adequately reflect the notion of concise legislative principles, as contemplated by the Commission.\textsuperscript{13} The Commission may also wish to identify any other issues for which the formulation of model legislative provisions would increase the value of the legislative guide.\textsuperscript{14}

\begin{footnotesize}
\begin{enumerate}
\item[13]Ibid., para. 204.
\item[14]Ibid., para. 21.
\end{enumerate}
\end{footnotesize}

A/CN. 9/458/Add. 1

\textbf{INTRODUCTION AND BACKGROUND}

\textbf{INFORMATION ON PRIVATELY FINANCED INFRASTRUCTURE PROJECTS*}

\textbf{CONTENTS}

\begin{tabular}{|l|l|}
\hline
A. Purpose and scope of the \textit{Guide} & 1-4 \\
B. Terminology used in the \textit{Guide} & 5-18 \\
1. "Public infrastructure" and "public services" & 6-9 \\
2. "Concession", "project agreement" and related expressions & 10-13 \\
\hline
\end{tabular}
A. Purpose and scope of the Guide

1. The purpose of the present Guide is to assist national authorities and legislative bodies wishing to establish a legal framework favourable to the development of public infrastructure through private investment. The Guide is intended to be used as a reference in the preparation of new laws or in the review of the adequacy of existing laws and regulations. For that purpose, the Guide helps identify areas of law that are typically most relevant to private capital investment in public infrastructure projects and discusses the content of those laws which would be conducive to attracting private capital, national and foreign.

2. The Guide does not provide a single set of model solutions, but it helps the reader to evaluate different approaches available and to choose the one most suitable in the national or local context. The advice provided in the Guide aims at achieving a balance between the desire to facilitate and encourage private participation in infrastructure projects, on the one hand, and various public interest concerns of the host country, on the other.

3. The Guide is not intended to provide advice on drafting agreements for the execution of privately financed infrastructure projects or on contractual solutions for problems that arise under such agreements. Where the Guide discusses contractual issues (for instance, in chaps. IV, "The project agreement", V, "Infrastructure development and operation", and VI, "End of project term, extension and termination") the focus of the discussion is on matters that might usefully be addressed in the legislation, in addition to being dealt with in the relevant agreements.
4. The Guide pays special attention to infrastructure projects that involve an obligation, on the part of the selected investors, to undertake physical construction, repair or expansion works in exchange for the right to charge a price, either to the public or to a governmental agency, for the use of the infrastructure facility or for the services it generates. Although such projects are sometimes grouped with other transactions for the "privatization" of governmental functions or property, the Guide is not concerned with "privatization" transactions that do not relate to the development and operation of public infrastructure. In addition, the Guide does not address projects for the exploitation of natural resources, such as mining, oil or gas exploitation projects under some "concession", "licence" or "permission" issued by the Government of the host country. Although such projects often involve long-term contractual arrangements between the investors and the public authorities of the host country, the award procedures are in most cases different from those commonly used for selecting a company to carry out a public infrastructure project. By the same token, the function of a concessionaire of natural resources, as a commodity producer, is quite distinct from the position of a concessionaire in a privately financed infrastructure project.

B. Terminology used in the Guide

5. The following paragraphs explain the meaning and use of certain expressions that appear frequently in the Guide. For terms not mentioned below, such as technical terms used in financial and business management writings, the reader is advised to consult other sources of information on the subject, such as the Guidelines for Infrastructure Development through Build-Operate-Transfer (BOT) Projects prepared by the United Nations Industrial Development Organization (UNIDO).\(^1\)

1. "Public infrastructure" and "public services"

6. "Public infrastructure" refers to physical facilities that provide public services to the public or the Government. Examples of public infrastructure in this sense may be found in various sectors and include various types of facility, equipment or system: power generation plants and power distribution networks (electricity sector); systems for local and long-distance telephone communications and data transmission networks (telecommunications sector); desalination plants, waste water treatment plants, water distribution facilities (water sector); facilities and equipment for waste collection and disposal (sanitation sector); and physical installations and systems used for public transportation, such as urban and inter-urban railways, underground trains, bus lines, roads, bridges, tunnels, ports, airlines and airports (transportation sector).

7. The line between "public" and "private" infrastructure must be drawn by each country as a matter of public policy. What distinguishes public infrastructure from other types of facility and operating equipment is the expressed policy conclusion of the Government concerned that the facility in question is infused with a public interest because it provides services essential to the general public. In some countries, airports are owned by the Government; in others they are privately owned but subject to regulation or to the terms of an agreement with an agency of the Government. Hospital and medical facilities, prisons and correctional facilities may be regarded as "public" or "private" infrastructure, depending on the country's tradition. Often, but not always, power and telecommunication facilities are regarded as "public" infrastructure. No view is expressed in the Guide as to where the line should be drawn in a particular country.

8. Public infrastructure projects typically entail the provision of services or goods to the public (or to an intermediary who distributes them to the public) or the operation or maintenance of a facility open to public use. Such activities are often referred to under national law as "public services" and, according to the legal tradition of the country concerned, their providers may be referred to as "public utilities", "public services enterprises" or "public service providers". It should be noted, however, that those expressions are not uniformly understood and may encompass different activities in different legal systems. While infrastructure projects as defined above would, under most legal systems, involve some form of "public service", this expression may also be used in connection with a number of other activities not covered by the Guide.

9. The notions of "public infrastructure" and "public services" are well established in the legal tradition of some countries, being sometimes the subject of constitutional law or detailed statutory provisions. In some countries, the provision of public services may be governed by a specific body of law, which is typically referred to as "administrative law" (see chap. I, "General legislative considerations", \_\_\_\). However, such a high degree of specificity is not present in all legal systems. In a number of countries, apart from being subject to special regulations, public services are not regarded as being intrinsically distinct from other types of business. As used in this Guide, the expression "public services" refers to services provided in connection with public infrastructure or as a result of its operation. The expression "public service providers" refers to the legal entities responsible for the management of infrastructure facilities or systems that supply those public services. As used in this Guide, the expressions should not be understood in a technical sense that may be attached to them under any particular legal system.

2. "Concession", "project agreement" and related expressions

10. In many countries, public services constitute government monopolies or are otherwise subject to special regulation by the Government. Where that is the case, the provision of a public service by an entity other than the Government typically requires an act of authorization by

\(^1\)UNIDO publication, Sales No. UNIDO.95.6.E
the appropriate governmental body. Different expressions are used to define such acts of authorization under national laws and in some legal systems different expressions may be used to denote different types of authorizations. Commonly used expressions include terms such as “concession”, “franchise” or “licence”. In some legal systems, in particular those belonging to the civil law tradition, certain forms of infrastructure projects are referred to by well-defined legal concepts such as “public works concession” or “public service concession”. The Guide uses the word “concession” to refer generally to the right to construct and operate or only to operate a public infrastructure facility and to charge for its use or for the services it generates. As used in the Guide, the word “concession” is not to be understood in a technical sense that may be attached to it under any particular legal system or domestic law.

11. As used in the Guide, the term “project agreement” means an agreement between an agency of the Government and the entity or entities selected by that agency to carry out the project that sets forth the terms and conditions for the construction or modernization, operation and maintenance of the infrastructure. Other expressions that may be used in some legal systems to refer to such an agreement, such as “concession agreement” or “concession contract”, are not used in the Guide.

12. The Guide sometimes uses the word “concessionaire” to refer generally to entities that carry out public infrastructure projects under a concession issued by the public authorities of the host country. However, when referring specifically to the independent legal entity especially established by the selected bidding consortium for the purpose of carrying a particular project, the term “project company” is used instead.

13. The expression “bidding consortium” refers to a group of companies that submits a joint proposal for the development of an infrastructure project and agrees to carry it out jointly if awarded the project by the Government. Those companies are sometimes also referred to as the “project sponsors”.

3. References to national authorities

14. The expression “contracting authority” is generally used in the Guide to refer to the public authority of the host country that has the overall responsibility for the project and on behalf of which the project is awarded. Such authority may be national, provincial or local.

15. As used in the Guide, the word “Government” encompasses the various public authorities of the host country entrusted with executive or policy-making functions, at the national, provincial or local level. The words “public authorities” or “governmental agencies” are used to refer, in particular, to entities of, or related to, the executive branch of the Government. The expression “legislature” is used specifically with reference to the organs that exercise legislative functions in the host country.

16. The expression “regulatory body” is used in the Guide to refer to the governmental organ or entity that is entrusted with the authority to issue rules and regulations governing the operation of the infrastructure. The regulatory body may be established by statute with the specific purpose of regulating a particular infrastructure sector.

4. “Build-operate-transfer” and related expressions

17. The various types of projects referred to in this Guide as privately financed infrastructure projects are sometimes divided into several categories, according to the type of private participation or the ownership of the relevant infrastructure, as indicated below:

(a) “Build-operate-transfer” (BOT). An infrastructure project is said to be a BOT project when the contracting authority selects a concessionaire to finance and construct an infrastructure facility or system and gives the entity the right to operate it commercially for a certain period, at the end of which the facility is transferred to the contracting authority;

(b) “Build-transfer-operate” (BTO). This expression is sometimes used to emphasize that the infrastructure facility becomes the property of the contracting authority immediately upon its completion, the concessionaire being awarded the right to operate the facility for a certain period;

(c) “Build-rent-operate-transfer” (BROT) or “build-lease-operate-transfer” (BLOT). These are variations of BOT or BTO projects where, in addition to the obligations and other terms usual to BOT projects, the concessionaire rents the physical assets on which the facility is located for the duration of the agreement;

(d) “Build-own-operate-transfer” (BOOT). These are projects in which a concessionaire is engaged for the financing, construction, operation and maintenance of a given infrastructure facility in exchange for the right to collect fees and other charges from its users. In contrast to BOT projects, under this arrangement the private entity owns the facility and its assets until it is transferred to the contracting authority;

(e) “Build-own-operate” (BOO). This is a variation of BOOT projects where the concessionaire owns the facility permanently and is not under an obligation to transfer it back to the contracting authority.

18. Besides acronyms used to highlight the particular ownership regime, other acronyms may be used to emphasize one or more of the obligations of the concessionaire. In some projects, existing infrastructure facilities are turned over to private entities to be modernized or refurbished, operated and maintained, permanently or for a given period of time. Depending on whether the private sector will own such an infrastructure facility, those arrangements may be called either “refurbish-operate-transfer” (ROT) or “modernize-operate-transfer” (MOT), in the first case, or “refurbish-own-operate” (ROO) or “modernize-own-operate” (MOO), in the latter. The expression “design-
build-finance-operate” (DBFO) is sometimes used to emphasize the concessionaire’s additional responsibility for designing the facility and financing its construction.

C. Forms of private sector participation in infrastructure projects

19. Private sector participation in infrastructure projects may be devised in a variety of different forms, ranging from publicly owned and operated infrastructure to fully privatized projects. The appropriateness of a particular variant for a given type of infrastructure is a matter to be considered by the Government in view of the national needs for infrastructure development and an assessment of the most efficient ways in which particular types of infrastructure facilities may be developed and operated (see paras. 54-82). In a particular sector more than one option may be used.

1. Public ownership and operation

20. In cases where public ownership and control is desired, direct private financing as well as infrastructure operation under commercial principles may be achieved by establishing a separate legal entity controlled by the Government to own and operate the project. Such an entity may be managed as an independent private commercial enterprise that is subject to the same rules and business principles that apply to private companies. Some countries have a well established tradition in operating infrastructure facilities through these types of company. Opening the capital of such companies to private investment, or making use of such a company’s ability to issue bonds or other securities may create an opportunity for attracting private investment in infrastructure.

21. Another form of involving private participation in publicly owned and operated infrastructure may be the negotiation of “service contracts” whereby the public operator contracts out specific operation and maintenance activities to the private sector. The Government may also entrust a broad range of operation and maintenance activities to a private entity acting on behalf of the contracting authority. Under such an arrangement, which is sometimes referred to as a “management contract”, the private operator’s compensation may be linked to its performance, often through a profit-sharing mechanism, although compensation on the basis of a fixed fee may also be used, in particular where the parties find it difficult to establish mutually acceptable mechanisms to assess the operator’s performance.

2. Public ownership and private operation

22. Alternatively, the whole operation of public infrastructure facilities may be transferred to private entities. One possibility is to give the private entity, usually for a certain period, the right to use a given facility, to supply the relevant services and to collect the revenue generated by that activity. Such a facility may already be in existence or may have been specially built by the private entity concerned. This combination of public ownership and private operation has the essential features of arrangements that in some legal systems may be referred to as “public works concessions” or “public service concessions”.

23. Another form of private participation in infrastructure is where a private entity is selected by the contracting authority to operate a facility that has been built by or on behalf of the Government, or whose construction has been financed with public funds. Under such an arrangement, the operator assumes the obligation to operate and maintain the infrastructure and is granted the right to charge for the services it provides. In such a case, the operator assumes the obligation to pay to the contracting authority a portion of the revenue generated by the infrastructure that is used by the contracting authority to amortize the construction cost. Such arrangements are referred to in some legal systems as “lease” or “affermage”.

24. In a number of countries some types of publicly owned infrastructure are rarely taken over by the contracting authority at the end of the concession period since the contracting authority usually prefers to maintain that facility under private operation. In those cases, the private use and possession of public assets, which was originally awarded for a definite period, may, in practice, become indefinite (see chap. VI, “End of project term, extension and termination”, ___).

3. Private ownership and operation

25. Under the third approach, the private entity not only operates the facility, but also owns the assets related to it. Here, too, there may be substantial differences in the treatment of those projects under domestic laws, for instance as to whether the contracting authority retains the right to reclaim title to the facility or to assume responsibility for its operation (see also chap. V, “Infrastructure development and operation”, ___).

26. Where the facility is operated pursuant to a governmental licence, private ownership of physical assets (e.g. a telecommunication network) is often separable from the licence to provide the service to the public (e.g. long-distance telephone services), in that the licence can be withdrawn by the Government under certain circumstances. Thus, private ownership of the facility may not necessarily entail an indefinite right to provide the service.

D. Financing structures and sources of finance for infrastructure projects

1. Notion of project finance

27. In traditional financing transactions, the lenders typically rely on the overall creditworthiness of the borrower and are protected against failure of the project by guarantees provided by the borrower’s shareholders or their parent
companies. This form of financing is usually described as "corporate finance" or "balance-sheet" finance, to emphasize that the amounts borrowed to finance the project become a corporate liability of the concessionaire's shareholders. Corporate finance would typically be provided to borrowers with a sufficiently strong credit to stand the risk of project failure.

28. However, for large-scale projects involving the construction of new infrastructure facilities, the project company's shareholders are typically not ready to guarantee this. Such projects are therefore often carried out as "project finance", where the repayment of loans taken out by the borrower is assured primarily by the revenue generated by the project. Other guarantees either are absent or cover only certain limited risks. To that end, the project’s assets and revenue, and the rights and obligations relating to the project, are independently estimated and are strictly separated from the assets of the project company’s shareholders.

29. Project finance is said to be "non-recourse" financing owing to the absence of recourse to the project company’s shareholders. In practice, however, lenders are seldom ready to commit the large amounts needed for infrastructure projects solely on the basis of a project’s expected cash flow or assets. The lenders may reduce their exposure by incorporating into the project documents a number of back-up or secondary security arrangements and other means of credit support provided by the project company’s shareholders, the Government, purchasers or other interested third parties. This modality is commonly called "limited recourse" financing.

2. Financing sources for infrastructure projects

30. Alternatives to traditional public financing are playing an increasing role in the development of infrastructure. In recent years, new infrastructure investment in various countries has included projects with exclusively or pre-dominantly private funding sources. The two main types of fund are debt finance, usually in the form of loans obtained on commercial markets, and equity investment. However, financing sources are not limited to those. Public and private investment have often been combined in arrangements sometimes called "public-private partnerships".

(a) Equity capital

31. The first type of capital for infrastructure projects is provided in the form of equity investment. Equity capital is obtained in the first place from the project sponsors or other individual investors interested in taking stock in the concessionaire. However, such equity capital normally represents only a portion of the total cost of an infrastructure project. In order to obtain commercial loans or to have access to other sources of funds to meet the capital requirements of the project, the project sponsors and other individual investors have to offer priority payment to the lenders and other capital providers, thus accepting that their own investment will only be paid after payment of those other capital providers. Therefore, the project sponsors, as the main promoters of the project, typically assume the highest financial risk. At the same time, they will hold the largest share in the project’s profit once the initial investment is paid. Substantial equity investment by the project sponsors is typically welcomed by the lenders and the Government, as it helps reduce the burden of debt service on the concessionaire’s cash flow and serves as an assurance of those companies’ commitment to the project.

(b) Commercial loans

32. Debt capital often represents the main source of funding for infrastructure projects. It is obtained on the financial market primarily by means of loans extended to the project company by national or foreign commercial banks, typically using funds that originate from short- to medium-term deposits remunerated by those banks at floating interest rates. Consequently, loans extended by commercial banks are often subject to floating interest rates and normally have a maturity term shorter than the project period. However, where feasible and economic, given financial market conditions, banks may prefer to raise and lend medium- to long-term funds at fixed rates, so as to avoid exposing themselves and the concessionaire over a long period to interest rate fluctuations, while also reducing the need for hedging operations.

33. Commercial loans are usually provided by lenders on condition that their payment takes precedence over the payment of any other of the borrower’s liabilities. Therefore, commercial loans are said to be "unsubordinated" or "senior" loans. Senior loans may be divided into "unsecured" and "secured" loans according to whether their payment is guaranteed by any security provided by the borrower. Unsecured loans (i.e. loans that are not guaranteed by any security offered by the borrower) are typically provided on account of the borrower's creditworthiness. However, with a view to minimizing their exposure, lenders providing unsecured loans often require an undertaking from the borrower that its net assets will not be pledged in favour of another party in preference to the unsecured creditors. Such an undertaking is usually referred to as a "negative pledge". Secured loans, in turn, are typically guaranteed by collaterals provided by the borrower, such as shares of the project company or its property and receivables. The borrower’s ability to offer such types of security and the creditworthiness of the borrower and their guarantors typically limit the risk to which the lenders are exposed, thus reducing the cost at which the credit is offered.

(c) "Subordinated" debt

34. The third type of fund typically used in these projects are "subordinated" loans, sometimes also called "mezzanine" capital. Such loans rank higher than equity capital in order of payment, but are subordinate to senior loans. This subordination may be general (i.e. ranking generally lower than any senior debt) or specific, in which case the
loan agreements specifically identify the type of debt to which it is subordinated. Subordinated loans are often provided at fixed rates, usually higher than those of senior debt. As an additional tool to attract such capital, or sometimes as an alternative to higher interest rates, providers of subordinated loans may be offered the prospect of direct participation in capital gains, by means of the issue of preferred or convertible shares or debentures, sometimes providing an option to subscribe for shares of the concessionaire at preferential prices.

(d) Institutional investors

35. In addition to subordinated loans provided by the project sponsors or by governmental financial institutions, subordinated debt may be obtained from financing companies, investment funds, insurance companies, collective investment schemes (e.g. mutual funds), pension funds and other so-called "institutional investors". These institutions normally have large sums available for long-term investment and may represent an important source of additional capital for infrastructure projects. Their main reasons for accepting the risk of providing capital to infrastructure projects are the prospect of remuneration and interest in diversifying investment.

(e) Capital market funding

36. As more experience is gained with privately financed infrastructure projects, increased use is being made of capital market funding. Funds may be raised by the placement of preferred shares, bonds and other negotiable instruments on a recognized stock exchange. Typically, the public offer of negotiable instruments requires regulatory approval and compliance with requirements of the relevant jurisdiction, such as requirements concerning the information to be provided in the prospectus of issuance and, in some jurisdictions, the need for prior registration. Bonds and other negotiable instruments may have no other security than the general credit of the issuer or may be secured by a mortgage or other lien on specific property.

37. The possibility of gaining access to capital markets is usually greater for existing public utilities with an established commercial record than for companies specially established to build and operate a new infrastructure and lacking the required credit rating. Indeed, a number of stock exchanges require that the issuing company have some established record over a certain minimum period before being permitted to issue negotiable instruments.

(f) Financing by Islamic financial institutions

38. One additional group of potential capital providers are Islamic financial institutions. Those institutions operate under rules and practices derived from the Islamic legal tradition. One of the most prominent features of banking activities under their rules is the absence of interest payments and consequently the establishment of other forms of consideration for the borrowed money, such as profit sharing or direct participation of the financial institutions in the results of the transactions of their clients. As a consequence of their operating methods, Islamic financial institutions may be more inclined to consider direct or indirect equity participation in a project than other commercial banks.

(g) Financing by international financial institutions

39. International financial institutions may also play a significant role as providers of loans, guarantees or equity to privately financed infrastructure projects. A number of projects have been co-financed by the World Bank, the International Finance Corporation or by regional development banks.

40. International financial institutions may also play an instrumental role in the formation of "syndications" for the provision of loans to the project. Some of those institutions have special loan programmes under which they become the sole "lender of record" to a project, acting on its own behalf and on behalf of participating banks and assuming responsibility for processing disbursements by participants and for subsequent collection and distribution of loan payments received from the borrower, either pursuant to specific agreements or other rights that are available under their status of preferred creditor. Some international financial institutions may also provide equity or mezzanine capital, by investing in capital market funds specialized in securities issued by infrastructure operators. Lastly, international financial institutions may also provide guarantees against a variety of political risks, which may facilitate the project company’s task of raising funds in the international financial market (see chap. II, “Project risks and government support”, __).}

(h) Support by export credit agencies

41. Export credit agencies may provide support to the project in the form of loans, guarantees or a combination of both. The participation of export credit agencies may provide a number of advantages, such as lower interest rates than those applied by commercial banks and longer-term loans, sometimes at a fixed interest rate (see chap. II, “Project risks and government support”, __).

(i) Combined public and private finance

42. In addition to loans and guarantees extended by commercial banks and national or multilateral public financial institutions, in a number of cases public funds have been combined with private capital for financing new projects.
Such public funds may originate from government income or sovereign borrowing. They may be combined with private funds as initial investment or as long-term payments, or may take the form of governmental grants or guarantees (see chap. II, “Project risks and government support”, __).

43. Infrastructure projects may be co-sponsored by the Government through equity participation in the concessionaire, thus reducing the amount of equity and debt capital needed from private sources. In some cases, Governments undertake to make direct payments to the concessionaire with a view to stimulating investment in projects perceived to be of high commercial risk. Private sector investment in new toll roads, for instance, may be discouraged by the fact that traffic forecasts, however professionally they may be prepared, are uncertain and depend on a number of unforeseeable factors. In order to attract investment to new projects deemed to be of public interest, some countries have introduced a system of direct payment by the Government of a flat sum established, for example, on the basis of a traffic estimate (see chap. IV, “The project agreement”, __).

E. Main parties involved in implementing infrastructure projects

44. The parties to a privately financed infrastructure project may vary greatly, depending on the infrastructure sector, the modality of private sector participation and the arrangements used for financing the project. The following paragraphs identify the main parties in the implementation of a typical privately financed infrastructure project involving the construction of a new infrastructure facility and carried out under the “project finance” modality.

1. The contracting authority and other agencies of the Government

45. The execution of a privately financed infrastructure project frequently involves a number of public authorities in the host country at the national, provincial or local level. The contracting authority is the main body responsible for the project within the Government. Furthermore, the execution of the project may necessitate the active participation (e.g., for the issuance of licences or permits) of other agencies in addition to the contracting authority, at the same or at a different level of Government. Those authorities play a crucial role in the execution of privately financed infrastructure projects.

46. The contracting authority or another agency of the Government normally identifies the project pursuant to its own policies for infrastructure development in the sector concerned and determines the type of private sector participation that would allow the most efficient operation of the infrastructure facility. Thereafter, the contracting authority conducts the process that leads to the selection of the concessionaire. Furthermore, throughout the life of the project, the Government may need to provide various forms of support—legislative, administrative, regulatory and sometimes financial—so as to ensure that the facility is successfully built and adequately operated. Finally, in some projects the Government may become the ultimate owner of the facility (___).

2. The project company and the project sponsors

47. Privately financed infrastructure projects are usually carried out by a joint venture of companies including construction and engineering companies and suppliers of heavy equipment interested in becoming the main contractors or suppliers of the project. The companies that participate in such a joint venture are often referred to as the “project sponsors”. Those companies will be intensively involved in the development of the project during its initial phase and their ability to cooperate with each other and to engage other reliable partners will be essential for timely and successful completion of the work. Furthermore, the participation of a company with experience in operating the type of facility being built is an important factor to ensure the long-term viability of the project (see chap. V, “Infrastructure development and operation”, __). Where an independent legal entity is established by the project sponsors, other equity investors not otherwise engaged in the project (usually institutional investors, investment banks, bilateral or multilateral lending institutions, sometimes also the Government or a government-owned corporation) may also participate. The participation of private sector investors from the host country is sometimes encouraged by the Government.

3. Lenders

48. The risks to which the lenders are exposed in project finance, be it non-recourse or limited recourse, are considerably higher than in conventional transactions. This is even more the case where the security value of the physical assets involved (e.g. a road, bridge or tunnel) is difficult to realize, given the lack of a “market” where such assets could easily be sold or act as obstacles to recovery or repossession. This circumstance affects not only the terms under which the loans are provided (e.g. the usually higher cost of project finance and extensive conditions to funding), but also, as a practical matter, the availability of funds.

49. Owing to the magnitude of the investment required for a privately financed infrastructure project, loans are often organized in the form of “syndicated” loans with one or more banks taking the lead role in negotiating the finance documents on behalf of the other participating financial institutions, mainly commercial banks. Commercial banks that specialize in lending for certain industries are typically not ready to assume risks with which they are not familiar (for a discussion of project risks, see chap. II, “Project risks and government support”, __). For
example, long-term lenders may not be interested in providing short-term loans to finance infrastructure construction. Therefore, in large-scale projects, different lenders are often involved at different phases of the project. With a view to avoiding disputes that might arise from conflicting actions taken by individual lenders or disputes between lenders over payment of their loans, lenders extending funds to large projects typically negotiate a so-called "inter-creditor agreement". An inter-creditor agreement usually contains provisions dealing with matters such as provisions for disbursement of payments, pro rata or in a certain order of priority; conditions for declaring events of default and accelerating the maturity of credits; and coordination of foreclosure on security provided by the project company.

4. International financial institutions and export credit agencies

50. International financial institutions and export credit agencies will have concerns of generally the same order as other lenders to the project. In addition to this, they will be particularly interested in ensuring that the project execution and its operation are not in conflict with particular policy objectives of those institutions and agencies. Increasing emphasis is being given by international financial institutions to the environmental impact of infrastructure projects and their long-term sustainability. The methods and procedures applied to select the concessionaire will also be carefully considered by international financial institutions providing loans to the project. Many global and regional financial institutions and bilateral development funding agencies have established guidelines or other requirements governing procurement with funds provided by them, which is typically reflected in their standard loan agreements (see also chap. III, “Selection of the concessionaire”, ____).

5. Insurers

51. Typically, an infrastructure project will involve casualty insurance covering its plant and equipment, third-party liability insurance and worker's compensation insurance. Other possible types of insurance include insurance for business interruption, interruption in cash flows and cost overrun insurance (see chap. V, “Infrastructure development and operation”, ____). Those types of insurance are usually available on the commercial insurance markets, although the availability of commercial insurance may be limited for certain extraordinary events outside the control of the parties (e.g. war, riots, vandalism, earthquakes or hurricanes). The private insurance market is playing an increasing role in coverage against certain types of political risk, such as contract repudiation, failure by a governmental agency to perform its contractual obligations or unfair calls for independent guarantees. In some countries, insurance underwriters structure comprehensive insurance packages aimed at avoiding certain risks being left uncovered owing to gaps between individual insurance policies. In addition to private insurance, guarantees against political risks may be provided by international financial institutions, such as the World Bank, the Multilateral Investment Guarantee Agency and the International Finance Corporation, by regional development banks or by export credit agencies (see chap. II, “Project risks and government support”, ____).

6. Independent experts and advisers

52. Independent experts and advisers play an important role at various stages of privately financed infrastructure projects. Experienced companies typically supplement their own technical expertise by retaining the services of outside experts and advisers, such as financial experts, outside international counsel or consulting engineers. Merchant and investment banks often act as advisers to project sponsors in arranging the finance and in formulating the project to be implemented, an activity that, while essential to project finance, is quite distinct from the financing itself. Independent experts may advise the lenders to the project, for example, on the assessment of project risks in a specific host country. They may also assist the Government in devising sector-specific strategies for infrastructure development and in formulating an adequate legal and regulatory framework. Furthermore, independent experts and advisers may assist the contracting authority in the preparation of feasibility and other preliminary studies, in the formulation of requests for proposals or standard contractual terms and specifications, in the evaluation and comparison of proposals or in the negotiation of the project agreement.

53. In addition to private entities, a number of intergovernmental organizations (e.g. UNIDO, the regional commissions of the Economic and Social Council) and international financial institutions (e.g. the World Bank and the regional development banks) have special programmes whereby they may either provide this type of technical assistance directly to the Government or assist the latter in identifying qualified advisers.

F. Infrastructure policy, sector structure and competition

54. The roles of the public and the private sectors in the development of infrastructure have evolved considerably in history. Public services such as gas street lighting, power distribution, telegraphy and telephony, steam railways and electrical tramways were launched in the nineteenth century and in many countries they were provided by private companies that had obtained a licence or concession from the Government. Numerous privately funded road or canal projects were carried out at that time and there was a rapid development of international project financing, including international bond offerings to finance railways or other major infrastructure.

55. However, during most of the twentieth century the international trend was, in turn, toward public provision of
infrastructure and other services. Infrastructure operators were often nationalized and competition was reduced by mergers and acquisitions. The degree of openness of the world economy also receded during this period. Infrastructure sectors remained privately operated only in a relatively small number of countries, often with little or no competition. In many countries the pre-eminence of the public sector in infrastructure service provision became enshrined in the constitution (see chap. I, "General legislative considerations").

56. The current reverse trend toward private sector participation and competition in infrastructure sectors started in the early 1980s and has been driven by general as well as country-specific factors. Among the general factors are significant technological innovations; high indebtedness and stringent budget constraints limiting the public sector's ability to meet increasing infrastructure needs; the expansion of international and local capital markets, with a consequent improvement in access to private funding; and an increasing number of successful international experiences with private participation and competition in infrastructure. In many countries, new legislation was adopted, not only to govern such transactions, but also to modify the market structure and the rules of competition governing the sectors in which they were taking place.

1. Private investment and infrastructure policy

57. In most of the countries that have recently built new infrastructure through private investment, privately financed infrastructure projects are an important tool in meeting national infrastructure needs. Essential elements of national policies include the level of competition sought for each infrastructure sector, the way in which the sector is structured and the mechanisms used to ensure adequate functioning of infrastructure markets. National policies to promote private investment in infrastructure are often accompanied by measures designed to introduce competition between public service providers or to prevent abuse of monopolistic conditions where competition is not feasible.

58. In devising programmes to promote private sector investment in the development and operation of public infrastructure, a number of countries have found it useful to review the assumptions under which public sector monopolies were established, including the historical circumstances and political conditions that had led to their creation, with a view to (a) identifying those activities which still maintain the characteristics of natural monopoly; and (b) assessing the feasibility and desirability of introducing competition in certain infrastructure sectors.

59. The measures that may be required to implement a governmental policy to promote competition in various infrastructure sectors will depend essentially on the prevailing market structure. The main elements that characterize a particular market structure include barriers to the entry of competitors of an economic, legal, technical or other nature, the degree of vertical or horizontal integration, the number of companies operating in the market as well as the availability of substitute products or services.

(a) Competition policy and monopolies

60. The term monopoly in the strict sense refers to a market with only one supplier. However, pure monopoly and perfect competition mark two ends of a spectrum. Most markets for commodities or services are characterized by a degree of competition that lies between those two ends. Generally, monopolies can be classified as natural monopolies, legal monopolies and de facto monopolies; each of them may require different policy approaches:

(a) Natural monopolies. These are economic activities that allow a single provider to supply the whole market at a lower cost than two or more providers. This situation is typical for economic activities that entail large investment and high fixed costs, but decreasing costs of producing an additional unit of services (e.g. an additional cubic metre of water) to attend an increase of demand. Natural monopolies tend to exhibit large up-front fixed investment requirements that make it difficult for a new company, lacking comparable economies of scale, to enter the market and undercut the incumbent;

(b) Legal monopolies. Legal monopolies are established by law and may cover sectors or activities that are or are not natural monopolies. In the latter category, monopolies exist solely because competition is prohibited. The developments that had led many countries to the establishment of legal monopolies were often based on the consideration that national infrastructure needs, both in terms of quality and quantity, could not be adequately met by leaving infrastructure to the free market;

(c) De facto monopolies. These monopolies may not necessarily be the result of economic fundamentals or of legal provisions, but simply of the absence of competition, resulting, for example, from the integrated nature of the infrastructure company and its ability to control essential facilities to the exclusion of other suppliers.

61. Monopolies (of whatever form) have been found to have negative economic effects. A service provider operating under monopolistic conditions is typically able to fix prices. The surplus profit that results from insufficient competition implies a transfer of wealth from consumers to producers. Monopolies have also been found to cause a net loss of welfare to the economy as a result of inflated prices generated by artificially low production; a reduced rate of innovation; and insufficient efforts to reduce production costs. Furthermore, in particular in infrastructure sectors, there may be secondary effects on other markets. (For example, lack of competition and efficiency in telecommunications has negative repercussions on increases in cost for the economy at large.)

62. Despite their negative economic effects, monopolies and other regulatory barriers to competition have sometimes been maintained in the absence of natural monopoly
conditions. One of the reasons cited for retaining monopolies is that they may be used to foster certain policy objectives, such as ensuring the provision of services in certain regions or to certain categories of consumer at low prices or even below cost. Examples of services for which the price may not cover costs include lifeline telephone, water or power service, discounted transport for certain categories of travellers (e.g. school-children or senior citizens), as well as other services for low-income or rural users. A monopolistic service provider is able to finance the provision of such services through internal “cross-subsidies” from other profitable services provided in other regions or to other categories of consumers.

63. Another reason sometimes cited for retaining legal monopolies in the absence of natural monopoly conditions is to make the sector more attractive to private investors. Private operators may insist on being granted exclusivity rights to provide a certain service so as to reduce the commercial risk of their investment. However, that objective has to be balanced against the interests of consumers and the economy as a whole. For those countries where the granting of exclusivity rights is found to be needed as an incentive to private investment, it may be advisable to consider restricting competition, though on a temporary basis only (see chap. IV, “The project agreement”, __).

(b) Scope for competition in different sectors

64. Until recently, monopolistic conditions prevailed in most infrastructure sectors either because the sector was a natural monopoly or because regulatory barriers or other factors (e.g. vertically integrated structure of public service providers) prevented effective competition. However, rapid technological progress has broadened the potential scope for competition in infrastructure sectors, as briefly discussed below:

(a) Telecommunication sector. New wireless technology not only makes mobile telecommunication services possible, but it is also increasingly competing with fixed (wired) services. Fibre optic networks, cable television networks, data transmission over power lines, global satellite systems, increasing computing power, improved data compression techniques, convergence between communications, broadcasting and data processing are further contributing to the breakdown of traditional monopolies and modes of service provision. As a result of these and other changes, telecommunication services have become competitive and countries are increasingly opening up the sector to free entry, while limiting access only to services that require the use of scarce public resources, such as radio frequency;

(b) Energy sector. In the energy sector, combined-cycle gas turbines and other technologies allowing for efficient power production on smaller scales and standardization in manufacturing of power generation equipment have led several countries to change the monopolistic and vertically integrated structure of domestic electricity markets. Increasing computing power and improved data-processing software make it easier to dispatch electricity across a grid and to organize power pools and other mechanisms to access the network and trade in electricity;

(c) Transport sector. Technology is in many cases also at the origin of changing patterns in the transport sector: the introduction of containers and other innovations, such as satellite communications, making it possible to track shipments across the globe, have had profound consequences on shipping, port management and rail and truck transport, while fostering the development of intermodal transport.

65. Technological changes such as these have prompted the legislatures in a number of countries to extend competition to infrastructure sectors by adopting legislation that abolishes monopolies and other barriers to entry, changes the way infrastructure sectors are organized and establishes a regulatory framework fostering effective competition. The extent to which this can be done depends on the sector, the size of the market and other factors.

2. Restructuring of infrastructure sectors

66. In many countries, private participation in infrastructure development has followed the introduction of measures to restructure infrastructure sectors. Legislative action typically begins with the abolition of rules that prohibit private participation in infrastructure and the removal of all other legal impediments to competition that cannot be justified by reasons of public interest. It should be noted, however, that the extent to which a particular sector may be opened to competition is a decision that is taken in the light of the country’s overall economic policy. Some countries, in particular developing countries, might have a legitimate interest in promoting the development of certain sectors of local industry and might thus choose not to open certain infrastructure sectors to competition.

67. For monopolistic situations resulting from legal prohibitions rather than economic and technological fundamentals, the main legislative action needed to introduce competition is the removal of the existing legal barriers. This may need to be reinforced by rules of competition (such as the prohibition of collusion, cartels, predatory pricing or other unfair trading practices) and regulatory oversight (see chap. I, “General legislative considerations”, (__)). For a number of activities, however, effective competition may not be obtained through the mere removal of legislated barriers without legislative measures to restructure the sector concerned. In some countries, monopolies have been temporarily maintained only for the time needed to facilitate a gradual, more orderly and socially acceptable transition from a monopolistic to a competitive market structure.

(a) Unbundling of infrastructure services

68. In the experience of some countries it has been found that vertically or horizontally integrated infrastructure companies may be able to prevent effective competition.
Integrated companies may try to extend their monopolistic powers in one market or market segment to other markets or market segments in order to extract monopoly rents in those activities as well. Therefore, some countries found it necessary to separate the monopoly element (such as the grid in many networks) from competitive elements in given infrastructure sectors. By and large, infrastructure services tend to be competitive, whereas the underlying physical infrastructure often has monopolistic characteristics.

69. The separation of competitive activities from monopolistic ones may in turn require the unbundling of vertically or horizontally integrated activities. Vertical unbundling occurs when upstream activities are separated from downstream ones, for example, by separating production, transmission, distribution and supply activities in the power sector. The objective is typically to separate key network components or essential facilities from the competitive segments of the business. Horizontal unbundling occurs when one or more parallel activities of a monopolist public service provider are divided among separate companies, which may either compete directly with each other in the market (as is increasingly the case with power production) or retain a monopoly over a smaller territory (as may be the case with power distribution). Horizontal unbundling refers both to a single activity or segment being broken up (as in the power sector examples) and to substitutes being organized separately in one or more markets (as in the case of separation of cellular services from fixed-line telephony, for example).

70. However, the costs and benefits of such changes need to be considered carefully. Costs may include the costs associated with the change itself (e.g. transaction and transition costs, including the loss incurred by companies that lose benefits or protected positions as a result of the new scheme) and those resulting from the operation of the new scheme, in particular higher coordination costs resulting, for example, from more complicated network planning, technical standardization or regulation. Benefits, on the other hand, may include new investments, better or new services, more choice and lower economic costs.

(b) Recent experience in major infrastructure sectors

(i) Telecommunications

71. Unbundling has not been too common in the telecommunication sector. In some countries, long-distance and international services were separated from local services; competition was introduced in the former, while the latter remained largely monopolistic. In some of those countries that trend is now being reversed, with local telephone companies being allowed to provide long-distance services and long-distance companies being allowed to provide local services, all in a competitive context. Mandatory open access rules are common in the telecommunication sector of those countries where the historical public service provider provides services in competition with other providers while controlling essential parts of the network.

(ii) Electricity

72. Electricity laws recently enacted in various countries call for the unbundling of the power sector by separating generation, transmission and distribution. In some cases, supply is further distinguished from distribution in order to leave only the monopolistic activity (i.e. the transport of electricity for public use over wires) under a monopoly. In those countries, the transmission and distribution companies do not buy or sell electricity but only transport it against a regulated fee. Trade in electricity occurs between producers or brokers on the one hand and users on the other. In some of the countries concerned, competition is limited to large users only or is being phased in gradually.

73. Where countries have opted for the introduction of competition in the power and gas sectors, new legislation has organized the new market structure, stipulating to what extent the market had to be unbundled (sometimes including the number of public service providers to be created out of the incumbent monopoly), or removed barriers to new entry. The same energy laws have also established specific competition rules, whether structural (e.g. prohibition of cross-ownership between companies in different segments of the market, such as production, transmission and distribution, or gas and electricity sale and distribution) or behavioural (e.g. third-party access rules, prohibition of alliances or other collusive arrangements). New institutions and regulatory mechanisms, such as power pools, dispatch mechanisms or energy regulatory bodies, have been established to make the new energy markets work. Finally, other aspects of energy law and policy have had to be amended in conjunction with these changes, including the rules governing the markets for oil, gas, coal and other energy sources.

(iii) Water and sanitation

74. The most common market structure reform introduced in the water and sanitation sector is horizontal unbundling. Some countries have created several water utilities where a single one existed before. This is particularly common in, but is not limited to, countries with separate networks that are not or only slightly interconnected. In practice, it has been found that horizontal unbundling facilitates comparison of the performance of service providers.

75. Some countries have invited private investors to provide bulk water to a utility or to build and operate water treatment or desalination plants, for example. In such vertical unbundling, the private services (and the discrete investments they require) are usually rendered under contract to a utility and do not fundamentally modify the monopolistic nature of the market structure: the plants usually do not compete with each other and are usually not allowed to bypass the utility to supply customers. A number of countries have introduced competition in bulk water supply and transportation; in some cases,
there are active water markets. Elsewhere, competition is limited to expensive bottled or trucked water and private wells.

(iv) Transport

76. In the restructuring measures taken in various countries, a distinction is made between transport infrastructure and transport services. The former may often have natural monopoly characteristics, whereas services are generally competitive. Competition in transport services should be considered not only within a single mode but also across modes, since trains, trucks, buses, airlines and ships tend to compete for passengers and freight.

77. With respect to railways, some countries have opted for a separation between the ownership and operation of infrastructure (e.g. tracks, signalling systems and train stations) on the one hand and of rail transport services (e.g. passenger and freight) on the other. In such schemes, the law does not allow the track operator also to operate transport services, which are operated by other companies often in competition with each other. Other countries have let integrated companies operate infrastructure as well as services, but have enforced third-party access rights to the infrastructure, sometimes called "trackage rights". In those cases, transport companies, whether another rail line or a transport service company, have right of access to the track on certain terms and the company controlling the track has the obligation to grant such access.

78. In many countries, ports were until recently managed as public sector monopolies. When opening the sector to private participation, legislators have considered different models. Under the landlord-port system, the port authority is responsible for the infrastructure as well as overall coordination of port activities; it does not, however, provide services to ships or merchandise. In service ports, the same entity is responsible for infrastructure and services. Competition between service providers (e.g. tugboats, stevedoring and warehousing) may be easier to establish and maintain under the landlord system.

79. Legislation governing airports may also require changes, whether to allow private investment or competition between or within airports. Links between airport operation and air traffic control may also need to be considered carefully. Within airports, many countries have introduced competition in handling services, catering and other services to planes, as well as in passenger services such as retail shops, restaurants, parking and the like. In some countries, the construction and operation of a new terminal at an existing airport has been entrusted to a new operator, thus creating competition between terminals. In others, new airports have been built on a BOT basis and existing ones transferred to private ownership.

(c) Transitional measures

80. The transition from monopoly to market needs to be carefully managed. Political, social or other factors have led some countries to pursue a gradual or phased approach to implementation. As technology and other outside forces are constantly changing, some countries have adopted sector reforms that could be accelerated or adjusted to take those changing circumstances into account.

81. Some countries have felt that competition should not be introduced at once. In such cases, legislation has provided for temporary exclusivity rights, limitation in the number of public service providers or other restrictions on competition. Those measures are designed to give the incumbent adequate time to prepare for competition and to adjust tariffs, while providing the public service provider adequate incentives for investment and service expansion. Other countries have included provisions calling for the periodic revision (at the time of tariff reviews, for example) of such restrictions with a view to ascertaining whether the conditions that justified them at the time when they were introduced still prevail.

82. Another transitional measure, at least in countries with government-owned public service providers, has been the restructuring or privatization of the incumbent service provider. While the sequence between privatization and liberalization has differed, liberalization has by and large either accompanied or preceded privatization. Some countries have proceeded otherwise and have privatized companies with significant exclusivity rights, often to increase privatization proceeds. They have, however, found it difficult and sometimes very expensive to remove, restrict or shorten at a later stage the exclusive rights or monopolies protecting private or privatized public service providers.
LEGISLATIVE RECOMMENDATIONS

General considerations (see paras. 1-15)

(1) The law should provide the contracting authorities in the host country with the necessary power to award concessions for infrastructure development and operation. It is advisable to review existing constitutional provisions so as to eliminate undesirable restrictions to private sector participation in infrastructure development and operation, or unnecessary limitations to the use of public property by private entities and obstacles to private ownership of infrastructure.

Scope of authority to award concessions (see paras. 16-25)

(2) The host country may wish to consider adopting legislative provisions that:

(a) Authorize contracting authorities in the host country, including, as appropriate, national, provincial and local authorities, to award concessions for the construction and operation of infrastructure of new infrastructure facilities or systems or for maintenance, repair, refurbishment, modernization, expansion and operation of existing infrastructure facilities and systems, or only for the management and delivery of a public service falling within their competence;

(b) Authorize the granting of concessions that extend to the entire region under the jurisdiction of the contracting authority or only to a geographical subdivision thereof, with or without exclusivity, as appropriate, in accordance with laws, regulations and policies applying to the sector concerned;

(c) Authorize the contracting authority or other agencies of the Government to transfer or make available to the concessionaire such public land or existing infrastructure that may be required for the execution of the project.

Administrative coordination (see paras. 26-32)

(3) The host country may wish to consider adopting legislative provisions requiring:

(a) That contracting authorities interested in developing a privately financed infrastructure projects, within their sphere of competence conduct a preliminary assessment of its feasibility, including economic and financial aspects such as expected economic advantages of the project, estimated cost and potential revenue anticipated from the operation of the infrastructure facility, as well as the environmental impact of the project;

(b) That the contracting authority concerned review existing statutory or regulatory requirements relating to the operation of infrastructure facilities of the type proposed with a view to identifying the main governmental bodies that have to give approvals, licences or authorizations or whose input will be otherwise required for the implementation of the project and take the necessary measures for coordinating their input to the proposed project.

Authority to regulate infrastructure services (see paras. 33-55)

(4) The host country may wish to consider adopting legislative provisions for the purpose of:
(a) Separating operational and regulatory functions and entrusting regulatory competence to legally and functionally independent bodies;

(b) Granting the regulatory body a sufficient level of autonomy to ensure that its decisions are taken without political interference or inappropriate pressures from infrastructure operators and public service providers.

(5) The host country may wish to consider adopting legislative provisions that:

(a) Require the publication of rules governing regulatory procedures;

(b) Require that regulatory decisions state the reasons on which they are based and be accessible to interested parties through publication or other means;

(c) Provide for appeal procedures against decisions of regulatory bodies and adequate remedies to protect public service providers from arbitrary decisions of regulatory bodies.

NOTES ON LEGISLATIVE RECOMMENDATIONS

A. GENERAL REMARKS

1. The successful implementation of privately financed infrastructure projects requires a legal framework that provides contracting authorities in the host country with the necessary power to award concessions for infrastructure development and operation. According to the legal and political traditions of the country, this power may be derived from existing constitutional rules, laws, regulations or case law, or it may need to be established by new provisions. This section deals with some general issues which domestic legislatures may wish to consider when setting up the legal framework for privately financed infrastructure projects. Firstly, it is important for the legislature to consider the possible implications that the constitutional law of the host country may have for the implementation of these projects. Second, a choice has to be made regarding the level and type of instrument or instruments that need to be enacted and their scope of application. Finally, it is important to consider how privately financed infrastructure projects are received in the legal tradition of the country, in particular which legal regime would apply to them.

1. Constitutional law and privately financed infrastructure projects

2. The constitutional law of a number of countries refers generally to the duty of the State to ensure the provision of public services. Some of them list the infrastructure and services sectors which come under the responsibility of the State, while in others the task of identifying those sectors is delegated to the legislator. Under some national constitutions, the provision of certain public services is reserved exclusively to the State or to specially created public entities. Other constitutions, however, authorize the State to award concessions to private entities for the development and operation of infrastructure and the provision of public services. In some countries, there are limitations to the participation of foreigners in certain sectors, or requirements that the State should participate in the capital of the companies providing public services.

3. For countries wishing to promote private investment in infrastructure it is important to review existing constitutional rules so as to identify possible restrictions to the implementation of privately financed infrastructure projects. In some countries, privately financed infrastructure projects have been delayed by uncertainties regarding the extent of the State’s authority to award them. Sometimes, concerns that those projects might contravene constitutional rules on State monopolies or on the provision of public services have led to judicial disputes, with negative impact on the implementation of the projects.

4. It is further important to take into account constitutional rules relating to the ownership of land or infrastructure facilities. The constitutional law of some countries contains limitations to private ownership of land and certain means of production. In other countries, private property is recognized, but the constitution declares all or certain types of infrastructure to be State property. Prohibitions and restrictions of this nature can be an obstacle to the execution of projects that entail private operation, or private operation and ownership, of the relevant infrastructure.

5. Irrespective of the choice made by the Government regarding the ownership of infrastructure, it is important for a country wishing to attract private investment in infrastructure to ensure that the State is authorized to make available to the concessionaire such land or existing infrastructure as may be required for the execution of infrastructure projects. In some countries it has been found necessary to amend the constitution so as to provide the State with that authority.

2. Choice of a legislative approach

6. Legislation frequently plays a central role in promoting private investment in public infrastructure projects. The law typically embodies a political commitment, provides specific legal rights and may represent an important guarantee of stability of the legal and regulatory regime. In most countries the implementation of privately financed infrastructure projects was in fact preceded by legislative measures setting forth the general rules under which those projects are awarded and executed.

7. In some countries, as a matter of legislative practice, it has been considered appropriate to adopt specific legislation regulating the execution and operation of one or more individual projects. In other countries with a well-established tradition of awarding concessions to the private sector for the provision of public services, the State is authorized by general legislation to award to the private sector any activity carried out by the public sector which has an economic value that makes such activity capable of
being exploited by private entities. General legislation of this type creates a framework for providing a uniform treatment to issues that are common to privately financed projects in different infrastructure sectors. Countries that consider it desirable to adopt general legislation may wish to determine what issues are suitable for being dealt with at this legislative level, and what issues should be left for specific legislation, regulations or for the project agreement.

8. By its very nature, general legislation is normally not suitable to address all the particular requirements of different sectors. This is why the provision of certain public services is in several countries subject to special legislation governing specific infrastructure sectors (e.g. telecommunications, power generation and distribution, road and railway transportation). One of the arguments in favour of the adoption of sector-specific legislation, even in countries that have adopted general legislation addressing cross-sectoral issues, is that it allows the legislator to take into account the market structure in formulating rules governing the activities of service providers in each infrastructure sector (see above, “Introduction and background information on privately financed infrastructure projects”).

9. Sector-specific legislation typically sets forth the policy of the Government for the sector concerned, lays down the mechanisms for implementing such policy and provides the general rules for the provision of the relevant services. In many countries, sector-specific legislation was adopted at a time when a significant portion, or even the entirety of the national infrastructure constituted State monopolies. Recent national strategies for promoting private sector investment in infrastructure were often based on the results of extensive studies that analysed questions such as the extent of competition that could be introduced in the market as a whole or within specific segments of it, and considered the potential economic costs and expected benefits of abolishing legal monopolies or retaining them in full or in part (see, “Introduction and background information on privately financed infrastructure projects”).

For countries interested in promoting private sector investment in infrastructure it is advisable to review existing sector-specific legislation so as to ascertain their suitability for privately financed infrastructure projects.

10. Sector-specific legislation may further play an important role in establishing a framework for the regulation of individual infrastructure sectors (see below, paras. 33-55). Legislative guidance is particularly useful in countries at the initial stages of setting up or developing national regulatory capacities. Such legislation is also useful to reassure the lenders and the concessionaire that the regulators do not have unlimited discretion in the exercise of their functions, but are bound by the parameters provided by the law. However, it is generally advisable to avoid rigid or excessively detailed legislation, which in most cases would not be adequate to the long-term nature of privately financed infrastructure projects.

11. Each instrument has its specificity which makes it more or less appropriate for given circumstances. Legislative provisions may be difficult to change. Many countries have used them to establish the general principles for the organization of infrastructure sectors and the basic policy, institutional and regulatory framework. However, the law may not be the best instrument to set detailed technical and financial requirements. Many countries have preferred to enact regulations setting forth more detailed rules to implement the general provisions of domestic laws on privately financed infrastructure projects. Regulations are found to be easier to adapt to a change in environment, whether the change results from the transition to market-based rules or from external developments, such as new technologies or changing economic market conditions. Whatever the instrument used, clarity and predictability are of the essence. However, this does not imply that all matters have to be clearly settled up-front.

### 3. Legal regime of privately financed infrastructure projects

12. In some legal systems, in particular those belonging to the civil law tradition, the provision of public services is governed by a body of law known as “administrative law”, which covers a wide range of State functions. In most of those countries there are well-defined concepts of administrative law that may cover certain forms of infrastructure projects, such as “public works concession”, “public services concession”, or “delegations”, “licences” or “permissions” for the provision of certain forms of public services. Various rights and obligations of the parties may derive from statutory provisions, judicial precedent or general principles of law, according to the type of the project and the nature of the instrument of award (e.g. whether a bilateral agreement or a unilateral act).

13. In some of those legal systems, for instance, the Government generally has the right to revoke administrative contracts or to modify their scope and terms, for reasons of public interest, usually subject to compensation of loss caused to, or additional cost incurred by, its contractors. Additional rights of the Government might include extensive monitoring and inspection rights, as well as the right to impose sanctions on the private operator for failure to perform (see chapter V, “Infrastructure development and operation”). In some countries, there are special provisions for the settlement of disputes arising out of Government contracts, and there may be limitations to the right of governmental agencies to agree on non-judicial procedures for settlement of disputes (see chapter VIII, “Settlement of disputes”). At the same time, some legal systems recognize certain implied conditions in all Government contracts that afford a certain level of protection to Government contractors, such as the right to review the terms of the contract following unforeseen changes in the circumstances for the purpose of restoring its economic and financial balance (see chapter V, “Infrastructure development and operation”).

14. The existence of a special legal regime applicable to infrastructure operators and public service providers is not limited to the legal systems referred to above. In several
countries belonging to the common law tradition special rules have been developed for Government contracts, often through the extensive use of standard forms and terms. Those special rules typically give the Government certain powers of termination or modification balanced by an obligation to indemnify the contractor against the damage sustained by reliance on the contract. In some common law jurisdictions detailed rules have been developed to govern the activities of operators of public utilities (e.g. telecommunications, railways, electricity).

15. In countries where Government contracts are subject to a special regime, it may be advisable for the legislature to review the adequacy of the existing regime for privately financed infrastructure projects and to identify possible difficulties that might result from its application. For purposes of transparency and to avoid doubts by potential foreign as well as domestic investors, it may be useful to incorporate into special legislation pertaining to privately financed infrastructure projects those rights and obligations that are implied or are not treated systematically in the legal system and which are found to be appropriate in connection with those projects (see chapter V, “Infrastructure development and operation”, ___). By the same token, the enactment of general legislation may provide an opportunity for introducing new rules to facilitate privately financed infrastructure projects or to exclude the application of those rules of law which are found to pose obstacles to their execution.

B. SCOPE OF AUTHORITY TO AWARD CONCESSIONS

16. The implementation of privately financed infrastructure projects may require the enactment of special legislation or regulations authorizing the State to entrust the provision of public services to private entities or decentralized entities wholly or partially owned by the State. Besides being sometimes needed to satisfy national constitutional and other requirements, the enactment of express legislative authorization may be an important measure to foster the confidence of potential investors, national or foreign, in a national policy to promote private sector investment in infrastructure. In many countries, legislative provisions on the authority to grant concessions for infrastructure projects are not limited to identifying the agencies of the Government that are vested with such authority. They would typically determine the scope of concessions that may be granted by the contracting authorities and define the ownership regime of the assets related to the project.

1. Authorized agencies and relevant fields of activity

17. In some legal systems where the State is directly responsible for the provision of public services this function may not be delegated without prior legislative authorization. For those countries that wish to attract private investment in infrastructure, it is therefore particularly important that the law states clearly the authority of the Government to entrust to entities other than governmental agencies the right to provide certain public services and to charge a price for them. Such a general provision in the enabling legislation may be particularly important in those countries where public services are State monopolies, or where it is envisaged to engage private entities to provide certain services that used to be available to the public free of charge. In some countries, the absence of prior legislative authorization has given rise to judicial disputes challenging the concessionaire’s authority to require the payment of a price for the services provided.

18. Furthermore, where general legislation is adopted, it is advisable to indicate clearly the agencies or levels of government competent to award infrastructure projects to the private sector. It may be useful to consider the extent of powers that may be needed by authorities other than the central Government to carry out projects falling within their purview. For clarity purposes, it may be also advisable to identify in such general legislation those fields of activity in which concessions may be awarded. These provisions may be instrumental to ensuring an adequate level of administrative coordination (see further below, paras. 26-32).

2. Purpose and scope of concessions

19. It may be useful for the law to define the nature and purpose of privately financed infrastructure projects for which concessions may be awarded in the host country. One possible approach may be to define the various categories of projects according to the extent of the rights and obligations assumed by the concessionaire (e.g. “build-operate-transfer”, “build-own-operate”, “build-transfer-operate”, “build-transfer”). However, given the wide variety of schemes that may come into play in connection with private investment in infrastructure, it may be difficult to provide exhaustive definitions of all of them. As an alternative, the law could generally provide that concessions may be awarded for the purpose of entrusting an entity, private or public, with the obligation to carry out infrastructure works and deliver certain public services, in consideration for the right to charge a price for the use of the facility or premises or for the service or goods it generates, or for other payment or remuneration agreed to by the parties. The law could further clarify that concessions may be awarded for the construction and operation of a new infrastructure facility or system or for maintenance, repair, refurbishment, modernization, expansion and operation of existing infrastructure facilities and systems, or only for the management and delivery of a public service.

20. Another important issue concerns the nature of the rights vested upon the concessionaire. One of the central questions arising in connection with privately financed infrastructure projects is whether the right to provide the service is exclusive or whether the project company will
face the competition from other infrastructure facilities or service providers. Exclusivity may concern the right to provide a service in a particular geographical region (e.g. a communal water distribution company) or embrace the whole territory of the country (e.g. a national railway company); it may relate to the right to supply one particular type of goods or services to one particular customer (e.g. a power generator being the exclusive regional supplier to a power transmitter and distributor) or to a limited group of customers (e.g. a national long-distance telephone carrier providing connections to local telephone companies).

21. The decision whether or not to grant exclusivity rights to a certain project or category of projects should be taken in the light of the host country’s policy for the sector concerned. As discussed earlier, the scope for competition varies considerably in different infrastructure sectors. While certain sectors, or segments thereof, have the characteristics of natural monopolies, in which case open competition is usually not an economically viable alternative, other infrastructure sectors have been successfully opened to free competition (see “Introduction and background information on privately financed infrastructure projects”).

22. Therefore, it is desirable to deal with the issue of exclusivity in a flexible manner. Rather than excluding or prescribing exclusive concessions, it may be preferable for the law to authorize the Government to grant exclusive concessions when it is deemed to be in the public interest, such as in cases where the exclusivity is justified for the purpose of ensuring the technical or economical viability of the project. The contracting authority may be required to state the reasons for granting an exclusive concession for each particular case. Such general legislation may be supplemented by sector-specific laws regulating the issue of exclusivity in a manner suitable for each particular sector.

3. Ownership and use of infrastructure

23. A number of countries have provisions on the preservation and protection of State property, including special procedures and authorizations required for transferring the title to such property to private entities or granting to private entities the right to use governmental property. Whatever choice is made by the Government regarding the ownership of the infrastructure facility to be built, modernized or rehabilitated, it is important to ensure that the contracting authority has sufficient powers to transfer or make available to the project company, as appropriate, any land or existing infrastructure required for the execution of the project for a period not less than the duration of the project agreement.

24. The ownership regime for a particular project may be the result of practical considerations, such as the operational life of the infrastructure or the interest of the Government in retaining title to it. Moreover, in some projects the parties may wish to distinguish between assets that are to be owned by or reverted to the Government at the end of the concession period, and other assets acquired by the concessionaire during that period and which remain the concessionaire’s property. In any event, the concessionaire would need assurances that its rights in respect of the project assets, no matter what form they may take, are based on sufficient legislative authority and that it will be able to enforce them against third parties. The same concern will be shared by the lenders and other project investors. Furthermore, in view of the legal restrictions that apply in many countries to the use of public property by private entities, the Government may necessitate prior legislative authorization to allow the concessionaire to use any additional public property that may be needed for the execution of the project, such as adjoining land, roads and other facilities.

25. Therefore, it is advisable that the relevant law clarify the nature of the property rights, if any, that may be granted to the concessionaire, taking into account the type of infrastructure concerned. Furthermore, it might be useful for the law to authorize the Government to grant to the concessionaire the right to use land, roads and other supporting facilities not directly related to the project, as required for the construction and operation of the infrastructure, under the terms and conditions to be provided in the project agreement.

C. ADMINISTRATIVE COORDINATION

26. Depending on the administrative structure of the host country, privately financed infrastructure projects may require the involvement of several governmental agencies, at various levels of Government. For instance, the competence to lay down regulations and rules for the activity concerned may rest in whole or in part with a governmental agency at a level different from the one that is responsible for providing the relevant service. It may also be that both the regulatory and the operational functions are combined in one entity, but that the authority to award Government contracts is centralized in a different governmental agency. For projects involving foreign investment, it may also happen that certain specific competences may fall within the mandate of the agency of the Government that is responsible for approving foreign investment proposals.

1. Coordination of preparatory measures

27. One important measure to ensure the successful implementation of privately financed infrastructure projects is the requirement that the relevant governmental agency conduct a preliminary assessment of the project’s feasibility, including economic and financial aspects such as expected economic advantages of the project, estimated cost and potential revenue anticipated from the operation of the infrastructure facility and the environmental impact of the project. The preliminary conclusions reached at this stage will play a crucial role in conceiving the type of private sector involvement that is sought for the implementation
of the project, for instance, whether the infrastructure facility will be owned by the Government and temporarily operated by the private entity, or whether the facility will be owned and operated by the project company.

28. Following the identification of the future project, it is for the Government to establish its relative priority and to assign human and other resources for its implementation. At that point, it is desirable that the Government review existing statutory or regulatory requirements relating to the operation of infrastructure facilities of the type proposed with a view to identifying the main governmental bodies whose input will be required for the implementation of the project. It is also important, at this stage to consider the measures that may be required in order for the contracting authority and the other governmental agencies involved to perform the obligations they may reasonably anticipate in connection with the project. For instance, the Government may need to make advance budgeting arrangements to enable it to meet financial commitments that extend over several budgetary cycles, such as long term commitments to purchase the project’s output (see below, chapter IV, “The project agreement”). Furthermore, a series of administrative measures may be needed to implement certain forms of support provided to the project, such as tax exemptions and customs facilitation (see chapter II, “Government support”, ...), and the time required may be considerable.

2. Arrangements for facilitating the issuance of licences and permits

29. The legislation may play a useful role in facilitating the issuance of approvals and licences that may be needed in the course of a project (such as licences under foreign exchange regulations; licences for the incorporation of the concessionaire; authorizations for the employment of foreigners; registration and stamp duties for the use or ownership of land; importation licences for equipment and supplies; construction licences; licences for the installation of cables or pipelines; licences for bringing the facility into operation; spectrum allocation for mobile communication). The required licences and authorizations may fall within the competence of various organs at different levels of the administration and the time required for their issuance may be significant, particularly when the approving organs or offices were not originally involved in conceiving the project or negotiating its terms.

30. By the time the project agreement is signed, the concessionaire will normally have spent considerable time and invested significant sums in the project (e.g. preparation of feasibility studies, engineering design and other technical documents; preparation of bidding documents and participation in the bidding process; negotiation of the project agreement, loan agreements and other project-related contracts; hiring consultants and advisers). The possibility of not obtaining the licences needed for the construction of the facility may dissuade serious investors from competing for the award of the project. Furthermore, delay in bringing an infrastructure project into operation as a result of missing licences is likely to compromise the project’s financial viability or cause considerable loss to its investors. Where the additional financial cost cannot be recovered by means of an extension of the concession period, or by raising the tariffs or charging higher prices, the concessionaire might turn to the Government for redress or support. The consequence would often be an increase in the cost of the project and in its cost to the public.

31. Thus, an early assessment of licences needed for a particular project may help to avoid delay in the implementation phase. A possible measure to enhance the coordination in the issuance of licences and approvals might be to entrust one organ with the authority to receive the applications for licences, to transmit them to the appropriate agencies and monitor the issuance of all licences listed in the request for proposals and other licences that might be introduced by subsequent regulations. The law may also authorize the relevant agencies to issue provisional licences and provide a time period beyond which those licences are deemed to be granted unless they are rejected in writing.

32. However, it should be noted that the distribution of administrative authority among various levels of government (e.g. local, regional and central) often reflect fundamental principles of a country’s political organization. Therefore, there are instances where the Government would not be in a position to assume responsibility for the issuance of all licences or to entrust one single body with such a coordinating function. In those cases, it is advisable to consider alternative measures to counter the possibility of delay that might result from such distribution of administrative authority, such as, for instance, measures intended to make the process of obtaining licences more transparent and efficient. Furthermore, the Government might wish to consider providing some assurance that it will as much as possible assist the concessionaire in obtaining licences required by domestic law, for instance by providing information and assistance to bidders regarding the required licences to be obtained, as well as the relevant procedures and conditions. From a practical point of view, in addition to coordination among various levels of government and various governmental departments, there is a need for ensuring consistency in the application of criteria for the issuance of licences and for the transparency of the administrative process.

D. AUTHORITY TO REGULATE INFRASTRUCTURE SERVICES

33. The provision of certain public services is in a number of countries subject to a special regulatory regime. The regulatory regime in a given country and sector defines the rights and obligations of service providers, consumers, regulatory bodies and the Government. This framework consists of substantive rules, procedures, instruments and institutions and it represents an important instrument to implement the governmental policy for the sector concerned (see “Introduction and background information on
privately financed infrastructure projects". Depending on the institutional structure of the country concerned and on the allocation of powers between different levels of Government, provincial or local legislation may govern some infrastructure sectors, in full or concurrently with national legislation.

34. Regulation of infrastructure services involves a wide range of general and sector-specific issues, which may vary considerably according to the social, political, legal and economic reality of each host country. While occasionally discussing some of the main regulatory issues that are encountered in a similar context in different sectors (see, for instance, chapter V, "Project execution"), the Guide is not intended to exhaust the legal or policy issues arising out of the regulation of various infrastructure sectors.

35. The Guide assumes that the host country has in place the proper institutional and bureaucratic structures and human resources necessary to the implementation of privately financed infrastructure projects. Nevertheless, as a contribution to domestic legislatures considering the need for, and desirability of, establishing regulatory bodies for monitoring the provision of public services, this section discusses some of the main institutional and procedural issues that arise in that connection. The discussion contained in this section is illustrative of different options that have been used in domestic legislative measures to set up a regulatory framework for privately financed infrastructure projects, but the Guide does not thereby advocate the establishment of any particular model or administrative structure. Practical information and technical advice may be obtained from international financial institutions which carry out programmes to assist their member countries in setting up an adequate regulatory framework (such as the World Bank and the regional development banks).

1. Regulatory bodies

36. The term "regulatory bodies" refers to the institutional mechanisms required to implement and monitor the rules governing the activities of infrastructure operators. Because the rules applicable to infrastructure operation often allow for a degree of discretion, a body is required to interpret and apply them, monitor compliance, impose sanctions, and settle disputes arising out of the implementation of the rules. The specific regulatory tasks and the amount of discretion they involve will be determined by the rules in question, which can vary widely.

(a) Sectoral attributions of regulatory bodies

37. Regulatory responsibilities may be organized on a sectoral or cross-sectoral basis. Countries that have opted for a sectoral approach have in many cases decided to place closely linked sectors or segments thereof under the same regulatory structure (e.g. a common regulatory body for power and gas or for airports and airlines). Other countries have organized regulation on a cross-sectoral basis, in some cases with one regulatory entity for all infrastructure sectors, and in others with one entity for utilities (water, power, gas, telecommunications) and one for transport. In some countries the attributions of regulatory bodies might also extend to several sectors within a given region.

38. Regulatory bodies whose competence is limited to a particular sector usually foster the development of technical, sector-specific expertise. Sector-specific regulation may facilitate the development of rules and practices that are tailored to the needs of the sector concerned. However, the decision between sector-specific and cross-sectoral regulation depends in part on the country's regulatory capacity. Countries with limited expertise and experience in infrastructure regulation may find it preferable to reduce the number of independent structures and try to achieve economies of scale.

(b) Institutional mechanisms

39. The range of institutional mechanisms for the regulation of infrastructure sectors varies greatly. While there are countries that entrust regulatory functions to organs of the Government (e.g. the concerned ministries or departments), other countries have preferred to establish autonomous regulatory bodies, separate from the Government. Some countries have decided to subject certain infrastructure sectors to autonomous and independent regulation while leaving others under ministerial regulation. Sometimes, powers may also be shared between an autonomous regulatory body and the Government, as is often the case with respect to licensing. From a legislative perspective, it is important to devise institutional arrangements for the regulatory functions, which ensure to the regulatory body an adequate level of efficiency, taking into account the political, legal and administrative tradition of the country.

40. The efficiency of the regulatory regime is in most cases a function of the objectivity with which regulatory decisions are taken. This, in turn, requires that regulatory bodies should be able to take decisions without interference or inappropriate pressures from infrastructure operators and public service providers. To that effect, legislative provisions in several countries require the independence of the regulatory decision making process. In order to achieve the desired level of independence it is advisable to separate the regulatory functions from operational ones by removing any regulatory functions that may still be vested with the public service providers and entrust them to a legally and functionally independent entity. Regulatory independence is supplemented by provisions to prevent conflicts of interest, as such as prohibitions for staff of the regulatory body to hold mandates, accept gifts, enter into contracts or have any other relationship (directly or through family members or other intermediaries) with regulated companies, their parents or affiliates.

41. This leads to a related issue, namely the need to minimize the risk of decisions being made or influenced by a body that is also the owner of enterprises operating in the regulated sector, or a body acting on political rather than
technical grounds. In some countries it was felt necessary to provide the regulatory body with a certain degree of autonomy vis-à-vis the political organs of Government. Independence and autonomy should not be considered solely on the basis of the institutional position of the regulatory function, but also on the basis of its functional autonomy (i.e. the availability of sufficient financial and human resources to discharge their responsibilities adequately).

(c) Mandate of regulatory bodies

42. The law setting up a regulatory mechanism often stipulates a number of general objectives that should guide the actions of regulatory bodies, such as the promotion of competition, the protection of users' interests, the satisfaction of demand, the efficiency of the sector or the public service providers, their financial viability, the safeguarding of the public interest or of public service obligations, and the protection of investors' rights. Having one or two overriding objectives helps clarify the mandate of regulatory bodies and establish priorities among sometimes conflicting objectives. A clear mandate may also increase a regulatory body's autonomy and credibility.

(d) Powers of regulatory bodies

43. Regulatory bodies may have decision-making powers, advisory powers or purely consultative powers or a combination of these different levels of powers depending on the subject matter. In some countries, regulatory bodies were initially given limited powers, which were expanded later as the regulatory bodies established a track record of independence and professionalism. The legislation often specifies which powers are vested with the Government and which ones with a regulatory body. Clarity in this respect is important to avoid unnecessary conflicts and confusion. Investors, as well as consumers and other interested parties, should know whom to turn to with various requests, applications or complaints.

44. Selection of public service providers, for example, is in many countries a process involving the Government as well as the regulatory body. If the decision to award a project involves broad judgement of a political rather than technical nature, which may often be the case in the context of infrastructure privatization, final responsibility often rests with the Government. If, however, the award criteria are more technical, as may be the case with a liberal licensing regime for power generation or telecommunications services, many countries entrust the decision to an independent regulatory body. In other cases, the Government may have to ask the regulatory body's opinion prior to awarding a concession. On the other hand, some countries exclude direct involvement of regulatory bodies in the award process on the basis that it could affect the way they later regulate the provision of the service concerned.

45. The jurisdiction of regulatory bodies normally extends to all enterprises operating in the sectors they regulate, with no distinction between private and public enterprises. The use of some regulatory powers or instruments may be limited by law to the dominant public service providers in the sector. A regulatory body may, for example, have price policing powers only vis-à-vis the incumbent or dominant public service provider, while new entrants may be allowed to set prices freely.

46. The matters on which regulatory bodies have to pronounce themselves range from normative responsibilities (e.g. rules on the award of concessions, conditions for certification of equipment) to the actual award of concessions; the modification of such instruments; the approval of contracts or decisions proposed by the regulated entities (e.g. a schedule or contract on network access); the definition and monitoring of an obligation to provide certain services; the oversight over public service providers (in particular compliance with licence conditions, norms, performance targets); tariff setting or adjustments; vetting of subsidies, exemptions or other advantages that could distort competition in the sector; sanctions; and dispute settlement.

(e) Composition of regulatory bodies and their staff

47. When setting up a regulatory body, a few countries have opted for a regulatory body comprised of a single officer, whereas most others have preferred a regulatory commission. A commission may provide greater safeguards against undue influence or lobbying and may limit the risk of rash regulatory decisions. A one-person regulatory body, on the other hand, may be able to reach decisions faster and may be held more accountable. To improve the management of the decision-making process in a regulatory commission, the number of members is often kept small (typically three or five members). Even numbers are often avoided to prevent a deadlock, though the chairman could have a casting vote.

48. To increase the regulatory body's autonomy, different institutions may be involved in the nomination process. In some countries regulatory bodies are appointed by the Head of State based on a list submitted by parliament; in others the executive branch of the Government appoints the regulatory body but subject to confirmation by parliament or upon nominations submitted by parliament, user associations or other bodies. Minimal professional qualifications are often required of regulatory bodies, as well as the absence of conflicts of interest that might disqualify them for the function. Mandates of members of regulatory commissions may be staggered in order to prevent total turnover and appointment of all members by the same administration; staggering also promotes continuity in regulatory decision-making. Mandates are often for a fixed term, may be non-renewable and may be terminated before the expiry of the term for limited reasons only (such as crime conviction, mental incapacitation, gross negligence or dereliction of duty). Regulatory bodies are often faced with experienced lawyers, accountants and other experts working for the regulated industry and need to be able to acquire the same level of expertise, skills and professionalism, either in-house or by hiring outside advisers as needed. They are often allowed to subcontract to outside
experts certain regulatory tasks short of the ultimate regulatory decision.

(f) **Budget of the regulatory body**

49. Stable funding sources are critical in order for the regulatory body to function adequately. In many countries, the budget of the regulatory entity is funded by fees and other levies on the regulated industry. Fees may be set as a percentage of the turnover of the public service providers, or be levied for the award of licences, concessions or other authorizations. In some countries, the entity’s budget is complemented as needed by budget transfers provided in the annual finance law. However, this may create an element of uncertainty that may reduce the regulatory body’s autonomy.

2. **Regulatory process and procedures**

50. The regulatory framework typically includes procedural rules governing the way the institutions in charge of the various regulatory functions have to exercise their powers.

(a) **Procedures**

51. The credibility of the regulatory process requires transparency and objectivity, irrespective of whether regulatory authority is exercised by a Government department or minister or by an autonomous regulatory body. Rules and procedures should be objective and clear so as to ensure fairness and impartiality. For transparency purposes, the law should require that they be published. Regulatory decisions should state the reasons on which they are based and should be made accessible to interested parties, through publication or other appropriate means.

52. Transparency may be further enhanced, as required by some laws, by the publication by the regulatory body of an annual report on the sector, including, for example, the decisions taken during the exercise, the disputes that have arisen and the way they were settled. Such annual report may also include the accounts of the regulatory body and an audit thereof by an independent auditor. Legislation in many countries further requires that this annual report be submitted to a committee of parliament.

53. Regulatory decisions may impact on the interests of diverse groups, including the concerned public service provider, its current or potential competitors, and business or non-business users. In many countries, the regulatory process includes consultation procedures for major decisions or recommendations. In some countries, this consultation takes the form of public hearings, in others of consultation papers on which comments from interested groups are solicited. Some countries have also established consultative bodies comprised of users and other concerned parties and require that their opinion be sought before major decisions and recommendations are made. To enhance transparency, comments, recommendations or opinions resulting from the consultation process may have to be published or made publicly available.

(b) **Sanctions and appeals**

54. In many countries, the law gives regulatory bodies some coercive or punitive powers. Such powers may include the authority to modify, suspend or withdraw a concession; the right to set the terms of contracts between public service providers (e.g. interconnection or access agreements); to issue injunctions and orders to public service providers; to impose civil penalties including penalties for any delay in implementing the regulatory body’s decision, and to initiate criminal or other court procedures.

55. Legislators have often provided for appeal procedures against decisions of a regulatory body. Appeals procedures are an essential element to protect public service providers against arbitrary decisions by regulatory bodies. However, in order to prevent the regulatory uncertainty that may arise from appeals intended primarily to delay the effect of regulatory decisions, the laws of many countries limit the causes that give ground to appeal. It is therefore desirable to strike a balance between the protection of legitimate rights of the public service providers and the efficiency of the regulatory system. It is often essential that decisions be made quickly. For instance, withdrawal of a competitor’s access to an infrastructure network could drive the competitor into bankruptcy if the matter cannot be resolved expeditiously. Where the right to appeal is granted, it should be to a body that has the required skills and expertise to adjudicate the matter. Some laws give public service providers the right to appeal against certain decisions of the regulatory body to the country’s competition authority, others to administrative tribunals or judicial courts.
Chapter II. PROJECT RISKS AND GOVERNMENT SUPPORT

CONTENTS

LEGISLATIVE RECOMMENDATIONS ................................................. (1)-2
NOTES ON LEGISLATIVE RECOMMENDATIONS ............................... 1-70
A. General remarks ......................................................... 1-2
B. Project risks and risk allocation ....................................... 3-24
   1. Overview of main categories of project risk ................. 6-15
   2. Contractual arrangements for risk allocation and mitigation 16-24
C. Government support ..................................................... 25-56
   1. Policy considerations relating to government support .... 27-29
   2. Forms of government support .................................. 30-56
D. Guarantees provided by international financial institutions 57-67
   1. Guarantees issued by multilateral lending institutions 58-62
   2. Guarantees provided by the Multilateral Investment Guarantee Agency 63-67
E. Guarantees provided by bilateral institutions ..................... 68-70

LEGISLATIVE RECOMMENDATIONS

Project risks and risk allocation (see paras. 3-24)

(1) The extent and nature of risks assumed by the project company and the contracting authority, respectively, should be set forth in the project agreement and related documentation. The host country may wish to consider removing unnecessary statutory or regulatory limitations to the contracting authority's ability to agree on an allocation of risks that, in the view of the contracting authority, is suited to the needs of the project.

Government support (see paras. 25-56)

(2) The host country may wish to consider adopting legislative provisions indicating the forms of financial support that the Government is authorized to provide.

NOTES ON LEGISLATIVE RECOMMENDATIONS

A. GENERAL REMARKS

1. Privately financed infrastructure projects create opportunities for reducing the commitment of public funds and other resources for infrastructure development and operation. They also make it possible to transfer to the private sector a number of risks that would otherwise be borne by the Government. The precise allocation of risks among the various parties involved is typically defined after consideration of a number of factors, including the public interest in the development of the infrastructure in question and the level of risk faced by the project company, other investors and lenders (and the extent of their ability and readiness to absorb those risks at an acceptable cost). Adequate risk allocation is essential to reducing...
project costs and to ensuring the successful implementation of the project. Conversely, an inappropriate allocation of project risks may compromise the project’s financial viability or hinder its efficient management, thus increasing the cost at which the service is provided.

2. Section B of the present chapter (see paras. 3-24) gives an overview of the main risks encountered in privately financed infrastructure projects and a brief discussion of common contractual solutions for risk allocation, which emphasizes the need for providing the parties with the necessary flexibility for negotiating a balanced allocation of project risks. Section C (see paras. 25-56) sets out policy considerations the Government may wish to take into account when designing the level of direct governmental support that may be provided to infrastructure projects, such as degree of public interest in the execution of any given project, and the need to avoid the assumption by the Government of open-ended or excessive contingent liabilities. Section C considers some additional support measures that have been used in governmental programmes to promote private investment in infrastructure development, without advocating the use of any of them in particular. Lastly, sections D (see paras. 57-67) and E (see paras. 68-70) outline guarantees and support measures that may be provided by international and bilateral financial institutions.

B. PROJECT RISKS AND RISK ALLOCATION

3. As used in this chapter, the notion of “project risks” refers to those circumstances which, in the assessment of the parties, may have a negative effect on the benefit they expected to achieve with the project. While there may be events that would represent a serious risk for most parties (e.g. the physical destruction of the facility by a natural disaster), each party’s risk exposure will vary according to its role in the project.

4. The expression “risk allocation” refers to the determination of which party or parties should bear the consequences of the occurrence of events identified as project risks. For example, if the project company is obliged to deliver the infrastructure facility to the contracting authority with certain equipment in functioning condition, the project company is bearing the risk that the equipment may fail to function at the agreed performance levels. The occurrence of that project risk, in turn, may have a series of consequences for the project company, including its liability for failure to perform a contractual obligation under the project agreement or the applicable law (e.g. payment of damages to the contracting authority for delay in bringing the facility into operation); loss (e.g. loss of revenue as a result of delay in beginning operating the facility); or additional cost (e.g. cost of repair of faulty equipment or of securing replacement equipment).

5. The party bearing a given risk may take preventive measures with a view to limiting the likelihood of the risk, as well as specific measures to protect itself, in whole or in part, against the consequences of the risk. Such measures are often referred to as “risk mitigation”. In the previous example, the project company will carefully review the reliability of the equipment suppliers and the technology proposed. The project company may require its equipment suppliers to provide independent guarantees concerning the performance of their equipment. The supplier may also be liable to pay penalties or liquidated damages to the project company for the consequences of failure of its equipment. In some cases, a more or less complex chain of contractual arrangements may be made to mitigate the consequences of a project risk. For instance, the project company may combine the guarantees provided by the equipment supplier with commercial insurance covering some consequences of the interruption of its business as a result of equipment failure.

1. Overview of main categories of project risk

6. For purposes of illustration, the following paragraphs provide an overview of the main categories of project risk and illustrate certain contractual arrangements used for risk allocation and mitigation. For further discussion on this subject, the reader is advised to consult other sources of information, such as the Guidelines for Infrastructure Development through Build-Operate-Transfer (BOT) Projects prepared by the United Nations Industrial Development Organization.¹

(a) Project disruption caused by events outside the control of the parties

7. The parties face the risk that the project may be disrupted by unforeseen or extraordinary events outside their control, which may be of a physical nature, such as natural disasters—floods, storms or earthquakes—or the result of human action, such as war, riots or terrorist attacks. Such unforeseen or extraordinary events may cause a temporary interruption of the project execution or the operation of the facility, resulting in construction delay, loss of revenue and other losses. Severe events may cause physical damage to the facility or even destruction beyond repair.

(b) Project disruption caused by adverse acts of Government (“political risk”)

8. The project company and the lenders face the risk that the project execution may be negatively affected by acts of the contracting authority, other agency of the Government or the host country’s legislature. Such risks are often referred to as “political risks” and may be divided into three broad categories: “traditional” political risks (e.g. nationalization of the project company’s assets or imposition of new taxes that jeopardize the project company’s prospects of debt repayment and investment recovery); regulatory risks (e.g. introduction of more stringent standards for service delivery or opening of a sector to competition) and “quasi-commercial” risks (e.g. breaches

¹UNIDO publication, Sales No. UNIDO. 95.6.E
by the contracting authority or project interruptions due to changes in the contracting authority’s priorities and plans). In addition to political risks originating from the host country, some political risks may result from acts of a foreign Government, such as blockades, embargoes or boycotts imposed by the Governments of the investors’ home countries.

(c) Construction and operation risks

9. The main risks that the parties may face during the construction phase are the risks that the facility cannot be completed at all or cannot be delivered according to the agreed schedule (completion risk); that the construction cost exceeds the original estimates (construction cost-overrun risk); or that the facility fails to meet performance criteria at completion (performance risk). Similarly, during the operational phase the parties may face the risk that the completed facility cannot be effectively operated or maintained to produce the expected capacity, output or efficiency (performance risk); or that the operating costs exceed the original estimates (operation cost-overrun). It should be noted that construction and operation risks do not affect only the private sector. The contracting authority and the users in the host country may be severely affected by an interruption in the provision of needed services.

10. Some of these risks may be brought about by the project company or its contractors or suppliers. For instance, construction cost-overrun and delay in completion may be the result of inefficient construction practices, waste, insufficient budgeting or lack of coordination among contractors. Failure of the facility to meet performance criteria may also be the result of defective design, inadequacy of the technology used or faulty equipment delivered by the project company’s suppliers. During the operational phase, performance failures may be the consequence, for example, of faulty maintenance of the facility or negligent operation of mechanical equipment. Operation cost-overruns may also derive from inadequate management.

11. However, some of these risks may also result from specific actions taken by the contracting authority, by other governmental agencies or even the host country’s legislature. Performance failures or cost-overruns may be the consequence of the inadequacy of the technical specifications provided by the contracting authority during the selection of the concessionaire. Delays and cost-overruns may also be brought about by actions of the contracting authority subsequent to the award of the project (delays in obtaining approvals and permits, additional costs caused by changes in requirements due to inadequate planning, interruptions caused by inspecting agencies or delays in delivering the land on which the facility is to be built). General legislative or regulatory measures, such as more stringent safety or labour standards, may also result in higher construction or operating costs. Shortfalls in production may be caused by the non-delivery of the necessary supplies (e.g. power or gas) on the part of public authorities.

(d) Commercial risks

12. “Commercial risks” relate to the possibility that the project cannot generate the expected revenue because of changes in market prices or demand for the goods or services it generates. Both of these forms of commercial risk may seriously impair the project company’s capacity to service its debt and may compromise the financial viability of the project.

13. Commercial risks vary greatly according to the sector and type of project. The risk may be regarded as minimal or moderate where the project company has a monopoly over the service concerned or where it supplies a single client through a standing off-take agreement. However, commercial risks may be considerable in projects that depend on market-based revenues, in particular where the existence of alternative facilities or supply sources makes it difficult to establish a reliable forecast of usage or demand. This may be a serious concern, for instance, in tollroad projects, since tollroads face competition from toll-free roads. Depending on the ease with which drivers may have access to toll-free roads, the toll revenues may be difficult to forecast, especially in urban areas where there may be many alternative routes and roads may be built or improved continuously. Furthermore, traffic usage has been found to be even more difficult to forecast in the case of new tollroads, especially those that are not an addition to an existing toll facility system, because there is no existing traffic to use as a historical basis.

(e) Exchange rate and other financial risks

14. Exchange rate risk relates to the possibility that changes in foreign exchange rates alter the currency value of cash flows from the project. Tariffs and user fees charged to local users or customers will most likely be paid for in local currency, while the loan facilities and sometimes also equipment or fuel costs may be denominated in foreign currency. This risk may be considerable, since exchange rates are particularly unstable in many developing countries. In addition to exchange rate fluctuations, the project company may face the risk that foreign exchange control or lowering reserves of foreign exchange may limit the availability in the local market of foreign currency needed by the project company to service its debt or repay the original investment.

15. Another risk faced by the project company concerns the possibility that interest rates may rise, forcing the project to bear additional financing costs. This risk may be significant in infrastructure projects given the usually large sums borrowed and the long duration of the project, with some loans extending over a period of several years. Where necessary, the debt can be raised at a fixed rate of interest (e.g. fixed rate bonds) to reduce the interest rate risk. In addition, the finance package may include hedging facilities against interest rate risks, for example, by way of interest rate swaps or interest rate caps.
2. Contractual arrangements for risk allocation and mitigation

16. The risk allocation eventually agreed to by the contracting authority and the project company will be reflected in their mutual rights and obligations, as set forth in the project agreement. The possible legislative implications of certain provisions commonly found in project agreements are discussed in other chapters of the Guide (see chaps. IV, "The project agreement", V, "Infrastructure development and operation", and VI, "End of project term, extension and termination"). Various other agreements will also be negotiated by the parties to mitigate or reallocate the risks they assume (e.g. loan agreements; construction, equipment supply, operation and maintenance contracts; direct agreement between the contracting authority and the lenders; and off-take and long-term supply agreements, where applicable).

17. Practical guidance provided to negotiators in a number of countries often refers to general principles for the allocation of project risks. One such principle is that specific risks should normally be allocated to the party best able to assess, control and manage the risk. Additional guiding principles envisage the allocation of project risks to the party with the best access to hedging instruments or the greatest ability to diversify the risks or to mitigate them at the lowest cost. In practice, however, risk allocation is often a factor of both policy considerations (e.g. the public interest in the project or the overall exposure of the contracting authority under various projects) and the negotiating strength of the parties. Furthermore, in allocating project risks it is important to consider the financial strength of the parties to which a specific risk is allocated and their ability to bear the consequences of the risk, should it occur.

18. It is usually for the project company and its contractors to assume ordinary risks related to the development and operation of the infrastructure. For instance, completion, cost overrun and other risks typical of the construction phase are usually allocated to the construction contractor or contractors through a turnkey construction contract, whereby the contractor assumes full responsibility for the design and construction of the facility at a fixed price, within a specified completion date and according to particular performance specifications (see chap. V, "Infrastructure development and operation", ____). The construction contractor is typically liable to pay liquidated damages or penalties for any late completion. In addition, the contractor is also usually required to provide a guarantee of performance, such as a bank guarantee or a surety bond. Separate equipment suppliers are also usually required to provide guarantees in respect of the performance of their equipment. Similarly, the project company typically mitigates its exposure to operation risks by entering into an operation and maintenance contract in which the operating company undertakes to achieve the required output and assumes the liability for the consequences of operational failures. In most cases, arrangements of this type will be an essential requirement for a successful project. The lenders, for their part, will seek protection against the consequences of those risks, by requiring the assignment of the proceeds of any bonds issued to guarantee the contractor’s performance, for instance.

19. The contracting authority, on the other hand, will be expected to assume those risks that relate to events attributable to its own actions, such as inadequacy of technical specifications provided during the selection process or delay caused by failure to provide agreed supplies on time. The contracting authority may also be expected to bear the consequences of disruptions caused by acts of Government, for instance by agreeing to compensate the project company for loss of revenue due to price control measures (see chap. V, "Infrastructure development and operation", ____). While some political risks may be mitigated by procuring insurance, such insurance, if at all available for projects in the country concerned, may not be obtainable at an acceptable cost. Thus, prospective investors and lenders may turn to the Government, for instance, to obtain assurances against expropriation or nationalization and guarantees that proper compensation will be payable in the event of such action (see para. 45). Depending on their assessment of the level of risk faced in the host country, prospective investors and lenders may not be ready to pursue a project in the absence of those assurances or guarantees.

20. Most of the project risks referred to in the preceding paragraphs can, to a greater or lesser extent, be regarded as falling within the control of one party or the other. However, a wide variety of project risks result from events outside the control of the parties or are attributable to the acts of third parties and other principles of risk allocation may thus need to be considered.

21. For example, the financing documentation usually provides for a floating rate of interest, which protects the lenders from interest rate risks, but it may be possible for the project company to hedge against higher interest rates through swap agreements to lock into a long-term fixed rate of interest. The project company could expect that this risk, together with the inflation risk, would be passed on to the end-users or customers of the facility through price increases, although this may not always be possible because of market-related circumstances or price control measures. The tariff structure negotiated between the project company and the contracting authority will determine the extent to which the project company will avoid those risks or whether it will be expected to absorb some of them (see chap. IV, "The project agreement", ____).

22. Another category of risk that may be allocated under varying schemes concerns extraneous events such as war, civil disturbance, natural disasters or other events wholly outside the control of the parties. In traditional infrastructure projects carried out by the public sector, the public entity concerned usually bears the risk, for example, of destruction of the facility by natural disasters or similar events, to the extent that those risks may not be insurable.
In privately financed infrastructure projects the Government may prefer this type of risk to be borne by the project company. However, depending on their assessment of the particular risks faced in the host country, the private sector may not be ready to bear those risks. Therefore, in practice there is not a single solution to cover this entire category of risk and special arrangements are often made to deal with each of them. For example, the parties may agree that the occurrence of some of those events may exempt the affected party from the consequences of failure to perform under the project agreement and there will be contractual arrangements providing solutions for some of their adverse consequences, such as contract extensions to compensate for delay resulting from events or even some form of direct payment under special circumstances (see chap. V, “Infrastructure development and operation”). Those arrangements will be supplemented by commercial insurance purchased by the project company, where available at an acceptable cost (see chap. IV, “The project agreement”).

23. Special arrangements may also need to be negotiated for the allocation of commercial risks. Projects such as mobile telecommunication projects usually have a relatively high direct cost recovery potential and in most cases the project company is expected to carry out the project without sharing those risks with the contracting authority and without recourse to support from the Government. In other infrastructure projects, such as power-generation projects, the project company may revert to contractual arrangements with the contracting authority or other governmental agency in order to reduce its exposure to commercial risks, for example, by negotiating long-term off-take agreements that guarantee a market for the product at an agreed price. Payments may take the form of actual consumption or availability charges or combine elements of both and the applicable rates are usually subject to escalation or indexation clauses in order to protect the real value of revenues from the increased costs of operating an ageing facility (see also chap. IV, “The project agreement”). Lastly, there are relatively capital-intensive projects with more slowly developing cost recovery potential, such as water supply and some tollroad projects, which the private sector may be reluctant to carry out without some form of risk-sharing with the contracting authority, for example, through fixed revenue assurances or agreed capacity payments regardless of actual usage (see also chap. IV, “The project agreement”).

C. GOVERNMENT SUPPORT

25. The discussion in the preceding section shows that the parties may use various contractual arrangements to allocate and mitigate project risks. Nevertheless, those arrangements may not always be sufficient to ensure the level of comfort required by private investors to participate in privately financed infrastructure projects. It may also be found that certain additional government support is needed to enhance the attractiveness of private investment in infrastructure projects in the host country.

26. Government support may take various forms. Generally, any measure taken by the Government to enhance the investment climate for infrastructure projects may be regarded as government support. From that perspective, the existence of legislation enabling the Government to award privately financed infrastructure projects or the establishment of clear lines of authority for the negotiation and follow-up of infrastructure projects (see chap. I, “General legislative considerations”) may represent important measures to support the execution of infrastructure projects. As used in the Guide, however, the expression “government support” has a narrower connotation and refers in particular to special measures, in most cases of a financial or economic nature, that may be taken by the Government to enhance the conditions for the execution of a given project or to assist the project company in meeting some of the project risks, above and beyond the ordinary scope of the contractual arrangements agreed to between the contracting authority and the project company to allocate project risks. Government support measures, where available, are typically an integral part of governmental programmes to attract private investment for infrastructure projects.

1. Policy considerations relating to government support

27. In practice, a decision to support the implementation of a project is based on an assessment by the Government of the economic or social value of the project and whether that justifies additional governmental support. The Government may estimate that the private sector alone may not be able to finance certain projects at an acceptable cost. The Government may also consider that particular projects may not materialize without certain support measures that mitigate some of the project risks. Indeed, the readiness of private investors and lenders to carry out large projects in a given country is not only based on their assessment of specific project risks, but is also influenced by their comfort with the investment climate in the host country, in particular in the infrastructure sector. Factors to which private investors may attach special importance include the host country’s economic system and the degree of development of market structures and the degree to which the country has already succeeded with privately financed infrastructure projects over a period of years.

28. For the above reasons, a number of countries have adopted a flexible approach for dealing with the issue of
government support. In some countries, this has been done by legislative provisions that tailor the level and type of support to the specific needs of individual infrastructure sectors. In other countries, this has been achieved by providing the host Government with sufficient legislative authority to extend certain types of assurance or guarantee while preserving its discretion not to make them available in all cases. However, the host Government will be interested in ensuring that the level and type of support provided to the project does not result in the assumption of open-ended liabilities. Indeed, over-commitment of governmental agencies through guarantees given to a specific project may prevent them from extending guarantees in other projects of perhaps even greater public interest.

29. The efficiency of government support programmes for private investment in infrastructure may be enhanced by the introduction of appropriate techniques for budgeting for government support measures or for assessing the total cost of other forms of government support. For example, loan guarantees provided by governmental agencies usually have a cost lower than the cost of loan guarantees provided by commercial lenders. The difference (less the value of fees and interests payable by the project company) represents a cost for the Government and a subsidy for the project company. However, loan guarantees are often not recorded as expenses until such time as a claim is made. Thus, the actual amount of the subsidy granted by the Government is not recorded, which may create the incorrect impression that loan guarantees entail a lesser liability than direct subsidy payments. Similarly, the financial and economic cost of tax exemptions granted by the Government may not be apparent, which makes them less transparent than other forms of direct government support. For these reasons, countries that are contemplating establishing support programmes for privately financed infrastructure projects may need to devise special methods for estimating the budgetary cost of support measures such as tax exemptions, loans and loan guarantees provided by governmental agencies that take into account the expected present value of future costs or loss of revenue.

2. Forms of government support

30. The availability of direct government support, be it in the form of financial guarantees, public loans or revenue assurances, may be an important element in the financial structuring of the project. The following paragraphs briefly describe forms of government support that are sometimes authorized under domestic laws and discuss possible legislative implications they may have for the host country, without advocating the use of any of them in particular.

31. Generally, besides the administrative and budgetary measures that may be needed to ensure the fulfillment of governmental commitments throughout the duration of the project, it is advisable for the legislature to consider the possible need for an explicit legislative authorization to provide certain forms of support. Where government support is found advisable, it is important for the legislature to bear in mind the host country’s obligations under international agreements on regional economic integration or trade liberalization, which may limit the ability of governmental agencies of the contracting States to provide financial support to companies operating in their territories. Furthermore, where a Government is contemplating support for the execution of an infrastructure project, that circumstance should be made clear to all prospective bidders at an appropriate time during the selection proceedings (see chap. III, “Selection of the concessionaire”, ___).

(a) Public loans and loan guarantees

32. In some cases, the law authorizes the Government to extend interest-free or low-interest loans to the project company to lower the project’s financing cost. Depending on the accounting rules to be followed, some interest-free loans provided by public agencies can be recorded as revenue in the project company’s accounts, with loan payments being treated as deductible costs for tax and accounting purposes. Moreover, subordinate loans provided by the Government may enhance the financial terms of the project by supplementing senior loans provided by commercial banks without competing with senior loans for repayment. Governmental loans may be generally available to all project companies in a given sector or they may be limited to providing temporary assistance to the project company in the event that certain project risks occur. The total amount of any such loan may be further limited to a fixed sum or to a percentage of the total project cost.

33. In addition to public loans, some national laws authorize the contracting authority or other agency of the host Government to provide loan guarantees for the repayment of loans taken by the project company. Loan guarantees are intended to protect the lenders (and, in some cases, investors providing funds to the project as well) against default by the project company. Loan guarantees do not entail an immediate disbursement of public funds and they may appear more attractive to the Government than direct loans. However, loan guarantees may represent a substantial contingent liability and the Government’s exposure may be significant, especially in the event of total failure by the project company. Indeed, the Government would in most cases find little comfort in a possible subrogation in the rights of the lenders against an insolvent project company.

34. Thus, in addition to introducing general measures to enhance the efficiency of governmental support programmes (see para. 29), it may be advisable to consider concrete provisions to limit the Government’s exposure under loan guarantees. Rules governing the provision of loan guarantees may provide a maximum ceiling, which could be expressed as a fixed sum or, if more flexibility is needed, a certain percentage of the total investment in any given project. Another measure to circumscribe the contingent liabilities of the guaranteeing agency may be to
define the circumstances under which such guarantees may be extended, taking into account the types of project risk the Government may be ready to share. For instance, if the Government considers sharing only the risks of temporary disruption caused by events outside the control of the parties, the guarantees could be limited to the event that the project company is rendered temporarily unable to service its loans owing to the occurrence of specially designated unforeseeable events outside the project company’s control. If the Government wishes to extend a greater degree of protection to the lenders, the guarantees may cover the project company’s permanent failure to repay its loans for the same reasons. In such a case, however, it is advisable not to remove the incentives for the lenders to arrange for the continuation of the project, for instance by identifying another suitable concessionaire or by stepping in through an agent appointed to remedy the project company’s default (see chap. V, “Infrastructure development and operation”). The call on the governmental guarantees could thus be conditional upon the prior exhaustion of other remedies available to the lenders under the project agreement, the loan agreements or their direct agreements with the contracting authority, if any. In any event, full loan guarantees by the Government amounting to a total protection of the lenders against the risk of default by the project company are not a common feature of infrastructure projects carried out under the project finance modality.

(b) Equity participation

35. Another form of additional support by the Government may consist of direct or indirect equity participation in the project company. Equity participation by the Government may help achieve a more favourable ratio between equity and debt by supplementing the equity provided by the project sponsors, in particular where other sources of equity capital, such as investment funds, cannot be tapped by the project company. Equity investment by the Government may also be useful to satisfy legal requirements of the host country concerning the composition of locally established companies. The company laws of some jurisdictions, or special legislation on infrastructure projects, require a certain amount of participation of local investors in locally established companies. However, it may not always be possible to secure the required level of local participation on acceptable terms. Local investors may lack the interest or financial resources to invest in large infrastructure projects; they may also be averse to or lack experience in dealing with specific project risks.

36. Governmental participation may involve certain risks that the Government may wish to consider. In particular, there is a risk that such participation may be understood as an implied guarantee by the Government so that the parties, or even third parties, might expect the Government to back the project fully or eventually even take it over at its own cost if the project company fails. Where such an implied guarantee is not intended, appropriate provisions should be made to clarify the limits of governmental involvement in the project (e.g. contractual provisions releasing the Government from any obligation to subscribe to additional shares in the event that the project company’s capital needs to be increased).

(c) Subsidies

37. Tariff subsidies are used in some countries to supplement the project company’s revenue when the actual income of the project falls below a certain minimum level. The provision of the services in some areas where the project company is required to operate may not be a profitable undertaking, because of low demand or high operational costs, or because the project company is required to provide the service to a certain segment of the population at low cost. Thus, the law in some countries authorizes the Government to undertake to extend subsidies to the project company in order to make it possible to provide the services at a lower price.

38. Subsidies usually take the form of direct payments to the project company, either lump-sum payments or payments calculated specifically to supplement the project company’s revenue. In the latter case, the Government should ensure that it has in place adequate mechanisms for verifying the accuracy of subsidy payments made to the project company, by means, for example, of audit and financial disclosure provisions in the project agreement. An alternative to direct subsidies may be to allow the project company to cross-subsidize less profitable activities with revenue earned in more profitable ones. This may be done by combining in the same concession both profitable and less profitable activities or areas of operation, or by granting to the project company the commercial exploitation of a separate and more profitable ancillary activity (see paras. 54-56).

39. However, it is important for the legislature to consider practical implications and possible legal obstacles to the provision of subsidies to the project company. For example, subsidies are found to distort free competition and the competition laws of many countries prohibit the provision of subsidies or other forms of direct financial aid that are not expressly authorized by legislation.

(d) Sovereign guarantees

40. In connection with privately financed infrastructure projects, the term “sovereign guarantees” is sometimes used to refer to two types of guarantee provided by the host Government. The first type includes guarantees issued by the host Government to cover the breach of obligations assumed by the contracting authority under the project agreement. A second category includes guarantees that the project company will not be prevented by the Government from exercising certain rights that are granted to it under the project agreement or that derive from the laws of the country, for example, the right to repatriate profits at the end of the project. Whatever form such guarantees may take, it is important for the Government and the legislature to consider the Government’s ability to assess and manage efficiently its own exposure to project risks and to
determine the acceptable level of direct or contingent liabilities it can assume.

\[(i)\] **Guarantees of performance by the contracting authority**

41. Performance guarantees may be used where the contracting authority is a separate or autonomous legal entity that does not engage the responsibility of the Government itself. Such guarantees may be issued in the name of the Government or of a public financial institution of the host country. They may also take the form of a guarantee issued by international financial institutions that are backed by a counter-guarantee by the Government (see paras. 57-67). Guarantees given by the Government may be useful instruments to protect the project company from the consequences of default by the contracting authority or other governmental agency assuming specific obligations under the project agreement. The most common situations in which such guarantees are used include the following:

(a) **Off-take guarantees.** Under these arrangements, the Government guarantees payment of goods and services supplied by the project company to public entities. Payment guarantees are often used in connection with payment obligations under "off-take" agreements in the power-generation sector (see chap. IV, "The project agreement"). Such guarantees may be of particular importance where the main or sole customer of the project company is a government monopoly. Additional comfort is provided to the project company and lenders when the guarantee is subscribed by an international financial institution (see paras. 61 and 66);

(b) **Supply guarantees.** Supply guarantees may also be provided to protect the project company from the consequences of default by public sector entities providing goods and supplies required for the operation of the facility—fuel, electricity or water, for example—or to secure payment of indemnities for which the contracting entity may become liable under the supply agreement;

(c) **General guarantees.** These are guarantees intended to protect the project company against any form of default by the contracting authority, rather than default on specifically designated obligations. Although general performance guarantees may not be very frequent, there are cases in which the project company and the lenders may regard them as a condition necessary for executing the project. This may be the case, for example, where the obligations undertaken by the contracting authority are not commensurate with its creditworthiness, as may happen in connection with large concessions granted by municipalities or other autonomous entities. Guarantees by the Government may be useful to ensure specific performance, for example, when the host Government undertakes to substitute for the contracting entity in the performance of certain acts (e.g. delivery of an appropriate site for disposal of by-products).

42. Generally, it is important not to overestimate the adequacy of sovereign guarantees alone to protect the project company against the consequences of default by the contracting authority. Except when their purpose is to ensure specific performance, sovereign guarantees usually have a compensatory function. Thus, they may not substitute for appropriate contractual remedies in the event of default by the contracting authority (see chap. IV, "The project agreement"). Different types of contractual remedies, or combinations thereof, may be used to deal with various events of default, for example, liquidated damages in the event of default and tariff increases or contract extensions in the event of additional delay in project execution caused by acts of the contracting authority. Furthermore, in order to limit the Government’s exposure and to reduce the risk of calls on the guarantee, it is advisable to consider measures to encourage the contracting authority to live up to its obligations under the project agreement or to make efforts to control the causes of default. Such measures may include express subrogation rights of the guarantor against the contracting authority or internal control mechanisms to ensure the accountability of the contracting authority or its agents in the event, for instance, of wanton or reckless breach of its obligations under the project agreement resulting in a call on the sovereign guarantee.

\[(ii)\] **Guarantees against adverse acts of Government**

43. Unlike performance guarantees, which protect the project company against the consequences of default by the contracting authority, the guarantees considered here relate to acts of other authorities of the host country that are detrimental to the rights of the project company or otherwise substantially affect the implementation of the project agreement. Such guarantees are often referred to as "political risk guarantees".

44. One type of guarantee contemplated in national laws consists of foreign exchange guarantees, which usually fulfil three functions: to guarantee the convertibility of the local earnings into foreign currency; to guarantee the availability of the required foreign currency and to guarantee the transferability abroad of the converted sums. However, a foreign exchange guarantee is not normally intended to protect the project company and the lenders against the risks of exchange rate fluctuation or market-induced devaluation, which are considered to be ordinary commercial risks. Foreign exchange guarantees are common in privately financed infrastructure projects involving a substantial amount of debt denominated in currencies other than the local currency, in particular in those countries which do not have freely convertible currencies. Some laws also provide that such a guarantee may be backed by a bank guarantee issued in favour of the project company.

45. Another important type of guarantee may be to assure the company and its shareholders that they will not be expropriated without adequate compensation. Such a guarantee would typically extend both to confiscation of property owned by the project company in the host country and to the nationalization of the project company itself, that is, confiscation of shares of the project company’s capital. This type of guarantee is usually provided for in laws
dealing with direct foreign investment and in bilateral investment protection treaties (see chap. VII, “Governing law”, _issue1_).

(e) Tax and customs benefits

46. Another method for the host Government to support the execution of privately financed projects could be to grant some form of tax and customs exemption, reduction or benefit. Domestic legislation on foreign direct investment often provides special tax regimes to encourage foreign investment and in some countries it has been found useful expressly to extend such a taxation regime to foreign companies participating in privately financed infrastructure projects (see also chap. VII, “Governing law”, _issue2_).

47. Typical tax exemptions or benefits include exemption from income or profit tax, or property tax on the facility, or exemptions from income tax on interest due on loans and other financial obligations assumed by the project company. Some laws provide that all transactions related to a privately financed infrastructure project will be exempted from stamp duties or similar charges. In some cases, the law establishes some preferential tax treatment or provides that the project company will benefit from the same favourable tax treatment generally given to foreign investments. Sometimes the tax benefit takes the form of a more favourable income tax rate, combined with a decreasing level of exemption during the initial years of the project. Such exemptions and benefits are sometimes extended to the contractors engaged by the project company, in particular foreign contractors.

48. Further taxation measures sometimes used to promote privately financed infrastructure projects are exemptions from withholding tax to foreign lenders providing loans to the project. Under many legal systems, any interest, commission or fee in connection with a loan or indebtedness that is borne directly or indirectly by locally established companies or is deductible against income earned locally is deemed to be local income for taxation purposes. Therefore, both local and foreign lenders to infrastructure projects may be liable to the payment of income tax in the host country, which the project company may be required to withhold from payments to foreign lenders, as non-residents of the host country. Income tax due by the lenders in the host country is typically taken into account in the negotiations between the project company and the lenders and may result in a higher financial cost for the project. In some countries, the competent organs are authorized to grant exemptions from withholding tax in connection with payments to non-residents that are found to be made for a purpose that promotes or enhances the economic or technological development of the host country or are otherwise deemed to be related to a purpose of public relevance.

49. Special accounting rules for infrastructure operators have also been introduced in some countries to take into account the particular revenue profile of infrastructure projects. Projects involving the construction of infrastructure facilities, in particular roads and other transportation facilities, are typically characterized by a relatively short investment period, with high financial cost and no revenue stream, followed by a longer period with increasing revenue and decreasing financial cost and, under normal circumstances, stable operating costs. Accordingly, if traditional accounting rules were applied, the particular financial structure of such projects would need to be recorded in the project company’s accounts as a period of continuous negative results followed by a long period of net profit. This would not only have negative consequences, for instance, for the project company’s credit rating during the construction phase, but might also result in a disproportionate tax debt during the operational phase of the project. In order to avoid such a distortion, some countries have adopted special accounting rules for companies undertaking infrastructure projects that take into account the fact that the financial results of privately financed infrastructure projects may only become positive on a medium-term basis. Those special rules typically authorize infrastructure developers to defer part of the financial cost accrued during the deficit phase to the subsequent financial years, in accordance with financial schedules provided in the project agreement. However, the special accounting rules are typically without prejudice to other rules of law that may prohibit the distribution of dividends during financial years closed with negative results.

50. Besides tax benefits or exemptions, national laws sometimes facilitate the import of equipment for the use of the project company by means of exemption from customs duties. Such exemption typically applies to the payment of import duties on equipment, machinery, accessories, raw materials and materials imported into the country for purposes of conducting preliminary studies, designing, constructing and operating infrastructure projects. In the event that the project company wishes to transfer or sell the imported equipment on the domestic market, the approval of the contracting authority usually needs to be obtained and the relevant import duties, turnover tax or other taxes need to be paid in accordance with the laws of the country. Sometimes the law authorizes the Government either to grant an exemption from customs duty or to guarantee that the level of duty will not be raised to the detriment of the project.

(f) Protection from competition

51. An additional form of government support may consist of assurances that no competing infrastructure project will be developed for a certain period or that no agency of the Government will compete with the project company, directly or through another concessionaire. Assurances of this sort serve as a guarantee that the exclusivity rights that may be granted to the concessionaire (see chap. I, “General legislative considerations”, _issue3_ ) will not be nullified during the life of the project. Protection from competition may be regarded by the project company and the lenders as an essential condition for participating in the development of
infrastructure in the host country. Some national laws contain provisions whereby the Government undertakes not to facilitate or support the execution of a parallel project that might generate competition to the project company. In some cases, the law contains an undertaking by the Government that it will not alter the terms of such exclusivity to the detriment of the project company without the project company’s consent.

52. Provisions of this type may be intended to foster the confidence of the project sponsors and the lenders that the basic assumptions under which the project was awarded will be respected. However, they may limit the ability of the Government to deal with an increase in the demand for the service concerned as the public interest may require or to ensure the availability of the services to various categories of user. It is therefore important to consider carefully the interests of the various parties involved. For instance, the required tariff level to allow profitable exploitation of a tollroad may exceed the paying capacity of low-income segments of the public. Thus, the contracting authority may have an interest in maintaining open to the public a toll-free road as an alternative to a new tollroad. At the same time, however, if the contracting authority decides to improve or upgrade the alternative road, the traffic flow may be diverted from the tollroad built by the project company, thus affecting its flow of income. Similarly, the Government may wish to introduce free competition for the provision of long-distance telephone services in order to expand the availability and reduce the cost of telecommunication services (see “Introduction and background information on privately financed infrastructure projects”, __). The consequence of such a measure, however, may be a significant erosion of the income anticipated by the project company.

53. Generally, it may be useful to authorize the Government, where appropriate, to give assurances that the project company’s exclusive rights will not be unduly affected by subsequent changes in governmental policies without appropriate compensation. However, it may not be advisable to adopt statutory provisions that rule out the possibility of subsequent changes in the Government’s policy for the sector concerned, including a decision to promote competition or to build parallel infrastructure. The possible consequences of such future changes for the project company should be dealt with by the parties in contractual provisions dealing with changes in circumstances (see chap. V, “Infrastructure development and operation”, __). It is particularly advisable to provide the contracting authority with the necessary power to negotiate with the project company the compensation that may be due for loss or damage that may result from a competing infrastructure project subsequently launched by the contracting authority or from any equivalent measure of the Government that adversely affects the project company’s exclusive rights.

(g) Ancillary revenue sources

54. One additional form of support to the execution of privately financed infrastructure projects may be to allow the project company to diversify its investment through additional concessions for the provision of ancillary services or the exploitation of other activities. In some cases, alternative sources of revenue may also be used as a subsidy to the project company for the purpose of pursuing a policy of low or controlled prices for the main service. Provided that the ancillary activities are sufficiently profitable, they may enhance the financial feasibility of a project: the right to collect tolls on an existing bridge, for example, may be an incentive for the execution of a new toll bridge project. However, the relative importance of ancillary revenue sources should not be overemphasized.

55. In order to allow the project company to pursue ancillary activities, it may be necessary for the Government to receive legislative authorization to grant the project company the right to use property belonging to the contracting authority for the purposes of such activities (e.g. land adjacent to a highway for construction of service areas). Where it is felt necessary to control the development and possibly the expansion of such ancillary activities, the approval of the contracting authority might be required in order for the project company to undertake significant expansion of facilities used for ancillary activities.

56. Under some legal systems, certain types of ancillary source of revenue offered by the Government may be regarded as a concession separate from the main concession and it is therefore advisable to review possible limitations to the project company’s freedom to enter into contracts for the operation of ancillary facilities (see chap. IV, “The project agreement”, __).

D. GUARANTEES PROVIDED BY INTERNATIONAL FINANCIAL INSTITUTIONS

57. Besides guarantees given directly by the host Government, there may be guarantees issued by international financial institutions, such as the World Bank, the Multilateral Investment Guarantee Agency and the regional development banks. Such guarantees usually protect the project company against certain political risks, but under some circumstances they may also cover breach of the project agreement, for instance, where the project company defaults on its loans as a result of the breach of an obligation by the contracting authority.

1. Guarantees issued by multilateral lending institutions

58. In addition to lending to Governments and governmental agencies, multilateral lending institutions, such as the World Bank and the regional development banks, have developed programmes to extend loans to the private sector. Sometimes they can also provide guarantees to commercial lenders for public and private sector projects. In most cases, such guarantees issued by those institutions require a counter-guarantee from the host Government.
59. Guarantees by multilateral lending institutions are designed to mitigate the risks of default on sovereign contractual obligations or long-maturity loans that private lenders are not prepared to bear and are not equipped to evaluate. For instance, guarantees provided by the World Bank may typically cover specified risks (the partial risk guarantee) or all credit risks during a specified part of the financing term (the partial credit guarantee), as summarized below. Most regional development banks provide guarantees under terms similar to those of the World Bank.

(a) Partial risk guarantees

60. A partial risk guarantee covers specified risks arising from non-performance of sovereign contractual obligations or certain political force majeure events. Such guarantees ensure payment in the case of debt service default resulting from the non-performance of contractual obligations undertaken by Governments or their agencies. They may cover various types of non-performance, such as failure to maintain the agreed regulatory framework, including tariff formulas; failure to deliver inputs, such as fuel supplied to a private power company; failure to pay for outputs, such as power purchased by a government utility from a power company or bulk water purchased by a local public distribution company; failure to compensate for project delays or interruptions caused by government actions or political events; procedural delays; and adverse changes in exchange control laws or regulations.

61. When multilateral lending institutions participate in financing a project, they sometimes provide support in the form of a waiver of recourse that they would otherwise have to the project company in the event that default is caused by events such as political risks. For example, a multilateral lending institution taking a completion guarantee from the project company may accept that it cannot enforce that guarantee if the reason for failure to complete was a political risk reason.

(b) Partial credit guarantees

62. Partial credit guarantees are provided to private sector borrowers with a government counter-guarantee. They are designed to cover the portion of financing that falls due beyond the normal tenure of loans provided by private lenders. These guarantees are generally used for projects involving private sector participation that need long-term funds to be financially viable. A partial credit guarantee typically extends maturities of loans and covers all events of non-payment for a designated part of the debt service.

2. Guarantees provided by the Multilateral Investment Guarantee Agency

63. The Multilateral Investment Guarantee Agency (MIGA) offers long-term political risk insurance coverage to new investments originating in any member country and destined for any developing member country other than the country from which the investment originates. New investment contributions associated with the expansion, modernization or financial restructuring of existing projects are also eligible, as are acquisitions that involve the privatization of state enterprises. Eligible forms of foreign investment include equity, shareholder loans and loan guarantees issued by equity holders, provided the loans and loan guarantees have terms of at least three years. Loans to unrelated borrowers can also be insured, as long as a shareholder investment in the project is concurrently insured. Other eligible forms of investment are technical assistance, management contracts and franchising and licensing agreements, provided they have terms of at least three years and the remuneration of the investor is tied to the operating results of the project. MIGA insures against the following risks: foreign currency transfer restrictions, expropriation, breach of contract, war and civil disturbance.

(a) Transfer restrictions

64. The purpose of guarantees of foreign currency transfer extended by MIGA is similar to that of sovereign foreign exchange guarantees that may be provided by the host Government (see para. 44). This guarantee protects against losses arising from an investor's inability to convert local currency (capital, interest, principal, profits, royalties and other remittances) into foreign exchange for transfer outside the host country. The coverage includes against excessive delays in acquiring foreign exchange caused by action or failure to act by the host Government, by adverse changes in exchange control laws or regulations and by deterioration in conditions governing the conversion and transfer of local currency. Currency devaluation is not covered. On receipt of the blocked local currency from an investor, MIGA pays compensation in the currency of its contract of guarantee.

(b) Expropriation

65. This guarantee protects against loss of the insured investment as a result of acts by the host Government that may reduce or eliminate ownership of, control over or rights to the insured investment. In addition to outright nationalization and confiscation, "creeping" expropriation—a series of acts that, over time, have an expropriatory effect—is also covered. Coverage is provided on a limited basis for partial expropriation (e.g. confiscation of funds or tangible assets). Bona fide, non-discriminatory measures taken by the host Government in the exercise of legitimate regulatory authority are not covered. For total expropriation of equity investments, MIGA pays the net book value of the insured investment. For expropriation of funds, MIGA pays the insured portion of the blocked funds. For loans and loan guarantees, the Agency insures the outstanding principal and any accrued and unpaid interest. Compensation is paid upon assignment of the investor's interest in the expropriated investment (e.g. equity shares or interest in a loan agreement) to MIGA.
(c) Breach of contract

66. This guarantee protects against losses arising from the host Government’s breach or repudiation of a contract with the investor. In the event of an alleged breach or repudiation, the investor must be able to invoke a dispute resolution mechanism (e.g. arbitration) under the underlying contract and obtain an award for damages. If, after a specified period of time, the investor has not received payment or if the dispute resolution mechanism fails to function because of actions taken by the host Government, MIGA will pay compensation.

(d) War and civil disturbance

67. This guarantee protects against loss from damage to, or the destruction or disappearance of, tangible assets caused by politically motivated acts of war or civil disturbance in the host country, including revolution, insurrection, coup d’etat, sabotage and terrorism. For equity investments, MIGA will pay the investor’s share of the least of the book value of the assets, their replacement cost and the cost of repair of damaged assets. For loans and loan guarantees, MIGA will pay the insured portion of the principal and interest payments in default as a direct result of damage to the assets of the project caused by war and civil disturbance. War and civil disturbance coverage also extends to events that, for a period of one year, result in an interruption of project operations essential to overall financial viability. This type of business interruption is effective when the investment is considered a total loss; at that point, MIGA will pay the book value of the total insured equity investment.

E. GUARANTEES PROVIDED BY BILATERAL INSTITUTIONS

68. Insurance against certain political, commercial and financial risks, as well as direct lending, may be obtained from export credit agencies. Export credit agencies have typically been established in a number of countries to assist in the export of goods or services originating from that country. Export credit agencies act on behalf of the Governments of the countries supplying goods and services for the project. Most export credit agencies are members of the International Union of Credit and Investment Insurers (Berne Union), whose main objectives include promoting international cooperation and fostering a favourable investment climate; developing and maintaining sound principles of export credit insurance; and establishing and sustaining discipline in the terms of credit for international trade.

69. While the support available differs from country to country, export credit agencies typically offer two lines of coverage:

(a) Export credit insurance. The essential purpose of export credit insurance is to guarantee payment to the seller whenever a foreign buyer of exported goods or services is allowed to defer payment. Export credit insurance may take the form of “supplier credit” or “buyer credit” insurance arrangements. Under the supplier credit arrangements the exporter and the importer agree on commercial terms that call for deferred payment evidenced by negotiable instruments (e.g. bills of exchange or promissory notes) issued by the buyer. Subject to proof of creditworthiness, the exporter obtains insurance from an export credit agency in his or her home country. Under the buyer credit modality, the buyer’s payment obligation is financed by the exporter’s bank, who, in turn obtains insurance coverage from an export credit agency. Export credits are generally classified as short-term (repayment terms of usually under two years), medium-term (usually two to five years) and long-term (over five years). Official support by export credit agencies may take the form of “pure cover”, by which is meant insurance or guarantees given to exporters or lending institutions without financing support. Official support may also be given in the form of “financing support”, which is defined as including direct credits to the overseas buyer, refinancing and all forms of interest rate support;

(b) Investment insurance. Export credit agencies may offer insurance coverage either directly to a borrower or to the exporter for certain political and commercial risks. Typical political and commercial risks include war, insurrection or revolution; expropriation, nationalization or requisition of assets; non-conversion of currency; and lack of availability of foreign exchange. Investment insurance provided by export credit agencies typically protects the investors in a project company established overseas against the insured risks, but not the project company itself. Investment insurance cover tends to be extended to a wide range of political risks. Export credit agencies prepared to cover such risks will typically require sufficient information on the legal system of the host country.

70. The conditions under which export credit agencies of countries members of the Organisation for Economic Co-operation and Development (OECD) offer support to both supplier and buyer credit transactions have to be in accordance with the OECD Arrangement on Guidelines for Officially Supported Export Credits (also referred to as the “OECD consensus”). The main purpose of the Arrangement is to provide a suitable institutional framework to prevent unfair competition by means of official support for export credits. In order to avoid market-distorting subsidies, the Arrangement regulates the conditions of terms of insurances, guarantees or direct lending supported by Governments.
A/CN.9/458/Add.4

Chapter III. SELECTION OF THE CONCESSIONNAIRE

CONTENTS

LEGISLATIVE RECOMMENDATIONS ......................................................... (1)-(22)

NOTES ON LEGISLATIVE RECOMMENDATIONS ....................................... 1-141

A. General considerations ................................................................. 1-38
   1. Selection procedures covered by the Guide ...................................... 3-5
   2. General objectives of selection procedures ...................................... 6-18
   3. Special features of selection procedures for privately financed infrastructure projects .................................................. 19-30
   4. Preparations for selection proceedings ........................................... 31-38

B. Preselection of bidders ................................................................. 39-56
   1. Invitation to the preselection proceedings ...................................... 40-42
   2. Preselection criteria ................................................................. 43-46
   3. Issues relating to the participation of bidding consortia .................... 47-48
   4. Preselection and domestic preferences .......................................... 49-50
   5. Contribution towards costs of participation in selection proceedings .... 51-52
   6. Preselection proceedings ............................................................. 53-56

C. Procedures for requesting proposals .............................................. 57-94
   1. Phases of the procedure ............................................................. 58-64
   2. Content of the final request for proposals ...................................... 65-74
   3. Clarifications and modifications ................................................... 75-76
   4. Content of the final proposals ....................................................... 77-82
   5. Evaluation criteria ................................................................. 83-86
   6. Submission, opening, comparison and evaluation of proposals .............. 87-91
   7. Final negotiations ................................................................. 92-93
   8. Notice of project award ............................................................. 94

D. Direct negotiations ................................................................. 95-107
   1. Circumstances authorizing the use of direct negotiations .................. 99-100
   2. Measures to enhance transparency in direct negotiations .................. 101-107

E. Unsolicited proposals ............................................................... 108-128
   1. Policy considerations ............................................................... 110-118
   2. Procedures for handling unsolicited proposals .................................. 119-128

F. Review procedures ................................................................. 129-133

G. Record of selection proceedings ............................................... 134-141
LEGISLATIVE RECOMMENDATIONS

General considerations (see paras. 1-30)

(1) The host country may wish to require the use of competitive procedures for the selection of the concessionaire, subject to the adjustments necessary to take into account the particular needs of privately financed infrastructure projects.

Preselection of bidders (see paras. 39-56)

(2) The host country may wish to provide:

(a) That the bidders should demonstrate that they possess the professional and technical qualifications, financial and human resources, equipment and other physical facilities, managerial capability, reliability and experience, as necessary to carry out all the phases of the project and that they meet such other qualification criteria as may be required under the general procurement laws of the host country.

(b) That the bidders may form consortia to submit proposals, provided that their members should not participate, directly or through subsidiary companies, in more than one consortium.

(c) That any margin of preference for national bidders or bidders who offer to procure supplies, services and products in the local market should be applied at the evaluation phase and must be announced in the invitation to the preselection proceedings;

(d) That the contracting authority may consider arrangements for compensating preselected bidders if the project cannot proceed for reasons outside their control or for contributing to the costs incurred by them;

(e) That the contracting authority should elaborate a short list of the preselected bidders that will subsequently be invited to submit proposals upon completion of the preselection phase.

Single-stage and two-stage procedure for requesting proposals (see paras. 58-64)

(3) The host country may wish to provide that, upon completion of the preselection proceedings, the contracting authority should invite the preselected bidders to submit final proposals with price with respect to the technical specifications or performance indicators and contractual terms.

(4) Notwithstanding the above, the host country may wish to provide that the contracting authority may use a two-stage procedure to request proposals from preselected bidders when it is not feasible for the contracting authority to formulate technical specifications or performance indicators and contractual terms in a manner sufficiently detailed and precise to permit final proposals to be formulated.

(5) Where a two-stage procedure is used, the host country may wish to provide:

(a) That the contracting authority should first call upon the preselected bidders to submit proposals relating to broad output specifications and other characteristics of the project as well as to the envisaged contractual terms;

(b) That the contracting authority may convene a meeting of bidders to clarify questions concerning the initial request for proposals and to engage in discussions with any bidder concerning any aspect of its proposal;

(c) That, following those discussions, the contracting authority may review and, as appropriate, revise the initial specifications prior to issuing a final request for proposals.

Content of the final request for proposals (see paras. 65-74)

(6) The host country may wish to provide that the final request for proposals should include the following information:

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

(b) Technical specifications and performance indicators, as appropriate;

(c) The contractual terms envisaged by the contracting authority;

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

Clarifications and modifications (see paras. 75-76)

(7) The host country may wish to provide:

(a) That the contracting authority may, whether on its own initiative or as a result of a request for clarification by a bidder, modify the request for proposals by issuing an addendum at any time prior to the deadline for submission of proposals;

(b) That the contracting authority should prepare minutes of any meeting of bidders convened by the contracting authority, which should contain the requests submitted at the meeting for clarification of the request for proposals, and its responses to those requests, without identifying the sources of the requests.

Contents of the final proposals (see paras. 77-82)

(8) The host country may wish to require that final proposals provide the information required in the request for proposals, in such a manner as to allow the contracting authority to consider the operational feasibility, technical soundness and environmental impact of the project; the total project cost, including operating and maintenance cost and proposed financing plan; and the proposed tariff or payment schedule, as appropriate.
Evaluation criteria (see paras. 83-86)

(9) The host country may wish to provide that evaluation criteria for the technical proposals should concern the effectiveness of the proposal submitted by the bidder in meeting the needs of the contracting authority, including the following:

(a) Technical soundness;
(b) Operational feasibility;
(c) Soundness of the proposed financial arrangements;
(d) Compliance with environmental standards;

(10) The host country may wish to provide that the criteria for the evaluation and comparison of the financial proposals may include, as appropriate:

(a) The present value of the proposed tolls, fees, and other charges over the concession period according to the prescribed minimum design and performance standards;
(b) The present value of the proposed schedule of amortization payments for the facility to be constructed;
(c) The costs for design and construction activities; annual operation and maintenance costs; present value of capital costs and operating costs;
(d) The amount of subsidy, if any, expected from the Government.

Submission, opening, comparison and evaluation of proposals (see paras. 87-91)

(11) The host country may wish to provide:

(a) That upon receipt of the final proposals, the contracting authority should ascertain whether they are prima facie responsive to the request for proposals and should reject proposals found to be incomplete or partial;
(b) That the contracting authority may establish a threshold with respect to quality and technical aspects to be reflected in the technical proposals in accordance with the technical criteria as set out in the proposals;
(c) That proposals that fail to achieve the threshold with respect to quality and technical aspects should be regarded as non-responsive.

Final negotiations (see paras. 92-93)

(12) The host country may wish to provide:

(a) That the contracting authority should rank all responsive proposals on the basis of the evaluation criteria set forth in the request for proposals and invite for final negotiation of the project agreement the bidder that has submitted the most advantageous proposal;
(b) That the most advantageous proposal should be:

(i) The proposal offering the lowest price among those that have passed the threshold with respect to quality and technical aspects, where the proposed unit price for the output is the deciding factor; or

(ii) The proposal that obtains the highest combined rating in respect of both price and non-price evaluation criteria. However, the awarding committee should provide a written justification of the reasons for selecting a proposal other than the one offering the lowest unit price for the output.

(c) That final negotiations may not concern those terms of the contract that were deemed not negotiable in the final request for proposals.

Notice of project award (see para. 94)

(13) The host country may wish to provide:

(a) That the contracting authority should cause a notice of the award of the project to be published;
(b) That the notice should identify the concessionaire and provide a summary of the essential terms of the project agreement.

Direct negotiations (see paras. 95-100)

(14) The host country may wish to provide that direct negotiations may be resorted to only in exceptional circumstances which may include the following:

(a) When there is an urgent need for ensuring continuity in the provision of the service, and engaging in a competitive selection procedure would therefore be impractical, provided that the circumstances giving rise to the urgency were neither foreseeable by the contracting authority nor the result of dilatory conduct on its part;
(b) In case of projects of short duration and with an anticipated initial investment value not exceeding a specified low amount;
(c) Reasons of national defence;
(d) Cases where there is only one source capable of providing the required service (e.g. because it requires the use of patented technology or unique know-how);
(e) Lack of experienced personnel or of an adequate administrative structure to conduct competitive selection procedures;
(f) Cases where a higher administrative authority of the host country authorizes such an exception for reasons of public interest.

(15) The host country may wish to provide that direct negotiations might be further resorted to when an invitation to the preselection proceedings or a request for proposals has been issued but no applications or proposals were submitted, or all proposals were rejected by the contracting authority, and when, in the judgement of the contracting authority, issuing a new request for proposals would be unlikely to result in a project award.
Measures to enhance transparency in direct negotiations (see paras. 101-107)

(16) The host country may wish to provide:

(a) That the approval of a higher authority should be obtained in order for the contracting authority to engage in selection through negotiation;

(b) That the contracting authority should publish a notice of the negotiation proceedings and engage in negotiations with as many companies judged susceptible of meeting the need as circumstances permit;

(c) That the contracting authority should establish the criteria for evaluating the proposals and determine the relative weight to be accorded to each criterion and the manner in which they are to be applied in the evaluation of the proposals;

(d) That the contracting authority should treat proposals in such a manner so as to avoid the disclosure of their contents to competing bidders;

(e) That any such negotiations between the contracting and bidders should be confidential and one party to the negotiations should not reveal to any other person any technical, price or other market information relating to the negotiations without the consent of the other party;

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

(g) That any award by the contracting authority be made to the bidder whose proposal best meets the needs of the contracting authority as determined in accordance with the criteria for evaluating the proposals set forth in the invitation to negotiate, as well as with the relative weight and manner of application of those criteria indicated in the request for proposals.

Unsolicited proposals (see paras. 108-118)

(17) The host country may wish to provide that, under exceptional circumstances, the contracting authority may be authorized to receive unsolicited proposals, provided that such proposals should not relate to a project for which selection procedures have been initiated or announced by the contracting authority.

Procedures for determining the admissibility of unsolicited proposals (see paras. 122-124)

(18) The host country may wish to provide:

(a) That the contracting authority should request the authors of an unsolicited proposal to submit an initial proposal containing sufficient information to allow the contracting authority to make a prima facie assessment of whether the conditions for handling unsolicited proposals are met, in particular whether the proposed project is in the public interest;

(b) That, following a preliminary examination, the contracting authority should inform the company, within a reasonably short period, whether or not there is a potential public interest in the project;

(c) That for projects found to be in the public interest, the contracting authority should invite the proponent to submit a formal proposal in sufficient detail to allow the contracting authority to properly evaluate the concept or technology and determine whether it meets the required conditions and is likely to be successfully implemented at the scale of the proposed project;

(d) That the proponent should retain title to all documents submitted throughout the procedure, and those documents should be returned to it in the event the proposal is rejected.

Procedures for handling unsolicited proposals that do not involve proprietary concepts or technology (see paras. 125-126)

(19) The host country may wish to provide:

(a) That the contracting authority should initiate competitive selection procedures under recommendations 3 to 22 above if it is found that the implementation of the project is possible without the use of a process, design, methodology or engineering concept for which the proponent or its partners possess exclusive rights or proposed concept or technology is not truly unique or new;

(b) That the company that submitted the original proposal should be invited to participate in such proceedings and might be given a premium for submitting the proposal.

Procedures for handling unsolicited proposals involving proprietary concepts or technology (see paras. 127-128)

(20) The host country may wish to provide:

(a) That the contracting authority should use a procedure for obtaining elements of comparison for the unsolicited proposal if it appears that the innovative aspects of the proposal are such that it would not be possible to implement the project without using a process, design, methodology or engineering concept for which the proponent or its partners possess exclusive rights;

(b) That the contracting authority should publish a summary of the essential terms of the proposal with an invitation for other interested parties to submit alternative or comparable proposals within a certain reasonable period;

(c) That the contracting authority may engage in direct negotiations with the original proponent if no alternative proposals are received, subject to approval by the same authority whose approval would normally be required in order for the contracting authority to select a concessionaire through direct negotiation;
(d) That, if alternative proposals are submitted, the contracting authority should invite all the proponents to competitive negotiations with a view to identifying the most advantageous proposal for carrying out the project.

Review procedures (see paras. 129-133)

(21) The host country may wish to establish procedures whereby bidders who claim to have suffered, or who may suffer, loss or injury due to a breach of a duty imposed on the contracting authority by the law may seek review of the contracting authority’s acts.

Record of selection proceedings (see paras. 134-141)

(22) The host country may wish to provide that the contracting authority should keep an appropriate record of key information pertaining to the selection proceedings.

NOTES ON LEGISLATIVE RECOMMENDATIONS

A. GENERAL CONSIDERATIONS

1. This chapter deals with methods and procedures recommended to be used for the award of privately financed infrastructure projects. In line with the advice of international organizations, such as the World Bank1 and UNIDO,2 the Guide expresses a preference for the use of competitive selection procedures, rather than negotiations with bidders, while recognizing that direct negotiations might also be used, according to the legal tradition of the country concerned (see further, paras. 95-98).

2. The selection procedures recommended in this chapter present some of the features of the principal method for the procurement of services under the UNCITRAL Model Law on Procurement of Goods, Construction and Services with a number of adaptations so as to take into account the particular needs of privately financed infrastructure projects. The method herein consists of a two stage procedure with a preselection phase. It allows some scope for negotiations between the contracting authority and the bidders within clearly defined conditions. The description of the procedures recommended for the selection of the concessionaire is primarily concerned with those elements that are special to, or particularly relevant for, privately financed infrastructure projects. Where appropriate, this chapter refers the reader to provisions of the UNCITRAL Model Law, which may mutatis mutandis supplement the selection procedure described herein.

1. Selection procedures covered by the Guide

3. Private investment in infrastructure may take various forms, each requiring special methods for selecting the concessionaire. For the purpose of discussing possible selection methods for the infrastructure projects dealt with in the Guide, a distinction may be made between three main forms of private investment in infrastructure:

(a) Purchase of public utilities enterprises. Private capital may be invested in public infrastructure through the purchase of physical assets or the shares of public utility enterprises. Those transactions are often carried out in accordance with rules governing the award of contracts for the disposition of State property. In many countries, the sale of shares of public utility enterprises requires prior legislative authorization. Disposition methods often include offering of shares on stock markets or competitive proceedings such as auctions or invitations to bid whereby the property is awarded to the qualified party offering the highest price;

(b) Provision of public services without development of infrastructure. In other types of projects, the service providers own and operate all the equipment necessary and sometimes compete with other suppliers for the provision of the relevant service. Some national laws establish special procedures whereby the State may authorize a private entity to supply public services by means of exclusive or non-exclusive “licences”. Licences may be publicly offered to interested parties who satisfy the qualification requirements set forth by the law or established by the licensing authority. Sometimes licensing procedures involve public auctions to interested qualified parties;

(c) Construction and operation of public infrastructure. In projects for the construction and operation of public infrastructure, a private entity is engaged to provide both works and services to the public. The procedures governing the award of those contracts are in some aspects similar to those that govern public procurement of construction and services. National laws provide a variety of methods for public procurement, ranging from structured competitive methods, such as tendering proceedings, to less structured negotiations with prospective suppliers.

4. This chapter deals primarily with selection procedures suitable to be used for infrastructure projects which involve an obligation, on the part of the selected private entity, to undertake physical construction, repair, or expansion works in the infrastructure concerned with a view to subsequent private operation (i.e. those referred to in paragraph 3(c)). It does not deal specifically with methods for disposal of State property for privatization purposes or procedures for licensing public service providers.

5. It should be noted, however, that some infrastructure projects may involve elements of more than one of
the categories mentioned above. For instance, the acquisition of a privatized public utility (e.g. a water distribution company) may be coupled with an obligation to effect substantial investment in new infrastructure (e.g. expansion of pipe network). In those situations, it is important to ascertain what is the predominant element of the project (e.g. privatization or construction of new infrastructure) in order to choose the appropriate selection procedure which may then be adjusted so as to take into account the main ancillary obligations expected to be assumed by the concessionaire. To that end, some of the considerations set forth in this chapter may also be relevant, mutatis mutandis, for the disposal of State property or licensing procedures which involve an obligation on the part of the new concessionaire or licensee to undertake infrastructure works.

2. General objectives of selection procedures

6. For the award of contracts for infrastructure projects, the contracting authority may either apply methods and procedures already provided in the laws of the host country or establish procedures specifically designed for that purpose. In either situation, it is important to ensure that such procedures are generally conducive to attaining the fundamental objectives of rules governing the award of public contracts. Those objectives are briefly discussed below.

(a) Economy and efficiency

7. In connection with infrastructure projects, economy refers to the selection of a concessionaire that is capable of performing works and delivering services of the desired quality at the most advantageous price and upon the most advantageous contractual terms. It is promoted by procedures that provide a favourable climate for participation in the selection process by competent companies and that provide incentives to them to offer their most advantageous terms.

8. In most cases, economy is best achieved by means of procedures that promote competition among bidders. Competition provides them with incentives to offer their most advantageous terms, and it can encourage them to adopt efficient or innovative technologies or production methods in order to do so. It should be noted, however, that competition does not necessarily require the participation of a large number of bidders in a given selection process. Particularly for large projects, there may be reasons for the contracting authority to wish to limit the number of bidders to a manageable number (see paras. 23-24). Provided that appropriate procedures are in place, the contracting authority can take advantage of effective competition even where the competitive base is limited.

9. Furthermore, economy can often be promoted through participation by foreign companies in selection proceedings. Not only can foreign participation expand the competitive base, it can also lead to the acquisition by the contracting authority and its country of technologies that are not available locally. Foreign participation in selection proceedings may be necessary where there exists no domestic expertise of the type required by the contracting authority. A country desiring to achieve the benefits of foreign participation should ensure that the relevant laws and procedures are conducive to such participation.

10. Efficiency refers to selection of a concessionaire within a reasonable amount of time, with minimal administrative burdens and at reasonable cost both to the contracting authority and to participating bidders. In addition to the losses that can accrue directly to the contracting authority from inefficient selection procedures (e.g. due to delayed selection or high administrative costs), excessively costly and burdensome procedures can lead to increases in the overall project costs or even discourage competent companies from participating altogether in the selection proceedings.

(b) Promotion of integrity of, and confidence in, the selection process

11. Another important objective of rules governing the selection of the concessionaire is to promote the integrity of, and confidence in, the process. Thus, an adequate selection system will usually contain provisions designed to ensure fair treatment of bidders, to reduce or discourage unintentional or intentional abuses of the selection process by persons administering it or by companies participating in it, and to ensure that selection decisions are taken on a proper basis.

12. Promoting the integrity of the selection process will help to promote public confidence in the process and in the public sector in general. Bidders will often refrain from spending the time and sometimes substantial sums of money to participate in selection proceedings unless they are confident that they will be treated fairly and that their proposals or offers have a reasonable chance of being accepted. Those that do participate in selection proceedings in which they do not have that confidence have a tendency to increase the project cost to cover the higher risks and costs of participation. Ensuring that selection proceedings are run on a proper basis could reduce or eliminate that tendency and result in more favourable terms to the contracting authority.

13. The host country should have in place generally an effective system of sanctions including of a criminal nature against corruption by Government officials, including employees of the awarding authorities, and by bidders, which would apply also to the selection process. Conflicts of interest should also be avoided, for instance by requiring that officials of the contracting authority, their spouses, relatives and associates abstain from owning a debt or equity interest in a company participating in a selection process or accepting to serve as a director or employee of such a company. Furthermore, the law governing the selection proceedings should obligate the contracting authority to reject offers
or proposals submitted by a party who gives or agrees to give, directly or indirectly, to any current or former officer or employee of the contracting authority or other governmental authority a gratuity in any form, an offer of employment or any other thing or service of value, as an inducement with respect to an act or decision of, or procedure followed by, the contracting authority in connection with the selection proceedings. These provisions may be supplemented by other measures, such as the requirement that all companies invited to participate in the selection process undertake neither to seek to influence unduly the decisions of the public officials involved in the selection process nor otherwise to distort the competition by means of collusive or other illicit practices (e.g. the so-called "integrity agreement"). Also, in the procurement practices adopted by some countries, bidders are required to guarantee that no official of the procuring entity has been or shall be admitted by the bidder to any direct or indirect benefit arising from the contract or the award thereof. Breach of such a provision typically constitutes a breach of an essential term of the contract.

14. An important corollary of the objectives of economy, efficiency, integrity and transparency is the availability of administrative and judicial procedures for the review of decisions made by the authorities involved in the selection proceedings (see paras. 129-133).

15. The confidence of investors may be further fostered by adequate provisions to protect the confidentiality of proprietary information submitted by them during the selection proceedings. This should include sufficient assurances that the contracting authority will treat proposals in such a manner as to avoid the disclosure of their contents to competing bidders; that any discussions or negotiations will be confidential; and that trade or other information that bidders might include in their proposals will not be made known to their competitors.

(c) Transparency of laws and procedures

16. Transparency of laws and procedures governing the selection of the concessionaire will help to achieve various of the policy objectives already mentioned. Transparent laws are those in which the rules and procedures to be followed by the contracting authority and by bidders are fully disclosed, are not unduly complex, and are presented in a systematic and understandable way. Transparent procedures are those which enable the bidders to ascertain what procedures have been followed by the contracting authority and the basis of decisions taken by it.

17. One of the most important ways to promote transparency and accountability is to include provisions requiring that the contracting authority maintain a record of the selection proceedings (see paras. 134-141). A record summarizing key information concerning those proceedings facilitates the exercise of the right of aggrieved bidders to seek review. That in turn will help to ensure that the rules governing the selection proceedings are, to the extent possible, self-policing and self-enforcing. Furthermore, adequate record requirements in the law will facilitate the work of Government bodies exercising an audit or control function and promote the accountability of awarding authorities to the public at large as regards the award of infrastructure projects.

18. Transparent laws and procedures create predictability, enabling bidders to calculate the costs and risks of their participation in selection proceedings and thus to offer their most advantageous terms. They also help to guard against arbitrary or improper actions or decisions by the contracting authority or its officials and thus help to promote confidence in the process. Transparency of laws and procedures is of particular importance where foreign participation is sought, since foreign companies may be unfamiliar with the country's practices for the award of infrastructure projects.

3. Special features of selection procedures for privately financed infrastructure projects

19. Generally, economy in the award of public contracts is best achieved through methods that promote competition among a range of bidders within structured, formal procedures. Competitive selection procedures, such as tendering, are usually prescribed by national laws as the rule for normal circumstances in procurement of goods or construction.

20. In competitive selection procedures, the contracting authority typically invites a range of companies to submit proposals which must be formulated on the basis of technical specifications and contractual terms specified by the contracting authority in the documents made available by it to bidders. Proposals are examined, evaluated and compared and the decision on which proposal to accept is made in accordance with essentially objective criteria and procedures that are set forth in the procurement laws and in the tender documents. Competitive selection procedures are said to be "open" when the contracting authority solicits proposals by means of a widely advertised invitation to tender directed to all companies wishing to participate in the proceedings. The procedures are said to be "restricted" when the contracting authority solicits proposals only from certain companies selected by it.

21. The formal procedures and the objectivity and predictability that characterize the competitive selection procedures generally provide optimal conditions for competition, transparency and efficiency. Thus, the use of competitive selection procedures in privately financed infrastructure projects has been recommended by UNIDO, which has formulated detailed practical guidance on how to structure those procedures. The rules for procurement under loans provided by the World Bank also advocate the use of competitive selection procedures and provide that a concessionaire selected pursuant to bidding procedures acceptable to the World Bank is generally free to adopt its own procedures for the award of contracts required to implement the project. However, where the concessionaire was not itself selected pursuant to those competitive

UNIDO BOT Guidelines, p. 96.
procedures, the award of subcontracts has to be done pursuant to competitive procedures acceptable to the World Bank.5

22. It should be noted, however, that no international legislative model has thus far been specifically devised for competitive selection procedures in privately financed infrastructure projects. On the other hand, domestic laws on competitive procedures for the procurement of goods, construction or services may not be entirely suitable for privately financed infrastructure projects. International experience in the award of privately financed infrastructure projects has in fact revealed some limitations of traditional forms of competitive selection procedures, such as the tendering method. In the light of the particular issues raised by privately financed infrastructure projects, which are briefly discussed below, it is advisable for the Government to consider adapting such procedures for the selection of the concessionaire.

(a) Range of bidders to be invited

23. In traditional Government procurement, the objective of economy is often maximized by allowing for as wide as possible competition among bidders. Invitations to tender are sometimes issued directly without prior preselection proceedings. Where preselection is required, it is sometimes limited to verifying a number of formal requirements (e.g. the bidders' professional qualification or legal capacity).

24. The award of privately financed infrastructure projects, in turn, typically involves complex, time-consuming and expensive proceedings. Furthermore, the sheer scale of most infrastructure projects reduces the likelihood of obtaining proposals from a large number of suitably qualified bidders. In addition, competent bidders may be reluctant to participate in procurement proceedings for high-value projects if the competitive field is too large and where they run the risk of having to compete with unrealistic proposals or proposals submitted by unqualified bidders. Therefore, open tendering without a preselection phase is usually not advisable for the award of infrastructure projects.

(b) Definition of project requirements

25. In traditional public procurement of construction works the Government usually assumes the position of a maître d'ouvrage or employer, while the selected contractor carries out the function of the performer of the works. The procurement procedures emphasize the inputs to be provided by the contractor, i.e. the contracting authority establishes clearly what is to be built, how and by what means. Therefore it is common that invitations to tender for construction works are accompanied by extensive and very detailed technical specifications of the type of works and services being procured. In those cases, the contracting authority will be responsible for ensuring that the specifications are adequate to the type of infrastructure to be built and that such infrastructure will be capable of being operated efficiently. In some privately financed infrastructure projects, the contracting authority may wish to establish precise specifications for the works to be performed or the technical means for the services to be provided (i.e. the "input" expected from the concessionaire). Such a choice is made, in particular, in connection with projects involving the construction of new infrastructure to be permanently owned by the Government and destined to be generally open for public use (e.g. roads, tunnels, bridges). In these cases, the contracting authority may see a need to have a larger degree of control over the engineering design and technical specifications than in the case of privately owned facilities generally closed to the public and accessible only to the concessionaire (e.g. a private power plant).

26. However, for many privately financed infrastructure projects, the contracting authority may envisage a different allocation of responsibilities between the public and the private sector. One of the underlying reasons for promoting private sector participation in infrastructure development may be to release the contracting authority from the immediate responsibility for those functions that are capable of being efficiently carried out by the private sector. In those cases, after having established a particular infrastructure need, the contracting authority may prefer to leave to the private sector the responsibility for proposing the best solution for meeting such a need, subject to certain requirements that may be established by the contracting authority (e.g. regulatory performance or safety requirements, sufficient evidence that the technical solutions proposed had been previously tested and satisfactorily met internationally acceptable safety and other standards). The selection procedure used by the contracting authority may thus give more emphasis to the output expected from the project (i.e. the services or goods to be provided) rather than to technical details of the works to be performed or means to be used to provide those services. While the Government remains ultimately accountable to the public for the quality of the works and services, the private sector will bear the risks that might result, for instance, from the inadequacy of the technical solutions used.

(c) Evaluation criteria

27. Goods, construction works or services are typically purchased by Governments with funds available under approved budgetary allocations. With the funding sources usually secured, the main objective of the procuring entity is to obtain the best value for the funds it spends. Therefore, in those types of procurement the decisive factor in establishing the winner among the responsive and technically acceptable proposals is often the global price offered for the construction works, which is calculated on the basis of the cost of the works and other costs incurred by the contractor plus a certain margin of profit.

5International Bank for Reconstruction and Development, Procurement under IBRD and IDA Loans, 1996, para. 3.13(a).
28. Privately financed infrastructure projects, in turn, are typically expected to be financially self-sustainable, with the development and operational costs being recovered from the project's own revenue. This and the large scale of most infrastructure projects render the task of evaluating proposals considerably more complex than in more traditional forms of procurement. Therefore, a number of other factors will need to be considered in addition to the construction and operation cost and the price to be paid by the users. For instance, the contracting authority will need to consider carefully the financial and commercial feasibility of the project, the soundness of the financial arrangements proposed by the bidders and the reliability of the technical solutions used. Such interest exists even where no governmental guarantees or payments are involved, because unfinished projects or projects with large cost overruns or higher than expected maintenance costs often have a negative impact on the overall availability of needed services and on the public opinion in the host country. Also, the contracting authority will aim at formulating qualification and evaluation criteria that give adequate weight to the need to ensure the continuous provision of, and, as appropriate, universal access to, the public service concerned. Furthermore, given the usually long duration of infrastructure concessions, the contracting authority will need to satisfy itself of the soundness and acceptability of the arrangements proposed for the operational phase and will weigh carefully the service elements of the proposals (see paras. 83-86).

4. Preparations for selection proceedings

31. The award of privately financed infrastructure projects is in most cases a complex exercise requiring careful planning and coordination among the offices involved. By ensuring that adequate administrative and personnel support is available to conduct the type of selection proceeding that it has chosen, the Government plays an essential role in promoting confidence in the selection process.

(a) Appointment of the award committee

32. One important preparatory measure is the appointment of the committee that will be responsible for evaluating the proposals and making an award recommendation to the contracting authority. The appointment of qualified and impartial members to the selection committee is not only a requirement for an efficient evaluation of the proposals, but may further foster the confidence of bidders in the selection process.

33. Another important preparatory measure is the appointment of the independent advisers who will assist the contracting authority in the selection procedures. The contracting authority may need, at this early stage, to retain the services of independent experts or advisers to assist in establishing appropriate qualification and evaluation criteria, defining performance indicators (and, if necessary, technical specifications) and preparing the documentation to be issued to bidders. Consultant services and advisers may also be retained to assist the contracting authority in the evaluation of proposals, drafting and negotiation of the project agreement in closing the final deal. Consultants and advisers can be particularly helpful by bringing a range of technical expertise which may not always be available in the host country's civil service, such as technical or engineering advice (e.g. on technical assessment of the project or installations, technical requirements of contract); environmental advice (e.g. on environmental assessment, operation requirements); or financial advice (e.g. on financial projections, review of financing sources, assessing the adequate ratio between debt and equity, drafting of financial information documents).

(b) Feasibility and other studies

34. As already indicated (see "Introduction and background information on privately financed infrastructure projects", para. ___), one of the initial steps taken by the Government in respect of a proposed infrastructure project is to conduct a preliminary assessment of its feasibility, including economic and financial aspects such as expected economic advantages of the project, estimated cost and potential revenue anticipated from the operation of the infrastructure facility. The option to

(d) Negotiations with bidders

29. Laws and regulations governing tendering proceedings often prohibit negotiations between the contracting authority and the contractors concerning a proposal submitted by them. The rationale for such a strict prohibition, which is also contained in article 35 of the UNCITRAL Model Law, is that negotiations might result in an "auction", in which a proposal offered by one contractor is used to apply pressure on another contractor to offer a lower price or an otherwise more favourable proposal. As a result of that strict prohibition, contractors selected to provide goods or services pursuant to traditional procurement procedures are typically required to sign standard contract documents provided to them during the procurement proceedings.
develop infrastructure as a privately financed project requires a positive conclusion on the feasibility and financial viability of the project. An assessment of the project's environmental impact should also be ordinarily carried out by the contracting authority as part of its feasibility studies. In some countries, it was found useful to provide for some public participation in the preliminary assessment of the project's environmental impact and the various options available to minimize it.

35. Prior to starting the proceedings leading to the selection of a prospective concessionaire, it is advisable for the contracting authority to review and, as required, expand those initial studies. In some countries awarding authorities are advised to formulate model projects for reference purposes (typically including a combination of estimated capital investment, operation and maintenance costs) prior to inviting proposals from the private sector. The purpose of such model projects is to demonstrate the viability of the commercial operation of the infrastructure and the affordability of the project in terms of total investment cost and cost to the public. They will also provide the contracting authority with a useful tool for comparison and evaluation of proposals. Confidence of bidders will be promoted by evidence that the technical, economical and financial assumptions of the project, as well as the proposed role of the private sector, have been carefully considered by the contracting authority.

(c) Preparation of documentation

36. Selection proceedings for the award of privately financed infrastructure projects typically require the preparation of extensive documentation including a project outline, preselection documents, the request for proposals, instructions for preparing proposals and a draft of the project agreement. The quality and clarity of the documents issued by the contracting authority plays a significant role in ensuring an efficient and transparent selection procedure.

37. In many countries it is customary for the Government to devise standard contract forms and general conditions of contract that are used in public contracting. In some countries there may be fairly detailed standard contracts for different infrastructure sectors. Standard documentation prepared in sufficiently precise terms may be an important element to facilitate the negotiations between bidders and prospective lenders and investors. It may also be useful for ensuring consistency in the treatment of issues common to most projects in a given sector.

38. However, in using standard contract terms it is advisable to bear in mind the possibility that a specific project may raise issues that had not been anticipated when the standard document was prepared or that the project may necessitate particular solutions that might be at variance with the standard terms. Where standard contract documents are provided to bidders during the selection proceedings, the contracting authority may have limited discretion to negotiate the terms of the project agreement with the selected bidders. Careful consideration should be given to the need for achieving the appropriate balance between the level of uniformity desired for project agreements of a particular type and the flexibility that might be needed for finding project-specific solutions.

B. PRESELECTION OF BIDDERS

39. Given the complexity of privately financed infrastructure projects the contracting authority may wish to limit the number of bidders from whom proposals will be subsequently requested only to those who satisfy certain qualification criteria. In traditional Government procurement, preselection proceedings may consist of the verification of certain formal requirements, such as adequate proof of technical capability or prior experience in the type of procurement, so that all bidders who meet the preselection criteria are automatically admitted to the tendering phase. Preselection proceedings for privately financed infrastructure projects, in turn, may involve elements of evaluation and selection. Thus, they do not show the same level of automaticity that characterizes the preselection proceedings usually applied for the procurement of goods or services. This may be the case, for example, where the contracting authority establishes a ranking of preselected bidders (see para. 55).

1. Invitation to the preselection proceedings

40. In order to promote transparency and competition, it is advisable that the invitation to the preselection proceedings be published in a manner that reaches an audience wide enough to provide an effective level of competition. The laws of many countries identify publications, usually the official gazette or other official publication, in which the invitation to the preselection proceedings is to be published. With a view to fostering participation of foreign companies and maximizing competition, the contracting authority may wish to cause the invitations to the preselection proceedings to be published also in a language customarily used in international trade, in a newspaper of wide international circulation or in a relevant trade publication or technical or professional journal of wide international circulation.

41. Preselection documents should contain sufficient information for bidders to be able to ascertain whether the works and services entailed by the project are of a type that they can provide and, if so, how they can participate in the selection proceedings. The invitation to the preselection proceedings should, in addition to identifying the infrastructure to be built or renovated, contain information on other essential elements of the project, such as the services to be delivered by the concessionaire, the financial arrangements envisaged by the contracting authority (e.g. whether the project will be entirely financed by user fees or tolls or whether public funds may be provided as direct payments, loans or guarantees) and, where already known, a summary of the main required terms of the project agreement to be entered into as a result of the selection proceedings.
42. In addition to that, the invitation to the preselection proceedings should include general information similar to the information typically provided in preselection documents under general rules on public procurement (such as, for example, instructions for preparing and submitting preselection applications; any documentary evidence or other information that must be submitted by bidders to demonstrate their qualifications; the manner, place and deadline for the submission of applications).

2. Preselection criteria

43. Generally, bidders should be required to demonstrate that they possess the professional and technical qualifications, financial and human resources, equipment and other physical facilities, managerial capability, reliability and experience, as necessary to carry out the project. Additional criteria that might be particularly relevant for privately financed infrastructure projects may include the ability to manage the financial aspects of the project and previous experience in operating public infrastructure or in providing services under regulatory oversight. Qualification requirements should cover all phases of an infrastructure project, including financing management, engineering, construction, operation and maintenance, where appropriate. In addition to that, the bidders should be required to demonstrate that they meet such other qualification criteria as would typically apply under the general procurement laws of the host country (e.g. that they have legal capacity to enter into the project agreement; that they are not insolvent, in receivership, bankrupt or being wound up, their affairs are not being administered by a court or a judicial officer, their business activities have not been suspended, and they are not the subject of legal proceedings for any of the foregoing; that they have fulfilled their obligations to pay taxes and social security contributions in the State; that they have not, and their directors or officers have not, been convicted of any criminal offence related to their professional conduct or the making of false statements or misrepresentations as to their qualifications to enter into a procurement contract within a certain period of years preceding the commencement of the selection proceedings, or have not been otherwise disqualified pursuant to administrative suspension or disbarment proceedings).

44. The contracting authority should determine the type of information to be provided by the bidders to substantiate their qualification, including, for instance, quality indicators of their past performance as public service providers or infrastructure operators. Such information may relate to the size and type of previous projects carried out by the bidders; the level of experience of the key personnel to be engaged in the project; sufficient organizational capability, including minimum levels of construction, operation and maintenance equipment. The contracting authority should set forth in some detail the manner in which the bidders have to demonstrate their capability to sustain the financing requirements for the engineering, construction and operational phases of the project. The contracting authority may request sufficient information showing the bidders’ ability to provide an adequate amount of equity to the project, and sufficient evidence from reputable banks attesting the bidder’s good financial standing, and that they have adequate resources.

45. One important aspect to be considered by the contracting authority relates to the relationship between the award of one particular project and the governmental policy pursued for the sector concerned (see "Introduction and background information on privately financed infrastructure projects", paras.____). Where competition is sought, the Government may be interested in ensuring that the relevant market or sector is not dominated by one enterprise (e.g. that the same company does not operate more than a certain limited number of local telephone companies within a given territory). The contracting authority may thus wish to retain the possibility of rejecting a particular proposal if it determines that the award of the project to that particular bidder might give rise to undesirable market domination by a particular company or would otherwise distort competition in the sector concerned. For purposes of transparency, it is desirable for the law to provide that, where the contracting authority reserves the right to reject a proposal on those or similar grounds, adequate notice of that circumstance must be included in the invitation to the preselection proceedings.

46. Qualification requirements should apply equally to all bidders. A contracting authority should not impose any criterion, requirement or procedure with respect to the qualifications of bidders which has not been set forth in the preselection documents. When considering the professional and technical qualifications of bidding consortia, the contracting authority should consider the individual specialization of the consortium members and assess whether the combined qualifications of the consortium members are adequate to meet the needs of all phases of the project.

3. Issues relating to the participation of bidding consortia

47. Given the large scale of most infrastructure projects, the interested companies typically participate in the selection proceedings through consortia especially formed for that purpose. Therefore, information required from members of bidding consortia should relate to the consortium as a whole as well as to its individual participants. For the purpose of facilitating the liaison with the contracting authority, it may be useful to require in the preselection documents that each consortium should designate one of its members as a focal point for all communications with the contracting authority. It is generally advisable for the contracting authority to require that the members of bidding consortia submit a sworn statement undertaking that, if awarded the contract, they shall bind themselves jointly and severally for the obligations assumed in the name of the consortium under the project agreement. Alternatively, the contracting authority may reserve itself the right to require at a later stage that the members of the selected consortium should establish an
independent legal entity to carry out the project (see further chapter IV, "The project agreement", paras. ____).

48. It is further advisable for the contracting authority to review carefully the composition of consortia and their parent companies. It may happen that one company, directly or through subsidiary companies, joins more than one consortium to submit proposals for the same project. Such a situation should not be allowed, since it raises the risk of leakage of information or collusion between competing consortia, thus undermining the credibility of the selection proceedings. It is therefore advisable to provide in the invitation to the preselection proceedings that no company may participate, either directly or through subsidiary companies, in more than one consortium in the same selection proceedings. A violation of this rule should cause the disqualification of the consortia concerned.

4. Preselection and domestic preferences

49. The laws of some countries provide for some sort of preferential treatment for domestic entities or afford special treatment to bidders that undertake to use national goods or employ local labour. Such preferential or special treatment is sometimes provided as a material qualification requirement (e.g. a minimum percentage of national participation in the consortium) or as a condition for participating in the selection procedure (e.g. to appoint a local partner as a leader of the bidding consortium).

50. Domestic preferences may give rise to a variety of issues. Their use is not permitted under the guidelines of some international financial institutions and might be inconsistent with international obligations entered into by many States pursuant to agreements on regional economic integration or trade facilitation. Furthermore, from the perspective of the host country it is further important to weigh the expected advantages against the disadvantage of depriving the contracting authority of the possibility of obtaining better options to meet the national infrastructure needs. It is also important not to allow total insulation from foreign competition so as not to perpetuate lower levels of economy, efficiency and competitiveness of the concerned sectors of national industry. This is the reason why many countries that wish to provide some incentive to national suppliers, while at the same time taking advantage of international competition, do not contemplate a blanket exclusion of foreign participation or restrictive qualification requirements. Domestic preferences may take the form of special evaluation criteria establishing margins of preference for national bidders or bidders who offer to procure supplies, services and products in the local market. The margin of preference technique, which is provided in article 34(4)(d) of the UNCITRAL Model Law, is more transparent than subjective qualification or evaluation criteria. Furthermore, it allows the contracting authority to favour local bidders that are capable of approaching internationally competitive standards, and it does so without simply excluding foreign competition. Where domestic preferences are envisaged, it is advisable that they be announced in advance, preferably in the invitation to the preselection proceedings.

5. Contribution towards costs of participation in selection proceedings

51. In some countries, a high price may be charged for the preselection documents, while in other countries that price might reflect only the cost of printing the preselection documents and providing them to the bidders. Expensive preselection documents may be used as an additional tool to limit the number of bidders. At the same time, however, they add to the already considerable cost of participation in the selection proceedings. The high costs of preparing proposals for infrastructure projects and the relatively high risks that a selection procedure may not lead to a contract award may function as a deterrent for some companies to join in a consortium to submit a proposal, particularly when they are not familiar with the selection procedures applied in the host country.

52. Therefore, some countries authorize the contracting authority to consider arrangements for compensating preselected bidders if the project cannot proceed for reasons outside their control or for contributing to the costs incurred by them after the preselection phase, when justified in a particular case by the complexity involved and the prospect of significantly improving the quality of the competition. It is advisable that such contribution or compensation, when authorized, be announced at an early stage, preferably in the invitation to the preselection proceedings.

6. Preselection proceedings

53. The contracting authority should respond to any request by a bidding consortium for clarification of the preselection documents that is received by the contracting authority within a reasonable time prior to the deadline for the submission of applications. The response by the contracting authority should be given within a reasonable time so as to enable the bidders to make a timely submission of their application. The response to any request that might reasonably be expected to be of interest to other bidders should, without identifying the source of the request, be communicated to all bidders to which the contracting authority provided the preselection documents.

54. In some countries, practical guidance on selection procedures encourages domestic contracting authorities to limit the prospective proposals to the lowest possible number sufficient to ensure meaningful competition (e.g. three or four). For that purpose, those countries apply a quantitative rating system for technical, managerial and financial criteria, taking into account the nature the project. Quantitative preselection criteria are found to be more easily applicable and transparent than qualitative criteria involving the use of merit points.
However, in devising a quantitative rating system, it is important to avoid unnecessary limitation of the contracting authority's discretion in assessing the qualifications of bidders. The contracting authority may also need to take into account the fact that the procurement guidelines of some multilateral financial institutions prohibit the use of preselection proceedings for the purpose of limiting the number of bidders to a predetermined number. In any event, where such a rating system is to be used, that circumstance should be clearly stated in the preselection documents.

55. Upon completion of the preselection phase, the contracting authority usually elaborates a short list of the preselected bidders which will be subsequently invited to submit proposals. One practical problem sometimes faced by awarding authorities concerns proposals for changes in the composition of bidding consortia during the selection proceedings. From the perspective of the contracting authority, it is generally advisable to exercise caution in respect of proposed substitutions of individual members of bidding consortia after the closing of the preselection phase. Changes in the composition of consortia may substantially alter the basis on which the preselected bidding consortia were short-listed by the contracting authority and may give rise to questions about the integrity of the selection proceedings. As a general rule, only preselected bidders should be allowed to participate in the selection phase, unless the contracting authority can satisfy itself that a new consortium member meets the preselection criteria to substantially the same extent as the retiring member of the consortium.

56. While the criteria used for preselecting bidders should not be weighted again at the evaluation phase, the contracting authority may wish to reserve itself the right to require, at any stage of the selection process, that the bidders again demonstrate their qualifications in accordance with the same criteria used to preselect them.

C. PROCEDURES FOR REQUESTING PROPOSALS

57. This section discusses the procedures for requesting proposals from the preselected bidders. The procedures described herein are in a number of respects similar to the procedures for the solicitation of proposals under the preferred method for the procurement of services provided in the UNCITRAL Model Law, with some adaptations needed to fit the needs of contracting authorities awarding infrastructure projects.

1. Phases of the procedure

58. Following the preselection of bidders, it is advisable for the contracting authority to review its original feasibility study and the definition of the output and performance requirements and consider whether a revision of those requirements is needed in the light of the information obtained during the preselection proceedings. At this stage, the contracting authority should have already determined whether a single or a two-stage procedure will be used to request proposals; whether bidders will be asked to formulate proposals on the basis of performance indicators or technical specifications; and, in the latter case, whether alternatives to those specifications will be considered.

(a) Single-stage procedure

59. The decision between having a single or a two-stage procedure for requesting proposals will depend on the nature of the contract, on how precisely the technical requirements can be defined, and whether output results (or performance indicators) are used for selection of the concessionaire. If it is deemed both feasible and desirable for the contracting authority to formulate performance indicators or technical specifications to the necessary degree of precision or finality, the selection process may be structured as a single-stage procedure, in which case, after having concluded the preselection of bidders, the contracting authority would proceed directly to issue a final request for proposals (see paras. 65–74).

(b) Two-stage procedure

60. There are cases, however, in which it may not be feasible for the contracting authority to formulate its requirement in sufficiently detailed and precise technical specifications or performance indicators to permit proposals to be formulated, evaluated and compared uniformly on the basis of those specifications and indicators. This may be the case, for instance, when the contracting authority has not determined the type of technical and material input that would be suitable for the project in question (e.g., the type of construction material to be used in a bridge). In such cases, it might be considered undesirable, from the standpoint of obtaining the best value, for the contracting authority to proceed on the basis of specifications or indicators it has drawn up in the absence of discussions with bidders as to the exact capabilities and possible variations of what is being offered. For that purpose, the contracting authority may wish to divide the selection proceedings into two stages and allow a certain degree of flexibility for discussions with bidders.

61. Where the selection procedure is divided in two stages, the initial request for proposals typically calls upon the bidders to submit proposals relating to broad output specifications and other characteristics of the project as well as to the envisaged contractual terms. The invitation for bids would allow bidders to offer their own solutions for meeting the particular infrastructure need in accordance with defined standards of service. The proposals submitted at this stage would typically consist of solutions on the basis of a conceptual design or performance indicators without indication of financial elements, such as the expected tariff or level of remuneration.

62. To the extent the terms of the contractual arrangements are already known by the contracting authority, they
should be included in the request for proposals, possibly in the form of a draft of the project agreement. Knowledge of certain contractual terms, such as the risk allocation envisaged by the contracting authority, is important in order for the bidders to formulate their proposals and discuss the "bankability" of the project with potential lenders. The initial response to those contract terms, in particular the risk allocation envisaged by the contracting authority, may help the contracting authority assess the feasibility of the project as originally conceived. However, it is important to distinguish between the procedure to request proposals and the negotiation of the final contract, after the project has been awarded. The purpose of this initial stage is to enable the contracting authority to formulate its requirement subsequently in a manner that enables a final competition to be carried out on the basis of a single set of parameters. The invitation of initial proposals at this stage should not lead to a negotiation of the terms of the contract prior to its final award.

63. The contracting authority may then convene a meeting of bidders to clarify questions concerning the request for proposals and accompanying documentation. The contracting authority may, in the first stage, engage in discussions with any bidder concerning any aspect of its proposal. The contracting authority should treat proposals in such a manner as to avoid the disclosure of their contents to competing bidders. Any discussions need to be confidential, and one party to the discussions should not reveal to any other party any technical, financial or other information relating to the discussions without the consent of the other party.

64. Following those discussions, the contracting authority should review and, as appropriate, revise the initial output specifications. In formulating those revised specifications, the contracting authority should be allowed to delete or modify any aspect of the technical or quality characteristics of the project originally set forth in the request for proposals, and any criterion originally set forth in those documents for evaluating and comparing proposals. Any such deletion, modification or addition should be communicated to bidders in the invitation to submit final proposals. Bidders not wishing to submit a final proposal should be allowed to withdraw from the selection proceedings without forfeiting any security that they may have been required to provide.

2. Content of the final request for proposals

65. At the final stage, the contracting authority should invite the bidders to submit final proposals with respect to the revised performance indicators (or technical specifications, as appropriate) and contractual terms.

66. The request for proposals should generally include all information necessary to provide a basis for enabling the bidders to submit proposals that meet the needs of the contracting authority and that the contracting authority can compare in an objective and fair manner.

(a) General information to bidders

67. General information to bidders should cover, as appropriate, those items that are ordinarily included in solicitation documents or requests for proposals for the procurement of goods, construction and services (cf., for example, articles 27 and 38 of the UNCTITRAL Model Law). It includes, for example:

(a) Instructions for preparing and submitting proposals, including the manner, place and deadline for the submission of proposals and the period of time during which proposals shall be in effect and any requirements concerning tender securities;

(b) The means by which bidders may seek clarifications of the request for proposals, and a statement as to whether the contracting authority intends, at this stage, to convene a meeting of bidders;

(c) The place, date and time for the opening of proposals and the procedures to be followed for opening and examining proposals;

(d) The manner in which the proposals will be evaluated. Particularly important is the disclosure of the criteria to be used by the contracting authority in determining the successful proposal, including any margin of preference and any criteria other than price to be used, and the relative weight of such criteria (see paras. 83-86).

68. If alternative proposals, including variations to non-mandatory elements of the request for proposals, are admitted, the contracting authority should indicate the manner in which they would be compared and evaluated. Alternative proposals should be rejected if they are not accompanied by a fully responsive proposal. Where the contracting authority further reserves the right to reject all proposals, without incurring liability towards bidders, such as compensation for their costs of preparing and submitting proposals, a statement to that effect should be included in the request for proposals.

(b) Technical specifications and performance indicators

69. The level of detail provided in the specifications, as well as the appropriate balance between the input and output elements, will be influenced by considerations of issues such as the type and ownership of the infrastructure and the allocation of responsibilities between the public and the private sectors (see paras. 25-26). It is generally advisable for the contracting authority to bear in mind the long-term needs of the project and to formulate its specifications in a manner that allows it to obtain sufficient information to select the bidder that offers the highest quality of services at the best economic terms.

70. Generally, when the contracting authority invites proposals on the basis of a single set of technical specifications the request for proposals typically includes the following information:

(a) Description of the works and services to be performed, including technical specifications, plans, drawings and designs;
(b) The location where the construction is to be effected and the services to be provided;

(c) Time schedule for the execution of works and provision of services;

(d) The technical requirements for the operation and maintenance of the facility.

71. Where the contracting authority requests proposals on the basis of performance indicators, it is important to formulate them in a way that defines adequately the output and performance required without being overly prescriptive in how that is to be achieved. Performance indicators typically cover items such as the following:

(a) Description of project and expected output. If the services require specific buildings, such as a transport terminal or an airport, the contracting authority may wish to provide no more than outline planning concepts for the division of the site as usage zones on an illustrative basis, instead of plans indicating the footprint of individual buildings, as would normally be the case in traditional procurement of construction services;

(b) Minimum applicable design and performance standards, including appropriate environmental standards. Performance standards are typically formulated in terms of the desired quantity and quality of the outputs of the facility. Proposals which deviate from the relevant performance standards should be regarded as non-responsive;

(c) Requirements for the expansion of service;

(d) Quality of maintenance of facilities;

(e) Attention to customers;

(f) Economic and financial soundness of the concessionaire.

72. Each of the above-mentioned performance indicators may require the submission of additional information by the bidders, according to the project being awarded. For the award of a concession for distribution of electricity in a specific region, for example, they may include minimum technical standards such as: (a) specified voltage (and frequency) fluctuation at consumer level; (b) outage duration (expressed in hours per year); (c) outage frequency (expressed in a number per year); (d) losses; (e) number of days to connect a new customer; (f) commercial standards for customer relationship (e.g. number of days to pay bills; to reconnect installations; to respond to customers' complaints).

(c) Contractual terms

73. It is advisable that the bidding documents provide some indication of how the contracting authority expects to allocate the project's risks. This is important in order to set the terms of debate for the detailed negotiations on the project agreement. If risk allocation is left entirely open, the bidders may likely respond by seeking to minimize the risks they accept, which may frustrate the purpose of seeking private investment for developing the project. Furthermore, the request of proposals should contain information on essential elements of the contractual arrangements envisaged by the contracting authority, such as:

(a) The duration of the concession or invitations to bidders to submit proposals for the duration of the concession;

(b) Formula and price indices to be used in adjustments to tariffs;

(c) Government support and investment incentives, if any;

(d) Bonding requirements;

(e) Requirements of regulatory bodies, if any;

(f) Monetary rules and regulations governing foreign exchange remittances;

(g) Revenue sharing arrangements, if any;

(h) Indication of the categories of assets which the concessionaire would be required to transfer to the contracting authority or make available to a successor concessionaire at the end of the project period;

(i) Where a new concessionaire is being selected to operate an existing infrastructure, a description of the assets and property that will be made available to the concessionaire;

(j) The possible alternative, supplementary or ancillary revenue sources (e.g. concessions for exploitation of existing infrastructure), if any, that may be offered to the successful bidder.

74. In order to establish clearly the scope of the negotiations that will take place following the evaluation of proposals (see paras. 92-93), the final request for proposals should indicate which are the terms of the project agreement that are deemed not negotiable.

3. Clarifications and modifications

75. It is desirable to establish procedures for clarification and modification of the request for proposals in a manner that will foster efficient, fair and successful conduct of selection proceedings. The right of the contracting authority to modify the request for proposals is important in order to enable it to obtain what is required to meet its needs. It is also desirable to authorize the contracting authority, whether on its own initiative or as a result of a request for clarification by a bidder, to modify the request for proposals by issuing an addendum at any time prior to the deadline for submission of proposals. However, in case of extensive amendments of the request for proposals, the deadline for submission of proposals may need to be extended.

76. Generally, clarifications, together with the questions that gave rise to the clarifications, and modifications must be communicated promptly by the contracting authority to all bidders to whom the contracting authority provided the request for proposals. If the contracting authority convenes a meeting of bidders, it should prepare minutes of the meeting containing the requests submitted at the meeting for clarification of the
request for proposals, and its responses to those requests, without identifying the sources of the requests, and send copies to the bidders.

4. Content of the final proposals

(a) Technical proposals

77. The technical proposals to be submitted by the bidders should include the following information:

(a) Operational feasibility of the project, which shall indicate the proposed organization, methods and procedures for the operation and maintenance of the project under bidding;

(b) Technical soundness of the preliminary engineering design, including proposed schedule of works;

(c) Preliminary environmental assessment, indicating the possible adverse effects of the project on the environment and the corresponding mitigating measures;

(d) Project cost including operating and maintenance cost requirements and proposed financing plan (e.g. proposed equity contribution, debt);

(e) Bid security (see paras. 81-82).

78. It is useful for the contracting authority to require that the final proposals submitted by the bidders contain evidence showing the comfort of the bidder’s preferred lenders with the proposed commercial terms and allocation of risks, as outlined in the request for proposals. Such a requirement might play a useful role in resisting pressures to reopen commercial terms at the stage of final negotiations. In some countries, bidders are required to initial and return to the contracting authority the draft project agreement together with their final proposals as a confirmation of their acceptance of all terms in respect of which they did not propose specific amendments.

(b) Financial proposals

79. For projects in which the concessionaire’s income is expected to consist primarily of tolls, fees or charges paid by the customers or users of the infrastructure facility, the financial proposal should indicate the proposed tariff structure. For projects in which the concessionaire’s income is expected to consist primarily of payments made by the contracting authority or another Governmental agency to amortize the concessionaire’s investment, the financial proposal should indicate the proposed amortization payments and repayment period. Furthermore, for either case the financial proposals should include:

(a) The present value of the proposed charges or amortization payments based on the discounting rate and foreign exchange rate prescribed in the bidding documents;

(b) The proposed duration of the concession, where it is not specified in the request for proposals;

(c) Level of governmental financial support required for the project, including, as appropriate, any subsidy or guarantee expected from the contracting authority;

(d) The extent of risks assumed by the bidders during construction and operation phase, including unforeseen events, insurance, equity investment and other guarantees against those risks.

(c) Feasibility studies

80. Feasibility studies are particularly important in privately financed infrastructure projects and should cover, for instance, the following aspects:

(a) Commercial viability: particularly in projects financed on a non-recourse or limited recourse basis, it is essential to establish the need for the project outputs and to evaluate and project such needs over the proposed operational life of the project, including expected demand (e.g. traffic forecasts for roads) and pricing (e.g. tolls);

(b) Engineering design and operational feasibility: bidders should be requested to demonstrate the suitability of the technology they propose, including equipment and processes, to national, local and environmental conditions, the likelihood of achieving the planned performance level and the adequacy of the construction methods and schedules. This study should also define the proposed organization, methods and procedures for operating and maintaining the completed facility;

(c) Financial viability: bidders should be requested to indicate the proposed sources of financing for the construction and operation phases, including debt capital and equity investment. While the loan and other financing agreements in most cases are not executed until after the signing of the project agreement, the bidders should be required to submit sufficient evidence of the lenders’ intention to provide the specified financing. In some countries, bidders are also required to indicate the expected financial internal rate of return in relation to the effective cost of capital corresponding to the financing arrangements proposed. Such information is intended to allow the contracting authority to consider the reasonableness and affordability of the proposed tariffs or prices to be charged by the concessionaire and the potential for subsequent increases therein;

(d) Environmental impact: this study should identify possible negative or adverse effects on the environment as a consequence of the project and indicate corrective measures that need to be taken.

(d) Bid securities

81. It is advisable for the laws or regulations governing the selection process to authorize the contracting authority to require the bidders to post a bid security so as to cover those losses that may result from withdrawal of proposals or failure by the selected bidder to conclude a project agreement.
82. It is advisable that the request for proposals indicate any requirements of the contracting authority with respect to the issuer and the nature, form, amount and other principal terms of any bid security to be provided by bidders submitting proposals. In order to ensure a fair treatment of all bidders, requirements that refer directly or indirectly to the conduct by the bidder submitting the proposal should not relate to conduct other than: withdrawal or modification of the proposal after the deadline for submission of proposals, or before the deadline if so stipulated in the request for proposals; failure to achieve financial closing; failure to sign the project agreement if required by the contracting authority to do so; and failure to provide a required security for the performance of the project agreement after the proposal has been accepted or to comply with any other condition precedent to signing the project agreement specified in the request for proposals. Safeguards should be included to ensure that a bid-security requirement is only imposed fairly and for the intended purpose.

5. Evaluation criteria

83. The award committee should rate the technical and financial elements of each proposal in accordance with the predisclosed rating systems for the technical evaluation criteria and specify in writing the reasons for the rating. Generally, it is important for the contracting authority to achieve an appropriate balance between evaluation criteria relating to the physical investment (e.g. the construction works) and evaluation criteria relating to the operation of the infrastructure and the quality of services to be provided by the concessionaire. Adequate emphasis should be given to the long term needs of the contracting authority, in particular the need to ensure the continuous delivery of the service at the required level of quality and safety.

84. Technical evaluation criteria are designed to facilitate the assessment of the technical, operational, environmental, and financing viability of the proposal vis-à-vis the prescribed specifications, indicators and requirements prescribed in the bidding documents. To the extent practicable, the technical criteria applied by the contracting authority should be objective and quantifiable, so as to enable proposals to be evaluated objectively and compared on a common basis. This reduces the scope for discretionary or arbitrary decisions. Regulations governing the selection process might spell out how such factors are to be formulated and applied.

Technical proposals for privately financed infrastructure projects are usually evaluated in accordance with the following criteria:

(a) Technical soundness. Where the contracting authority has established minimum engineering design and performance specifications or standards, the basic design of the project should conform to those specifications or standards. Bidders should be required to demonstrate the soundness of the proposed construction methods and schedules;

(b) Operational feasibility. The proposed organization, methods, and procedures for operating and maintaining the completed facility must be well defined, should conform to the prescribed performance standards, and should be shown to be workable. Where feasible, it should provide for the transfer of technology used in every phase of the project;

(c) Quality of services. Evaluation criteria used by the contracting authority may include an analysis of the manner in which the bidders undertake to maintain and expand the service, including the guarantees offered for ensuring its continuity;

(d) Environmental standards. The proposed design and the technology of the project to be used should be in accordance with the environmental standards set forth in the request for proposals. Any negative or adverse effects on the environment as a consequence of the project as proposed by the bidders should be properly identified, including the corresponding corrective or mitigating measures;

(e) Financial viability. Technical proposals should demonstrate that the proposed financing plan is adequate to meet the construction, operating and maintenance costs of the project. The contracting authority should assess whether the financing proposals of the bidders adequately meet the cost requirements of the project;

(f) Enhancements. Other terms which the project proponent may offer to make the proposals more attractive, such as revenue-sharing with the contracting authority, less governmental guarantees or reduction in the level of Government support.

85. In addition to criteria for the technical evaluation of proposals, the contracting authority needs to define criteria for assessing and comparing the financial proposals. For projects in which the concessionaire's income is expected to consist primarily of tolls, fees or charges paid by the customers or users of the infrastructure facility, the assessment and comparison of the financial elements of the final proposals is typically based on the present value of the proposed tolls, fees, rentals and other charges over the concession period according to the prescribed minimum design and performance standards. For projects in which the concessionaire’s income is expected to consist primarily of payments made by the contracting authority to amortize the concessionaire’s investment, the assessment and comparison of the financial elements of the final proposals is typically based on the present value of the proposed schedule of amortization payments for the facility to be constructed according to the prescribed minimum design and performance standards, plans and specifications. However, the contracting authority’s assessment of financial elements of the final proposals should not be limited.
to a comparison of the unit prices offered for the expected output. In order to consider adequately the financial feasibility of the proposals and the likelihood of subsequent increases in the proposed prices, additional criteria may need to be considered, such as the costs for design and construction activities; annual operation and maintenance costs; present value of capital costs and operating costs; and the amount of subsidy, if any, expected from the Government.

86. Evaluation of financial proposals vary in form and complexity depending on the form of the desired private participation. In some cases the financial proposal may include the cost of financing offered by bidders; in this case the requirement for financing and how it will be considered in the evaluation of proposals should be defined in the request for proposals. In establishing the criteria for the evaluation of financial proposals, it is important for the contracting authority to consider carefully the relative importance of the proposed unit price for the expected output as an evaluation criterion. While the unit price is an important factor for ensuring objectiveness and transparency in the choice between equally responsive proposals, it should be noted that the notion of “price” usually does not have the same value for the award of privately financed infrastructure projects as it has in the procurement of goods and services. Indeed, the remuneration of the concessionaire is often the combined result of charges paid by the users, ancillary revenue sources and direct subsidies or payments made by the public entity awarding the contract. Therefore, while the unit price for the expected output retains its role as an important element of comparison of proposals, it may not always be regarded as the most important factor.

6. Submission, opening, comparison and evaluation of proposals

87. Proposals should be required to be submitted in writing, signed and in sealed envelopes. Proposals received by the contracting authority after the deadline for the submission of proposals should not be opened and should be returned to the bidders that submitted them.

88. For the purpose of ensuring transparency, national laws often prescribe formal procedures for the opening of proposals, usually at a time previously specified in the request for proposals, and require that the bidders that have submitted proposals, or their representatives, be permitted by the contracting authority to be present at the opening of proposals. Such a requirement helps to minimize the risk that the proposals might be altered or otherwise tampered with and represents an important guarantee of the integrity of the proceedings.

89. In view of the complexity of privately financed infrastructure projects and the variety of evaluation criteria usually applied in the award of the project, in some countries bidders are required to formulate and submit their technical and financial proposals in two separate envelopes. The two-envelope system is sometimes used because it permits the contracting authority to evaluate the technical quality of proposals without being influenced by their financial components. However, the method has been criticized as being contrary to the objective of economy in the award of public contracts. In particular, there is said to be a danger that, by selecting proposals initially on the basis of technical merit alone and without reference to price, a contracting authority might be tempted to select, upon the opening of the first envelope, proposals offering technically superior works and to reject proposals offering less sophisticated solutions that nevertheless meet the contracting authority’s needs at an overall lower cost. International financial institutions, such as the World Bank, do not accept the two-envelope system for projects financed by them because of concerns that the system gives margin to a higher degree of discretion in the evaluation of proposals and makes it more difficult to compare them in an objective manner.

90. As an alternative to the use of a two-envelope system, the awarding authorities may require both technical and financial proposals to be contained in one single proposal, but structure their evaluation in two stages, as in the evaluation procedure provided in article 42 of the UNCITRAL Model Law. In an initial stage, the contracting authority typically establishes a threshold with respect to quality and technical aspects to be reflected in the technical proposals in accordance with the technical criteria as set out in the proposals, and rates each technical proposal in accordance with such criteria and the relative weight and manner of application of those criteria as set forth in the request for proposals. The contracting authority then compares the financial proposals that have attained a rating at or above the threshold. When the technical and financial proposals are to be evaluated consecutively, the contracting authority should initially ascertain whether the technical proposals are prima facie responsive to the request for proposals (e.g. whether they cover all items required to be addressed in the technical proposals). Incomplete or partial proposals, as well as proposals that deviate from the request for proposals, should be rejected at this stage. While the contracting authority may ask bidders for clarifications of their proposals, no change in a matter of substance in the proposal, including changes aimed at making an unresponsive proposal responsive, should be sought, offered or permitted at this stage.

91. In addition to deciding whether to use a two-envelope system or a two-stage evaluation procedure, it is important for the contracting authority to disclose the relative weight to be accorded to each evaluation criterion and the manner in which they are to be applied in the evaluation of proposals. Two possible approaches might be used to reach an appropriate balance between financial and technical aspects of the proposals. One possible approach is to consider as most advantageous the proposal that obtains the highest combined rating in respect of both price and non-price evaluation criteria. Alternatively, the price
proposed for the output (e.g., the water or electricity tariff, the level of tolls) might be the deciding factor for establishing the winning proposal among the responsive proposals (i.e., those that have passed the threshold with respect to quality and technical aspects). In any event, in order to promote the transparency of the selection process and to avoid improper use of non-price evaluation criteria, it is advisable to require the awarding committee to provide a written justification of the reasons for selecting a proposal other than the one offering the lowest unit price for the output.

7. Final negotiations

92. The contracting authority should rank all responsive proposals on the basis of the evaluation criteria set forth in the request for proposals and invite for final negotiation of the project agreement the bidder that has attained the best rating or, as appropriate, the one that offered the lowest price for the output among those that attained the minimum threshold in respect of technical aspects. The final negotiations should be limited to fixing the final details of the transaction documentation and satisfying the reasonable requirements of the selected bidder's lenders. One particular problem faced by awarding authorities is the danger that the negotiations with the selected bidder might lead to pressures to amend, to the detriment of the Government or the consumers, the price or risk allocation originally contained in the proposal. Changes in essential elements of the proposal should not be permitted, as they may distort the assumptions on the basis of which the proposals were submitted and rated. Therefore, the negotiations at this stage may not concern those terms of the contract that were deemed not negotiable in the final request for proposals. The risk of re-opening commercial terms at this late stage could be further minimized by insisting that the selected bidder's lenders indicate their comfort with the risk allocation embodied in their bid at a stage where there is competition among bidders (see para. 78). The contracting authority's financial advisers might contribute to this process by advising whether bidders' proposals are realistic, and what levels of financial commitment are appropriate at each stage. The process of reaching financial close can itself be quite lengthy.

93. The contracting authority should inform the remaining responsive bidders that they may be considered for negotiation if the negotiations with the bidder with better ratings do not result in a project agreement. If it becomes apparent to the contracting authority that the negotiations with the bidder invited will not result in a project agreement, the contracting authority should inform that bidder that it is terminating the negotiations and then invite for negotiations the next bidder on the basis of its ranking until it arrives at a project agreement or rejects all remaining proposals. To avoid the possibility of abuse and unnecessary delay, the awarding entity should not reopen negotiations with any bidder with whom they had already been terminated.

8. Notice of project award

94. Project agreements frequently include provisions that are of direct interest for parties other than the contracting authority and the concessionaire, and who might have a legitimate interest in being informed about certain essential elements of the project. This is particularly the case for projects involving the provision of a service directly to the general public. For transparency purposes, it may be advisable to establish procedures for publicizing those terms of the project agreement that may be of public interest. One possible procedure may be to require the contracting authority to publish a notice of the award of the project, indicating, inter alia, the following elements: (a) the name of the concessionaire; (b) the annexes and enclosures that form part of the agreement; (c) a description of the works and services to be performed by the concessionaire; (d) the duration of the concession; (e) the tariff structure; (f) the rights and obligations of the concessionaire and the guarantees to be provided by it; (g) the monitoring rights of the contracting authority and remedies for breach of the project agreement; (h) the obligations of the Government, including any payment, subsidy or compensation offered by the Government; and (i) any other essential term of the project agreement, as provided in the request for proposals. Where such a system is used, it is important to ensure consistency between the notice of award and the project agreement.

D. DIRECT NEGOTIATIONS

95. In the legal tradition of certain countries, privately financed infrastructure projects involve the delegation by the contracting authority of the right and duty to provide a public service. As such, they are subject to a special legal regime that differs in many respects from the regime that applies generally to the award of public contracts for the purchase of goods, construction or services.

96. In those legal systems, the Government generally has the choice of a number of procedures for the award of public contracts for the purchase of goods or services. As a general rule, those procedures involve publicity requirements, competition and the strict application of pre-established award criteria. The most common procedure is the tendering method, in which the contract is awarded to the tenderer offering the lowest price. While there also exist less rigid procedures, such as the request for proposals, which allows for consideration of other elements in addition to price (e.g., operating cost, technical merit and proposed completion time), negotiations are only resorted to under exceptional circumstances. However, those countries apply different procedures for the award of privately financed infrastructure projects. Given the very particular nature of the services required (e.g., complexity, amount of investment and completion time), the procedures used place the accent on the contracting authority's freedom to choose the operator who best suits its need, in terms of professional qualification, financial strength, ability to ensure the continuity of the service, equal treatment of the users
and quality of the proposal. In contrast to the competitive selection procedures usually followed for the award of public contracts, which sometimes may appear to be excessively rigid, selection by direct negotiation is characterized by a high degree of flexibility as to the procedures involved and discretion on the part of the contracting authority. However, freedom of negotiation does not mean arbitrary choice and the laws of those countries provide procedures to ensure transparency and fairness in the conduct of the selection process.

97. In other countries, where tendering is under normal circumstances the rule for the award of public contracts, guidelines issued to awarding authorities advise the use of direct negotiations whenever possible for the award of privately financed infrastructure projects. The rationale for encouraging negotiations in those countries is that in negotiating with bidders the Government is not bound by pre-determined requirements or rigid specifications and has more flexibility for taking advantage of innovative or alternative proposals that may be submitted by the bidders in the selection proceedings, as well as for changing and adjusting its own requirements in the event that more attractive options for meeting the infrastructure needs are formulated during the negotiations.

98. Negotiated methods generally afford a high degree of flexibility that some countries may find beneficial to the selection of the concessionaire. However, negotiated methods may have a number of disadvantages that make them less suitable to be used as a principal selection method in a number of countries. Because of the high level of flexibility and discretion afforded to the contracting authority, negotiated methods require highly skilled personnel with sufficient experience in negotiating complex projects. They also require a well-structured negotiation team, clear lines of authority and a high level of coordination and cooperation among all the offices involved. Therefore, the use of negotiations for the award of privately financed infrastructure projects may not represent a viable alternative for countries that do not have the tradition of using such methods for the award of large Government contracts. Another disadvantage of negotiated methods is that they may not ensure the level of transparency and objectivity that can be achieved by more structured competitive methods. In some countries there might be concerns that the higher level of discretion in negotiated methods might carry with it a higher risk of abusive or corrupt practices. In the light of the above, the host country may wish to prescribe the use of the competitive selection procedures as a rule for the award of privately financed infrastructure projects and reserve direct negotiations only for exceptional cases.

1. Circumstances authorizing the use of direct negotiations

99. For transparency purposes as well as for ensuring discipline in the award of projects, it might be generally desirable for the law to identify the exceptional circumstances that may authorize the use of direct negotiations. They may include, for example, the following:

(a) When there is an urgent need for ensuring immediate provision of the service, and engaging in a competitive selection procedure would therefore be impractical, provided that the circumstances giving rise to the urgency were neither foreseeable by the contracting authority nor the result of dilatory conduct on its part. Such an exceptional authorization may be needed, for instance, in cases of interruption in the provision of a given service or where an incumbent concessionaire fails to provide the service at acceptable standards or if the project agreement is rescinded by the contracting authority, when engaging in a competitive selection procedure would be impractical in view of the urgent need to ensure the continuity of the service;

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

(c) Reasons of national defence;

(d) Cases where there is only one source capable of providing the required service (e.g. because it can be provided only by the use of patented technology or unique know-how);

(e) Lack of experienced personnel or of an adequate administrative structure to conduct competitive selection procedures.

100. In addition to the above, after a competitive selection procedure has been initiated, situations might arise under which the contracting authority may prefer to change the selection method in favour of direct negotiations. This may be particularly the case when an invitation to preselection proceedings or a request for proposals has been issued but no applications or proposals were submitted, or all proposals were rejected by the contracting authority, and when, in the judgement of the contracting authority, issuing a new request for proposals would be unlikely to result in a project award. In such a case, the contracting authority might prefer to enter into negotiations with responsive bidders, as an alternative to having to reject all proposals and start another procedure with possible uncertain results.

2. Measures to enhance transparency in direct negotiations

101. Procedures to be followed in procurement through negotiation are typically characterized by a higher degree of flexibility than the procedures applied to other methods of procurement. Few rules and procedures are established to govern the process by which the parties negotiate and conclude their contract. In some countries, procurement laws allow contracting authorities virtually unrestricted freedom to conduct negotiations as they see fit. The laws of other countries establish a procedural framework for negotiation designed to maintain fairness and objectivity and to bolster competition by encouraging participation of bidders. Provisions on procedures for selection through negotiation address a variety of issues discussed below, in particular, requirements for approval of the contracting authority's decision to select the concessionaire through
negotiation, selection of negotiating partners, criteria for comparison and evaluation of offers, and recording of the selection proceedings.

(a) Approval

102. A threshold requirement found in many countries is that a contracting authority obtain the approval of a higher authority prior to engaging in selection through negotiation. Such provisions generally require the application for approval to be in writing and to set forth the grounds necessitating the use of negotiation. Approval requirements are intended, in particular, to ensure that the negotiation method of selection is used only in appropriate circumstances.

(b) Selection of negotiating partners

103. In order to make the negotiation proceedings as competitive as possible, it is advisable to require the contracting authority to engage in negotiations with as many companies judged susceptible of meeting the need as circumstances permit. Beyond such a general provision, there is no specific provision in the laws of some countries on the minimum number of contractors or suppliers with whom the contracting authority is to negotiate. The laws of some other countries, however, require the contracting authority, where practicable, to negotiate with, or to solicit proposals from, a minimum number of bidders (e.g. three). The contracting authority is permitted to negotiate with a smaller number in certain circumstances, in particular, when less than the minimum number of contractors or suppliers were available.

104. For the purpose of enhancing transparency, it is also advisable to require a notice of the negotiation proceedings to be given to bidders in a specified manner. For example, the contracting authority may be required to publish the notice in a particular publication normally used for that purpose. Such notice requirements are intended to bring the procurement proceedings to the attention of a wider range of bidders than might otherwise be the case, thereby promoting competition. Given the magnitude of most infrastructure projects, the notice should normally contain certain minimum information (e.g. description of the project, qualification requirements) and should be issued in sufficient time to allow bidders to prepare offers. Generally, the formal eligibility requirements applicable to bidders in competitive selection proceedings should also apply in negotiation proceedings.

105. In some countries, notice requirements are waived when the contracting authority resorts to negotiation following unsuccessful tendering proceedings (see para. 100), if all qualified contractors or suppliers that submitted tenders are permitted to participate in the negotiations or if no tenders at all were received.

(c) Criteria for comparison and evaluation of offers

106. Another useful measure to enhance transparency and effectiveness of direct negotiations consists of establishing general criteria that proposals are requested to meet (e.g. general performance objectives, output specifications), as well as criteria for comparing and evaluating offers made during the negotiations and for selecting the winning concessionaire (e.g. the technical merit of an offer, tariffs, operating and maintenance costs, the effect of the contract terms on the concessionaire, and the profitability and development potential of the project agreement). The contracting authority should identify the proposals that appear to meet those criteria and engage in discussions with the author of each such proposal in order to refine and improve upon the proposal to the point where it is satisfactory to the contracting authority. The price of each proposal does not enter into those discussions. When the proposals have been finalized, it may be advisable for the contracting authority to seek a best and final offer on the basis of the clarified proposals. It is recommendable that bidders should include with their final offer evidence that the risk allocation that the offer embodies would be acceptable to their proposed lenders. From the best and final offers received, the preferred bidder can then be chosen. The project would then be awarded to the party offering the “most economical” or “most advantageous” proposal. It is recommended that the contracting authority’s intention to seek a best and final offer or not should be stated in the invitation to negotiate.

(d) Record of selection proceedings

107. The contracting authority should be required to establish a record of the selection proceedings. The record should include information concerning the circumstances necessitating the use of negotiation, the contractors or suppliers invited to negotiate, the contractors or suppliers that requested to participate, and the contractors or suppliers that were excluded from participating and the grounds for their exclusion.

E. UNSOLICITED PROPOSALS

108. Government agencies are sometimes approached directly by private companies who submit proposals for the development of projects in respect of which no selection procedures have been opened. These proposals are usually referred to as “unsolicited proposals”. Unsolicited proposals may result from the identification by the private sector of an infrastructure need that may be met by a privately financed project. They may also involve innovative proposals for infrastructure management and offer the potential for transfer of new technology to the host country.

109. The main issue raised by unsolicited proposals is whether or not it is advisable to authorize the
contracting authority to negotiate unsolicited proposals directly with the bidder or whether unsolicited proposals, too, need to be awarded pursuant to the generally applicable award procedures.

1. Policy considerations

110. One possible reason sometimes cited for waiving the requirement of competitive selection procedures is to provide an incentive for the private sector to submit proposals involving the use of new concepts or technologies to meet the contracting authority's needs. By the very nature of competitive selection procedures, no bidder has an assurance of being awarded the project, unless it wins the competition. The cost of formulating proposals for large infrastructure projects may be a deterrent for companies concerned about their ability to match proposals submitted by competing bidders. In contrast, the private sector may see an incentive for the submission of unsolicited proposals in rules that allow a contracting authority to negotiate such proposals directly with their authors. The contracting authority, too, may have an interest in the possibility of engaging in direct negotiations in order to stimulate the private sector to formulate innovative proposals for infrastructure development.

111. At the same time, however, the award of projects pursuant to unsolicited proposals and without competition from other bidders may expose the Government to serious criticism, particularly in cases involving exclusive concessions. In addition to that, prospective lenders, including multilateral and bilateral financial institutions, may have difficulties in lending or providing guarantees for projects that have not been the subject of competitive selection proceedings. They may fear the possibility of challenge and cancellation by future governments (e.g., because the project award may be subsequently deemed to be the result of favouritism or because the procedure did not provide objective parameters for comparing prices, technical elements and the overall effectiveness of the project) or legal or political challenge by other interested parties, such as customers dissatisfied with increased tariffs or competing companies alleging unjust exclusion from a competitive selection procedure.

112. In the light of the above considerations, it is important for the host country to consider the need for, and the desirability of, devising special procedures for handling unsolicited proposals which deviate from the procedures usually followed for the award of privately financed infrastructure projects. For that purpose, in may be useful to analyse two situations most commonly mentioned in connection with unsolicited proposals, namely: unsolicited proposals claiming to involve the use of new concepts or technologies to address the contracting authority's infrastructure needs, and unsolicited proposals claiming to address an infrastructure need not already identified by the contracting authority.

(a) Unsolicited proposals claiming to involve the use of new concepts or technologies to address the contracting authority's infrastructure needs

113. Generally, for infrastructure projects which require the use of some kind of industrial process or method, the contracting authority would have an interest in stimulating the submission of proposals incorporating the most advanced processes, designs, methodologies or engineering concepts with demonstrated ability to enhance the project's outputs (e.g. by significantly reducing construction costs, accelerating project execution, improving safety, enhancing project performance, extending economic life, reducing costs of facility maintenance and operations, or reducing negative environmental impact or disruptions during either the construction or the operation phase of the project).

114. The contracting authority's legitimate interests might also be achieved through appropriately modified competitive selection procedures instead of a special set of rules for handling unsolicited proposals. For instance, if the contracting authority is using selection procedures which emphasize the expected output of the project, without being prescriptive about the manner in which that output is to be achieved (see paras. 71-72), the bidders would have sufficient flexibility for offering their own proprietary processes or methods. In such a situation, the fact that each of the bidders has its own proprietary processes or methods would not pose an obstacle to competition, provided that all the proposed methods are technically capable of generating the output expected by the contracting authority.

115. Adding the necessary flexibility to the competitive selection procedures may in these cases be a more satisfactory solution than devising special non-competitive procedures for dealing with proposals claiming to involve new concepts or technologies. With the possible exception of proprietary concepts or technologies whose uniqueness may be ascertained on the basis of the existing intellectual property rights a contracting authority may face considerable difficulties in defining what constitutes a new concept or technology. Such determination may require the services of costly independent experts, possibly from outside the host country to avoid allegations of bias. A determination that a project involves a novel concept or technology might also be met by claims from other interested companies also claiming to have appropriate new technologies.

116. However, a somewhat different situation may arise if the uniqueness of the proposal or its innovative aspects are such that it would not be possible to implement the project without using a process, design, methodology or engineering concept for which the proponent or its partners possess exclusive rights, either worldwide or regionally. The existence of intellectual property rights in respect of a method or technology may indeed reduce or eliminate the scope for meaningful competition. This is why the procurement laws of most countries authorize procuring entities to engage in single-source procurement if the goods, construction or services are available only from a particular supplier or
contractor, or the particular supplier or contractor has exclusive rights in respect of the goods, construction or services, and no reasonable alternative or substitute exists (cf. UNCTRAL Model Law, article 22).

117. In such a case, it would be appropriate to authorize the contracting authority to negotiate the execution of the project directly with the proponent of the unsolicited proposal. The difficulty, of course, would be how to establish, with the necessary degree of objectivity and transparency, that there exists no reasonable alternative or substitute to the method or technology contemplated in the unsolicited proposal. For that purpose, it is advisable for the contracting authority to establish procedures for obtaining elements of comparison for the unsolicited proposal.

(b) Unsolicited proposals claiming to address an infrastructure need not already identified by the contracting authority

118. The merit of unsolicited proposals of this type consists of the identification of a potential for infrastructure development which has not been considered by the authorities of the host country. However, in and of itself this circumstance should not normally provide sufficient justification for a directly negotiated project award in which the contracting authority has no objective assurance that it has obtained the most advantageous solution for meeting its needs.

2. Procedures for handling unsolicited proposals

119. In the light of the above considerations, it is advisable for the contracting authority to establish transparent procedures for determining whether an unsolicited proposal meets the required conditions and whether it is in the contracting authority’s interest to pursue it.

(a) Restrictions to the receivability of unsolicited proposals

120. In the interest of ensuring proper accountability for public expenditures, some domestic laws provide further that no unsolicited proposal may be considered if the execution of the project would require significant financial commitments from the contracting authority or other governmental agency such as guarantees, subsidies or equity participation. The reason for such a limitation is that the procedures for handling unsolicited proposals are typically less elaborate than ordinary selection procedures and may not ensure the same level of transparency and competition that would otherwise be achieved. However, there may be reasons for allowing some flexibility in the application of this condition. In some countries, the presence of government support other than direct government guarantees, subsidy or equity participation (e.g., the sale or lease of government assets to project proponents) does not necessarily disqualify a proposal from being treated and accepted as an unsolicited proposal.

121. Another condition for consideration of an unsolicited proposal is that it should relate to a project for which no selection procedures have been initiated or announced by the contracting authority. The rationale for handling an unsolicited proposal without using a competitive selection procedure is to provide an incentive for the private sector to identify new or unanticipated infrastructure needs or formulate innovative proposals for meeting those needs. This justification may no longer be valid if the project has already been identified by the authorities of the host country and the private sector is merely proposing a technical solution different from the one envisaged by the contracting authority. In such a case, the contracting authority could still take advantage of innovative solutions by applying a two-stage selection procedure or by inviting the submission of alternative proposals within the selection procedures originally foreseen (see paras. 60-84). However, it would not be consistent with the principle of fairness in the award of public contracts to entertain unsolicited proposals outside selection proceedings already started or announced.

(b) Procedures for determining the admissibility of unsolicited proposals

122. The company or group of companies who approach the Government with a suggestion for private infrastructure development should be requested to submit an initial proposal containing sufficient information to allow the contracting authority to make a prima facie assessment of whether the conditions for handling unsolicited proposals are met, in particular whether the proposed project is in the public interest. The initial proposal should include, for instance, the following information: statement of the proponent’s previous project experience and financial standing; description of the project (type of project, location, regional impact, proposed investment, operational costs, financial assessment, resources needed from the Government or third parties); the site (ownership and whether land or other property will have to be expropriated); a description of the service and the works.

123. Following a preliminary examination, the contracting authority should inform the company, within a reasonably short period, whether or not there is a potential public interest in the project. If the contracting authority reacts positively to the project, the company should be invited to submit a formal proposal which, in addition to the items covered in the initial proposal, should contain a technical and economical feasibility study (including characteristics, costs and benefits) and an environmental impact study. Furthermore, the proponent should be required to submit satisfactory information regarding the concept or technology contemplated in the proposal. The information disclosed should be in sufficient detail to allow the contracting authority to properly evaluate the concept or technology and determine whether it meets the required conditions and is likely to be successfully implemented at the scale of the proposed project. The company submitting the unsolicited proposal should retain title to all documents submitted throughout the procedure, and those documents should be returned to it in the event the proposal is rejected.
124. Once all the required information is provided by the proponent, the contracting authority should decide, within a reasonably short period, whether it intends to pursue the project and, if so, what procedure will be used. The choice of the appropriate procedure should be made on the basis of the contracting authority’s preliminary determination as to whether or not the implementation of the project would be possible without the use of a process, design, methodology or engineering concept for which the proponent or its partners possess exclusive rights.

(c) Procedures for handling unsolicited proposals which do not involve proprietary concepts or technology

125. If the contracting authority, upon examination of an unsolicited proposal, decides that there is public interest in pursuing the project, but the implementation of the project is possible without the use of a process, design, methodology or engineering concept for which the proponent or its partners possess exclusive rights, the contracting authority should be required to award the project by using the procedures which would be normally required for the award of privately financed infrastructure projects, such as, for instance, the competitive selection procedures described in this Guide (see paras. 39-94). However, the selection procedures may include certain special features so as to provide an incentive to the submission of unsolicited proposals. These incentives may consist of the following measures:

(a) The contracting authority could undertake not to initiate selection proceedings regarding a project in respect of which an unsolicited proposal was received without inviting the company that submitted the original proposal;

(b) The original bidder might be given some form of premium for submitting the proposal. In some countries, the premium takes the form of a margin of preference over the final rating (i.e., a certain percentage over and above the final combined rating obtained by that company in respect of both price and non-price evaluation criteria). One possible difficulty of such a system is the risk of setting the margin of preference so high as to discourage competing meritorious bids, thus resulting in the receipt of a project of lesser value in exchange for the preference given to the innovative proponent. Alternative forms of incentives may include the reimbursement, in whole or in part, of the costs incurred by the original proponent in the preparation of the unsolicited proposal. For purposes of transparency, any such incentives should be announced in the request for proposals.

126. Notwithstanding the incentives that may be provided, the author of the unsolicited proposal should generally be required to meet essentially the same qualification criteria as would be required of the bidders participating in the competitive selection procedure (see paras. 43-46).

(d) Procedures for handling unsolicited proposals involving proprietary concepts or technology

127. If it appears that the innovative aspects of the proposal are such that it would not be possible to implement the project without using a process, design, methodology or engineering concept for which the proponent or its partners possess exclusive rights, either worldwide or regionally, it may be useful for the contracting authority to confirm that preliminary assessment by applying a procedure for obtaining elements of comparison for the unsolicited proposal. One such procedure may consist in the publication of a summary of the essential terms of the proposal with an invitation for other interested parties to submit alternative or comparable proposals within a certain period. The period should be commensurate with the complexity of the project and should afford the prospective competitors sufficient time for formulating their proposals. This may be a crucial factor for obtaining alternative proposals, for example, if the bidders would have to carry out detailed sub-surface geological investigations that might have been carried out over many months by the original proponent, who would want the geological findings to remain secret.

128. The invitation for comparative or competitive proposals should be published with a minimum frequency (e.g., once every week for three weeks) in at least one newspaper of general circulation. It should indicate the time and place where bidding documents could be obtained and should specify the time during which proposals may be received. It is important for the contracting authority to protect the intellectual property rights of the original proponent and to ensure the confidentiality of proprietary information received with the unsolicited proposal. Any such information should not form part of the bidding documents. Both the original proponent and any other company that wishes to submit an alternative proposal should be required to submit a bid security (see paras. 81-82). Two possible avenues may then be pursued, according to the answers to reactions received to the invitation:

(a) If no alternative proposals are received, the contracting authority may reasonably conclude that there is no reasonable alternative or substitute to the method or technology contemplated in the unsolicited proposal. This finding of the contracting authority should be appropriately recorded and the contracting authority could be authorized to engage in direct negotiations with the original proponent. It may be advisable to require that the decision of the contracting authority be reviewed and approved by the same authority whose approval would normally be required in order for the contracting authority to select a concessionaire through direct negotiation (see para. 102);

(b) If alternative proposals are submitted, the contracting authority should invite all the proponents to competitive negotiations with a view to identifying the most advantageous proposal for carrying out the project (see paras. 103-105). In the event that the contracting authority receives a sufficiently large number of alternative proposals which appear prima facie to meet its infrastruc-
ture needs, there may be scope for engaging in full-fledged competitive selection procedures, subject to any incentives that may be given to the author of the original proposal (see para. 125 (b)).

F. REVIEW PROCEDURES

129. An important safeguard of proper adherence to the rules governing the selection procedure is that bidders have the right to seek review of actions by the contracting authority in violation of those rules. Various remedies and procedures are available in different legal systems and systems of administration, which are closely linked to the question of review of governmental actions. What is crucial is that, whatever the exact form of review procedures, an adequate opportunity and effective procedures for review should be provided. Elements for the establishment of an adequate review system are contained in chapter VI of the UNCITRAL Model Law.

130. Appropriate review procedures should establish in the first place that suppliers and contractors have a right to seek review. In the first instance, that review may be sought from the contracting authority itself, in particular where the project is yet to be awarded. This may facilitate economy and efficiency, since in many cases, in particular prior to the awarding of the project, the contracting authority may be quite willing to correct procedural errors, of which it may even not have been aware. It may also be useful to provide for a review by higher administrative organs of the Government, where such a procedure would be consistent with constitutional, judicial and administrative structures. Finally, most domestic procurement regimes affirm the right to judicial review, which should generally also be available in connection with the award of infrastructure projects.

131. In order to strike a workable balance between, on the one hand, the need to preserve the rights of bidders and the integrity of the selection process and, on the other hand, the need to limit disruption of the selection process, domestic laws often include a number of restrictions on the review procedures that it establishes. These include: limitation of the right to review to bidders; time limits for filing of applications for review and for disposition of cases, including any suspension of the selection proceedings that may apply at the level of administrative review; exclusion from the review procedures of a number of decisions that are left to the discretion of the contracting authority and that do not directly involve questions of the fairness of treatment accorded to bidders.

132. There exist in most States mechanisms and procedures for review of acts of administrative organs and other public entities. In some States, review mechanisms and procedures have been established specifically for disputes arising in the context of procurement by those organs and entities. In other States, those disputes are dealt with by means of the general mechanisms and procedures for review of administrative acts. Certain important aspects of proceedings for review, such as the forum where review may be sought and the remedies that may be granted, are related to fundamental conceptual and structural aspects of the legal system and the system of State administration in every country. Many legal systems provide for review of acts of administrative organs and other public entities before an administrative body that exercises hierarchical authority or control over the organ or entity (hereinafter referred to as "hierarchical administrative review"). In legal systems that provide for hierarchical administrative review, the question of which body or bodies are to exercise that function in respect of acts of particular organs or entities depends largely on the structure of the State administration. In the context of general procurement laws, for example, some States provide for review by a body that exercises overall supervision and control over procurement in the State (e.g. a central procurement board); in other States the review function is performed by the body that exercises financial control and oversight over operations of the Government and of the public administration. In some States, the review function in respect of particular types of cases involving administrative organs or other public entities is performed by specialized independent administrative bodies whose competence is sometimes referred to as "quasi-judicial". Those bodies are not, however, considered in those States to be courts within the judicial system.

133. Many national legal systems provide for judicial review of acts of administrative organs and public entities. In several of those legal systems judicial review is provided in addition to administrative review, while in other systems only judicial review is provided. Some legal systems provide only administrative review, and not judicial review. In some legal systems where both administrative and judicial review is provided, judicial review may be sought only after opportunities for administrative review have been exhausted; in other systems the two means of review are available as options.

G. RECORD OF SELECTION PROCEEDINGS

134. In order to ensure transparency and accountability and to facilitate the exercise of the right of aggrieved bidders to seek review of decisions made by the contracting authority, the contracting authority should be required to keep an appropriate record of key information pertaining to the selection proceedings.

135. The record to be kept by the contracting authority should contain, as appropriate, such general information concerning the selection proceedings as is usually required to be recorded for public procurement (e.g. the information listed in article 11 of the UNCITRAL Model Law), including the following:

(a) A description of the project for which the contracting authority requested proposals;

(b) The names and addresses of the companies participating in bidding consortia and the name and address of the members of the bidders with whom the project agreement is entered into;
(c) Information relative to the qualifications, or lack thereof, of bidders; a summary of the evaluation and comparison of proposals including the application of any margin of preference;

(d) The price, or the basis for determining the price, and a summary of the other principal terms of the proposals and of the project agreement;

(e) A summary of any requests for clarification of the preselection documents or the request for proposals, the responses thereto, as well as a summary of any modification of those documents;

(f) If all proposals were rejected, a statement to that effect and the grounds therefor.

136. In addition to the above information, it may be useful to require the contracting authority to include the following information in the record of the selection proceedings:

(a) A summary of the conclusions of the preliminary feasibility studies commissioned by the contracting authority and a summary of the conclusions of the feasibility studies submitted by the qualified bidders;

(b) The list of the preselected bidders;

(c) If changes to the composition of the preselected bidders are subsequently permitted, a statement of the reasons for authorizing such changes and a finding as to the qualifications of the new members or members admitted to the consortia concerned;

(d) If the contracting authority finds most advantageous a proposal other than the proposal offering the lowest unit price for the expected output, a justification of the reasons for such finding by the awarding committee;

(e) If the negotiations with the consortium that submitted the most advantageous proposal and any subsequent negotiations with remaining responsive consortia did not result in a project agreement, a statement to that effect and of the grounds therefor.

137. For selection proceedings involving direct negotiations (see paras. 95-107) it may be useful to include the following information in the record of the selection proceedings:

(a) A statement of the grounds and circumstances on which the contracting authority relied to justify the direct negotiation;

(b) The name and address of the company or companies invited to those negotiations;

(c) If those negotiations did not result in a project agreement, a statement to that effect and of the grounds therefor.

138. For selection proceedings engaged in as a result of unsolicited proposals (see paras. 108-128) it may be useful to include in the record of the selection proceedings the following information, in addition to the information mentioned above:

(a) The name and address of the company or companies submitting the unsolicited proposal and a brief description thereof;

(b) A certification by the contracting authority that the unsolicited proposal was found to be of public interest and involve new concepts or technologies, as appropriate.

139. It is advisable that the rules on record requirements specify the extent and the recipients of the disclosure. Setting the parameters of disclosure involves balancing factors such as: the general desirability, from the standpoint of the accountability of contracting authorities, of broad disclosure; the need to provide bidders with information necessary to permit them to assess their performance in the proceedings and to detect instances in which there are legitimate grounds for seeking review; and the need to protect the bidders’ confidential trade information. In view of these considerations, it may be advisable to provide two levels of disclosure, as envisaged in article 11 of the UNCITRAL Model Law. The information to be provided to any member of the general public may be limited to basic information geared to the accountability of the contracting authority to the general public. However, it is advisable to provide for the disclosure for the benefit of bidders of more detailed information concerning the conduct of the selection, since that information is necessary to enable the bidders to monitor their relative performance in the selection proceedings and to monitor the conduct of the contracting authority in implementing the requirements of the applicable laws and regulations.

140. Moreover, appropriate measures should be taken to avoid the disclosure of confidential trade information of suppliers and contractors. That is true in particular with respect to what is disclosed concerning the evaluation and comparison of proposals, as excessive disclosure of such information may be prejudicial to the legitimate commercial interests of bidders. As a general rule, the contracting authority should not disclose more detailed information relating to the examination, evaluation and comparison of proposals and proposal prices, except when ordered to do so by a competent court.

141. Provisions on limited disclosure of information relating to the selection process would not preclude the applicability to certain parts of the record of other statutes in the enacting State that confer on the public at large a general right to obtain access to Government records. Disclosure of the information in the record to legislative or parliamentary oversight bodies may be mandated pursuant to the law applicable in the host country.
A/CN.9/458/Add.5

Chapter IV. THE PROJECT AGREEMENT

CONTENTS

LEGISLATIVE RECOMMENDATIONS .................................................. (1)-(11)

NOTES ON LEGISLATIVE RECOMMENDATIONS ................................ 1-67

A. General considerations .................................................. 1-8
   1. Legislative approaches .................................................. 2-4
   2. Conclusion of the project agreement .................................. 5-8

B. Core terms of the project agreement .................................. 9-67
   1. Financial arrangements .................................................. 10-21
   2. The project site .................................................. 22-27
   3. Easements .................................................. 28-31
   4. Security interests .................................................. 32-40
   5. Organization of the concessionaire .................................. 41-51
   6. Assignment of the concession ...................................... 52-55
   7. Transferability of shares of the project company ................ 56-63
   8. Duration of the project agreement .................................. 64-67

LEGISLATIVE RECOMMENDATIONS

Conclusion of the project agreement (see paras. 5-8)

(1) The host country may wish to adopt provisions that simplify the procedures for the conclusion of the project agreement and identify in advance the offices or agencies competent to approve and sign the project agreement.

Financial arrangements (see paras. 10-21)

(2) The host country may wish to provide:

(a) That any financing of the infrastructure facility may be in such amounts and upon such terms and conditions as may be determined by the concessionaire and that, for that purpose, the concessionaire may in particular issue debt, equity and other securities or obligations, and secure any financing with a security interest in any of its property;

(b) That the project agreement should provide for tariffs or user fees that may be charged by the concessionaire for the use of the facility or the services it provides, and should set forth the method and formulae for the adjustment of those tariffs or user fees;

(c) That the project agreement should provide for tariffs or user fees that allow for the recovery of the capital invested and the operation and maintenance costs with a reasonable rate of return.

(3) The host country may further wish to provide:

(a) That the contracting authority is authorized, where appropriate, to agree to make direct payments to the concessionaire as a substitute for, or in addition to, service charges to be paid by the users;

(b) That the contracting authority is authorized, where appropriate, to enter into commitments for the purchase of fixed sums of goods or services.
The project site (see paras. 22-27)

(4) The host country may wish to provide:

(a) That the project agreement should specify, as appropriate, which assets will remain the property of the contracting authority or of other governmental agencies and which categories of assets will remain the private property of the concessionaire;

(b) That the compulsory acquisition of any land required for privately financed infrastructure projects should be carried out pursuant to the most efficient proceedings available under the laws of the host country.

Easements (see paras. 28-31)

(5) The host country may wish to adopt legislative provisions that identify the easements that might be needed by the concessionaire.

Security interests (see paras. 32-40)

(6) The host country may wish to provide:

(a) That the concessionaire may create a security in respect of any of its property interests in the infrastructure facility;

(b) That the concessionaire may secure any financing with a pledge of the proceeds and receivables arising out of the concession.

Organization of the concessionaire (see paras. 41-51)

(7) The host country may wish to provide that the selected bidders should establish an independent legal entity with a seat in the country, except for cases where the contracting authority has waived such requirement.

(8) Where the selected bidders are required to establish an independent legal entity, the host country may wish to provide that the project agreement should specify:

(a) The form of the legal entity and its minimum capital;

(b) The procedures for obtaining the approval of the contracting authority to fundamental changes in the statutes and by-laws of the concessionaire company, which approval should not be unreasonably withheld.

Assignment of the concession (see paras. 52-55)

(9) The host country may wish to require that the project agreement set forth the conditions under which the contracting authority may give its consent to the assignment of a concession, including:

(a) Acceptance by the new concessionaire of all obligations under the project agreement;

(b) Evidence of the new concessionaire’s technical and financial capability as necessary for providing the service.

Transferability of shares of the project company (see paras. 56-63)

(10) The host country may wish to provide that the transfer of equity participation in the capital of a concessionaire company may require the consent of the contracting authority if:

(a) The concessionaire is in the possession of public assets or assets which the concessionaire is required to hand over to the contracting authority at the end of the concession period; or

(b) The concessionaire has received or benefited from loans, subsidies, equity or other forms of direct financial support by the Government.

Duration of the project agreement (see paras. 64-67)

(11) The host country may wish to provide that all concessions should have a limited duration, which should be specified in the project agreement, taking into account the nature and amount of investment required to be made by the concessionaire.

NOTES ON LEGISLATIVE RECOMMENDATIONS

A. GENERAL CONSIDERATIONS

1. The “project agreement” between the Government and the concessionaire is the central document in an infrastructure project. The project agreement defines the scope and purpose of the project as well as the rights and obligations of the parties; it provides details on the execution of the project and sets forth the conditions for the operation of the infrastructure or the delivery of the relevant services. Project agreements may be contained in one single document or may consist of more than one separate agreement between the contracting authority and the concessionaire. This section discusses the relation between the project agreement and the host country’s legislation on privately financed infrastructure projects. It also discusses procedures and formalities for the conclusion and entry into force of the project agreement.

1. Legislative approaches

2. The project agreement is the instrument through which the Government exercises its authority to entrust a concessionaire with the responsibility to carry out an infrastructure project (see chapter I, “General legislative considerations”, __). Therefore, there is an intrinsic link between the project agreement and the laws of the host country that govern the execution of privately financed infrastructure projects or, more generally, the provision of public services. Domestic legislation often contains provisions dealing with the content of the project agreement. In this respect, three main approaches have been used. While the laws of some coun-
tries merely refer to the need for an agreement between the concessionaire and the contracting authority, the laws of other countries contain extensive mandatory provisions concerning the content of clauses to be included in the agreement. An intermediate approach is taken by those laws that list a number of issues that need to be addressed in the project agreement without regulating in detail the content of its clauses.

3. Legislative provisions on certain essential elements of the project agreement may serve the purpose of establishing a general framework for the allocation of rights and obligations between the parties. They may be intended to ensure consistency in the treatment of certain contractual issues and to provide guidance to the public authorities involved in the negotiation of project agreements at different levels of Government (national, provincial or local). Such guidance may be found particularly useful by contracting authorities lacking experience in the negotiation of project agreements. Some countries may further consider that legislative provisions on certain elements of the project agreement may enhance the contracting authority’s negotiating position vis-à-vis the concessionaire. Lastly, legislation may sometimes be required so as to provide the contracting authority with the power to agree on certain types of provisions.

4. The possible disadvantage of legislative provisions dealing in detail with the rights and obligations of the parties is that they might deprive the contracting authority and the concessionaire of the necessary flexibility to negotiate an agreement that takes into account the needs and particularities of a specific project. Therefore, it is advisable to limit the scope of legislative provisions concerning the project agreement to those strictly necessary, such as, for instance, provisions on matters for which prior legislative authorization might be needed or those that might affect the interests of third parties or provisions relating to essential policy matters on which variation by agreement is not admitted.

2. Conclusion of the project agreement

5. For projects as complex as infrastructure projects, it is not unusual that several months elapse in negotiations before the parties are ready to sign the project agreement. A number of factors have been reported to cause delay in the negotiations, such as inexperience of the parties, poor coordination between different governmental agencies, uncertainty as to the extent of governmental support, or difficulties in establishing security arrangements acceptable to the lenders.\(^1\) In order to avoid unnecessary delay in the conclusion of the project agreement, it is advisable to have rules in place that identify clearly the persons or offices that have the authority to enter into commitments on behalf of the contracting authority (and, as appropriate, of other agencies of the Government) at different stages of negotiation and to sign the project agreement. For projects involving offices or agencies at different levels of government (e.g. national, provincial or local), where it may not be possible to identify in advance all the relevant offices and agencies involved, other measures may be needed to ensure appropriate coordination among them (see chapter I, “General legislative considerations”, __).\(^2\)

6. Moreover, a significant contribution may be made by the Government by providing adequate guidance to negotiators acting on behalf of the contracting authority. The clearer the understanding of the parties as to the matters to be provided in the project agreement, the greater the chances that the negotiation of the project agreement will be conducted successfully. Conversely, where important issues remain open after the selection process and little guidance is provided to the negotiators as to the substance of the project agreement, there might be considerable risk of costly and protracted negotiations as well as of justified complaints that the selection process was not sufficiently transparent and competitive (see further chapter III, “Selection of the concessionaire”, __).\(^3\)

7. In addition to practical arrangements to facilitate the negotiation of the project agreement, it is important to consider measures to expedite its conclusion. Some national laws prescribe certain formalities for the conclusion and entry into force of project agreements. In some countries the terms of the agreement negotiated between the contracting authority and the selected bidders may be subject to approval by a higher authority. The entry into force of the project agreement or of certain categories of project agreements is in some countries subject to an act of parliament or even the adoption of special legislation.

8. With a view to expediting matters and avoiding the adverse consequences of delays in the project’s timetable, in some countries the authority to bind the contracting authority or the Government, as appropriate, is delegated in the relevant legislation to designated officials, so that the entry into force of the project agreement occurs upon signature or upon the completion of certain formalities, such as publication in the official gazette. In countries where such a procedure might not be feasible, or in which final approvals by another entity would still be required, it would be desirable to consider ways to avoid unnecessary delay. It is important to bear in mind that the risk of the project being frustrated by lack of approval after negotiations have been completed is not one that the concessionaire would be ready to assume. Where approval requirements are perceived as arbitrary or cumbersome, the Government might be requested to provide sufficient guarantees to the concessionaire and the lenders against such risk (see chapter II, “Project risks and Government support”, __). In some countries where those approval requirements exist, Governments have sometimes agreed in the project agreement to compensate the concessionaire for all costs incurred in the event the final approval of a project is withheld for reasons not imputable to the concessionaire.

B. CORE TERMS OF THE PROJECT AGREEMENT

9. Project agreements are typically lengthy documents that deal extensively with a wide variety of general and project-specific issues. This section discusses possible legislative implications of what in national laws appear to be core provisions of project agreements, i.e. those that define the essential financial obligations of the parties, the nature of the rights granted to the concessionaire, the project site and the ownership regime in respect of project assets, the organization of the concessionaire and the duration of the project.

1. Financial arrangements

10. The financial arrangements belong to the essential terms of the project agreement. They typically include provisions concerning the concessionaire’s obligations for raising funds for the project, outline the mechanisms for disbursing and accounting for funds, set forth methods for calculating and adjusting the prices charged by the concessionaire and deal with the types of security interests that may be established in favour of the concessionaire’s creditors. In drafting these provisions care needs to be taken to ensure their consistency with the loan agreements and other financial commitments entered into by the concessionaire. It is further important to ensure that the laws of the host country are conducive or do not pose obstacles to the financial management of the project.

(a) Financial obligations of the concessionaire

11. In privately financed infrastructure projects the concessionaire is typically responsible for raising sufficient financing for the project. In most cases, the contracting authority or other governmental agencies would be interested in limiting their financial obligations to those specifically expressed in the project agreement or those forms of direct support that the Government has agreed to extend to the project (see chapter II, “Project risks and Government support”).

12. The amount of private capital contributed directly by the project company’s shareholders typically represents only a portion of the total proposed investment. A far greater portion derives from loans extended to the concessionaire by commercial banks and from the proceeds of the placement of bonds and other negotiable instruments on the capital market (see “Introduction and background information on privately financed infrastructure projects”, ). Therefore, it may be useful for the law to acknowledge the concessionaire’s authority to enter into the financial arrangements it sees fit for the purpose of financing the infrastructure. It is further important to ensure that the laws of the host country will not unreasonably restrict the concessionaire’s ability to conclude the necessary financing arrangements, for instance by limiting the concessionaire’s ability to offer adequate security to its lenders (see paras. 32-40).

13. The revenue obtained with the placement of bonds and other negotiable instruments may represent a substantial source of financing for infrastructure projects. Those instruments may be issued by the concessionaire itself, in which case the investors purchasing the security will become its creditors, or they may be issued by a third party to whom the project receivables (see para. 39) have been assigned through a mechanism known as “securitization”. Securitization involves the creation of financial securities backed by the project’s revenue stream, which is pledged to pay the principal and interest of that security. Securitization transactions usually involve the establishment of a legal entity separate from the concessionaire and especially dedicated to the business of securitizing assets or receivables. This legal entity is often referred to as “special purpose vehicle”.

The concessionaire assigns project receivables to the special purpose vehicle, which, in turn, issues to investors interest-bearing instruments that are backed by the project receivables. The securitized bondholders acquire thereby the right to the proceeds of the concessionaire’s transactions with its customers. The concessionaire collects the tariffs from the customers and transfers the funds to the special purpose vehicle which then transfers it to the securitized bondholders. In some countries, recent legislation has expressly recognized the concessionaire’s authority to assign project receivables to a special purpose vehicle, who holds and manages the receivables in trust for the benefit of the project’s creditors. With a view to protecting the bondholders against the risk of insolvency of the concessionaire, it may be advisable to adopt the necessary legislative measures to enable the legal separation between the concessionaire and the special purpose vehicle.

(b) The concessionaire’s authority to charge prices for public services

14. In a number of countries prior legislative authorization may be necessary in order for a concessionaire to charge a price for the provision of public services or for the use of public infrastructure facilities. Therefore it is desirable that the law contains general provisions authorizing the contracting authority and the concessionaire to agree on the suitable form of payment for the concessionaire, including the right to charge a price for the use of the infrastructure or the service or goods it provides. The absence of such a general provision in legislation has in some countries given rise to judicial disputes challenging the concessionaire’s authority to charge a price for the service.

15. In addition to a general recognition of the concessionaire’s authority to charge a price for the provision of public services or for the use of public infrastructure facilities, it is important to consider the level of tariffs and prices that the concessionaire may charge. Tariffs and prices charged by the concessionaire may be the main (sometimes even the sole) source of revenue to pay the investment made in the project in the absence of subsidies or payments by the contracting authority (see paras. 17-21) or the Government (see chapter II,
“Project risks and Government support,” __). The concessionaire will therefore seek to be able to set and maintain those tariffs and prices at a level that ensures sufficient cash flow for the project. However, in some legal systems there may be limits to the concessionaire’s freedom to establish tariffs and prices. The cost at which public services are provided is typically an element of the Government’s infrastructure policy, and a matter of immediate concern for large portions of the public. Thus, the regulatory framework in many countries includes special rules to control tariffs and prices for the provision of public services (see chapter V, “Infrastructure development and operation”, __). Furthermore, statutory provisions or general rules of law in some legal systems establish parameters for pricing goods or services, for instance by requiring that prices meet certain standards of “reasonableness”, “fairness” or “equity”.

16. Where provisions on the level of tariffs and prices that the concessionaire may charge are deemed necessary, they should seek to achieve a balance between the interests of investors and current and future users. It is advisable that statutory criteria for determining prices take into account, in addition to social factors which the Government regards as relevant, the concessionaire’s interest in achieving a level of cash flow that ensures the economic viability and commercial profitability of the project. It may thus be useful for the law to acknowledge that the recovery of the capital and the operation and maintenance cost with a reasonable rate of return is one of the essential elements of a fair tariff system. Furthermore, it is advisable to provide the parties with the necessary authority to negotiate appropriate arrangements, including compensation provisions, in order to address situations where the application of price control rules directly or indirectly related to the provision of public services may result in fixing prices below the level required for the profitable operation of the project (see chapter V, “Infrastructure development and operation”, __)

(c) Financial obligations of the contracting authority

17. Where the concessionaire offers services directly to the general public, the contracting authority or other governmental agency may undertake to make direct payments to the concessionaire as a substitute for, or in addition to, service charges to be paid by the users. Where the concessionaire produces a commodity for further transmission or distribution by another service provider, the contracting authority may undertake to purchase wholesale such commodity at an agreed price and conditions. The main examples of those arrangements are briefly discussed below.

(i) Direct payments

18. Direct payments by the contracting authority have been used in some countries as a substitute for, or as supplement to, payments by the end users, in particular in toll road projects, through a mechanism known as “shadow tolling”. Shadow tolls are arrangements whereby the concessionaire assumes the obligation to develop, build, finance and operate a road or another transportation facility for a set number of years in exchange for periodic payments in place of, or in addition to, real or explicit tolls paid by users. Shadow toll schemes may be used to address risks which are specific to transportation projects, in particular the risk of lower-than-expected traffic levels (see chapter II, “Project risks and Government support”, __). Furthermore, shadow toll schemes may be politically more acceptable than direct tolls, for example where it is feared that the introduction of toll payments on public roads may give rise to protests by road users.

19. Shadow tolls may involve a substantial expenditure for the contracting authority and require close and extensive monitoring by the contracting authority. In countries that have used shadow tolls for the development of new road projects, payments by the contracting authority to the concessionaire are based primarily on actual traffic levels, as measured in vehicle-kilometres. It is considered advisable to provide that payments are not made until traffic begins, so that the concessionaire has an incentive to open the road as quickly as possible. At the same time, it has been found useful to calculate payments on the basis of actual traffic for the duration of the concession, so that the concessionaire also has reason to ensure that the road will need a minimum of disruptive repairs during that time. Alternatively, the project agreement could contain a penalty or liquidated damages clause for lack of lane availability due to repair works calculated. Payment systems used in some countries are further refined by dividing traffic into a number of “bands”, with different levels of annual traffic volumes and per-vehicle payments, whereby lower traffic levels entail higher per-vehicle payments, while higher traffic levels cause lower per-vehicle payments. The bands themselves may be increased over time to match anticipated growth in traffic. Separate bands may be established according to the length of the vehicles. The concessionaire is typically required to perform continuous traffic counts to calculate annual vehicle-miles, which are verified periodically by the contracting authority. A somewhat modified system may combine both shadow tolls and direct tolls paid by the users. In such a system, shadow tolls are only paid by the contracting authority in the event that the traffic level over a certain period falls below the agreed minimum level necessary in order for the concessionaire to operate the road profitably.

(ii) Purchase commitments

20. In the case of privately financed facilities that generate goods or services that can be delivered on a long-term basis to an identified purchaser, the concessionaire’s exposure to market demand and price risks may be mitigated by contractual arrangements that ensure the purchase of the whole output of the facility or of an agreed minimum portion thereof. When the contracting authority or another governmental entity is the sole customer for the services or goods supplied by the concessionaire, the law sometimes provides that those entities will be under an obligation to purchase such goods and services, at an agreed rate, as they are
offered by the concessionaire. Contracts of this type are usually referred to as “off-take agreements” and are frequently, but not exclusively, used to support the development of power generation plants by independent power producers. Off-take agreements often include two types of payments: payments for the availability of the production capacity and payments for units of actual consumption. In a power generation project, for example, the power purchase agreement may contemplate the following charges:

(a) **Capacity charges.** These are charges payable regardless of actual output in a billing period and are calculated to be sufficient to pay all of the concessionaire’s fixed costs incurred to finance and maintain the project, including debt service and other ongoing financing expenses, fixed operation and maintenance expenses and a certain rate of return. The payment of capacity charges is often subject to the observance of certain performance or availability standards;

(b) **Consumption charges.** These charges are not intended to cover all of the concessionaire’s fixed costs, but rather to pay the variable or marginal costs that the concessionaire has to bear to generate and deliver a given unit of the relevant service or good (e.g. a kilowatt-hour of electricity). Consumption charges usually are calculated to cover the concessionaire’s variable operating costs, such as of fuel consumed when the facility is operating, water treatment expenses and costs of consumables. Variable payments often are tied to the concessionaire’s own variable operating costs, or to an index that reasonably reflects changes in operating costs.

21. From the perspective of the concessionaire, a combined scheme of capacity and consumption charges is particularly useful to ensure cost recovery where the transmission or distribution function for the goods or services generated by the concessionaire is subject to a monopoly. However, the capacity charges provided in the off-take agreement should be commensurate with the other sources of generating capacity available to, or actually used by, the contracting authority. High capacity charges place a burden on the contracting authority’s purchasing capacity and increase the risk of default or repudiation of the agreement, for instances on grounds of public interest. In order to ensure the availability of funds for payments by the contracting authority under the off-take agreement, it is advisable to consider whether advance budgeting arrangements are required. Payments under an off-take agreement may be backed by a guarantee issued by the host Government or by a national or international guarantee agency (see chapter II, “Project risks and Government support”, __). The contracting authority may either transfer to the concessionaire title to the land or facilities or retain title thereto, while granting the concessionaire a right to use the land or facilities and build upon it. In addition to the general legislative authority that may be required in order for the contracting authority to transfer public property to the concessionaire or to grant to the concessionaire the right to use such public property (see chapter I, “General legislative considerations”, __), it is important to consider the ownership regime of the various categories of assets that are required to the development and operation of infrastructure facilities, and the procedures for acquiring the property, where it is not already in the contracting authority’s possession.

23. In some countries the law provides that the physical infrastructure required for the provision of public services remains the property of the contracting authority. However, during the life of the project the concessionaire may make extensive improvements or additions to the physical infrastructure originally received from the contracting authority or built by the concessionaire itself. The concessionaire may also acquire various other assets which, without being indispensable or strictly necessary for the provision of the service, may enhance the convenience or efficiency of operating the facility or the quality of the service. In either situation there may be doubts about the ownership in respect of those assets. Clarity in this respect is needed in order to determine the type and extent of security interests that the concessionaire may establish over project assets in order to raise financing for the project (see paras. 34-36). Clarity will be further needed with a view to ensuring an orderly hand-over of assets to the contracting authority or to another concessionaire at the end of the project term in case of “build-operate-transfer” and similar types of projects (see chapter VI, “End of project term, extension and termination”, __). While the law may provide a general definition of categories of assets that should ordinarily remain the property of the contracting authority or of another governmental agency or that are mandatorily required to be handed over to the contracting authority, there may be no compelling need for detailed legislative provisions on this matter. In fact, in various countries it was found sufficient to require in the law that the project agreement specify, as appropriate, which assets will remain the property of the contracting authority or other governmental agency and which categories of assets will remain the private property of the concessionaire.

(b) **Acquisition of land required for executing the project**

24. Both in cases where the infrastructure facility will be transferred back to the contracting authority or will be permanently owned by the concessionaire, it is advisable that the parties establish the condition of such land and facility at the time it is handed over to the concessionaire. Such determination may reduce disagreements at the time the infrastructure facility is returned to the contracting authority. Therefore, the
project agreement should provide for the inspection, measurement and demarcation of such land and existing facility prior to its being transferred or made available to the concessionaire. Further matters which would be typically dealt with in the project agreement include procedures for handing over the land or facilities and the submission of required documentation.

25. The situation may become more complex when the land is not already owned by the contracting authority and needs to be purchased from its owners. In most cases, the concessionaire would not be in the best position to assume the responsibility for purchasing the land needed for the project. The concessionaire may fear the potential delay and expense involved in negotiations with possibly a large number of individual owners and, as necessary in some parts of the world, to undertake complex searches of title deeds and review of chains of previous property transfers so as to establish the regularity of the title of individual owners. Therefore, it is typical for the contracting authority to assume the responsibility for providing the land required for the implementation of the project, so as to avoid unnecessary delay or increase in the project cost as a result of the acquisition of land. The contracting authority may purchase the required land from its owners or, if necessary, acquire it compulsorily. The procedure for the compulsory acquisition of private property against the payment of appropriate compensation to the owners, in accordance with the rules in force in the host country and relevant rules of international law, is referred to in domestic laws by such technical expressions. In the Guide it is referred to as “expropriation”.

26. Where expropriation procedures are required, various preparatory measures may need to be taken to ensure that construction works are not delayed. In countries where the law contemplates more than one type of expropriation proceeding, it may be desirable to provide that all expropriations required for privately financed infrastructure projects be carried out pursuant to the most efficient of those proceedings, such as the special proceedings that in some countries apply for reasons of compelling public need (see chapter VII, “Governing law”, ____).

27. The right to expropriate private property is usually vested in the Government, but the laws of a number of countries also authorize infrastructure operators or public service providers (e.g. railway companies, electricity authorities, telephone companies) to perform certain actions for the expropriation of private property required for providing or expanding their services to the public. Particularly in those countries where the award of compensation to the owners of the property expropriated is adjudicated in court proceedings, it has been found useful to delegate to the concessionaire the authority to carry out certain acts relating to the expropriation, while the Government remains responsible for accomplishing those acts that, under the relevant legislation, are conditions precedent to the initiation of expropriation proceedings. Upon expropriation, title to the land is often vested in the Government, although in some cases the law may authorize the contracting authority and the concessionaire to agree on a different arrangement, taking into account their respective shares in the cost of expropriating the property.

3. Easements

28. Besides the acquisition of property for the construction of the facility, there might be a need for ensuring the concessionaire’s access to such property, in cases where the location of the site of the project is such that access to it requires transit on or through the property of third parties. The nature of the project may also be such that it requires the concessionaire to enter property belonging to third parties (e.g. to place traffic signs on adjacent lands; to install poles or electric transmission lines above third parties’ property; to instal and maintain transforming and switching equipment; to trim trees that interfere with telephonic lines placed on abutting property). The right to use another person’s property for a specific purpose or to do work on it is generally referred to in the Guide by the word “easement”.

29. Easements usually require the consent of the owner of the property to which they pertain, unless such rights are provided by the law. Except for cases where the required easements affect only a small number of adjacent properties, it is usually not an expedientious or cost-effective solution to leave it to the concessionaire to acquire easements directly from the owners of the properties concerned. Instead it is more frequent that those easements are acquired by the Government simultaneously with the expropriation of the project site. The compulsory acquisition of easements is usually subject to essentially the same conditions that apply to the compulsory acquisition of property, namely, the existence of grounds or reasons of public interest and the payment of appropriate compensation in accordance with the rules in force in the host country and relevant rules of international law.

30. A somewhat different alternative might be for the law itself to provide the types of easements given to the concessionaire, without necessarily requiring the expropriation of the property to which such easements pertain. Such an approach might be used in respect of sector-specific legislation, where the Government deems it possible to determine, in advance, certain minimum easements that might be needed by the concessionaire. For instance, a law specific to the power generation sector may lay down the conditions under which the concessionaire obtains a right of cabling for the purpose of placing and operating basic and distribution networks on property belonging to third parties. Such a right may be needed for a number of measures, such as establishing or placing underground and overhead cables, as well as establishing supporting structures and transforming and switching equipment; maintaining, repairing and removing any of those installations; establishing a safety zone along underground or overhead cables; removing obstacles along the wires or encroaching on the safety zone.
31. Under some legal systems, the concessionaire might be under an obligation to pay compensation to the owner, as would have been due in the case of expropriation, should the nature of the easement be such that the use of the property by its owner is substantially hindered.

4. Security interests

32. Generally, security interests in personal property provide the secured creditor with essentially two kinds of rights: a property right allowing the secured creditor, in principle, to repossess the property or have a third party repossess and sell it, and a priority right to receive payment with the proceeds from the sale of the property in the event of default by the debtor. In general financing practice, lenders negotiate security interests that allow them to foreclose and take possession of a project that they can take over and operate either to restore its economical viability with a view to reselling at an appropriate time or to retaining the project indefinitely and collect an ongoing revenue. Furthermore, security may play a defensive or preventive role by ensuring that, in the event a third party acquires the debtor’s operations (e.g. by foreclosure, in bankruptcy or directly from the debtor) all of the proceeds resulting from the sale of those assets will go first to repayment of outstanding loans.

33. Security arrangements play a central role in financing infrastructure projects, in particular where the financing is structured under the “project finance” modality. The financing documents for privately financed infrastructure projects typically include extensive security arrangements that in most cases comprise both security over physical assets related to the project and security over intangible assets held by the concessionaire. A few of the main requirements for the successful closure of the security arrangements are discussed below.

34. The negotiation of security arrangements required in order for the project company to obtain financing for the project may be generally facilitated if the laws of the host country expressly authorize the creation of security interests over the physical assets comprised in the infrastructure. However, there may be legal obstacles to the creation of such security interests, in particular where the assets remain the property of the contracting authority or other governmental agency throughout the project term. If the concessionaire lacks the title to the property it will in many legal systems have no (or only limited) power to encumber such property.

35. Where limitations of this type exist, the law may still facilitate the negotiation of security arrangements, for instance by indicating the types of assets in respect of which such security interests may be created or the type of security interests that is permissible. In some legal systems, a concessionaire who is granted a leasehold interest or right to use certain property may create a security interest over the leasehold interest or right to use. Furthermore, security interests may also be created where the concession encompasses different types of public property, such as when title to adjacent land (and not only the right to use it) is granted to a railway company in addition to the right to use the public infrastructure.

36. Where it is possible to create any form of security interests in respect of assets owned by, or required to be handed over to, the contracting authority, or assets in respect of which the contracting authority has a contractual option of purchase (see chapter VI, “End of project term, extension and termination”), the law may require the approval of the contracting authority in order for the concessionaire to create such security interests. With a view to facilitating the creation of security, in such a situation, it may be useful to authorize the contracting authority to express such approval by a general provision in the project agreement, rather than requiring specific acts of approval for each asset in respect of which a security interest is created.

(b) Security over intangible assets

37. The main intangible asset in an infrastructure project is the concession itself, i.e. the concessionaire’s right to operate the infrastructure or provide the relevant service. In most legal systems, the concession provides its holder with the authority to control the entire project and entitles the concessionaire to earn the revenue generated by the project. Thus, the value of the concession well exceeds the combined value of all of the physical assets involved in a project. Because the concession holder would usually have the right to possess and dispose of all project assets (with the possible exception of those which are owned by other parties, such as assets owned by the contracting authority or other governmental agency), the concession would typically encompass both present and future assets of a tangible or intangible nature. Therefore, the lenders may regard the concession as an essential component of the security arrangements negotiated with the concessionaire. A pledge of the concession itself may have various practical advantages for the concessionaire and the lenders, in particular in legal systems that would not otherwise allow the creation of security over all of a company’s assets, or which do not generally recognize non-possessory security interests (see chapter VII, “Governing law”, ___). These advantages may include: avoiding the need for creating separate security interests for each project asset, allowing the concessionaire to continue to deal with those assets in the ordinary course of business, making it possible to pledge certain assets without transferring actual possession of the assets to the creditors. Furthermore, a pledge of the concession may entitle the lenders, upon occurrence of default by the concessionaire, to avert termination of the project by taking over the concession and making arrangements for continuation of the project under another concessionaire. A pledge of the concession may, therefore, represent a useful complement to or, under certain circumstances, a substitute for a direct agreement between the lenders and the contracting authority concerning the
lenders’ step-in-rights (see chapter V, “Infrastructure development and operation”, __).  

38. However, in some legal systems there may be obstacles to a pledge of the concession in the absence of express legislative authorization. Under various legal systems, security interests may only be created in respect of assets that can be freely transferable by the grantor of the security. Since the right to operate the infrastructure is in most cases not transferable without the consent of the contracting authority (see paras. 52-55), in some legal systems it may not be possible for the concessionaire to create security interests over the concession itself. Recent legislation in some civil law jurisdictions has removed that obstacle by creating a special category of security interest, sometimes referred to by expressions such as “hipoteca de concesión de obra pública” or “prenda de concesión de obra pública” (“concession mortgage” or “pledge of public works concessions”), which generally provides the lenders with an enforceable security interest covering all of the rights granted to the concessionaire under the project agreement. However, in order to protect the public interest, the law requires the consent of the contracting authority for any measure by the lenders to enforce such right, under conditions to be provided in an agreement between the contracting authority and the lenders. A somewhat more limited solution has been achieved in some common law jurisdictions in which a distinction has been made between the non-transferable right to carry out a certain activity under a governmental licence (i.e. the “public rights” arising under the licence) and the right to claim proceeds received by the licencie (i.e. the latter’s “private rights” under the licence).  

39. For countries where it may not be legally possible to allow the creation of security interest over the concession itself, it may be useful for the law to expressly authorize the concessionaire to create security interests over the economic rights arising out of the concession or the proceeds therefrom. Those proceeds typically include the tariffs charged to the public for the use of the infrastructure (e.g. tolls on a toll road) or the price paid by the customers for the goods or services provided by the concessionaire (e.g. electricity charges). They may also include the revenue of ancillary concessions. Security of this type is a typical element of the financing arrangements negotiated with the lenders. It may further play an essential role for the issuance of bonds and other negotiable instruments by the concessionaire. Statutory provisions recognizing the concessionaire’s authority to pledge the proceeds of infrastructure projects have been included in recent domestic legislation in various legal systems.  

(c) Security over shares of the concessionaire  

40. The establishment of security interests over the shares of the concessionaire raises, in principle, concerns similar to those raised by an assignment of the concession (see paras. 52-55). Where the concession may not be assigned or transferred without the consent of the contracting authority, the law sometimes prohibits the establishment of security over the shares of the concessionaire. It should be noted, however, that security over the shares of the concessionaire is commonly required by lenders in project finance transactions, and that general prohibitions on the establishment of such security may unnecessarily limit the concessionaire’s ability to raise funding for the project. As with other forms of security, it might therefore be useful for the law to authorize the concessionaire’s shareholders to create such security, subject to the contracting authority’s prior approval where an approval would be required for the transfer of equity participation in the project company (see para. 62).  

5. Organization of the concessionaire  

41. Project agreements typically contain provisions on the legal status of the concessionaire and deal with the question of whether the concessionaire has to be established as an independent legal entity or whether the project may be awarded collectively to a project consortium. Provisions on these matters are often contained in national legislation on privately financed infrastructure projects as well.  

42. As understood in business practice, a consortium is a contractual arrangement whereby a group of enterprises undertakes to cooperate in carrying out a project without integrating into an independent legal entity. Consortia have been widely used in the construction industry for the development of large, capital-intensive projects requiring technical expertise in different fields. Consortia are commonly regarded as purely contractual arrangements which do not have a juridical personality of their own. However, there is no uniform legal regime governing consortia. They may fall under different contractual categories provided in national laws, and the legal status of consortia as well as the rights and obligations of their members vary in different legal systems.  

43. Forming a project consortium may present some advantages, such as more flexibility in dealings among the consortium members. Avoiding double taxation may also be a reason for choosing not to establish an independent legal entity in the host country, in case there is no bilateral double taxation agreement between the host country and the country or countries where the foreign investors have their residence for taxation purposes. There might also be instances where the contracting authority would wish to retain the possibility of engaging consortia for infrastructure projects, depending on the scale and nature of the project, or with a view to holding all consortium members jointly liable for the entire project.  

44. For those countries that wish to retain such possibility, the law might give the awarding authority the option to award the project to a consortium or to require that a separate legal entity be established by the selected project consortium, depending on the needs of the project. However, a number of issues would need to be addressed in the project agreement, and extensive negotiations and detailed provisions might be required to ensure coordination among members of the consortium, adequate liaison with the contracting authority, as
well as clarifying the extent of responsibilities and liabilities of each of the members of the consortium for the execution of the project.\footnote{A brief discussion of issues arising out of contracting construction works with a non-integrated group of enterprises is contained in the UNCITRAL Construction Legal Guide (chapter II, "Choice of Contracting Approach", paras. 9-16). Some of the issues mentioned therein might also apply, mutatis mutandis, to negotiations concerning privately financed infrastructure projects, including the following: how the difficulty of bringing a claim against consortium members from different countries, should a dispute arise, may be overcome; how the dispute-settlement clause may be formulated so as to enable any dispute between the contracting authority and several or all the members of the consortium to be settled in the same arbitral or judicial proceeding; how guarantees to be given by third parties as security for performance and quality guarantees to be given by members of the consortium are to be structured; what ancillary agreements may have to be entered into by the contracting authority; whether there are any mandatory rules of the law governing an agreement with a group of contractors.}

45. More common, however, is for the concessionaire to be established as an independent legal entity. From the perspective of the contracting authority, an independent legal entity facilitates coordination in the execution of the project and may provide a mechanism for protecting the interests of the project, which may not necessarily coincide with the individual interests of all of the consortium members. This aspect may be of particular importance where significant portions of the services or supplies required by the project are to be provided by members of the project consortium. Since a substantial part of the liabilities and obligations of the concessionaire, including long-term ones (project agreement, loan and security agreements, construction contracts), are usually agreed upon at an early stage, the project may benefit from being independently represented at the time those instruments are negotiated.

46. Entities who receive concessions for the provision of public services are often required to be established as domestic legal entities under the laws of the host country. Given the public interest in the concessionaire’s activities, the contracting authority may wish that the concessionaire comply with national accounting and publicity provisions (e.g., publication of financial statements; publicity requirements concerning certain corporate acts). However, such a requirement emphasizes the need for the host country to have adequate company laws in place (see chapter VII, “Governing law”, \(\_\_\_\_\_\)). The ease with which the concessionaire can be established, with due regard to reasonable requirements deemed to be of public interest, may help to avoid unnecessary delay in the implementation of the project.

47. The appropriate time for the establishment of the concessionaire is a matter to be considered in the light of the different interests involved in a typical project. Moved by the interest to start the implementation phase as soon as possible, some contracting authorities might be inclined to require that the concessionaire be established at the earliest possible stage. However, it should be borne in mind that firm and final commitments by the lenders and other capital providers typically may not be available prior to the final award of the concession, particularly where a separate legal entity is the envisaged vehicle for raising funds for the project, such as in a “project finance” transaction (see “Introduction and background information on privately financed infrastructure projects”, paras. \(\_\_\_\_\_\)). Therefore, where the contracting authority requires the establishment of an independent legal entity by the members of the selected bidding consortium to carry out the project, it is generally advisable to require that the concessionaire be established within a reasonably short period after, but not before, the award of the project.

48. Another important issue in connection with the organization of the concessionaire concerns the equity investment required for the establishment of the concessionaire. The contracting authority has a legitimate interest in seeking an equity level that ensures a sound financial basis for the concessionaire and guarantees its capability to meet its obligations. The total investment needed as well as the ideal proportion of debt and equity capital vary from project to project so that it would normally be difficult to establish a fixed sum or percentage that would be adequate for all instances. Thus, it may be undesirable to provide a legislative requirement of a fixed sum as minimum capital for all companies carrying out infrastructure projects in the country. A more flexible approach might be to indicate the minimum capital required for the establishment of the concessionaire as an ideal percentage of the total project cost in the request for proposals. Where the contracting authority prefers to negotiate the amount or ratio of equity investment offered by the selected bidding consortium, the contracting authority might prefer to have the flexibility to arrive at an adequate minimum capital in the course of the selection process.

49. In addition to the question of minimum capital, national laws may contain provisions concerning the form under which the concessionaire has to be organized. Some laws specifically require that the concessionaire be incorporated as a certain type of company, while other laws make no provision on this subject. In cases where it is considered important to specify the form in which the concessionaire is to be established, it is desirable to bear in mind the interest of the consortium members in ensuring that their liability will be limited to the amount of their investment. In order to avoid a subsidiary liability for payment of the concessionaire’s debts, its shareholders will normally prefer a corporate form in which their liability is limited to the value of their shares in the company’s capital, such as a joint stock company. They would not be ready to carry out a project that would require them to assume unlimited liability for the concessionaire’s debts.

50. Some laws contain provisions concerning the scope of activities of the concessionaire, requiring, for instance, that they be limited to the development and operation of a particular project. Such restrictions might serve the purpose of ensuring the transparency of the project’s accounts and preserving the integrity of its assets, by segregating the assets, proceeds and liabilities of this project from those of other projects or other activities not related to the project. Also, such a
requirement may facilitate the assessment of the performance of each project since deficits or profits could not be covered with, or set off against, debts or proceeds from other projects or activities.

51. The contracting authority might also wish to be assured that the statutes and by-laws of the concessionaire will adequately reflect the obligations assumed by the company in the project agreement. Therefore, project agreements sometimes provide that the entry into force of changes in the statutes and by-laws of the concessionaire is effective upon approval by the contracting authority. Where the contracting authority or another governmental agency participates in the concessionaire, provisions are sometimes made to the effect that certain decisions necessitate the positive vote of the contracting authority in the shareholders’ or board’s meeting. In any event, it is important to weigh the public interests represented through the Government against the need for affording the concessionaire the necessary flexibility for the conduct of its business. The daily management of the project would be impaired if even minor matters concerning the company’s internal affairs routinely required prior governmental clearance. Furthermore, requirements of this type may increase the risk of improper pressure being exercised against the concessionaire. Where it is deemed necessary to require the contracting authority’s approval to proposed amendments to the statutes and by-laws of the concessionaire it is advisable to limit such a requirement to those cases that concern provisions deemed to be of essential importance (e.g. amount of capital, classes of shares and their privileges, liquidation procedures) and which should be identified in the project agreement.

6. Assignment of the concession

52. Concessions are granted in view of the particular qualifications and reliability of the concessionaire and in most legal systems they are not freely transferable. Indeed, domestic laws often prohibit the assignment of the concession without the consent of the contracting authority. The purpose of these restrictions is typically to ensure the contracting authority’s control over the qualifications of infrastructure operators or public service providers.

53. Some countries have found it useful to mention in the legislation the conditions under which an approval to the transfer of a concession prior to its expiry may be granted, such as, for example, acceptance by the new concessionaire of all obligations under the project agreement and evidence of the new concessionaire’s technical and financial capability to provide the service. General legislative provisions of this type may be supplemented by specific provisions in the project agreement setting forth the scope of those restrictions, as well as the conditions under which the consent of the contracting authority may be granted. However, it should be noted that these restrictions typically apply to the voluntary transfer of its rights by the concessionaire; they do not preclude the compulsory transfer of the concession to an entity appointed by the lenders, pursuant to a direct agreement between them and the contracting authority, for the purpose of averting termination due to serious default by the concessionaire (see further chapter V, “Infrastructure development and operation”, __). 

54. Another situation that may require legislative consideration concerns the transfer, to another entity, of the responsibility to carry out one particular project activity, rather than full assignment of the concession. In cases where the concessionaire is given the right to provide ancillary services, or where the concession involves multiple activities capable of being carried out separately, the concessionaire may wish to engage another entity to carry out some of those activities by way of a partial assignment of its rights under the project agreement. Such a partial assignment is referred to in some legal systems as a “subconcession”. Where the concession itself is not transferable, there may be obstacles to a partial assignment without legislative authorization. Under normal circumstances, however, the contracting authority would have no compelling reason for excluding altogether the possibility of subconcessions, provided that it can be satisfied of the reliability and the qualifications of the subconcessionaire.

55. Another related issue concerns the method for selecting a subconcessionaire. Some countries have special rules governing the award of contracts by public service providers, and in some countries the law expressly requires the use of competitive selection procedures for the award of subconcessions. Rules of this type were often adopted at times when nearly all infrastructure was owned and operated by the State, with little or marginal private sector investment. Their purpose was to ensure economy, efficiency, integrity and transparency in the use of public funds. However, in the case of infrastructure projects implemented by privately owned entities, there may no longer be a compelling reason of public interest for prescribing to the concessionaire the procedure to be followed for the award of subconcessions.

7. Transferability of shares of the project company

56. The contracting authority may be concerned that the original members of the bidding consortium maintain their commitment to the project throughout its duration and that the effective control over the concessionaire will not be transferred to entities unknown to the contracting authority. Concessionaires are selected to carry out infrastructure projects at least partly on the basis of their experience and capabilities for that sort of project (see chapter III, “Selection of the concessionaire”, __). Contracting authorities are therefore concerned that, if the concessionaire’s shareholders are entirely free to transfer their investment in a given project, there will be no assurance as to who will actually be delivering the relevant services.

57. Restrictions on the transferability of shares in companies providing public services have been introduced
in some countries in order to address the contracting authority’s legitimate concern about those companies’ ability to deliver the relevant service at the agreed standards and conditions. From a legislative perspective, however, it is important to consider the possible disadvantages of imposing limitations on the transferability of investment in concessionaire companies and the adequacy of such limitations to ensure delivery of the services promised.

58. Contracting authorities may draw comfort from the experience that the selected bidding consortium demonstrated in the pre-selection phase, and from the performance guarantees provided by the parent organizations of the original consortium and its subcontractors. In practice, however, the comfort that may result from the apparent expertise of the shareholders in the concessionaire should not be overemphasized. Where a separate legal entity is established to carry out the project, which is often the case (see paras. 41-51), the backing of the concessionaire’s shareholders, should the project run into difficulties, may be limited to their minimum liability. Thus, restrictions on the transferability of investment, in and of themselves, may not represent sufficient protection against the risk of performance failure by the concessionaire. In particular, these restrictions are not a substitute for appropriate contractual remedies under the project agreement, such as monitoring of the level of service provided (see chapter V, “Infrastructure development and operation”, ____), termination without full compensation in case of unsatisfactory performance (see chapter VI, “End of project term, extension and termination”, ____), or for the substitution of the project company by another concessionaire appointed by the lenders under a direct agreement with the contracting authority (see chapter V, “Infrastructure development and operation”, ____).

59. It should also be noted that, to a certain extent, concerns about the concessionaire’s ability to perform satisfactorily under the project agreement are not unique to the contracting authority. The partners of the concessionaire, including the lenders, will be as concerned as the contracting authority to ensure that the designer, the construction contractor and the operating company meet their obligations under the project agreement. In practice, contractual guarantees, performance bonds or insurance policies (see chapter V, “Infrastructure development and operation”, ____), may be more effective in protecting against future non-performance than the forced retention of investment by a defaulting partner.

60. In addition to the above, restrictions on the transferability of shares in companies providing public services may also present some disadvantages for the contracting authority. Limitations on the private sector’s freedom to the transfer of its equity participation in privately financed infrastructure projects may also limit the variety of investment types and investors, thus reducing the chances of lowering the cost of funding. From a long-term perspective, the development of a market place for investment in public infrastructure may be hindered if investors are unnecessarily constrained in the freedom to transfer their interest in privately financed infrastructure projects.

61. As noted earlier (see “Introduction and background information on privately financed infrastructure projects”, ____), there are numerous types of funding available from different investors for different risk and reward profiles. The initial investors, such as construction companies and equipment suppliers, will seek to be rewarded for the higher risks which they take on, while subsequent investors may require a lesser return commensurate with the reduced risks they bear. Most of the initial investors have finite resources and need to recycle capital in order to be able to participate in new projects. Therefore, those investors would typically avoid tying up capital in long-term projects. At the end of the construction period, the initial investors might prefer to sell their interest on to a secondary equity provider whose required rate of return is less. Once usage is more certain, another refinancing could take place. However, if the investors’ ability to invest and reinvest capital for project development is restricted by constraints on the transferability of shares in infrastructure projects, there is a risk of a higher cost of funding. In some circumstances it may not be possible to fund a project at all, as some investors whose involvement may be crucial for the implementation of the project might not be willing to participate.

62. For the above reasons, it may be advisable to limit the restrictions on the transfer of shares of concessionaire companies to situations where such restrictions are justified by compelling reasons of public interest. One such situation may be where the contracting authority or other agency of the Government has entrusted a concessionaire with public assets (see para. 23), or where the concessionaire receives loans, subsidies, equity or other forms of direct governmental support (see chapter II, “Project risks and Government support”, ____). In these cases, the contracting authority’s accountability for the proper use of public funds requires assurances that the funds and assets are entrusted to a solid company, to which the original investors remain committed during a reasonable period. Another situation which may justify imposing limitations on the transfer of shares of concessionaire companies may be where the contracting authority has an interest in preventing transfer of shares to particular investors. For example, the contracting authority may wish to control acquisition of controlling shares of public service providers to avoid the formation of oligopolies or monopolies in liberalized sectors (see “Introduction and background information on privately financed infrastructure projects”, ____). Or it might not be thought appropriate for a company that had defrauded one part of Government to be employed by another through a newly acquired subsidiary.

63. In these exceptional cases it may be advisable to require that the initial investors seek the prior consent of the contracting authority before transferring their equity participation. It should be made clear in the project agreement that any such consent should not be unreasonably withheld or unduly delayed. For trans-
8. Duration of the project agreement

64. The laws of some countries contain provisions that limit the duration of infrastructure concessions to a certain number of years. Some laws establish a general limit for most infrastructure projects, and special limits for projects in particular infrastructure sectors. In some countries there are maximum duration periods only for certain infrastructure sectors.

65. The desirable duration of a project agreement may depend on a number of factors, such as the operational life of the facility; the period during which the service is likely to be required; the expected useful life of the assets associated with the project; how changeable is the technology required for the project; the time needed for the concessionaire to repay its debts and amortize the initial investment. Given the difficulty of establishing a single statutory limit for the duration of infrastructure projects, it is advisable to consider adopting statutory solutions that afford the contracting authority some flexibility to negotiate, in each case, a term that is appropriate to the project in question.

66. In some legal systems, this result is achieved by provisions which require that all concessions should be subject to a maximum duration period, without specifying any number of years. Sometimes the law only indicates which elements are to be taken into account for determining the duration of the concession (e.g. nature and amount of investment required to be made by the concessionaire, the normal amortization period for the particular facilities and installations concerned). Some project or sector-specific laws provide for a combined system requiring that the project agreement should provide for the expiry of the concession at the end of a certain period, or once the debts of the concessionaire have been fully repaid and a certain revenue, production or usage level has been achieved, whichever is the earliest.

67. However, where it is found necessary to adopt statutory limits, the maximum period should be sufficiently long to allow the concessionaire to fully repay its debts and to achieve a reasonable profit. Furthermore, it may be useful to authorize the contracting authority, in exceptional cases, to agree to longer concession periods, taking into account the amount of the investment and the required recovering period, and subject to special approval procedures.

Chapter V. INFRASTRUCTURE DEVELOPMENT AND OPERATION

CONTENTS

<table>
<thead>
<tr>
<th>LEGISLATIVE RECOMMENDATIONS</th>
<th>(1)-(7)</th>
</tr>
</thead>
<tbody>
<tr>
<td>NOTES ON LEGISLATIVE RECOMMENDATIONS</td>
<td>1-91</td>
</tr>
<tr>
<td>A. General remarks</td>
<td>1</td>
</tr>
<tr>
<td>B. Subcontracting</td>
<td>2-4</td>
</tr>
<tr>
<td>C. Construction projects</td>
<td>5-17</td>
</tr>
<tr>
<td>1. Review and approval of construction plans</td>
<td>8-9</td>
</tr>
<tr>
<td>2. Variation in the project terms</td>
<td>10-13</td>
</tr>
<tr>
<td>3. Monitoring powers of the contracting authority</td>
<td>14-17</td>
</tr>
</tbody>
</table>
LEGISLATIVE RECOMMENDATIONS

(1) Subcontracting (see paras. 2-4)

1. The host country may wish to provide:

   (a) That the concessionaire should have the right to enter into contracts, as necessary, for the execution of public works and the operation and maintenance of the infrastructure facility. The contracting authority should be advised of the names and qualifications of the subcontractors engaged by the concessionaire;

   (b) That, notwithstanding the above, the contracting authority may reserve the right to review and approve contracts entered into by the concessionaire with its own shareholders or affiliated persons. The contracting authority’s approval should not normally be withheld except where the contracts contain provisions manifestly contrary to the public interest or to mandatory rules of a public law nature.

(2) Construction projects (see paras. 5-17)

2. The host country may wish to provide:

   (a) That, where appropriate, the project agreement should set forth the procedures for the review and approval of construction plans and specifications by the contracting authority;

   (b) That the project agreement should set forth the specific circumstances under which the contracting authority may order variations in respect of construction terms; the compensation that may be due to the concessionaire, as appropriate, to cover the additional cost entailed by the variations; the procedures for ascertaining and liquidating such costs; and the circumstances and amounts beyond which the concessionaire should no longer be under an obligation to implement the variations;

   (c) That the contracting authority may, as appropriate, reserve the right to monitor the construction of, or improvements to, the infrastructure facility to ensure that they conform to the engineering standards acceptable to the contracting authority. Any suspension of the project ordered by the contracting authority should not exceed the time necessary, taking into consideration the circumstances that gave rise to the requirement to suspend the project;

   (d) That the project agreements should set forth the procedures for testing and final inspection of the facility, its equipment and appurtenances. Where the law requires that the facility be accepted by the contracting
authority, such acceptance should not be denied unless the work is found to be incomplete or defective.

(3) Infrastructure operation (see paras. 18-46)

3. The host country may wish to provide that the project agreement should set forth, as appropriate, the extent of the concessionaire’s obligations to ensure:

(a) The expansion of the service so as to meet the demand of the community or territory served;

(b) The continuity of the service, except where the provision of the service is rendered impossible by an exempting impediment, as provided in the project agreement;

(c) The availability of the service under essentially the same conditions to all users, except for reasonable differentiation between categories of users that are based on objective grounds, as provided in the project agreement;

(d) The non-discriminatory access, as appropriate, of other service providers to any public infrastructure network operated by the concessionaire, under the terms and conditions established in the project agreement.

4. Where the prices charged by the concessionaire are subject to external control by a regulatory body, the host country may wish to provide that the project agreement should set forth the mechanisms for periodic or extraordinary revisions of the price adjustment formulas.

5. The host country may wish to provide that the project agreement should set forth:

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

(b) The procedures for monitoring the concessionaire’s performance and for the taking of such reasonable actions as the contracting authority may find appropriate, to ensure that the infrastructure facility is properly maintained and the services are provided in accordance with the applicable legal and contractual requirements.

6. The host country may wish to provide that, subject to the approval of the contracting authority, the concessionaire may issue and enforce rules governing the use of the facility.

(4) Guarantees of performance and insurance (see paras. 47-58)

7. The host country may wish to provide that the project agreement should set forth:

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

(b) The forms and amounts of the insurance policies that the concessionaire may be required to maintain to ensure coverage of workers’ compensation, environmental damage, tort liability to the public and employees, property damage and other insurance that may be required to enable the continued operation of the facility.

(5) Changes in conditions (see paras. 59-68)

8. The host country may wish to provide that the project agreement should set forth the mechanisms for revising the terms of the project agreement following the occurrence of legislative changes that affect specifically the particular project, or a class of similar projects, or privately financed infrastructure projects in general, or other changes in the economic or financial conditions that, without preventing the performance of the obligations assumed by the concessionaire, render the performance of the obligation substantially more onerous than originally foreseen.

(6) Exemption provisions (see paras. 69-79)

9. The host country may wish to provide that the project agreement should set forth the circumstances under which either party may be exempt from liability for failure or delay in complying with any obligation under the project agreement, to the extent that such failure or delay has been caused by an occurrence beyond their reasonable control that causes either party to be unable to perform its obligation and that the party has been unable to overcome by the exercise of due diligence.

(7) Events of default and remedies (see paras. 80-91)

10. The host country may wish to provide that the project agreement should set forth the remedies available to the contracting authority and the concessionaire in the event of default by the other party.

11. The host country may wish in particular to provide:

(a) That, in the event of serious failure by the concessionaire to perform its obligations under the project agreement, the contracting authority may temporarily take over the operation of the facility for the purpose of ensuring the effective and uninterrupted delivery of the service;

(b) That the contracting authority may enter into agreements with the lenders allowing them to appoint a new concessionaire to perform under the existing project agreement if the concessionaire seriously fails to deliver the service required under the project agreement or if other specified events occur that could justify the termination of the project agreement.
NOTES ON LEGISLATIVE RECOMMENDATIONS

A. GENERAL REMARKS

1. The conditions under which infrastructure is developed and operated may vary considerably from project to project and, therefore, it is generally not advisable to attempt to regulate by means of general legislation specific aspects of the mutual rights and obligations of the concessionaire and the contracting authority. However, in most infrastructure projects there will be issues that might need to be considered by the legislature. The contracting authority might need to be provided, for instance, with specific powers to enter into the necessary contractual arrangements for addressing certain issues in a suitable fashion. Furthermore, the Government may have an interest in ensuring predictability and coherence in the treatment of certain recurrent issues relating to the execution of privately financed infrastructure projects.

B. SUBCONTRACTING

2. Given the complexity of infrastructure projects, the concessionaire typically retains the services of one or more construction contractors for performing some or the bulk of the construction work under the project agreement. Furthermore, the concessionaire may also wish to retain the services of contractors with experience in the operation and maintenance of infrastructure during the operational phase of the project. The laws of some countries generally acknowledge the concessionaire’s faculty to enter into contracts as needed for the execution of the construction work. A legislative provision recognizing the concessionaire’s authority to subcontract may be particularly useful in countries where there are limitations to the ability of Government contractors to subcontract.

3. The concessionaire’s freedom to hire subcontractors is in some countries restricted by rules that prescribe the use of tendering and similar procedures for the award of subcontracts by public service providers. Such statutory rules have often been adopted when infrastructure facilities were primarily or exclusively operated by the Government, with little or only marginal private sector investment. The purpose of such statutory rules was to ensure economy, efficiency, integrity and transparency in the use of public funds. However, in the case of privately financed infrastructure projects, there may no longer be a compelling reason of public interest for prescribing to the concessionaire the procedure to be followed for the award of its contracts. On the contrary, such provisions may discourage the participation of potential investors, since the project sponsors typically include engineering and construction companies that participate in the project in the expectation that they will be given the main contracts for the execution of the construction and other work.

4. The concessionaire’s freedom to select its subcontractors is not unlimited, however. In some countries, the concessionaire has to identify in its proposal which contractors will be retained, including information on their technical capability and financial standing. Other countries either require that such information be provided at the time the project agreement is concluded or subject such contracts to prior review and approval by the contracting authority. The purpose of such provisions is to avoid possible conflicts of interest between the project company and its shareholders, a point that would normally also be of interest to the lenders, who may wish to ensure that the project company’s contractors are not overpaid. In any event, if it is deemed necessary for the contracting authority to have the right to review and approve the project company’s subcontracts, the project agreement should clearly define the purpose of such review and approval procedures and the circumstances under which the contracting authority’s approval may be withheld. As a general rule, approval should not normally be withheld unless the subcontracts are found to contain provisions manifestly contrary to the public interest (e.g. excessive payments to subcontractors or unreasonable limitations of liability) or contrary to mandatory rules having the nature of public law that apply to the execution of privately financed infrastructure projects in the host country.

C. CONSTRUCTION PROJECTS

5. Domestic laws and regulations on traditional contracts for public works often contain extensive provisions on the execution of the work and the procedures to ensure compliance by the contractors with the design and other project specifications. Contracting authorities purchasing construction work typically act as the employer under a construction contract and retain extensive monitoring and inspection rights, including the right to review the construction project and request modifications thereof, to follow closely the construction work and schedule, to inspect and formally accept the completed work and to give final authorization for the operation of the facility.

6. In contrast, in many privately financed infrastructure projects, the contracting authority may envisage a different allocation of responsibilities between the public and the private sector. Instead of assuming the direct responsibility for managing the details of the project, contracting authorities in those countries may prefer to transfer such responsibility to the concessionaire by requiring the concessionaire to assume full responsibility for the timely completion of the construction. The concessionaire, too, will be interested in ensuring that the project is completed on time and that the cost estimate is not exceeded and will typically negotiate fixed-price, fixed-time turnkey contracts including guarantees of performance by the construction contractors. Therefore, in privately financed infrastructure projects it is the concessionaire that for most purposes performs the role of the employer under the construction contracts.

7. It flows from the above that laws and regulations governing traditional contracts for public works may not be entirely suitable for privately financed infra-
structure projects. For that reason, legislative provisions on the construction of privately financed infrastructure facilities are in some countries limited to a general definition of the concessionaire's obligation to perform the public works in accordance with the provisions of the project agreement and give the contracting authority the general right to monitor the progress of the work with a view to ensuring that it conforms to the provisions of the agreement. In those countries, more detailed provisions are then left to the project agreement.

1. Review and approval of construction plans

8. Where it is felt necessary to deal with construction projects and related matters in legislation, it is advisable to devise procedures that help to keep completion time and construction costs within estimates and lower the potential for disputes between the concessionaire and the public authorities involved. For instance, where statutory provisions require that the contracting authority review and approve the construction project, the project agreement should establish a deadline for the review of the construction project and provide that the approval shall be deemed to be granted if no objections are made by the contracting authority within the relevant period. It may also be useful to set out in the project agreement the grounds on which the contracting authority may raise objections to or request modifications in the project (e.g. safety, defence, security, environmental concerns or non-conformity with the specifications).

9. It should be noted that, in some legal systems, the party exercising ultimate control over the design or specification of a construction project may bear a certain degree of liability for defects arising from the inadequacy of the approved design or specifications. Therefore, it may be advisable for the project agreement to clarify that the contracting authority does not bear any liability in that regard, except where the design and specifications were originally provided by the contracting authority itself (see also chap. III, "Selection of the concessionaire", ).

2. Variation in the project terms

10. During the course of the construction of an infrastructure facility, it is common for situations to be encountered that make it necessary or advisable to vary certain aspects of the construction. The contracting authority may therefore wish to retain the right to order changes in respect of such aspects as the scope of construction, the technical characteristics of equipment or materials to be incorporated in the work or the construction services required under the specifications. Such changes are referred to in the Guide as "variations". As used in the Guide, the word "variation" does not include adjustments or revision of tariffs and prices because of cost changes or currency fluctuations (see paras. 32-37). Likewise, renegotiation of the project agreement in cases of substantial change in conditions (see paras. 59-68) is not regarded in the Guide as a variation.

11. Given the complexity of most infrastructure projects, it is not possible to exclude the need for variations in the construction specifications or other requirements of the project. However such variations often cause delay in the execution of the project or in the delivery of the public service; they may also render the performance under the project agreement more onerous for the concessionaire. Furthermore, the cost of implementing extensive variation orders may exceed the concessionaire's own financial means, thus requiring substantial additional funding that may not be obtainable at an acceptable cost. Therefore, it is advisable for the contracting authority to consider measures to control the possible need for variations. The quality of the feasibility studies conducted by the contracting authority and of the specifications provided during the selection process (see chap. III, "Selection of the concessionaire", ) play an important role in avoiding subsequent changes in the project.

12. The concessionaire will require assurances that it will not incur additional cost or liability for delay resulting from variations sought by the contracting authority. Thus, it is advisable to require that the project agreement set forth the specific circumstances under which the contracting authority may order variations in respect of construction terms and the compensation that may be due to the concessionaire, as appropriate, to cover the additional cost entailed by the variations. The project agreement should also clarify the extent to which the concessionaire is obliged to implement those variations and whether the concessionaire may object to variations and, if so, on which grounds. Furthermore, following a contractual practice common in some legal systems, it may be advisable to provide in the project agreement that the concessionaire is released of its obligations when the amount of additional costs entailed by the modification exceeds a set maximum limit.

13. Various contractual approaches for dealing with variations have been used in large construction contracts to deal with the extent of the contractor's obligations to implement changes and the required adjustments in the contract price or contract duration. Such solutions may also be used, mutatis mutandis, to deal with variations sought by the contracting authority under the project agreement. It should be noted, however, that, in infrastructure concessions, the project company's payment consists in user fees or prices for the output of the facility, rather than a global price for the construction work. Thus, compensation methods used in connection with infrastructure concessions sometimes include a combination of various methods ranging from lump-sum payments to tariff increases, or extensions of the concession period. For instance, there may be changes that result in an increase in the cost that the concessionaire might be able to absorb or finance itself and amortize by means of an adjustment in the tariffs or

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1For a discussion of approaches and possible solutions used in construction contracts for complex industrial works, see UNCTRAL, Legal Guide on Drawing Up Contracts for the Construction of Industrial Works (United Nation publication, Sales No. E.87.V.10), chapter XXIII, "Variation clauses".
payment mechanism, as appropriate. If the concessionaire cannot refinance or fund the changes itself, the parties may wish to consider lump-sum payments as an alternative to an expensive and complicated refinancing structure.

3. Monitoring powers of the contracting authority

14. In some legal systems, governmental agencies purchasing construction projects customarily retain the power to order the suspension or interruption of the projects for reasons of public interest. However, with a view to providing some comfort to potential investors, it may be useful to limit the possibility of such interference only to extraordinary circumstances and to provide that no such interruption should be of a duration or extent greater than is necessary, taking into consideration circumstances that gave rise to the requirement to suspend or interrupt the work. It may also be useful to agree on a maximum period of suspension and to provide for compensation to the concessionaire for any suspension in excess of the agreed maximum period. Furthermore, guarantees may be provided to ensure payment of compensation or to indemnify the concessionaire for loss resulting from suspension of the project (see also chap. II, “Project risks and Government support”, __).

15. Provisions concerning final inspection and approval of the construction work by the contracting authority may be of particular importance in connection with health, safety, building or labour regulations. They may also be of importance in respect of facilities that are the subject of regulatory control (for safety or similar reasons) or where the Government would have a direct or residual liability to the public for damage or injury attributable to defects in the construction of the facility.

16. The project agreement should set out in detail the nature of the completion tests or the inspection of the completed facility; the timetable for the tests (for instance, it might be appropriate to undertake partial tests over a period, rather than a single test at the end); the consequences of failure to pass a test; and the responsibility for organizing the resources for the test and covering the corresponding costs. Final approval of the work by the contracting authority is usually a condition for authorizing that the facility should be brought into operation. In some countries, it was found useful to authorize the facility to operate on a provisional basis, pending final acceptance by the contracting authority, and to provide an opportunity for the concessionaire to rectify defects that might be found at that juncture. Where regulatory or liability issues are not an immediate concern for the contracting authority, the contracting authority may satisfy itself with requiring the concessionaire to undertake those tests and to provide appropriate guarantees that the facility is fit for being put into operation.

17. For projects requiring that the facility and related assets be handed over to the contracting authority at the end of the concession period (see chap. VI, “End of project term, extension and termination”, __), such as in “build-operate-transfer” (BOT) and similar types of projects, or where the operation is handed over to the contracting authority immediately upon completion of the construction work, it is important to lay down in the project agreement the requirements to ensure the long-term durability of the facility being constructed beyond the concession period. Also, the contracting authority should have assurances that it will receive all that is necessary in order to carry out the long-term operation of the facility, such as drawings, maintenance records kept during its operation by the concessionaire and any manuals that have been developed for operation and maintenance. It is also important to make provisions for adequate training of the contracting authority’s personnel prior to the ultimate handing over of the facility.

D. INFRASTRUCTURE OPERATION

18. During the operational phase the concessionaire undertakes to operate and maintain the infrastructure facility and to collect revenue from the users. Conditions for the operation and maintenance of the facility, as well as for quality and safety standards, are often recited in the law and spelled out in detail in the project agreement. In countries that have general legislation on concessions, the law might, for example, limit itself to a general description of the main obligations of public service providers and refer the matter to the project agreement. Where specific legislation is required in order for the contracting authority to carry out certain types of projects, the relevant statute often sets forth the conditions for the operation and maintenance of the relevant infrastructure facilities and is supplemented by more detailed provisions in regulations governing that particular infrastructure sector and in the project agreement, an approach that is common to various legal systems. In addition, particularly in the fields of electricity, water and sanitation and public transportation, the contracting authority or an independent regulatory body may exercise an oversight function over the operation of the facility. An exhaustive discussion of legal issues relating to the conditions of operation of infrastructure facilities would exceed the scope of the Guide. Therefore, the following paragraphs contain only a brief presentation of some of the main issues.

19. Regulatory provisions on infrastructure operation and legal requirements for the provision of public services are intended to achieve various objectives of public relevance. Given the usually long duration of infrastructure projects, there is a possibility that such provisions and requirements may need to be changed during the life of the project agreement. It is important, however, to bear in mind the private sector’s need for a stable and predictable regulatory framework. Changes in regulations or the frequent introduction of new and more stringent rules may have a disruptive impact on the implementation of the project and compromise its financial viability. Therefore, while contractual arrangements may be agreed to by the parties to counter the adverse effects of subsequent regulatory changes (see paras. 60-
63), regulatory bodies would be well advised to avoid excessive regulation or unreasonably frequent changes in existing rules.

1. General duties of public service providers

20. In various legal systems, entities providing public services have certain special obligations to their users or customers or to other public service providers. The most common such obligations are discussed below.

(a) Extension of services

21. In some legal systems, an entity operating under a governmental concession to provide certain essential services (e.g. electricity or potable water) to a community or territory and its inhabitants is held to assume an obligation to provide a service system that is reasonably adequate to meet the demand of the community or territory. That obligation often relates not only to the historic demand at the time the concession was awarded, but implies an obligation to keep pace with the growth of the community or territory served and gradually to extend the system as may be required by the reasonable demand of the community or territory. In some legal systems, the obligation has the nature of a public duty that may be invoked by any resident of the relevant community or territory. In other legal systems, it has the nature of a statutory or contractual obligation that may be enforced by the contracting authority or by a regulatory body, as the case may be.

22. The obligation, where it exists, is not absolute and unqualified. The concessionaire’s duty to extend its service facilities depends, in some legal systems, upon various factors, such as the need and cost of the extension and the revenue that may be expected as a result of the extension; the concessionaire’s financial condition; the public interest in effecting such an extension; and the scope of the obligations assumed by the concessionaire in that regard under the project agreement. In some legal systems, the concessionaire may be under an obligation to extend its service facilities even if the particular extension is not immediately profitable or even if, as a result of the extensions being carried out, the concessionaire’s territory might eventually include unprofitable areas. That obligation is nevertheless subject to some limits, since the concessionaire is not required to carry out extensions that place an unreasonable burden on the concessionaire or its customers. Depending on the particular circumstances, the cost of carrying out extensions of service facilities may be absorbed by the concessionaire, passed on to the customers or end users in the form of price increases or extraordinary charges, or it may be absorbed in whole or in part by the contracting authority or other governmental agency by means of subsidies or grants. Given the variety of factors that may need to be taken into account in order to assess the reasonableness of any particular extension, it is advisable to require that the project agreement set forth the circumstances under which the concessionaire may be required to carry out extensions in its service facilities and the appropriate methods for financing the cost of any such extension.

(b) Continuity of service

23. Another obligation of public service providers is to ensure the continuous provision of the service under most circumstances, except for narrowly defined exempting events (see also paras. 70-73). In some legal systems, the obligation has the nature of a statutory duty that applies even if it is not expressly recited in the project agreement. The corollary of that rule, in legal systems where it exists, is that various circumstances that under general principles of contract law might authorize a contract party to suspend or discontinue the performance of its obligations (e.g. economic hardship or breach by the other party) cannot be invoked by the concessionaire as grounds for suspending or discontinuing, in whole or in part, the provision of a public service. In some legal systems, the contracting authority may even have special enforcement powers to compel the concessionaire to resume providing service in the event of unlawful discontinuance.

24. That obligation, too, is subject to a general rule of reasonableness. Various legal systems recognize the concessionaire’s right to fair compensation for having to deliver the service under situations of hardship (see paras. 74-79). Moreover, in some legal systems, it is held that a public services provider may not be required to operate where its overall operation results in a loss. Where the public service as a whole, and not only one or more of its branches or territories, ceases being profitable, the concessionaire may have the right to a direct compensation by the contracting authority or, alternatively, the right to terminate the project agreement. However, termination typically requires the consent of the contracting authority or a judicial decision. It is therefore advisable to clarify in the project agreement which extraordinary circumstances would justify the suspension of the service or even release the concessionaire from its obligations under the project agreement (see also chap. VI, “End of project term, extension and termination”, ___).

(c) Equal treatment of customers or users

25. Entities that provide certain services to the general public are, in some jurisdictions, under an obligation to ensure the availability of the service under essentially the same conditions to all users and customers falling within the same category. However, any differentiation based on a reasonable and objective classification of customers and users is accepted in those legal systems as long as like contemporaneous service is rendered to consumers and users engaged in like operations under like circumstances. Therefore, it may not be inconsistent with the principle of equal treatment to charge different prices or to offer different access conditions to different categories of users (e.g. domestic consumers, on the one hand, and business or industrial consumers, on the other), provided that the differentiation is based on ob-
jective criteria and corresponds to actual differences in the situation of the consumers or the conditions under which the service is provided to them. Nevertheless, where a difference in charges or other conditions of service is based on actual differences in service (e.g., higher charges for services provided at hours of peak consumption), it typically has to be commensurate with the amount of difference.

26. In addition to differentiation established by the concessionaire itself, different treatment of certain users or customers may be the result of legislative action. In many countries, the law requires that specific services must be provided at particularly favourable terms to certain categories of users and customers (e.g., discounted transport for schoolchildren or senior citizens or reduced water or electricity rates for lower-income or rural users). Public service providers may recoup these service burdens or costs in several ways, including through Government subsidies, through funds or other official mechanisms created to share the financial burden of these obligations among all public service providers, or through internal cross-subsidies from other profitable services (see chap. II, “Project risks and Government support”, _).

(d) Interconnection and access to infrastructure networks

27. Companies operating infrastructure networks in sectors such as railway transport, telecommunications or power or gas supply are sometimes required to allow other companies to have access to the network. The requirement may be set forth in the project agreement or may be stated in sector-specific laws or regulations. Interconnection and access requirements have been introduced in certain infrastructure sectors as a complement to vertical unbundling measures; in others, they have been adopted to foster competition in sectors that remained fully or partially integrated (for a brief discussion of market structure issues, see above, “Introduction and background information”, _).

28. Network operators are often required to provide access on terms that are fair and non-discriminatory from a financial as well as a technical point of view. Non-discrimination implies that the new entrant or service provider should be able to use the infrastructure of the network operator on conditions that are not less favourable than those granted by the network operator to its own services or to those of competing providers. It should be noted, however, that many pipeline access regimes, for example, do not require completely equal terms for the carrier and rival users. The access obligation may be qualified in some way. It may, for instance, be limited to spare capacity only or be subject to reasonable, rather than equal, terms and conditions.

29. While access pricing is usually cost-based, regulatory bodies will wish to retain the right to monitor access prices to ensure that they are high enough to give adequate incentive to invest in the required infrastructure and low enough to allow new entrants to compete at fair terms. Where the network operator provides services in competition with other providers, there may be requirements that its activities be separated from an accounting point of view in order to determine the actual cost of the use by third parties of the network or parts thereof.

30. Technical access conditions may be equally important, and network operators may be required to adapt their network to satisfy the access requirements of new entrants. Access may be to the network as a whole or to monopolistic parts or segments of the network (sometimes also referred to as bottleneck or essential facilities). Many Governments allow service providers to build their own infrastructure or to use alternative infrastructure where available. In such cases, the service provider may only need access to a small part of the network and cannot, under many regulations, be forced to pay more than the cost corresponding to the use of the specific facility it needs, such as the local telecommunications loop, transmission capacity for the supply of electricity or the use of a track section of railway.

2. Price control

31. Except where the concessionaire is free to determine its tariff and commercial policy, domestic laws often subject the prices charged by the concessionaire to some control mechanism. Many countries have chosen to set only the broad pricing principles in legislation while leaving their actual implementation to the regulatory body concerned and to the terms and conditions of licences or concessions. Where price control measures are used, the law typically requires that the formula must be advertised with the request for proposals and must be incorporated in the project agreement. Price control systems typically consist of formulas for the adjustment of prices and monitoring provisions to ensure compliance with the parameters for price adjustment.

(a) Price control methods

32. The most common price control methods used in domestic laws are rate-of-return and price-cap methods. There are also hybrid regimes that have elements of both. These methods are briefly discussed below.

(i) Rate-of-return method

33. Under the rate-of-return method, the price adjustment mechanism is devised so as to allow the concessionaire a given return on its investment, usually expressed in percentage terms and representing a weighted average of the cost of debt and the cost of equity. The tariffs for any given period are established on the basis of the concessionaire’s overall revenue requirement to operate the facility, which involves determining its expenses, the investments undertaken to provide the services and the allowed rate of return. Reviews of the tariffs are undertaken periodically,
sometimes whenever the contracting authority or other interested parties consider that the actual revenue is higher or lower than the revenue requirement of the facility. For that purpose, the contracting authority verifies the expenses of the facility, determines to what extent investments undertaken by the concessionaire are eligible for inclusion in the rate base, and calculates the revenues that need to be generated to cover the allowable expenses and the agreed-upon return on investment.

34. The implementation of the rate-of-return method requires a substantial amount of information, as well as extensive negotiations (e.g., on eligible expenditures and cost allocation). The rate-of-return method has been found to provide a high degree of security for infrastructure operators, since the concessionaire is assured that the tariffs charged will be sufficient to cover its operating expenses and allow the agreed rate of return. Because prices are adjusted regularly, thus keeping the concessionaire’s rate of return essentially constant, investment in companies providing public services is exposed to little market risk. The result is typically lower costs of capital. The possible disadvantage of the rate-of-return method is that it provides little incentive for infrastructure operators to minimize their costs because of the assurance that those costs will be recovered through tariff adjustments. However, some level of incentive may exist if the tariffs are not adjusted instantaneously or if the adjustment does not apply retroactively.

(ii) Price-cap method

35. Under the price-cap method, a price formula is set for a given period (e.g., four or five years) taking into account future inflation and future efficiency gains expected from the facility. Prices are allowed to fluctuate within the limits set by the formula. In some countries, the formula is a weighted average of various indices, in others it is a consumer price index minus a productivity factor. Where substantial new investments are required, the formula may include an additional component to cover these extra costs. The formula can apply to all services of the company or to selected groups of services only, and different formulas may be used for different groups. The periodic readjustment of the formula is, however, based on the rate-of-return type of calculations, requiring the same type of detailed information as indicated above, though on a less frequent basis.

36. The implementation of the price-cap method may be less complex than the rate-of-return method. The price-cap method has been found to provide greater incentives for public service providers, since the concessionaire retains the benefits of lower than expected costs until the next adjustment period. At the same time, however, public service providers are typically exposed to more risk under the price-cap method than under the rate-of-return method. In particular, the concessionaire faces the risk of loss when the costs turn out to be higher than expected, since the concessionaire cannot raise the prices until the next price adjustment.

The greater risk exposure increases the costs of capital. If the project company’s returns are not allowed to rise, there might be difficulties in attracting new investment. Also, the company might be tempted to lower the quality of the service in order to reduce costs.

(iii) Hybrid methods

37. Many tariff adjustment methods being currently used combine elements of both the rate-of-return and the price-cap methods with a view to both reducing the risk borne by the service providers and providing sufficient incentives for efficiency in the operation of the infrastructure. One such hybrid method employs sliding scales for adjusting the tariffs that ensure upward adjustment when the rate of return falls below a certain threshold and downward adjustment when the rate of return exceeds a certain maximum, with no adjustment for rates of return falling between those levels. Other possible methods include a review by the contracting authority of the investments made by the concessionaire to ensure that they meet the criteria of usefulness in order to be taken into account when calculating the concessionaire’s revenue requirement. Another price adjustment technique that may be used to set prices, or more generally to monitor price levels, is benchmark or yardstick pricing. By comparing the various cost components of one public service provider with those of another and with international norms, the contracting authority may be able to judge whether tariff adjustments requested by the public service provider are reasonable.

(b) Policy considerations

38. Each of the main tariff adjustment methods discussed above has its own advantages and disadvantages that have to be taken into account by the legislature when considering the appropriateness of price control methods for the domestic circumstances. Different methods may also be used for different infrastructure sectors. Some laws indeed authorize the contracting authority to apply either a fixed-price or rate-of-return method in the selection of concessionaires, according to the scope and nature of investments and services. Whatever mechanism is chosen, it is important to consider carefully the capacity of the contracting authority to monitor adequately the performance of the concessionaire and to implement satisfactorily the adjustment method (see also chap. I, “General legislative considerations”, __).
concessionaire (see also paras. 59-68). The tariff regime will also require adequate stability and predictability to enable public service providers and users to plan accordingly and to allow financing based on a predictable revenue. Investors and lenders may be particularly concerned about regulatory changes affecting the price adjustment method. Thus, they typically require that the price adjustment formula be incorporated in the project agreement.

3. Disclosure requirements

40. Many domestic laws impose on public service providers an obligation to provide to the regulatory body accurate and timely information on their operations, and grant regulatory bodies specific enforcement rights. They may encompass inquiries and audits, including detailed performance and compliance audits, sanctions for non-cooperative companies, and injunctions or penalty procedures to enforce disclosure.

41. Public service providers are normally required to maintain and disclose to the regulatory body their financial accounts and statements and to maintain detailed cost accounting allowing the regulatory body to track various aspects of the company’s activities separately. Financial transactions between the concessionaire company and affiliated companies may also require scrutiny, as concessionaire companies may try to transfer profits to non-regulated businesses or foreign affiliates. Infrastructure operators may also have detailed technical and performance reporting requirements. As a general rule, however, it is important to define reasonable limits to the extent and type of information that infrastructure operators are required to submit. Furthermore, appropriate measures should be taken to protect the confidentiality of any proprietary information that the concessionaire and its affiliated companies may submit to the regulatory body.

4. Performance standards

42. Public service providers generally have to meet a set of technical and service standards. Such standards are in most cases too detailed to figure in legislation and may be included in implementing decrees, regulations or other instruments. Service standards are often spelt out in great detail in the project agreement. They include quality standards, such as requirements with respect to water purity and pressure; ceilings on time to perform repairs; ceilings on the number of defects or complaints; timely performance of transport services; continuity in supply; and health, safety and environmental standards. Legislation may, however, impose the basic principles that will guide the drafting of detailed standards or require compliance with international standards.

43. The contracting authority typically retains the power to monitor the adherence of the project company to the regulatory performance standards. The concessionaire will be interested in avoiding as much as possible any interruption in the operation of the facility and protecting itself against the consequences of any such interruption. It will seek assurances that the exercise by the contracting authority of its monitoring or regulatory powers does not cause undue disturbance or interruption in the operation of the facility, and that it does not result in undue additional costs to the concessionaire.

5. Enforcement powers of the concessionaire

44. Governmental agencies are typically entrusted with powers designed to facilitate the provision of the service and to ensure that the users comply with the pertinent regulations and rules. Such powers may include, for instance, the right to issue, or control compliance with, safety rules and the right to suspend the provision of service for emergency or safety reasons. Those powers typically derive from the overall authority of the Government, and in some legal systems, they are inherently governmental.

45. In countries with a well-established tradition of awarding concessions for the provision of public services, the concessionaire may be entrusted with the necessary powers by a delegation of authority from the Government. The extent of powers delegated to the concessionaire is usually defined in the project agreement and may not need to be provided in detail in legislation. Nevertheless, it may be useful for the law to provide that the concessionaire may be authorized to issue rules governing the use of the facility by the public and to take reasonable measures to ensure compliance by the public with those rules. It may be advisable to provide that they should become effective upon approval by the regulatory body or the contracting authority, as appropriate. However, the right to approve operating rules proposed by the concessionaire should not be discretionary and the concessionaire should have the right to appeal a decision to refuse approval of the proposed rules (see chap. I, “General legislative considerations”;

46. Of particular importance for the concessionaire is the question whether the provision of the service may be discontinued because of default or non-compliance by its users. Despite the concessionaire’s general obligation to ensure the continuous provision of the service (see paras. 23-24), many legal systems recognize that entities providing public services may issue and enforce rules that provide for shutting off of the service for a consumer or user who has defaulted in payment for it or who has seriously infringed the conditions for using it. The power to do so is often regarded as crucial in order to prevent abuse and ensure the economic viability of the service. However, given the essential nature of certain public services, that power may require legislative authority in some legal systems. Furthermore, there may be a number of expressed or implied limitations or conditions for the exercise of that power, such as special notice requirements and specific consumer remedies. Additional limitations and conditions may derive from
the application of general consumer protection rules (see chap. VII, "Governing law").

E. PERFORMANCE GUARANTEES
AND INSURANCE

47. The obligations of the concessionaire are usually complemented by the provision of some form of guarantee of performance in the event of default and insurance coverage against a number of risks. The law in some countries generally requires that adequate guarantees of performance be provided by the concessionaire and refer the matter to the project agreement for further details. In other countries, the law contains more detailed provisions, for instance requiring the provision of a certain type of guarantee up to a certain percentage of the basic investment.

1. Types, functions and the nature of performance guarantees

48. Performance guarantees are generally of two types. Under one type, the monetary performance guarantee, the guarantor undertakes only to pay the contracting authority funds up to a stated limit to satisfy the liabilities of the concessionaire in the event of the latter's failure to perform. Monetary performance guarantees may take the form of a contract bond, a stand-by letter of credit or an on-demand guarantee. Under the other type of guarantee, the performance bond, the guarantor chooses one of two options: (a) to rectify defective or finish incomplete construction itself; or (b) to obtain another contractor to rectify defective or finish incomplete construction and compensate the contracting authority for losses caused by the failure to perform. The value of such an undertaking is limited to a stated amount or a certain percentage of the contract value. Under a performance bond, the guarantor also frequently reserves the option to discharge its obligations solely by the payment of money to the contracting authority. Performance bonds are generally furnished by specialized guarantee institutions, such as bonding and insurance companies. A special type of performance bond is the maintenance bond, which protects the contracting authority against future failures that could arise during the start-up or maintenance period and serve as guarantee that any repair or maintenance work during the post-completion warranty period will be duly carried out by the concessionaire.

49. As regards their nature, performance guarantees may be generally divided into independent guarantees and accessory guarantees. A guarantee is said to be “independent” if the guarantor's obligation is independent from the concessionaire’s obligations under the project agreement. Under an independent guarantee (often called a first-demand guarantee) or a stand-by letter of credit, the guarantor or issuer is obligated to make payment on demand by the beneficiary, and the latter is entitled to recover under the instrument if it presents the document or documents stipulated in the terms of the guarantee or stand-by letter of credit. Such a document might be simply a statement by the beneficiary that the contractor has failed to perform. The guarantor or issuer is not entitled to withhold payment on the ground that there has in fact been no failure to perform under the main contract; however, under the law applicable to the instrument, payment may in very exceptional and narrowly defined circumstances be refused or restrained (e.g. when the claim by the beneficiary is manifestly fraudulent). In contrast, a guarantee is accessory when the obligation of the guarantor involves more than the mere examination of a documentary demand for payment in that the guarantor may have to evaluate evidence of liability of the contractor for failure to perform under the work contract. The nature of the link may vary under different guarantees, and may include the need to prove the contractor’s liability in arbitral proceedings. By their nature, performance bonds have an accessory character to the underlying contract.

2. Advantages and disadvantages of various types of performance guarantee

50. From the perspective of the contracting authority, monetary performance guarantees may be particularly useful in covering additional costs that may be incurred by the contracting authority as a result of delay or default by the concessionaire. Monetary performance guarantees may also serve as an instrument to put pressure on the concessionaire to complete construction in time and to perform its other obligations in accordance with the requirements of the project agreement. However, the amount of those guarantees is typically only a fraction of the economic value of the obligation guaranteed and is usually not sufficient to cover the cost of engaging a third party to perform instead of the concessionaire or its contractors.

51. From the perspective of the contracting authority, a first-demand guarantee has the advantage of ensuring prompt recovery of funds under the guarantee, without evidence of failure to perform by the contractor or of the extent of the beneficiary's loss. Furthermore, guarantors furnishing monetary performance guarantees, in particular banks, prefer first-demand guarantees, as the conditions are clear as to when their liability to pay accrues, and the guarantors will thus not be involved in disputes between the contracting authority and the concessionaire as to whether or not there has been a failure to perform under the project agreement. Another advantage for a bank issuing a first-demand guarantee is the possibility of quick and efficient recovery of the sums paid under a first-demand guarantee by direct access to the concessionaire's assets.

52. A disadvantage to the contracting authority of a first-demand guarantee or a stand-by letter of credit is that those instruments may increase the overall project costs, since the concessionaire is usually obliged to obtain and set aside large counter-guarantees in favour of the institutions issuing the first-demand guarantee or the stand-by letter of credit. Also, a concessionaire that furnishes such a guarantee may wish to take out insurance against the risk of recovery by the contracting
authority under the guarantee or the stand-by letter of credit when there has been in fact no failure to perform by the concessionaire, and the cost of that insurance is included in the project cost. The concessionaire also may include in the project cost the potential costs of any action that it may need to institute against the contracting authority to obtain the repayment of the sum improperly claimed. In addition, to the extent the contracting authority can obtain the sum payable under the guarantee or the stand-by letter of credit upon its bare statement that the concessionaire has failed to perform, the concessionaire may wish to fix the sum payable at a small percentage of the project cost, and thereby limit the loss it may suffer from having to reimburse the guarantor in the event of a claim by the contracting authority when there has been no failure to perform.

53. A disadvantage to the concessionaire of a first-demand guarantee or a stand-by letter of credit is that, if there is recovery by the contracting authority when there has been no failure to perform by the concessionaire, the latter may suffer immediate loss if the guarantor or the issuer of the letter of credit reimburses itself from the assets of the concessionaire after payment to the contracting authority. The concessionaire may also experience difficulties and delays in recovering from the contracting authority the sum improperly claimed.

54. The terms of an accessory guarantee usually require the beneficiary to prove the failure of the contractor to perform and the extent of the loss suffered by the beneficiary. Furthermore, the defences available to the debtor if it is sued for a failure to perform are also available to the guarantor. Accordingly, there is a possibility that the contracting authority will face a protracted dispute when it makes a claim under the bond. However, as a reflection of the lesser risk borne by the guarantor, which also reflects the lower cost of an accessory guarantee, the monetary limit of liability of the guarantor may be considerably higher than under a first-demand guarantee, thus covering a larger percentage of work under the project agreement. A performance bond may also be advantageous if the contracting authority cannot conveniently arrange for the rectification of faults or completion of construction itself and requires the assistance of a third party to arrange for rectification or completion. Where, however, the construction involves the use of a technology known only to the concessionaire, rectification or completion by a third person may not be feasible, and a performance bond may not have the last-mentioned advantage over a monetary performance guarantee. For the concessionaire, accessory guarantees have the advantage of preserving the concessionaire's borrowing power, since accessory guarantees, unlike first-demand guarantees and stand-by letters of credit, do not affect the concessionaire's line of credit with the lenders.

55. It flows from the above considerations that different types of guarantees may be useful in connection with the various obligations assumed by the concessionaire. While it is useful to require the concessionaire to provide adequate guarantees of performance, it is advisable to leave it to the parties to determine the extent to which guarantees are needed and which guarantees should be provided in respect of the various obligations assumed by the concessionaire, rather than requiring in the law only one form of guarantee to the exclusion of others. It should be noted that the project company itself will require a series of performance guarantees to be provided by its contractors (see para. 6) and that additional guarantees to the benefit of the contracting authority usually increase the overall cost and complexity of a project. In some countries, practical guidance provided to domestic contracting authorities advises them to consider carefully whether and under what circumstances such guarantees are required, which specific risks or loss they should cover and which type of guarantee is best suited in each case. The ability of the project company to raise finance for the project may be jeopardized by bond requirements set at an excessive level.

56. One particular problem of privately financed infrastructure projects concerns the duration of the guarantee. The contracting authority may have an interest in obtaining guarantees of performance that remain valid during the entire life of the project, covering both the construction and the operational phase. However, given the long duration of infrastructure projects and the difficulty in evaluating the various risks that may arise, it may be problematic for the guarantor to issue a performance bond for the whole duration of the project or to procure reinsurance for its obligations under the performance bond. In practice, this problem is compounded by stipulations that the non-renewal of a performance bond constitutes a reason for a call on the bond, so that merely allowing the project company to provide bonds for shorter periods may not be a satisfactory solution. One possible solution, used in some countries, is to require separate bonds for the construction and the operation phase, thus allowing for better assessment of risks and reinsurance prospects. Such a system may be enhanced by defining in precise terms the risk to be covered during the operational period, thus allowing for a better assessment of risks and a reduction of the total amount of the bond. Another possibility to be considered by the contracting authority may be to require the provision of performance guarantees during specific crucial periods, rather than for the entire duration of the project. For instance, a bond might be required during the construction phase and last for an appropriate period beyond completion, so as to cover possible late defects. Such a bond might then be replaced by a performance bond for a certain number of years of operation, as appropriate in order for the project company to demonstrate its capability to operate the facility in accordance with the required standards. If the project company's performance proves to be satisfactory, the bond requirement might be waived for the remainder of the operation phase, up to a certain period before the end of the concession term, when the project company might be required to place another bond to guarantee its obligations in connection with the handing over of assets and other measures for the orderly wind-up of the project, as appropriate (see chap. VI, "End of project term, extension and termination", __).
3. Insurance arrangements

57. Insurance arrangements made in connection with privately financed infrastructure projects typically vary according to the phase to which they apply, with certain types of insurance only being purchased during a particular project phase. Some forms of insurance, such as business interruption insurance, may be purchased by the concessionaire in its own interest, while other forms of insurance may be a requirement under the laws of the host country. Forms of insurance often required by law include insurance coverage against damage to the facility, third-party liability insurance, workers’ compensation insurance and pollution and environmental damage insurance.

58. Mandatory insurance policies under the laws of the host country often need to be obtained from a local insurance company or from another institution admitted to operate in the country, which in some cases may pose a number of practical difficulties. In some countries, the type of coverage usually offered may be more limited than the standard coverage available on the international market, in which case the concessionaire may remain exposed to a number of perils that may exceed its self-insurance capacity. That risk is particularly serious in connection with environmental damage insurance. Further difficulties may arise in some countries as a result of limitations on the ability of local insurers to reinsure the risks on the international insurance and reinsurance markets. As a consequence, the project company may often need to procure additional insurance outside the country, thus adding to the overall cost of financing the project.

F. CHANGES IN CONDITIONS

59. Privately financed infrastructure projects normally last for a long period of time, during which many circumstances relevant to the project may change. The impact of many changes may be automatically covered in the project agreement, either through financial arrangements such as a tariff structure that includes an indexation clause (see paras. 33-37), or by the assumption by either party, expressly or by exclusion, of certain risks (for example, if the price of fuel or electricity supply is not taken into account in the indexation mechanisms, then the risk of higher than expected prices is absorbed by the concessionaire). However, there are changes that might not lend themselves easily to inclusion in an automatic adjustment mechanism or that the parties may prefer to exclude from such a mechanism. From a legislative perspective, two particular categories deserve special attention: legislative or regulatory changes and unexpected changes in economic conditions.

1. Legislative and regulatory changes

60. Given the long duration of privately financed infrastructure projects, the concessionaire may face additional costs in meeting its obligations under the project agreement because of future, unforeseen changes in legislation applying to its activities. In extreme cases, legislation could even make it financially or physically impossible for the concessionaire to carry on with the project. For the purpose of considering the appropriate solution for dealing with legislative changes, it may be useful to distinguish between legislative changes having a particular incidence on privately financed infrastructure projects or on one specific project, on the one hand, and general legislative changes affecting also other economic activities, and not only infrastructure operation, on the other hand.

61. All business organizations, in the private and public sectors alike, are subject to changes in law and generally have to deal with the consequences that such changes may have for business, including the impact of changes on the price of or demand for their products. Possible examples might include: changes in the structure of capital allowances that apply to entire classes of assets, whether owned by the public or private sector and whether related to infrastructure projects or not; regulations that affect the health and safety of construction workers on all construction projects not just infrastructure projects; and changes in the regulations on the disposal of hazardous substances. General changes in law may be regarded as an ordinary business risk rather than a risk specific to the concessionaire’s activities, and it might be difficult for the Government to undertake to protect infrastructure operators from the economic and financial consequences of changes in legislation that affect equally other business organizations. Thus, there may not be a prima facie reason why the concessionaire should not bear the consequences of general legislative changes, including the risk of costs arising from changes in law applying to the whole business sector.

62. Nevertheless, it is important to take into account possible limitations in the concessionaire’s capacity to respond to or absorb cost increases that result from general legislative changes. Infrastructure operators are often subject to service standards and price control mechanisms (see paras. 31-39) that make it difficult for them to respond to changes of law in the same manner as other private companies (e.g. by increasing tariffs or by reducing services). Where price control mechanisms are provided in the project agreement, the concessionaire will seek to obtain assurances from the contracting authority and the regulatory body, as appropriate, that it will be allowed to recover the additional costs entailed by changes in legislation by means of price increases. Where such an assurance cannot be given, it is advisable to empower the contracting authority to negotiate with the concessionaire the compensation to which the concessionaire might be entitled in the event that price control measures do not allow for full recovery of the additional costs generated by general legislative changes.

63. A different situation arises when the concessionaire faces increased costs as a result of specific legislative changes that target the particular project, a class of similar projects or privately financed
infrastructure projects in general. Such changes cannot be regarded as an ordinary business risk and may significantly alter the economic and financial assumptions under which the project agreement was negotiated. Thus, the contracting authority often agrees to bear the additional cost resulting from specific legislation that targets the particular project, a class of similar projects or privately financed infrastructure projects in general. For example, in highways projects, legislation aimed at a specified road project or road operating company, or at that class of privately operated road projects, might result in a price adjustment under the relevant provisions in the project agreement.

2. Changes in economic conditions

64. Some legal systems have rules that allow a revision of the terms of the project agreement following changes in the economic or financial conditions that, without preventing the performance of a party's contractual obligations, render the performance of those obligations substantially more onerous than originally foreseen at the time they were entered into. In some legal systems, the possibility of a revision of the terms of the agreement is generally implied in all Government contracts, or is expressly provided for in the relevant legislation.

65. The financial and economic considerations for the concessionaire's investment are negotiated in the light of assumptions based on the circumstances prevailing at the time of the negotiations and the reasonable expectations of the parties as to how those circumstances will evolve during the life of the project. Given the long duration of infrastructure projects, the concessionaire will seek to negotiate mechanisms that provide some protection against the adverse financial and economic impact of extraordinary and unforeseen events that could not have been taken into account when the project agreement was negotiated or mechanisms that, had they been taken into account, would have resulted in a different risk allocation or consideration for the concessionaire's investment. As a consequence, revision rules have been applied in a number of countries and have been found useful to help the parties find equitable solutions for ensuring the continued economic and financial viability of infrastructure projects, thus averting a disruptive failure of performance by the concessionaire. However, revision rules may also have some disadvantages, particularly from the perspective of the Government.

66. As with general legislative changes, changes in economic conditions are risks to which most business organizations are exposed without having recourse to a general guarantee of the Government that would protect them against the economic and financial effects of those changes. An unqualified obligation of the contracting authority to compensate the concessionaire for changes of economic conditions may result in a reversion to the public sector of a substantial portion of the commercial risks originally allocated to the concessionaire and represent an open-ended financial liability. Furthermore, it should be noted that the proposed tariff level and the essential elements of risk allocation are important if not decisive factors in the selection of the concessionaire. An excessively generous recourse to renegotiation of the project may lead to unrealistically low proposals being submitted during the selection procedure in the expectation of tariff increases once the project has been awarded. Thus, the contracting authority may have an interest in establishing reasonable limits for statutory or contractual provisions authorizing revisions of the project agreement following changes in economic conditions.

67. It may be desirable to provide in the project agreement that a change in circumstances that justifies a revision of the project agreement must have been beyond the control of the concessionaire and of such a nature that the concessionaire could not reasonably be expected to have taken it into account at the time the project agreement was negotiated or to have avoided or overcome its consequences. For example, a tollroad operator holding an exclusive concession (see chap. IV, "The project agreement", ...) might not be expected to take into account and assume the risk of traffic shortfalls brought about by the subsequent opening of an alternative toll-free road by an entity other than the contracting authority. However, the concessionaire would normally be expected to take into account the possibility of reasonable labour cost increases over the life of the project. Thus, under normal circumstances, the fact that wages turned out to be higher than expected would not be sufficient reason for revising the project agreement.

68. It may also be desirable to provide in the project agreement that a request for revision of the project agreement requires that the alleged changes of economic and financial conditions amount to a certain minimum value in proportion to the total project cost or the concessionaire's revenue. Such a rule might be useful to avoid cumbersome adjustment negotiations for small changes until the changes have accumulated to comprise a significant figure. In some countries, there are rules that establish a ceiling for the cumulative amount of periodic revisions of the project agreement. The purpose of such rules is to avoid the misuse of the change mechanism as a means for achieving an overall financial balance that bears no relation to the one contemplated in the original project agreement. From the perspective of the concessionaire and the lenders, however, such limitations may represent a considerable risk exposure in the event, for instance, of dramatic cost increases resulting from an extraordinarily severe change of circumstances. Therefore, the desirability of introducing such a ceiling, and the appropriate amount, should be carefully considered.

G. EXEMPTION PROVISIONS

69. During the life of an infrastructure project, events may occur that impede the performance by a party of its contractual obligations. The events causing such impediment are typically outside either party’s control and may be of a physical nature, such as a natural disaster, or may be the
result of human action, such as war, riots or terrorist attacks. Many legal systems generally recognize that a party that fails to perform a contractual obligation because of the occurrence of certain types of events may be exempted from the consequences of such failure to perform.

1. Definition of exempting events

70. Exempting circumstances typically include occurrences beyond the control of a party that cause the party to be unable to perform its obligation and that the party has been unable to overcome by the exercise of due diligence. Common examples include the following: natural disasters (e.g. cyclones, floods, droughts, earthquakes, storms, fires or lightning); war (whether declared or not) or other military activity, including riots and civil disturbance; failure or sabotage of facilities, acts of terrorism, criminal damage or the threat of such acts; radioactive or chemical contamination or ionizing radiation; effects of the natural elements, including geological conditions that cannot be foreseen and resisted; and employees’ strikes of exceptional importance.

71. Some laws make only a general reference to exempting circumstances, whereas other laws contain extensive lists of circumstances that excuse the parties from performance under the project agreement. The latter technique may serve the purpose of ensuring a consistent treatment of the matter for all projects developed under the relevant legislation, thus avoiding situations where one concessionaire obtains a more favourable allocation of risks than that provided in other project agreements. However, it is important to consider the possible disadvantages of setting forth in statutory or regulatory provisions a list of events that are to be considered exempting impediments for all cases. There is a risk that the list might be incomplete, leaving out important impediments. Furthermore, certain natural disasters, such as storms, cyclones and floods, may be normal conditions at a particular time of the year at the project site. As such, those natural disasters may represent risks that any public service provider acting in the region would be expected to assume.

72. Another aspect that may need to be carefully considered is whether and to what extent certain acts of governmental agencies other than the contracting authority may constitute exempting impediments. The concessionaire may be required to secure a licence or other official approval for the performance of certain of its obligations. The project agreement might thus provide that, if the licence or approval is refused, or if it is granted but later withdrawn, because of the concessionaire’s own failure to meet the relevant criteria for the issuance of the licence or approval, cannot rely on the refusal as an exempting impediment. However, if the licence or approval is refused or withdrawn for extraneous or improper motives, it would be equitable to provide that the concessionaire may rely on the refusal as an exempting impediment. A further possibility of impediment might be an interruption of the project brought about by an organ of the Government other than the contracting authority, for instance, because of changes in governmental plans and policies that require the interruption or major revision of the project that affect substantially the original design. In such situations, it may be important to consider the institutional relationship between the contracting authority and the governmental agency that brings about the impediment as well as their degree of independence from one another. An event classified as an exempting impediment may in some cases amount to an outright breach of the project agreement by the contracting authority depending on whether the contracting authority could reasonably control or influence the acts of the other governmental agency.

73. In the light of the above, it is advisable to identify in the project agreement the circumstances that exempt either party from performance under that agreement, so as to give the parties the necessary freedom to find suitable arrangements. In order to avoid practical controversies, the project agreement should also clarify whether exempting circumstances produce automatic effects or whether their occurrence needs to be established by the parties using a special procedure.

2. Consequences for the parties

74. In some legal systems, the occurrence of an exempting circumstance suspends the execution of the project or the operation of the concession for the duration of the impediment. In other legal systems, the project agreement is not technically suspended, but if the circumstances are such that the concessionaire is rendered unable to comply with its obligations under the project agreement, such inability is not construed as being a breach of the project agreement. The main issues to be considered in connection with the occurrence of any exempting event are whether additional time is granted for the performance of the obligation, and which party bears the cost entailed by the delay or the cost of repairing damaged property.

75. During the construction phase, the occurrence of exempting circumstances usually justifies an extension of the time allowed for the completion of the facility. In that connection, it is important to consider the implications of any such extension for the overall duration of the project, particularly where the construction phase is taken into account for calculating the total concession period. Delays in the completion of the facility reduce the operational period and may adversely affect the global revenue estimates of the concessionaire and the lenders. It may therefore be advisable to consider under what circumstances it may be justified to extend the concession period so as to take into account possible extensions that occur during the construction phase. Lastly, it is advisable to provide that, if the event in question is of a permanent nature, the parties may have the option to terminate the project agreement (see also chap. VI, “End of project term, extension and termination”).
76. Another important question is whether the concessionaire will be entitled to compensation for revenue loss or property damage that results from the occurrence of exempting circumstances. The answer to that question is given by the risk allocation provided in the project agreement. Except for cases in which the Government provides some form of direct support (see chap. II, "Project risks and government support", ___), privately financed infrastructure projects are typically undertaken at the concessionaire's own risk, including the risk of losses that may result from natural disasters and other exempting circumstances, against which the concessionaire is usually required to procure adequate insurance coverage (see paras. 57 and 58). Thus, some laws expressly exclude any form of compensation to the concessionaire in the event of loss or damage that results from the occurrence of exempting circumstances. It does not necessarily follow, however, that an event qualified as an exempting circumstance may not, at the same time, justify a revision of the terms of the project agreement so as to restore its economic and financial balance (see also paras. 59-68).

77. However, a different type of risk allocation is sometimes contemplated for projects involving the construction of facilities that are permanently owned by the contracting authority or facilities that are required to be transferred to the contracting authority at the end of the project period. In some countries, the contracting authority is authorized to make arrangements for assisting the concessionaire to repair or rebuild infrastructure facilities damaged by natural disasters or similar occurrences defined in the project agreement, provided that the possibility of such assistance was contemplated in the request for proposals. Sometimes the contracting authority is authorized to agree to pay compensation to the concessionaire in case of an interruption of the work for more than a certain number of days up to a maximum time limit, if the interruption is caused by an event for which the concessionaire is not responsible.

78. Should the concessionaire become unable to perform because of any such impediment, and should the parties fail to achieve an acceptable revision of the contract, some national laws authorize the concessionaire to terminate the project agreement, without prejudice to the compensation that might be due under the circumstances (see chap. VI, "End of project term, extension and termination", ___).

79. Statutory and contractual provisions on exempting circumstances also need to be considered in the light of other rules governing the provision of the service concerned. The law in some legal systems requires public service providers to make best efforts to continue providing the service despite the occurrence of circumstances defined as contractual impediments (see paras. 23 and 24). In those cases, it is advisable to consider the extent to which such an obligation may reasonably be imposed on the concessionaire and what compensation may be due for the additional costs and hardship faced by it.

H. EVENTS OF DEFAULT AND REMEDIES

80. Generally, there is a wide range of remedies that the parties may agree on to deal with the consequences of default, culminating with termination. The present section discusses general considerations on events of default and remedies by either party (see paras. 81 and 82). It considers the legislative implication of certain types of remedies intended to rectify the causes of default and preserve the continuity of the project, in particular the intervention of the contracting authority (see paras. 83-86) or the substitution of the concessionaire (see paras. 87-91). The ultimate remedy of terminating the project agreement, and the consequences that result from termination, are discussed elsewhere in the Guide (see chap. VI, "End of project term, extension and termination", ___).

1. General considerations on failures to perform and remedies

81. The remedies for default by the concessionaire typically include those that are customary in construction or long-term services contracts such as forfeiture of guarantees, contractual penalties and liquidated damages. In most cases, such remedies are typically contractual in nature and do not give rise to significant legislative considerations. Nevertheless, it is important to establish adequate procedures for ascertaining failures and giving opportunity for rectifying such failures. In some countries, the imposition of contractual penalties requires findings of official inspections and other procedural steps, including the review of the contracting authority by senior officials prior to the imposition of more serious sanctions. Those procedures may be complemented by provisions distinguishing between defects that can be rectified and those that cannot, and setting down the corresponding procedures and remedies. It is usually advisable to require that the concessionaire be given notice requiring it to remedy the breach within a sufficient period. It may also be advisable to contemplate the payment of penalties or liquidated damages by the concessionaire in the event of breach to perform essential obligations and to clarify that no penalties apply in case of breach of secondary or ancillary obligations and for which other remedies may be obtained under national law. Furthermore, a performance monitoring system contemplating penalties or liquidated damages may be complemented by a scheme of bonuses payable to the concessionaire for improving over agreed terms.

82. While the contracting authority may protect itself against the consequences of default by the concessionaire through a variety of judicially enforceable contractual arrangements, the remedies available to the concessionaire may be subject to a number of limitations under the applicable law. Important limitations may

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For a discussion of remedies used in construction contracts for complex industrial works, see UNICITRAL Legal Guide on Drawing Up Contracts for the Construction of Industrial Works ..., chapter XVIII, "Delay, defects and other failures to perform".
derive from rules of law that recognize the immunity of governmental agencies from judicial suit and enforcement measures. Depending on the legal nature of the contracting authority or of other governmental agencies that assume obligations vis-à-vis the concessionaire, the latter may be deprived of the possibility of enforcing measures of execution to secure the fulfillment of obligations entered into by those public entities (see also chap. VII, "Settlement of disputes", ____.). This situation makes it the more important to provide mechanisms to protect the concessionaire against the consequences of default by the contracting authority, for example by means of governmental guarantees covering specific events of default or guarantees provided by third parties, such as multilateral lending institutions (see also chapter II, "Project risks and government support", ____). 

2. Step-in rights for the contracting authority

83. Some national laws expressly authorize the contracting authority to temporarily take over the operation of the facility, normally in case of failure to perform by the concessionaire, in particular where the contracting authority has a statutory duty to ensure the effective delivery at all times of the service concerned. In some legal systems, such a prerogative is considered to be inherent in most Government contracts and might be presumed to exist even without being expressly mentioned in legislation or in the project agreement.

84. It should be noted that the contracting authority's right to intervene, its "step-in right", is an extreme measure. Private investors may fear that the contracting authority may use it, or threaten to use it, in order to impose its own desires about the way in which the service is provided, or even to get control of the project assets. It is therefore advisable to define as clearly as possible the circumstances in which step-in rights can be exercised. It may be useful to clarify in the law that the contracting authority's intervention in the project is temporary and is intended to remedy a specific, urgent problem that the concessionaire has failed to remedy. The concessionaire should resume responsibility for service delivery once the emergency situation has been remedied. It is important to reserve the contracting authority's right to intervene to cases of severe failures of service and not merely in case of dissatisfaction about the concessionaire's performance.

85. The contracting authority's ability to step in may be limited in that it may be difficult immediately to identify and engage a subcontractor to carry out the actions that the contracting authority is stepping in to do. Furthermore, frequent interventions carry a risk of the reversion to the contracting authority of risks that have been transferred in the project agreement to the concessionaire. The concessionaire should not rely on the contracting authority to step in to deal with a particular risk instead of handling it itself, as required by the project agreement.

86. It is advisable to clarify in the project agreement which party bears the cost of an intervention by the contracting authority. In most cases, the concessionaire should bear the costs incurred by the contracting authority when the intervention is prompted by a performance failure attributable to the concessionaire's own fault. In some cases, to prevent disputes about liability and about the appropriate level of costs, the agreement may authorize the contracting authority to take steps to remedy the problem itself, and then charge the actual cost of having done so (including its own administrative costs) to the concessionaire. However, when such intervention takes place following the occurrence of an exempting impediment (see paras. 69-79), the parties might agree on a different solution, depending on how that particular risk has been allocated in the project agreement.

3. Step-in rights for the lenders and compulsory transfer of the concession

87. During the life of the project situations may arise where, because of default by the concessionaire or the occurrence of an extraordinary event outside of the concessionaire's control, it might be in the interest of the parties to avert termination of the project (see chap. VI, "End of project term, extension and termination", ____ ) by allowing the project to continue under the responsibility of a different concessionaire. The lenders, whose main security is the revenue generated by the project, are particularly concerned about the risk of interruption or termination of the project prior to repayment of the loans. In the event of default of or an impediment affecting the concessionaire, the lenders will be interested in ensuring that the work will not be left incomplete and that the concession will be operated profitably. The contracting authority, too, may be interested in allowing the project to be carried out by a new concessionaire, as an alternative for having to take it over and continue it under its own responsibility.

88. Clauses allowing the lenders to select, with the consent of the contracting authority, a new concessionaire to perform under the existing project agreement have been included in a number of recent agreements for large infrastructure projects. Such clauses are typically supplemented by a direct agreement between the contracting authority and the lenders who are providing finance to the concessionaire. The main purpose of such a direct agreement is to allow the lenders to avert termination by the contracting authority when the concessionaire is in default by substituting a concessionaire that will continue to perform under the project agreement in place of the concessionaire in default. Unlike the contracting authority's right to intervene, which relates to a specific, temporary and urgent failure of the service, lenders' step-in rights are for cases where the concessionaire's failure to provide the service is recurrent or apparently irremediable.

89. In the experience of countries that have recently made use of such direct agreements, it has been found
that the ability to head off termination and provide an alternative concessionaire gives the lenders additional security against default by the concessionaire. At the same time, it provides the contracting authority an opportunity to avoid the disruption entailed by terminating the project agreement, thus maintaining continuity of service. In countries where the lenders may obtain a security interest over the entirety of the concessionaire’s rights and interests under the project agreement (see chap. IV, “The project agreement”, __), there may be an implied step-in right, whenever a particular situation constitutes an event of default under the loan agreements.

90. However, in some countries, the implementation of such clauses may face difficulties in the absence of legislative authorization. The concessionaire’s inability to carry out its obligations is usually a ground for the contracting authority to take over the operation of the facility or terminate the agreement (see chap. VI, “End of project term, extension and termination”, __). For the purpose of selecting a new concessionaire to succeed the defaulting one, the contracting authority often needs to follow the same procedures that applied to the selection of the original concessionaire, and it might not be possible for the contracting authority to agree in consultation with the lenders on engaging a new concessionaire that has not been selected pursuant to those procedures. On the other hand, even where the contracting authority is authorized to negotiate with a new concessionaire under emergency conditions, a new project agreement might need to be entered into with the new concessionaire and there may be limitations for its ability to assume obligations of its predecessor.

91. Therefore, it may be useful to acknowledge in the law the contracting authority’s right to enter into agreements with the lenders allowing them to appoint a new concessionaire to perform under the existing project agreement, when the concessionaire seriously fails to deliver the service required under the project agreement, or following the occurrence of other specified events that could justify the termination of the project agreement. The agreement between the contracting authority and the lenders should, inter alia, specify the following: the circumstances in which the lenders are permitted to substitute a new concessionaire; the procedures for the substitution of the concessionaire; the grounds for refusal by the contracting authority of a proposed substitute; and the obligations of the lenders to maintain the service at the same standards and on the same terms as required by the project agreement.
**LEGISLATIVE RECOMMENDATIONS**

1. The host country may wish to provide that the project agreement may be extended under exceptional circumstances, such as:
   
   (a) To compensate for project suspension or loss of profit due to the occurrence of impeding events;
   
   (b) To compensate for project suspension brought about by acts of the contracting authority or other government agencies;
   
   (c) To allow the concessionaire to recover the cost of extraordinary work required on the facility and which the concessionaire would not be able to amortize during the normal term of the project agreement without unreasonable tariff increase.

2. **Termination by the contracting authority**  
   (see paras. 10-23)

   2. The host country may wish to provide that the contracting authority may terminate the project agreement:
      
      (a) In the event of serious default by the concessionaire, in the circumstances provided in the project agreement, in particular if it can no longer be reasonably expected that the concessionaire will be able or willing to perform its obligations;
      
      (b) In the event that the concessionaire is declared insolvent or bankrupt;
      
      (c) For the contracting authority’s convenience, subject to payment of fair compensation to the concessionaire.

3. The host country may wish to provide that before terminating the project agreement the contracting authority should, as appropriate:

   (a) Grant the concessionaire an additional period of time to perform the obligation or remedy the consequences of its default;
   
   (b) Give notice to the concessionaire’s lenders and sureties, as appropriate, to remedy the consequences of the concessionaire’s default within a reasonable time or to appoint a substitute concessionaire under the terms of their agreements with the contracting authority.

4. **Termination by the concessionaire**  
   (see paras. 24-29)

4. The host country may wish to provide that the concessionaire may terminate the project agreement:

   (a) In the event of serious default by the contracting authority or other agency of the host Government as regards the fulfilment of their obligations under the project agreement;
   
   (b) In the event that the concessionaire’s performance is rendered substantially more onerous as a result of variation orders made by the contracting authority or unforeseen changes in conditions and that the parties have failed to agree on an appropriate revision of the project agreement.

5. **Termination by either party**  
   (see paras. 30 and 31)

5. The host country may wish to provide that the project agreement may also be terminated:

   (a) In the event that the performance by either party is rendered impossible by the occurrence of exempting impediments;
   
   (b) By mutual consent.

6. **Transfer of assets to the contracting authority**  
   (see paras. 34 and 35)

6. The host country may wish to provide that the project agreement should:

   (a) Identify the categories of assets that the concessionaire is required to transfer to the contracting authority upon expiry or termination of the project agreement and lay down the criteria for establishing, as appropriate, the compensation to which the concessionaire may be entitled in that respect;
   
   (b) Identify the categories of assets that the contracting authority, at its option, may purchase from the concessionaire against payment of their fair market value;
   
   (c) Identify the categories of assets that the concessionaire may freely remove or dispose of upon expiry or termination of the project agreement.

7. **Transfer of assets to a new concessionaire**  
   (see para. 36)

7. The host country may wish to provide that the concessionaire may be required to make any of the assets referred to in subparagraphs 6 (a) and (b) above available to a new concessionaire against adequate compensation for those assets which have not been fully amortized during the project period.

8. **Financial arrangements upon termination**  
   (see paras. 39-45)

8. The host country may wish to provide that the project agreement should stipulate how compensation due to the concessionaire in the event of termination of the project agreement is to be calculated, including:

   (a) Compensation for the fair value of works performed under the project agreement if the project agreement is terminated for reasons attributable to the concessionaire;
   
   (b) Compensation for the fair value of the works performed by as well as for the loss caused to the concessionaire, including lost profits, if the project
agreement is terminated for reasons attributable to the contracting authority;

(c) Compensation for the fair value of the works performed by the concessionaire and other compensation that may be appropriate in the circumstances, if the project agreement is terminated due to the occurrence of exempting impediments or for the contracting authority’s convenience.

(8) Wind-up and transitional measures (see paras. 46-58)

9. The host country may wish to provide that the project agreement should set out the rights and obligations of the parties with respect to:

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

(b) The training of the contracting authority’s personnel in the operation and maintenance of the facility;

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

NOTES ON LEGISLATIVE RECOMMENDATIONS

A. GENERAL REMARKS

1. Most privately financed infrastructure projects are undertaken for a certain period, at the end of which the concessionaire transfers to the contracting authority responsibility for the operation of the infrastructure facility. The elements to be taken into account when establishing the concession period have been considered elsewhere in the Guide (see chap. IV, “The project agreement”, __). This chapter deals with issues arising in connection with the expiry or termination of the project agreement, which in many countries have been addressed in statutory provisions. Section B deals with the question of whether and under what circumstances the project agreement may be extended (see paras. 2-4). Section C considers circumstances that may authorize the termination of the project agreement prior to the expiry of its term (see paras. 5-31). Lastly, section D deals with the consequences of the expiry or termination of the project agreement, including the transfer of project assets and the compensation to which either party may be entitled upon termination and provisions for the wind-up of the project (see paras. 32-58).

B. EXTENSION OF THE PROJECT AGREEMENT

2. In the contracting practice of some countries, the contracting authority and the concessionaire may agree on one or more extensions of the concession period. More often, however, domestic laws only authorize an extension of the project agreement under exceptional circumstances. In this case, upon expiry of the project agreement the contracting authority is normally required to begin a new selection process to select a new concessionaire, normally using the same procedures applied to select the concessionaire whose concession has expired (see chap. III, “Selection of the concessionaire”, __).

3. A number of countries have found it useful to require that exclusive concessions be rebid from time to time rather than freely extended by the parties. Periodic rebidding may give the concessionaire strong performance incentives. The period between the initial award and the first (and subsequent) rebidding should take into account the level of investment and other risks faced by the concessionaire. For example, for solid waste collection concessions not requiring heavy fixed investments, the periodicity may be relatively short (e.g. three to five years), whereas longer periods may be desirable for power or water distribution concessions, for example. In most countries, rebidding coincides with the end of the project term, but in others a concession may be granted for a long period (e.g. 99 years), with periodic rebidding (e.g. every 10 or 15 years). In the latter mechanism, which has been adopted in a few countries, the first rebidding occurs before the concessionaire has fully recouped its investments. As an incentive to the incumbent operator, some laws provide that the concessionaire may be given preference over other bidders in the award of subsequent concessions for the same activity. However, the concessionaire may have property rights that will need to be compensated for if it does not win the next bidding round, in which case all or part of the bidding proceeds may revert to the incumbent concessionaire. Requiring that the winning bidder should pay off the incumbent concessionaire for its property rights and for the investment not yet recovered reduces the longer-term risk faced by investors and lenders and provides them a valuable exit option.

4. Notwithstanding the above, it is advisable not to exclude entirely the option to negotiate an extension of the concession period under exceptional circumstances. The duration of an infrastructure project is one of the main factors taken into account in the negotiation of financial arrangements and has a direct impact on the price of the services provided by the concessionaire. The parties may find that an extension of the project agreement (as a substitute for, or combined with, other compensation mechanisms) may be a useful option to deal with unexpected or extraordinary circumstances arising during the life of the project. Such circumstances may include any of the following: extension to compensate for project suspension or loss of profit due to the occurrence of impeding events (see chap. V, “Infrastructure development and operation”, __); extension to compensate for project suspension brought about by the contracting authority or other government agencies (see chap. V, “Infrastructure development and operation”, __); or extension to allow the concessionaire to recover the cost of extraordinary work required to be done on the facility and which the concessionaire would not be able to amortize during the normal term of the project agreement without unreasonable tariff increases (see chap. V, “Infrastructure devel-
C. TERMINATION

5. The grounds for termination of the project agreement before the expiry of its term and the consequences of early termination are often dealt with in domestic legislation. Usually the law authorizes the parties to terminate the project agreement following the occurrence of certain types of event. The main interest of all parties involved in a privately financed infrastructure project is to ensure the satisfactory completion of the facility and the continuous and orderly provision of the relevant public service. Given the serious consequences of termination, as provision of the service may be interrupted or even discontinued, termination should under most circumstances be regarded as a measure of last resort. The conditions for the exercise of this right by either party should be carefully considered. While they may not need to be identical, it is generally desirable to achieve a broadly equitable balance of rights and conditions regarding termination for both parties.

6. In addition to identifying the circumstances or types of event that may give rise to a termination right, it is advisable for the parties to consider appropriate procedures to establish whether there are valid grounds for terminating the project agreement. Of particular importance is the question whether the project agreement may be unilaterally terminated or whether termination requires a decision by a judicial or other dispute settlement body (see chap. VIII, "Settlement of disputes", __).

7. The concessionaire is usually not allowed the right to terminate the project agreement unilaterally, but in the general contracting practice of some countries such a right may be exercised by government agencies, subject to payment of compensation. In some countries, however, an exception is made in the case of public services concessions, whose contractual nature is found to be incompatible with unilateral termination rights. Lastly, some legal systems do not recognize unilateral termination rights for government agencies. The contracting authority may find that a unilateral termination right is a powerful tool to encourage performance by the concessionaire. It may also find that unilateral termination rights save time in taking the necessary measures to ensure the continuity of the service upon irremediable default by the concessionaire. However, project sponsors and lenders would be concerned about the risk of premature or unjustified termination by the contracting authority, even where a decision to terminate might be subject to review through the dispute settlement mechanism. It should also be noted that giving the contracting authority the unilateral right to terminate the project agreement would not be an adequate substitute for well-designed contractual mechanisms of performance monitoring or for appropriate guarantees of performance (see chap. V, "Infrastructure development and operation", __).

8. Provisions concerning termination should therefore be brought into line with the remedies for default provided in the project agreement. In particular, it is useful to distinguish the conditions for termination from those for step-in by the contracting authority (see chap. V, "Infrastructure development and operation", __). It is also important to consider the contracting authority’s termination rights against the background of the financing agreements negotiated by the concessionaire with its lenders. In most cases, events that may lead to the termination of the project agreement would also constitute events of default under the loan agreements, with the consequence that the entire outstanding debt of the concessionaire may fall due immediately. It would thus be useful to attempt to avoid the risk of termination by recourse first to a direct agreement, which would allow the lenders to substitute another concessionaire when termination of the project agreement with the original concessionaire appears imminent (see chap. V, "Infrastructure development and operation", __).

9. In the light of the above, it is generally advisable to provide that the termination of the project agreement should in most cases require a final finding by the dispute settlement body stipulated in the agreement. Such a requirement would reduce concerns about premature or unjustified recourse to termination. At the same time, it would not preclude the taking of appropriate measures to ensure the continuity of the service, pending the final decision of the dispute settlement body, as long as contractual remedies for default, such as step-in rights for the contracting authority and the lenders, are provided in the project agreement.

1. Termination by the contracting authority

10. The contracting authority’s termination rights usually relate to three categories of circumstances: serious default by the concessionaire; insolvency or bankruptcy of the concessionaire; and termination for the contracting authority’s convenience.

(a) Serious default by the concessionaire

11. A number of national laws give the contracting authority the right to terminate the project agreement in the event of default by the concessionaire. Because of the disruptive effects of termination and in the interest of preserving the continuity of the service, it is not advisable to regard termination as a sanction for each and every instance of unsatisfactory performance by the concessionaire. On the contrary, it is generally advisable to resort to the extreme remedy of termination only in cases of “particularly serious” or “repeated” failures to perform, especially when it can no longer be reasonably expected that the concessionaire will be able or willing to perform under the project agreement. Many legal systems use specific technical expressions to refer to situations where the degree of default by one con-
tracting party is of such a nature that the other party may terminate their contractual relation before the expiry of its term (e.g. "fundamental breach", "material breach" or similar expressions). Such situations are referred to in the Guide as "serious default".

12. Circumscribing the possibility of termination to cases of serious default may give assurance to lenders and project sponsors that they will be protected against unreasonable or premature decisions by the contracting authority. The law may generally provide for the contracting authority’s right to terminate the project agreement upon serious default by the concessionaire and leave it for the project agreement to define further the notion of serious default and, as appropriate, provide illustrative examples of it. From a practical point of view, it is not advisable to attempt, by statute or in the project agreement, to provide an exhaustive list of the events that justify termination.

13. As a general rule, it is desirable that the concessionaire be granted an additional period of time to fulfil its obligations and to parry the consequences of its default prior to the contracting authority’s resorting to remedies. For example, the concessionaire should be given notice specifying the nature of the relevant circumstances and requiring it to rectify them within a certain period. The possibility should also be given for the lenders and sureties, as the case may be, to parry the consequences of the concessionaire’s default in accordance with the terms of a direct agreement between the lenders and the contracting authority or the terms of the performance bonds provided to the contracting authority (see chap. V, "Infrastructure development and operation", __). The project agreement may also provide that, if the circumstances are not rectified before the expiry of the relevant period, the contracting authority may then terminate the project agreement, subject to first notifying the lenders and giving them an opportunity to exercise their right of substitution within a certain period in accordance with the relevant procedure provided in the direct agreement. However, reasonable deadlines need to be set, since the contracting authority cannot be expected to bear indefinitely the continuing cost of a situation of potential breach of agreement by the concessionaire. Furthermore, the procedures should be without prejudice to the contracting authority’s right to step in to avert the risk of disruption of service by the concessionaire (see chap. V, "Infrastructure development and operation", __).

(i) Serious default before the beginning of construction

14. The concessionaire typically needs to accomplish a series of steps prior to undertaking construction works. Such requirements are often conceived as conditions to the entry into force of the project agreement. Examples of events that often justify the withdrawal of the concession at an early stage include the following:

(a) Failure to secure the required financial means, to sign the project agreement or to establish the project company within the established deadline;

(b) Failure to obtain licences or permits required for pursuing the activity that is the object of the concession;

(c) Failure to undertake the construction of the facility, to commence development of the project or to submit the plans and designs required within a set period of time from the award of the concession.

15. Termination should in principle be reserved for situations where the contracting authority may no longer reasonably expect that the selected concessionaire will take the necessary measures to commence execution of the project. In that connection, it is important for the contracting authority to take into account any circumstances that may excuse the concessionaire’s delay in fulfilling its obligations. Furthermore, the concessionaire should not suffer the consequences of inaction or error on the part of the contracting authority or other government agencies. For instance, the termination of the project agreement would not normally be justified if the concessionaire’s failure to obtain government licences and permits within the agreed schedule was not attributable to the concessionaire’s own fault.

(ii) Serious default during the construction phase

16. Examples of events that may justify the termination of the project agreement during the construction phase include the following:

(a) Failure to observe building regulations, specifications or minimum design and performance standards and non-excusable failure to complete work within the agreed schedule;

(b) Failure to provide or renew the required guarantees in the agreed terms;

(c) Violation of essential statutory or contractual obligations, as provided in the project agreement.

17. Termination should be commensurate with the degree of default by the concessionaire and the consequences of default for the contracting authority. For instance, the contracting authority may have a legitimate interest in specifying a date when the construction must be completed and may therefore be justified in regarding a delay in completion as an event of default and hence a ground for termination. However, delay alone, in particular if it is not excessive in relation to the specifications of the project agreement, should not be sufficient reason for termination when the contracting authority is otherwise satisfied of the concessionaire’s ability to complete the construction in accordance with the required quality standards and its commitment to doing so.

(iii) Serious default during the operational phase

18. Examples of particular instances of default that may justify the termination of the concession during the operational phase include any of the following:
(a) Serious failure to provide services in accordance with the statutory and contractual standards of quality;

(b) Non-excusable suspension or interruption of the provision of the service without prior consent from the contracting authority;

(c) Serious failure by the concessionaire to maintain the facility, its equipment and appurtenances in accordance with the agreed standards of quality or non-excusable delay in carrying out maintenance works in accordance with the agreed plans, schedules and timetables;

(d) Disregard of price control measures, if any, or other serious violation of rules, regulations or contractual provisions governing the provision of the service;

(e) Failure to comply with sanctions imposed by the contracting authority or the regulatory body, as appropriate, for infringements of the concessionaire’s duties.

19. For the purpose of enhancing transparency and integrity in governmental matters, the laws of some countries also provide for the termination of project agreements if the concessionaire is guilty of tax fraud or other types of fraudulent acts, or if its agents or employees are involved in bribery of public officials and other corrupt practices (see also chap. VII, “Governing law”, __). In such cases it may be advisable to consider the extent to which the concessionaire actually initiates any such corrupt acts in order to influence the decisions of public officials in the concessionaire’s favour or whether illegal payments are made following irresistible demands or threats by officials of the host country (a crime sometimes referred to as “extortion”).

(b) Insolvency of the concessionaire

20. Infrastructure services typically need to be provided continuously and for that reason most domestic laws stipulate that the agreement may be terminated if the concessionaire is declared insolvent or bankrupt. In order to ensure the continuity of the service, the assets and property required to be handed over to the contracting authority may be excluded from the insolvency proceedings and the law may require prior governmental approval for any act of disposition by a liquidator or insolvency administrator of any categories of assets owned by the concessionaire.

21. In legal systems that allow the establishment of security interests over the concession itself (see chap. IV, “The project agreement”, __), the law usually provides that the contracting authority may, in consultation with the secured creditors, appoint a temporary administrator so as to ensure the continued provision of the relevant service, until the secured creditors admitted to the insolvency proceedings decide, upon the recommendation of the insolvency administrator, whether the activity should be pursued or whether the right to exploit the concession should be put to auction.

(c) Termination for convenience

22. In the contracting practice of some countries, government agencies procuring construction works traditionally retain the right to terminate the construction contract for convenience (i.e. without having to provide any justification other than that the termination is in the Government’s interest). In some common law jurisdictions, that right can only be exercised if expressly provided for in a statute or in the relevant contract. Several legal systems belonging to the civil law tradition also recognize a similar power of government agencies to terminate contracts for reasons of “public interest” or “general interest”. In some countries, such a right may be implied in the Government’s contracting authority, even in the absence of an explicit statutory or contractual provision to that effect. In so far as the authority to determine what constitutes public interest may lie within the Government’s discretion, an unqualified right to terminate for reasons of public interest is comparable to a termination for the contracting authority’s convenience. The Government’s right to terminate for convenience or for reasons of public interest, in those legal systems which recognize it, is regarded as essential in order to preserve the Government’s unfettered ability to exercise its functions affecting the public good.

23. Nevertheless, the conditions for the exercise of this right, and the consequences of doing so, should be carefully considered. A general and unqualified right to terminate for the contracting authority’s convenience may represent an imponderable risk that neither the concessionaire nor the lenders may be ready to accept without sufficient guarantees that they will receive prompt and fair compensation for loss sustained. The possibility of termination for convenience, where contemplated, should therefore be made known to prospective investors at the earliest possible occasion and should be expressly mentioned in the draft project agreement circulated with the request for proposals (see chap. III, “Selection of the concessionaire”, __). The compensation due for termination for convenience may, in practice, cover items that are taken into account when calculating the compensation that is due for termination for serious default by the contracting authority (see para. 42). Furthermore, it is generally advisable to limit the exercise of the right of termination for convenience to exceptional situations where a compelling reason of public interest requires the termination of the project agreement (for example, where subsequent changes in governmental plans and policies require the integration of a project into a larger network or where changes in the contracting authority’s plans require major project revisions that substantially affect the original design or the project’s commercial feasibility under private operation). In particular, it is not advisable to regard the right of termination for convenience as a substitute for other contractual remedies in case of dissatisfaction with the concessionaire’s performance (see chap. V, “Infrastructure development and operation”, __).

2. Termination by the concessionaire

24. While the contracting authority in some legal systems may retain an unqualified right to terminate the project agreement, the grounds for termination by the concessionaire are usually limited to serious default by
the contracting authority or other exceptional situations and do not normally include a general right to terminate the project agreement at will.

(a) Serious default by the contracting authority

25. Pursuant to a rule of law followed in many legal systems, a party to a contract may withhold performance of its obligations in the event of breach by the other party. In some legal systems that rule does not apply to government contracts, however, and the law provides instead that government contractors are not excused from performing solely on the ground of breach by the contracting authority unless and until the contract is rescinded by a judicial or arbitral decision. Rules of this type may be intended to ensure the continuity of public services (see chap. V, “Infrastructure development and operation”, __).  

26. It should be noted, however, that while the contracting authority may mitigate the consequences of default by the concessionaire by using its right to step in, the concessionaire does not usually have a comparable remedy. In the event of serious default by the contracting authority, the concessionaire may sustain considerable or even irreparable damage, depending on the time required to obtain a final decision releasing the concessionaire from its obligations under the project agreement. These circumstances underscore the importance of government guarantees in respect of obligations assumed by contracting authorities (see chap. II, “Government support”, __) and the need for allowing the parties the choice of expeditious and effective dispute settlement mechanisms (see chap. VIII, “Settlement of disputes”, __).  

27. In those legal systems where the contracting authority has the right to request modifications in the project, some laws give the concessionaire the right to terminate the project agreement if the contracting authority alters or modifies the original project in such a fashion as to cause a substantial increase in the amount of investment required and the parties fail to agree on the appropriate amount of compensation (see chap. V, “Infrastructure development and operation”, __).  

28. In addition to serious default by the contracting authority itself, it may be equitable to authorize termination by the concessionaire should the latter be rendered unable to provide the service as a result of acts of government agencies other than the contracting authority, such as failure to provide certain measures of support required for the execution of the project agreement (see chap. II, “Government support”, __).  

(b) Changes in conditions

29. Some legal systems allow the concessionaire to terminate the project agreement if the concessionaire’s performance has been rendered substantially more onerous by the occurrence of an unforeseen change in conditions and the parties have failed to agree on an appro-

3. Termination by either party

(a) Impediment of performance

30. Some laws provide that the parties may terminate the project agreement if the performance of their obligations is rendered permanently impossible as a result of a circumstance defined in the project agreement as an exempting impediment (see chap. V, “Infrastructure development and operation”, __). In that connection, it is advisable to provide in the project agreement that if the exempting impediment persists for a specified amount of time or if the cumulative duration of two or more exempting impediments exceeds a specified amount of time, the contract may be terminated by either party. If the execution of the project is further rendered impossible on legal grounds, for instance, because of changes in legislation or as a result of judicial decisions affecting the validity of the project agreement, such a termination right might not require any specified amount of time to elapse and might be exercised immediately upon the change of legislation or other legal obstacle becoming effective.

(b) Mutual consent

31. Lastly, some legal systems authorize the parties to terminate the project agreement by mutual consent, usually subject to the approval of a specified authority of the Government.

D. CONSEQUENCES OF EXPIRY OR TERMINATION OF THE PROJECT AGREEMENT

32. The concessionaire’s right to operate the facility and to provide the relevant service typically finishes upon expiry of the project term or termination of the project agreement. This often requires the transfer of assets to the contracting authority or to another concessionaire who undertakes to operate the facility (see paras. 33-38). There may be important financial consequences that will need to be regulated in detail in the project agreement, in particular in the event of termination by either party (see paras. 39-45). The parties will also need to agree on various wind-up measures to ensure the orderly transfer of the responsibility for operating the facility and providing the service (see paras. 46-58).

1. Transfer of project-related assets

33. A number of laws provide that, upon termination of the concession, the assets and property originally made available to the concessionaire and other goods related to the project should revert to the contracting authority.
However, there may be projects where the concessionaire is not required to hand over the assets to the contracting authority, for instance, because it owns those assets or because the assets are transferred directly from the concessionaire to another concessionaire who succeeds it in the provision of the service.

(a) Transfer of assets to the contracting authority

34. The laws of some countries place particular emphasis on the contracting authority’s interest in the physical assets related to the project and generally require the handover to the contracting authority of all of them, whereas in other countries privately financed infrastructure projects are regarded primarily as a means for procuring services over a specified period, rather than for the construction of assets. Thus, the laws of the latter countries limit the concessionaire’s handover obligations to particular categories of assets deemed to be necessary for ensuring the provision of the service. This difference in legislative approaches often reflects the varying role of the public and private sectors under different legal and economic systems, but may also be the result of practical considerations on the part of the contracting authority.

35. One practical reason for the contracting authority to allow the concessionaire to retain certain assets at the end of the project period may be the desire to lower the cost at which the service would be provided. If the project assets are likely to have a residual value for the concessionaire and that value can be taken into account during the selection process, the contracting authority may expect that the price charged for the service will be lower. Indeed, if the concessionaire does not expect to have to cover the entire cost of the assets in the life of the project, but can cover part of it by selling them on, or using them for other purposes, after the project agreement expires, there is a possibility that the service may be provided at a lower cost than if the concessionaire had to cover all the costs in the life of the project. Moreover, certain assets may require such extensive refurbishing or technological upgrading at the end of the project period that it might not be cost-effective for the contracting authority to claim them. There may also be residual liabilities or consequential costs, for instance, because of liability for environmental damage or demolition costs. For these reasons, therefore, the laws of some countries do not contemplate an unqualified transfer of all assets to the contracting authority, but allow a distinction between three main categories of assets:

(a) Assets that must be transferred to the contracting authority. This category typically includes assets owned by the contracting authority or other agency of the host Government that were used by the concessionaire to provide the service concerned. They may include both facilities made available to the concessionaire by the contracting authority and new facilities built by the concessionaire pursuant to the project agreement. Some laws also require the transfer of assets, goods and property subsequently acquired by the concessionaire for the purpose of operating the facility, in particular where they become part of, or are permanently affixed to, the infrastructure facility to be handed over to the contracting authority. In the legal tradition of some countries, at the end of the project term, the concessionaire is required to transfer such assets free of any liens and encumbrances and at no cost to the contracting authority, except for compensation for improvements made to, or modernization of, the property for the purpose of ensuring the continuity of the service the cost of which has not yet been recovered by the concessionaire. In practice, such a rule presupposes the negotiation of a concession period sufficiently long and a level of revenue high enough for the concessionaire to fully amortize its investment and repay its debt. Other laws allow for more flexibility by authorizing the contracting authority to compensate the concessionaire for the residual value, if any, of assets built by the concessionaire;

(b) Assets that may be purchased by the contracting authority, at its option. This category usually includes assets originally owned by the concessionaire, or subsequently acquired by it, which, without being indispensable or strictly necessary for the provision of the service, may enhance the convenience or efficiency of operating the facility or the quality of the service. If the contracting authority decides to exercise its option to purchase those assets, the concessionaire is normally entitled to compensation corresponding to their fair market value at the time. However, if those assets were expected to be fully amortized (i.e. the concessionaire’s financing arrangements do not envisage any expectation of residual value of the assets), then the price paid might be only nominal. In the contracting practice of some countries, it is usual for contracting authorities to retain some security interest in such assets (such as a retention right), as a guarantee for their effective transfer;

(c) Assets that remain the private property of the concessionaire. These are assets owned by the concessionaire that do not fall under (b) above. Typically the contracting authority is not entitled to such assets, which may be freely removed or disposed of by the concessionaire.

(b) Transfer of assets to a new concessionaire

36. As indicated earlier, the contracting authority may wish to rebid the concession at the end of the project agreement, rather than to operate the facility itself (see para. 3). For that purpose, it may be useful for the law to require the concessionaire to make the assets available to a new concessionaire. In order to ensure an orderly transition and continuity of the service, the concessionaire should be required to cooperate with the new concessionaire in the handover. The transfer of assets between the concessionaires may require that some compensation be paid to the incumbent concessionaire, depending on whether or not the assets have been amortized during the life of the project:

(a) Compensation at fair market value. The concessionaire may be entitled to compensation for assets handed over to a successor concessionaire, in par-
2. Financial arrangements upon termination

39. The early termination of the project agreement may occur before the concessionaire has been able to recover its investment, repay its debt and yield the expected profit, which may cause significant loss to the concessionaire. Loss may also be sustained by the contracting authority, which may need to make additional investment or incur considerable expense in order, for instance, to ensure the completion of the facility or the continued provision of the relevant services. In the light of these circumstances, project agreements typically contain extensive provisions dealing with the financial rights and obligations of the parties upon termination. The usual standards of compensation typically vary according to the various grounds for termination. Nevertheless, when negotiating compensation arrangements, the parties usually take into account the following factors:

(a) Outstanding debt, equity investment and anticipated profit. Project termination is typically included among the events of default in the concessionaire’s loan agreements. Since loan agreements usually include a so-called “acceleration clause” whereby the entire debt may become due upon the occurrence of an event of default, the immediate loss sustained by the concessionaire upon termination of the project agreement may include the amount of debt then outstanding. Whether and to what extent such a loss might be compensated for by the contracting authority usually depends on the grounds for terminating the project agreement. Partial compensation may be limited to an amount corresponding to the value of works satisfactorily performed by the concessionaire, whereas full compensation may cover the entire outstanding debt. Another category of loss that is sometimes taken into account in compensation arrangements refers to loss of equity investment by the project sponsors, to the extent that such an investment has not yet been recovered at the time of termination. Lastly, termination also deprives the concessionaire of future profits that the facility may generate. Although lost profits are not usually regarded as actual damage, in exceptional circumstances, such as wrongful termination by the contracting authority, the current value of expected future profit may be included in the compensation due to the concessionaire;

(b) Degree of completion, residual value and amortization of assets. Contractual compensation schemes for various termination grounds typically include compensation commensurate with the degree of completion of the works at the time of termination. The value of the works is usually determined on the basis of the investment required for its construction (in particular if the termination takes place during the construction phase) or the “residual” value of the facility. The residual value means the market value of the infrastructure at the time of termination. Market value may be difficult to determine or even non-existent for certain types of physical infrastructure (such as bridges or roads) or for facilities whose operational life is close to expiry. Sometimes the residual value may be estimated taking into account the expected usefulness of the facility for the contracting authority. However, difficulties may be found in establishing the value of unfinished works, in particular if the

c. Condition of assets at the time of transfer

37. Where assets are handed over to the contracting authority or transferred directly to a new concessionaire, the concessionaire is typically obligated to transfer them in good and operating condition, free of liens or encumbrances. The contracting authority’s right to receive those assets in such operating condition is complemented in some laws by the obligation imposed upon the concessionaire to keep and transfer the project in such proper condition as prudent maintenance requires and to provide some sort of guarantee to that effect (see chap. V, “Infrastructure development and operation”, __). Where the contracting authority requires the assets to be returned in a prescribed condition, the required conditions should be reasonable. While it may be reasonable for the contracting authority to require that the assets have some defined period of residual life, it would not be reasonable to expect them to be as new.

38. It is advisable to devise procedures for ascertaining the condition of the assets that should be transferred to the contracting authority. It may be useful, for example, to establish a committee comprised of representatives of both the contracting authority and the concessionaire to establish whether the facilities are in the prescribed condition and conform to the relevant requirements set forth in the project agreement. The project agreement may also provide for the appointment and terms of reference of such a committee, which may be given authority to request reasonable measures by the concessionaire to repair or eliminate any defects and deficiencies found in the facilities. It may be advisable to provide for a special inspection to take place one year prior to the termination of the concession, following which the contracting authority may require additional maintenance measures by the concessionaire so as to ensure that the goods are in proper condition at the time of the transfer. The contracting authority may wish to require that the concessionaire provide special guarantees for the satisfactory handover of the facilities (see chap. V, “Infrastructure development and operation”, __). The contracting authority might draw on such guarantees to pay the repair cost of damaged assets or property.
amount of the investment still required by the contracting authority to render the facility operational would exceed the amount actually invested by the concessionaire. In any event, full payment of residual value seldom takes place, in particular where the project’s revenue constitutes the sole remuneration for the concessionaire’s investment. Thus, instead of full compensation for the facility’s value, the concessionaire often receives compensation only for the residual value of assets that have not yet been fully amortized at the time of termination. The notion of economic “amortization”, in this context, refers to the gradual charging of the investment made against project revenue on the assumption that the facility would have no residual value at the end of the project term.

(c) Assets that remain the private property of the concessionaire. Where the project agreement does not provide for the handover of assets at the end of the concession period and alternative suppliers of the service can easily be found, the contracting authority may not have an interest in taking over the concessionaire’s assets. However, where the contracting authority finds it necessary to take over the assets, even though not contemplated in the project agreement, it would be equitable to compensate the concessionaire for the fair market value of the assets. The project agreement may, however, provide that the compensation should be reduced by the amount incurred by the contracting authority in obtaining alternative service.

(a) Termination due to default by the concessionaire

40. The concessionaire is not usually entitled to damages in the event of termination due to its own default. In some cases the concessionaire may even be under an obligation to pay damages to the contracting authority, although, in practice, a defaulting concessionaire whose debts are declared due by its creditors would seldom have sufficient financial means left for actually paying such damages.

41. Termination due to default, even where it is regarded as a sanction for serious performance failures, should not result in the unjust enrichment of either party. Thus, termination does not necessarily entail a right for the contracting authority to take over assets without making any payment to the concessionaire. An equitable solution for dealing with this issue may be to distinguish between the different types of asset, according to the arrangements envisaged for them in the project agreement (see para. 35):

(a) Assets that must be transferred to the contracting authority. Where the project agreement requires the automatic transfer of project assets to the contracting authority at the end of the project agreement, termination on default does not usually entail the payment of compensation to the concessionaire for those assets, except for the residual value of work satisfactorily performed, to the extent that it has not yet been amortized by the concessionaire;

(b) Assets that may be purchased by the contracting authority, at its option. Some financial compensation may be adequate in cases where the contracting authority has an option to buy the assets at market value or for a nominal sum on expiry of the project agreement or the right to require that they be offered to the winner of a new project award. However, it may be legitimate to envisage a financial compensation that is less than the full value of the assets so as to stimulate performance by the concessionaire. By the same token, such compensation may not need to cover the full cost of repaying the concessionaire’s outstanding debt. It is advisable to set forth the details of the formula for financial compensation in the project agreement (e.g. whether it covers the break-up value of the asset or the lesser of the outstanding debt and the alternative use value);

(b) Termination due to default by the contracting authority

42. The concessionaire is usually entitled to full compensation for loss sustained as a result of termination on grounds attributable to the contracting authority. The compensation due to the concessionaire usually includes compensation for the value of the works and installations, to the extent they have not already been amortized, as well as for the damage caused to the concessionaire, including lost profits, which are usually calculated on the basis of the concessionaire’s revenue during previous financial years. The concessionaire may be entitled to full compensation of debt and equity, including debt service and lost profit.

(c) Termination on other grounds

43. When considering compensation arrangements for termination due to circumstances unrelated to default by either party, it may be useful to distinguish exempting impediments from termination declared by the contracting authority for reasons such as public interest or other similar reasons.

(i) Termination due to exempting impediments

44. By definition, exempting impediments are events beyond the parties’ control and, as a general rule, termination under such circumstances might not give rise to claims for damages by either party. However, there may be circumstances where it might be equitable to provide for some compensation to the concessionaire, such as fair compensation for works already completed, in particular where, because of the specialized nature of the assets, they cannot be removed by the concessionaire or meaningfully used by it, but may be effectively used by the contracting authority for the purpose of providing the relevant service (e.g. a bridge). However, since termination in such cases cannot be attributed to the contracting authority, the compensation due to the concessionaire may not necessarily need to be “full” compensation (i.e. repayment of debt, equity and lost profits).
(ii) Termination for convenience

45. Where the project agreement recognizes the contracting authority's right to terminate for its convenience, the compensation payable to the concessionaire usually covers compensation for the same items included in compensation payable upon termination for default by the contracting authority (see para. 42), although not necessarily to the full extent. In order to establish the equitable amount of compensation due to the concessionaire, it may be useful to distinguish between termination for convenience during the construction phase and termination for convenience during the operational phase:

(a) Termination for convenience during the construction phase. If the project agreement is terminated during the construction phase, the compensation arrangements may be similar to those that are followed in connection with large construction contracts that allow for termination for convenience. In those cases, the contractor is usually entitled to the portion of the price that is attributable to the construction satisfactorily performed, as well as for expenses and losses incurred by the contractor arising from the termination. However, since the contracting authority does not normally pay a price for the construction work carried out by the concessionaire, the main criterion for calculating compensation would typically be the total investment effectively made by the concessionaire up to the time of termination, including all sums actually disbursed under the loan facilities extended by the lenders to the concessionaire for the purpose of carrying out construction under the project agreement, and expenses related to the cancellation of loan agreements. One additional question is whether and to what extent the concessionaire may be entitled to recover lost profit for the portion of the contract that has been terminated for convenience. On the one hand, the concessionaire might have foregone other business opportunities in anticipation of completing the project and operating the facility through the anticipated duration of the concession. On the other hand, an obligation of the contracting authority to compensate the concessionaire for its lost profit might make it financially prohibitive for the contracting authority to exercise its right of termination for convenience. One approach may be for the project agreement to establish a scale of payments to be made by the contracting authority as compensation for lost profits, the amount of the payments depending upon the stage of the construction that has been completed when the project agreement is terminated for convenience. It should be noted, however, that in the contract practice of some countries, government agencies do not assume any obligation to compensate for lost profits when a large construction contract is terminated for convenience;

(b) Termination for convenience during the operational phase. As regards the construction work satisfactorily completed by the concessionaire, the compensation arrangements may be the same as for termination for convenience during the construction phase. However, equitable compensation for termination for convenience during the operational phase might require fair compensation for lost profits, which is usually calculated on the basis of the concessionaire's revenue during a certain number of previous financial years. The higher standard of compensation in this case may be justified by the fact that, unlike termination during the construction phase, when the contracting authority might need to undertake to complete the work at its own expense, upon termination during the operational phase the contracting authority might be able to receive a completed facility capable of being operated profitably.

3. Wind-up and transitional measures

46. Where the facility is transferred to the contracting authority at the end of the concession period, the parties may need to make a series of arrangements in order to ensure that the contracting authority will be able to operate the facility at the prescribed standards of efficiency and safety. The project agreement may provide for the concessionaire's obligation to transfer certain technology or know-how required to operate the infrastructure facility (see paras. 47-51). The project agreement may also provide for the continuation, for a certain transitional period, of certain obligations of the concessionaire in respect of the operation and maintenance of the facility (see paras. 52-54). It may further include an obligation, on the part of the concessionaire, to supply or facilitate the supply of spare parts that may be needed by the contracting authority to carry out repairs in the facility (see paras. 55-58).

(a) Transfer of technology

47. In some cases, the facility transferred to the contracting authority will embody various technological processes necessary for the generation of certain goods (e.g. electricity or potable water) or the provision of the relevant services (e.g. telephone services). The contracting authority will often wish to acquire a knowledge of those processes and their application. The contracting authority will also wish to acquire the technical information and skills necessary for the operation and maintenance of the facility. Even where the contracting authority has the basic capability to undertake certain elements of the operation and maintenance (e.g. building or civil engineering), the contracting authority may need to acquire a knowledge of special technical processes necessary to effect the operation in a manner appropriate to the facility in question. The communication to the contracting authority of that knowledge, information and skills is often referred to as the "transfer of technology".

48. Differing contractual arrangements can be adopted for the transfer of technology and the performance of the other obligations necessary to construct and operate the facility. The transfer of technology itself may occur in different ways, for example, through the licensing of industrial property, through the creation of a joint venture between the parties or the supply of confidential know-how. The Guide does not attempt to deal comprehensively with contract negotiation and drafting relating to the licensing of industrial property or the supply of know-how, as this subject has already been dealt with in detail in publications issued
by other United Nations bodies. The following paragraphs merely note certain major issues concerning the communication of skills necessary for the operation and maintenance of the facility through the training of the contracting authority’s personnel or through documentation.

49. The most important method of conveying to the contracting authority the technical information and skills necessary for the proper operation and maintenance of the works is the training of the contracting authority’s personnel. In order to enable the contracting authority to decide on its training requirements, in the request for proposals or during the contract negotiations the contracting authority might request the concessionaire to supply the contracting authority with an organizational chart showing the personnel requirements for the operation and maintenance of the works, including the basic technical and other qualifications the personnel must possess. Such a statement of requirements should be sufficiently detailed to enable the contracting authority to determine the extent of training required in the light of the personnel available to it. The concessionaire will often have the capability to provide the training. In some cases, however, the training may be given more effectively by a consulting engineer or through an institution specializing in training.

50. Technical information and skills necessary for the proper operation and maintenance of the facility may also be conveyed through the supply of technical documentation. The documentation to be supplied may consist of plans, drawings, formulas, manuals of operation and maintenance and safety instructions. It may be advisable to list in the project agreement the documents to be supplied. The concessionaire may be required to supply documents that are comprehensive and clearly drafted, and are in a specified language. It may be advisable to obligate the concessionaire, at the request of the contracting authority, to give demonstrations of procedures described in the documentation if the procedures cannot be understood without demonstrations.

51. The points in time when the documentation is to be supplied may be specified. The project agreement may provide that the supply of all documentation is to be completed by the time fixed in the contract for completion of the construction. The parties may also wish to provide that transfer of the facility is not to be considered completed unless all documentation relating to the operation of the works and required under the contract to be delivered prior to the completion has been supplied. It may be advisable to provide that some documentation (e.g. operating manuals) is to be supplied during the course of construction, as such documentation may enable the contracting authority’s personnel or engineer to obtain an understanding of the working of machinery or equipment while it is being erected.

(b) Assistance in connection with operation and maintenance of the facility after its transfer

52. The degree of assistance from the concessionaire needed by the contracting authority with regard to the supply of spare parts and services will depend on the technology and skilled personnel possessed by or available to the contracting authority. If the contracting authority lacks personnel sufficiently skilled for the technical operation of the facility, it may wish to obtain the concessionaire’s assistance in operating the facility, at least for an initial period. The contracting authority may, in some cases, wish the concessionaire to provide the personnel to occupy many of the technical posts in the facility, while in other cases the contracting authority may wish the concessionaire only to provide technical experts to collaborate in an advisory capacity with the contracting authority’s personnel in the performance of a few highly specialized operations.

53. In order to assist the contracting authority in operating and maintaining the facility, the project agreement may obligate the concessionaire to submit, prior to the transfer of the facility, an operation and maintenance programme designed to keep the facility operating over its remaining lifetime at the level of efficiency required under the project agreement. An operation and maintenance programme would include matters such as an organizational chart showing the key personnel required for the technical operation of the facility and the functions to be discharged by each person; periodic inspection of the facility; lubrication, cleaning and adjustment; and replacement of defective or worn-out parts. Maintenance may also include operations of an organizational character, such as establishing a maintenance schedule or maintenance records. The concessionaire may also be required by the contracting authority to supply operation and maintenance manuals setting out appropriate operation and maintenance procedures. Those manuals should be in a format and language readily understood by the contracting authority’s personnel.

54. An effective means of training the contracting authority’s personnel in operation and maintenance procedures may be to provide in the project agreement that the personnel of the contracting authority are to be associated with the personnel of the concessionaire in carrying out the operation and maintenance for a certain time prior to or beyond the transfer of the facility. The positions to be occupied by the personnel employed by
the concessionaire can then be identified and their qualifications and experience specified. The functions assigned to posts to be filled by employees of the concessionaire need to be defined with particular care. In order to avoid friction and inefficiency, it is desirable that any authority to be exercised by the personnel of each party over the personnel of the other during the relevant period be clearly described.

(c) Supplies of spare parts

55. In projects that provide for the transfer of the facility to the contracting authority, the contracting authority will have to obtain spare parts to replace those that are worn out or damaged and to maintain, repair and operate the facility. Spare parts may not be available locally or from any other source and the contracting authority may have to depend on the concessionaire to supply them. The planning of the parties with respect to the supply of spare parts and services after the transfer of the facility would be greatly facilitated if the parties were to anticipate and provide in the project agreement for the needs of the contracting authority in that regard. However, given the long duration of most infrastructure projects, it may be difficult for the parties to anticipate and provide in the project agreement for the needs of the contracting authority after the transfer of the facility.

56. A possible approach may be for the parties to enter into a separate contract regulating these matters. Such a contract may be entered into closer in time to the transfer of the facility, when the contracting authority may have a clearer view of its requirements. If spare parts are manufactured not by the concessionaire but for the concessionaire by suppliers, the contracting authority may prefer to enter into contracts with those suppliers rather than to obtain them from the concessionaire or, alternatively, the contracting authority may wish to have the concessionaire procure them as the contracting authority’s agent.

57. It is desirable for the contracting authority’s personnel to develop the technical capacity to instal the spare parts. For this purpose, the project agreement may oblige the concessionaire to supply the necessary instruction manuals, tools and equipment. The instruction manuals should be in a format and language readily understood by the contracting authority’s personnel. The contract may also require the concessionaire to furnish “as built” drawings indicating how the various pieces of equipment interconnect and how access can be obtained to them to enable the spare parts to be installed and to enable maintenance and repairs to be carried out. In certain cases, it may be appropriate for the concessionaire to be required to train the contracting authority’s personnel in the installation of spare parts.

(d) Repairs

58. It is in the contracting authority’s interest to enter into contractual arrangements that will ensure that the facility will be repaired expeditiously in the event of a breakdown. In many cases, the concessionaire may be better qualified than a third person to effect repairs. In addition, if the project agreement prevents the contracting authority from disclosing to third persons the technology supplied by the concessionaire, this may limit the selection of third persons to effect repairs to those who provide assurances regarding non-disclosure of the concessionaire’s technology that are acceptable to the concessionaire. On the other hand, if major items of equipment have been manufactured for the concessionaire by suppliers, the contracting authority may find it preferable to enter into independent contracts for repair with the suppliers, as they may be better qualified to repair the items. In defining the nature and duration of repair obligations imposed on the concessionaire, if any, it is advisable to do so clearly and to distinguish them from obligations assumed by the concessionaire under quality guarantees to remedy defects in the facility.

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*The Economic Commission for Europe has prepared a Guide on Drawing Up International Contracts for Services Relating to Maintenance, Repair and Operation of Industrial and Other Works, which may, mutatis mutandis, assist parties in drafting a separate contract or contracts dealing with maintenance and repair of the facility after its transfer to the contracting authority (ECE/TRADE/154).*

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A/CONF.217/9/IV/Rev.1

Chapter VII. GOVERNING LAW

CONTENTS

<table>
<thead>
<tr>
<th>LEGISLATIVE RECOMMENDATIONS</th>
<th>(1)-(3)</th>
</tr>
</thead>
<tbody>
<tr>
<td>NOTES ON LEGISLATIVE RECOMMENDATIONS</td>
<td>1-63</td>
</tr>
<tr>
<td>A. General remarks</td>
<td>1-2</td>
</tr>
<tr>
<td>B. The law governing the project agreement and related contracts</td>
<td>3-8</td>
</tr>
</tbody>
</table>
## LEGISLATIVE RECOMMENDATIONS

### (1) The law governing the project agreement
(see paras. 4 and 5)

1. The host country may wish to enact provisions that indicate, as appropriate, the statutory or regulatory texts that govern the project agreement and those whose application is excluded.

### (2) The law governing contracts entered into by the concessionaire (see paras. 6-8)

2. The host country may wish to consider adopting legislative provisions recognizing the freedom of the concessionaire and its lenders, insurers and other contracting partners to choose the applicable law to govern their contractual relations.

### (3) Other relevant areas of legislation
(see paras. 9-58)

3. The host country may wish to consider reviewing and, as appropriate, revising rules of law in other areas relevant to privately financed infrastructure projects (investment promotion and protection, property law, rules and procedures on expropriation, intellectual property law, security interests, company law, accounting practices, contract law, rules on government contracts and administrative law, insolvency law, tax law, environmental and consumer protection law and anti-corruption measures).

## NOTES ON LEGISLATIVE RECOMMENDATIONS

### A. GENERAL REMARKS

1. The stage of development of the relevant laws of the host country, the stability of its legal system and the adequacy of remedies available to private parties are essential elements of the overall legal framework for privately financed infrastructure projects. By reviewing and, as appropriate, improving its laws in those areas of immediate relevance for privately financed infrastructure projects, the host country will make an important contribution to securing a hospitable climate for private sector investment in infrastructure. Greater legal certainty and a favourable legal framework will translate into a better assessment of country risks by lenders and project sponsors. This will have a positive influence on the cost of mobilizing private capital and reduce the need for governmental support or guarantees (see chap. II, “Government support”, __).

2. Section B deals with choice of the law or laws governing the project agreement and other contracts
entered into by the concessionaire during the life of the project (see paras. 3-8). Section C points out a few selected aspects of the laws of the host country that, without necessarily dealing directly with privately financed infrastructure projects, may have an impact on their implementation (see paras. 9-58). Section D indicates the possible relevance of a few international agreements for the implementation of privately financed infrastructure projects in the host country (see paras. 59-63).

B. THE LAW GOVERNING THE PROJECT AGREEMENT AND RELATED CONTRACTS

3. Statutory provisions governing the project agreement are not frequently found in domestic legislation on privately financed infrastructure projects. Where they do appear, they usually provide for the application of the laws of the host country by a general reference to domestic law or by mentioning special statutory or regulatory texts that apply to the project agreement. In some legal systems there may be an implied submission to the laws of the host country, even in the absence of a statutory provision to that effect. Statutory provisions concerning the law governing contracts entered into by the concessionaire appear even more rarely in domestic legislation, as discussed below.

1. The law governing the project agreement

4. The law governing the project agreement would typically include the rules contained in laws and regulations of the host country related directly to privately financed infrastructure projects, where specific legislation on the matter exists. The main elements of those laws have been considered in previous chapters of the Guide. As noted earlier (see chap. I, "General legislative considerations", __), in some countries the project agreement may be subject to administrative law, while in others the project agreement may be governed by private law (see also paras. 38-41). The governing law would also include legal rules of other fields of law that apply to the various issues that arise during the execution of an infrastructure project (see paras. 9-58). Some of those rules may be of an administrative or other public law nature and their application in the host country may be mandatory, such as environmental protection measures and health and labour conditions. Some domestic laws expressly identify the matters that are subject to rules of mandatory application. However, a number of issues arising out of the project agreement or the operation of the facility may not be the subject of mandatory rules of a public law nature. This is typically the case of most contractual issues arising under the project agreement (e.g., formation, validity and breach of contract, including liability and compensation for breach of contract and wrongful termination).

5. Even though it would not be possible to list exhaustively in the law all the statutes or regulations of direct or subsidiary relevance for privately financed infrastructure projects, for purposes of clarity it may be advisable to indicate in the law those statutory and regulatory texts that are directly applicable to the execution of privately financed infrastructure projects and, as appropriate, those whose application is excluded.

2. The law governing contracts entered into by the concessionaire

6. It is common for the concessionaire and its contractors to choose a law that is familiar to them and that in their view adequately governs the issues addressed in their contracts. Depending upon the type of contract, different issues concerning the governing-law clause will arise. For example, as regards the financing agreements that the concessionaire enters into, it is most likely that the lenders will require that the governing law be that of a jurisdiction with an established set of laws regarding international financial transactions. Equipment supply and other contracts may be entered into with foreign companies and the parties may wish to choose a law known to them as providing, for example, an adequate warranty regime for equipment failure or non-conformity of equipment. In turn, the concessionaire may agree to the application of the laws of the host country in connection with contracts entered into with local customers.

7. Domestic laws seldom contain provisions concerning the law governing the contracts entered into by the concessionaire. In a few countries, the law limits the application of foreign law to issues that are not regulated by domestic law or subjects choices of foreign law to approval by the contracting authority. However, most countries have found no compelling reason for making provisions concerning the law governing the contracts between the concessionaire and its contractors and have preferred to leave the question to a choice-of-law clause in their contracts or to the applicable conflict-of-laws rules.

8. In some cases, provisions have been included in domestic legislation for the purpose of clarifying, as appropriate, that the contracts entered into between the concessionaire and its contractors are governed by private law and that the contractors are not agents of the contracting authority. A provision of that type may in some countries have a number of practical consequences, such as no subsidiary liability of the contracting authority for the acts of the subcontractors or no obligation on the part of the responsible public entity to pay worker’s compensation for work-related illness, injury or death to the subcontractors’ employees.

C. OTHER RELEVANT AREAS OF LEGISLATION

9. In addition to issues pertaining to legislation directed specifically towards privately financed infrastructure projects, a favourable legal framework also requires supportive provisions in other areas of legislation. Private investment in infrastructure will be encouraged by the existence of legislation that promotes and
protects private investment in economic activities. The following paragraphs pinpoint only a few selected aspects of other fields of law that may have an impact on the implementation of infrastructure projects. The existence of adequate legal provisions in those other fields may facilitate a number of transactions necessary to carrying out infrastructure projects and help to reduce the perceived legal risk of investment in the host country.

1. Promotion and protection of investment

10. One matter of particular concern for the project consortia and the lenders is the degree of protection afforded to investment in the host country. The confidence of investors in the host country may be fostered, for example, by protection from nationalization or dispossession without judicial review and appropriate compensation in accordance with international law. Project sponsors participating in project consortia will also be concerned about their ability, *inter alia*, to bring to the country without unreasonable restriction the qualified personnel required to work with the project, to import needed goods and equipment, to have access to foreign exchange as needed and to transfer abroad or repatriate their profits or sums needed to repay loans that the company has entered into for the purpose of the infrastructure project. In addition to specific guarantees that may be provided by the Government (see chap. II, "Government support", ___), legislation on promotion and protection of investment may play an important role in connection with privately financed infrastructure projects. For countries that already have adequate investment protection legislation, it may be useful to consider expressly extending the protection provided in such legislation to private investment in infrastructure projects.

11. An increasing number of countries have entered into bilateral investment agreements that aim at facilitating and protecting the flow of investment between the contracting parties. Investment protection agreements usually contain provisions concerning the admission and treatment of foreign investment; transfer of capital between the contracting parties (e.g., payment of dividends abroad or repatriation of investment); availability of foreign exchange for transfer or repatriation of proceeds of investment; protection from expropriation and nationalization; and settlement of investment disputes. The existence of such an agreement between the host country and the originating country or countries of the project sponsors may play an important role in their decision to invest in the host country. Depending on its terms, such an agreement may reduce the need for assurances or guarantees by the Government geared to individual infrastructure projects.

2. Property law

12. It is desirable for the property laws of the host country to reflect acceptable modern standards, contain adequate provisions on the ownership and use of land and buildings, as well as movable and intangible property, and ensure the concessionaire's ability to purchase, sell, transfer and license the use of property, as appropriate. Constitutional provisions protecting property rights have been found to be important factors to foster private investment in many countries (see also chap. I, "General legislative considerations", ___).

13. Where the concessionaire owns the land on which the facility is built, it is important that the ownership of the land can be clearly and unequivocally established through adequate registration and publicity procedures. The concessionaire and lenders will need clear proof that ownership of the land will not be subject to dispute. They will therefore be reluctant to commit funds to the project if the laws of the host country do not provide adequate means for ascertaining ownership of the land.

14. It is also necessary to provide effective mechanisms for the enforcement of the property and possessory rights granted to the concessionaire against violation by third parties. Enforcement should also extend to easements and rights of way that may be needed by the concessionaire for providing and maintaining the relevant service (e.g., placing of poles and cables on private property to ensure the distribution of electricity) (see chap. IV, "The project agreement", ___).

3. Rules and procedures on expropriation

15. Where the host Government assumes responsibility for providing the land required for the implementation of the project, it may be either purchased from its owners or, if necessary, compulsorily acquired against the payment of adequate compensation by procedures referred to in the *Guide* as "expropriation" (see chap. IV, "The project agreement", ___). Many countries have legislation governing expropriation procedures and that legislation would probably apply to the compulsory acquisition of property required for privately financed infrastructure projects.

16. Expropriation proceedings often involve both administrative and judicial phases, which may be lengthy and complex. The host Government might thus wish to review existing provisions on expropriation for reasons of public interest with a view to assessing their adequacy to the needs of large infrastructure projects and to determining whether such provisions allow quick and cost-effective procedures, with due consideration of the rights of the owners. It is particularly important to enable the host Government to take possession of the property as early as possible, to the extent permitted by law, so as to avoid start-up delay and increased project costs.

4. Intellectual property law

17. Privately financed infrastructure projects frequently involve the use of new or advanced technologies protected under patents or similar intellectual property rights. They may also involve the formulation and
submission of original or innovative solutions, which may constitute the proponent's proprietary information under copyright protection. Therefore, private investors, national and foreign, bringing new or advanced technology into the host country or developing original solutions will need to be assured that their intellectual property rights will be protected and that they will be able to enforce those rights against infringements.

18. A legal framework for the protection of intellectual property may be provided by adherence to international agreements regarding the protection and registration of intellectual property rights. It would be desirable to strengthen the protection of intellectual property rights in line with such instruments as the Paris Convention for the Protection of Industrial Property of 1883. The Convention applies to industrial property in the widest sense, including inventions, marks, industrial designs, utility models, trade names, geographical indications and the repression of unfair competition. The Convention provides that, as regards the protection of industrial property, each contracting State must grant national treatment. It also provides for the right of priority in the case of patents, marks and industrial designs and establishes a few common rules that all the contracting States must follow in relation to patents, marks, industrial designs, trade names, indications of source, unfair competition and national administrations. A framework for further international patent protection is provided under the Patent Cooperation Treaty of 1970, which makes it possible to seek patent protection for an invention simultaneously in each of a large number of countries by filing an international patent application.

19. Other important instruments providing international protection of industrial property rights are the Madrid Agreement Concerning the International Registration of Marks of 1891; the Protocol Relating to the Madrid Agreement of 1989 and the Common Regulations under the Madrid Agreement and the Protocol Relating thereto of 1998. The Madrid Agreement provides for the international registration of marks (both trademarks and service marks) at the International Bureau of the World Intellectual Property Organization (WIPO). International registration of marks under the Madrid Agreement has effect in several countries, potentially in all the contracting States (except the country of origin). Furthermore, the Trademark Law Treaty of 1994 simplifies and harmonizes procedures for the application for registration of trademarks, changes after registration and renewal.

20. In the area of industrial designs, the Hague Agreement Concerning the International Deposit of Industrial Designs of 1925 provides for the international deposit of industrial designs at the International Bureau of WIPO. The international deposit has, in each of the contracting States designated by the applicant, the same effect as if all the formalities required by the domestic law for the grant of protection had been complied with by the applicant and as if all administrative acts required to that end had been accomplished by the office of that country.

21. The above instruments are complemented by treaties establishing international classifications, such as the Strasbourg Agreement Concerning the International Patent Classification of 1971, the Nice Agreement Concerning the International Classification of Goods and Services for the Purposes of the Registration of Marks of 1957, the Vienna Agreement Establishing an International Classification of the Figurative Elements of Marks of 1973 and the Locarno Agreement Establishing an International Classification for Industrial Designs of 1968.

5. Security interests

22. Crucial to the success of privately financed infrastructure projects is a domestic legal regime that offers lenders reliable security. The types of asset that might be encumbered and the types of security interest that might be created will vary from one system of law to the next. Because of the significant differences between legal systems regarding the law of security interests, the Guide does not discuss in detail the technicalities of the requisite legislation and the following paragraphs provide only a general outline of the main elements of a modern regime for secured transactions.

23. In some legal systems, security interests can be created in virtually all kinds of assets, including intellectual property, whereas in other systems security interests can only be created in a limited category of assets, such as land and buildings. In some countries, security interests can be created over assets that do not yet exist (future assets) and security may be taken over all of a company's assets, while allowing the company to continue to deal with those assets in the ordinary course of business. Some legal systems provide for a non-possessor security interest, so that security can be taken over assets without taking actual possession of the assets; in other systems, as regards those assets which are not subject to a title registration system, security may only be taken by physical possession or constructive possession. Under some systems, enforcement of the security interest can be undertaken without court involvement, whereas in other systems it may only be enforced through court procedures. Some countries provide enforcement remedies that not only include sale of the asset, but also enable the secured lender to operate the asset either by taking possession or appointing a receiver; in other countries, judicial sale may be the primary enforcement

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mechanism. Under some systems, certain types of security will rank ahead of preferential creditors, whereas in others the preferential creditors rank ahead of all types of security. In some countries, creation of a security interest is cost-efficient, with minimal fees and duties payable, whereas in other countries it can be costly. In some countries, the value of the amount of security taken may be unlimited, while in others the value of security cannot be excessive in comparison with the debt owed. Some legal systems impose obligations on the secured lender to the debtor and to third parties on enforcement of the security, such as the obligation to sell the asset at fair market value.

24. The type and extent of security offered by the concessionaire or its shareholders will play a central role in the contractual arrangements for the financing of infrastructure projects. The security arrangements may be complex and consist of a variety of forms of security, including fixed security over physical assets of the concessionaire (e.g. mortgages or charges), pledges of shares of the concessionaire and assignment of intangible assets (receivables) of the project. While the loan agreements are usually subject to the governing law chosen by the parties, the laws of the host country will in most cases determine the type of security that can be enforced against assets located in the host country and the remedies available. Differences in the type of security or limitations in the remedies available under the laws of the host country may be a cause of concern to potential lenders. It is therefore important to ensure that domestic laws provide adequate legal protection to secured creditors and do not hinder the ability of the parties to establish appropriate security arrangements.

25. Basic legal protection may include provisions ensuring that fixed security (e.g. a mortgage) is a registrable interest and that, once such security is registered in the central register of title or other public register, any purchaser of the property to which the security attaches should take the property subject to such security. This may be difficult, since in many countries no central registers of title exist. Furthermore, security should be enforceable against third parties, have the nature of a property right and not a mere obligation, and should entitle the person receiving security to a sale, in enforcement proceedings, of the assets taken as security. Secured creditors should enjoy preference to unsecured creditors in insolvency proceedings.

26. Another important aspect concerns the flexibility given to the parties to define the assets that are given as security. In some legal systems, broad freedom is given to the parties in the definition of assets that may be given as security. In some legal systems, it is possible to create security that covers all the assets of an enterprise, making it possible to sell the enterprise as a going concern, which may enable an enterprise in financial difficulties to be rescued while increasing the recovery of the secured creditor. Other legal systems, however, allow only the creation of security that attaches to specific assets and do not recognize security covering the entirety of the debtor’s assets. There may also be limitations on the debtor’s ability to trade in goods given as security. The existence of limitations and restrictions of this type makes it difficult or even impossible for the debtor to create security over generically described assets or over assets traded in the ordinary course of its business.

27. Given the long-term nature of privately financed infrastructure projects, the parties may wish to be able to define the assets that are given as security specifically or generally. They may also wish such security to cover present or future assets and assets that might change during the life of the security. It may be desirable to review existing provisions on security interests with a view to including provisions enabling the parties to agree on suitable security arrangements.

28. As indicated earlier (see chap. IV, “The project agreement”, __), another form of security typically given in connection with certain privately financed infrastructure projects is an assignment to lenders of proceeds from contracts with customers of the concessionaire. Those proceeds may consist of the proceeds of a single contract (e.g. a power purchase commitment by a power distribution entity) or of a large number of individual transactions (e.g. monthly payment of gas or water bills). In most cases it would not be practical for the concessionaire to specify individually the receivables being assigned to the creditors. Therefore, assignment of receivables in project finance typically takes the form of a bulk assignment of future receivables. However, there may be considerable uncertainty in various legal systems with regard to the validity of the wholesale assignment of receivables and of future receivables.

29. Thus far, no comprehensive uniform regime or model for the development of domestic security laws has been developed by international intergovernmental bodies. Governments would be advised, however, to take account of various efforts being undertaken in different organizations.

30. A model for the development of modern legislation on security interests is offered in the Model Law on Secured Transactions, which was prepared by the European Bank for Reconstruction and Development (EBRD) to assist legislative reform efforts in central and eastern European countries. Besides general provisions on who can create and who can receive a security right and general rules concerning the secured debts and the charged property, the EBRD Model Law on Secured Transactions covers other matters, such as the creation of security rights, the interests of third parties, enforcement of security and registration proceedings. The solutions proposed in the EBRD Model Law are intended to achieve the objectives discussed in paragraphs 24-29 above.

[Note for the Commission. Appropriate reference will be made to the draft convention on assignment in receivables financing presently being developed by the Working Group on International Contract Practices, as well as to other international initiatives (e.g. the draft model inter-American law on secured transactions currently being considered by the Organization of American States]
6. Company law

31. In most projects involving the development of a new infrastructure, the project sponsors will establish the project entity as a separate legal entity in the host country (see chap. IV, “The project agreement”, ____). It is recognized that the project entity may take various forms in different countries, which may not necessarily entail a corporation. As in most cases it is a corporate form that is selected, it is particularly important for the host country to have adequate company laws with modern provisions on essential matters such as establishment procedures, corporate governance, issuance of shares and their sale or transfer, accounting and financial statements and protection of minority shareholders. Furthermore, the recognition of the investors’ ability to establish separate entities to serve as special-purpose vehicles for raising financing and disbursing funds may facilitate the closing of project finance transactions (see chap. IV, “The project agreement”, ____). 

32. Although various corporate forms may be used for incorporating project operators, a common characteristic is that the concessionaire’s owners (or shareholders) will require that their liability be limited to the value of their shares in the company’s capital. If it is intended that the concessionaire will offer shares to the public, limited liability will be necessary, as the prospective investors will usually only purchase those shares for their investment value and will not be closely involved in the operation of the concessionaire. It is therefore important that the laws of the host country provide adequately for the limitation of liability of shareholders. Furthermore, adequate provisions governing the issuance of bonds, debentures or other securities by commercial companies will enable the concessionaire to obtain funds from investors on the security market, thus facilitating the financing of certain infrastructure projects.

33. Legislation should establish the responsibilities of directors and administrators of the concessionaire, including the basis for criminal responsibility. It can also set out provisions for the protection of third parties affected by any breach of corporate responsibility. Modern company laws often contain specific provisions regulating the conduct of managers so as to prevent conflicts of interest. Provisions of this type require that managers act in good faith in the best interest of the company and do not use their position to foster their own or any other person’s financial interests to the detriment of the company. Provisions intended to curb conflicts of interest in corporate management may be particularly relevant in connection with infrastructure projects, where the concessionaire may wish to engage its own shareholders, at some stage of the project, to perform work or provide services in connection with it (see chap. V, “Infrastructure development and operation”, ____). 

34. It is important for the law to regulate adequately the decision-making process both for meetings of the shareholders and meetings of management organs of the company (e.g. the board of directors or supervisory board). Protection of shareholders’ rights and, in particular, protection for minority shareholders from abuse by controlling or majority shareholders are important elements of modern company laws. Mechanisms for the settlement of disputes among shareholders are also critical. It is useful to recognize the right of the shareholders to regulate a number of additional matters concerning the management of the concessionaire through agreements among themselves or through management contracts with the directors of the concessionaire.

7. Accounting practices

35. In several countries, companies are required by law to follow generally accepted accounting practices. Among the reasons for this is that the adoption of standard accounting practices is a measure taken in many countries to achieve uniformity in the valuation of businesses. The use of modern and internationally acceptable accounting practices may be instrumental in ensuring the marketability of bonds and other security issued by the concessionaire for the purpose of raising funds in international financial markets. In connection with the selection of the concessionaire, the use of standard accounting practices may also facilitate the task of evaluating the financial standing of bidders in order to determine whether they meet the pre-selection criteria required by the contracting authority (see chap. III, “Selection of the concessionaire”, ____). Standard accounting practices are also essential for carrying out audits of the profits of companies, which may be required for the application of tariff structures and the verification of compliance by the regulatory body (see chap. V, “Infrastructure development and operation”, ____). 

8. Contract law

36. The contract laws of the host country play an important role in connection with contracts entered into by the concessionaire with subcontractors, suppliers and other parties. The domestic law on commercial contracts should provide adequate solutions to the needs of the concessionaire and its contracting parties, including flexibility in devising the contracts needed for the construction and operation of the infrastructure facility. Apart from some essential elements of adequate contract law, such as general recognition of party autonomy, judicial enforceability of contract obligations and adequate remedies for breach of contract, the laws of the host country may create a favourable environment for privately financed infrastructure projects by facilitating contractual arrangements likely to be used in those projects. An adequate set of rules of private international law is also important, given the likelihood that contracts entered into by the concessionaire will include some international element.

37. Where new infrastructure is to be built, the concessionaire may need to import large quantities of
supplies and equipment. Greater legal certainty for such transactions will be ensured if the laws of the host country contain provisions specially adapted to international sales contracts. A particularly suitable legal framework may be provided by adherence to the United Nations Convention on Contracts for the International Sale of Goods (Vienna, 1980) or other international instruments dealing with specific contracts, such as the UNIDROIT Convention on International Financial Leasing (Ottawa, 1988), drawn up by the International Institute for the Unification of Private Law (UNIDROIT).

9. Rules on government contracts and administrative law

38. In many legal systems belonging to or influenced by the tradition of civil law, the provision of public services may be governed by a body of law known as "administrative law", which regulates a wide range of governmental functions. Such systems operate under the principle that the Government can exercise its powers and functions either by means of an administrative act or an administrative contract. It is also generally understood that, alternatively, the Government may enter into a private contract, subject to the law governing private commercial contracts. The differences between the two types of contract may be significant.

39. Under the concept of the administrative contract, the freedom and autonomy the parties to a private contract enjoy are subordinate to the public interest. In some legal systems, the Government has the right to terminate administrative contracts (see chap. VI, "End of project term, extension and termination", ...) or to modify their scope and terms, for reasons of public interest, usually subject to compensation for loss sustained by the private contracting party (see chap. V, "Infrastructure development and operation", ...). Additional rights might include extensive monitoring and inspection rights, as well as the right to impose sanctions on the private operator for failure to perform. This is often balanced by the requirement that other changes may be made to the contract as may be necessary to restore the original financial equilibrium between the parties and to preserve the contract's general value for the private contracting party (see chap. V, "Infrastructure development and operation", ...). In some legal systems, disputes arising out of government contracts are subject to the exclusive jurisdiction of special tribunals dealing solely with administrative matters, which in some countries are separate from the judicial system (see chap. VIII, "Settlement of disputes", ...).

40. The existence of a special legal regime applicable to infrastructure operators and public service providers is not limited to the legal systems referred to above. Although in other legal systems influenced by the tradition of common law no such categorical distinction is made between administrative contracts and private contracts, similar consequences may be achieved by different means. While under such systems of law it is frequently held that the rule of law is best maintained by subjecting the Government to ordinary private law, it is generally recognized that the administration cannot by contract fetter the exercise of its sovereign functions. It cannot hamper its future executive authority in the performance of those governmental functions which affect the public interest. Under the doctrine of sovereign acts, which is upheld in some common law jurisdictions, the Government as contractor is excused from the performance of its contracts if the Government as sovereign enacts laws, regulations or orders in the public interest that prevent that performance. Thus, the law may permit a government agency to interfere with vested contractual rights. Usually such action is limited so that the changes cannot be of such magnitude that the other party could not fairly adapt to them. In those circumstances, the private party is ordinarily entitled to some sort of compensation or equitable adjustment (see chap. V, "Infrastructure development and operation", ...). In anticipation of such possibilities, in some countries a standard "changes" clause is included in a governmental contract that enables the Government to alter the terms on a unilateral basis or that provides for changes as a result of an intervening sovereign act.

41. Special prerogatives for governmental agencies are justified in those legal systems by reasons of public interest. It is however recognized that special governmental prerogatives, in particular the power to alter the terms of contracts unilaterally, may, if improperly used, adversely affect the vested rights of government contractors. For this reason, countries with a well-established tradition of private participation in infrastructure projects have developed a series of control mechanisms and remedies to protect government contractors against arbitrary or improper acts by government agencies, such as access to impartial dispute settlement bodies and full compensation schemes for governmental wrongdoing. Where protection of this nature is not afforded, rules of law providing government agencies with special prerogatives may be regarded by potential investors as an intolerable risk, which may discourage them from investing in particular jurisdictions. For this reason, some countries have reviewed their legislation on government contracts so as to provide the degree of protection needed to foster private investment and remove those provisions which gave rise to concern about the long-term contractual stability required for infrastructure projects.

10. Insolvency law

42. The insolvency of an infrastructure operator or public service provider raises a number of issues that have led some countries to establish special rules to deal with such situations, including rules that enable the host Government to take the measures required to ensure the continuity of the project (see chap. VI, "End of project term, extension and termination", ...). The continuity in the provision of
the service may be achieved by means of a legal framework that allows for the rescue of economically viable enterprises facing financial difficulties, such as reorganization and similar proceedings. In the event that bankruptcy proceedings become inevitable, the secured lenders will be specially concerned about provisions concerning secured claims, in particular as to whether secured creditors may foreclose on the security despite the opening of bankruptcy proceedings, whether secured creditors are given priority for payments made with the proceeds of the security and how claims of secured creditors are ranked. As noted earlier, a substantial portion of the concessionaire’s debt takes the form of “senior” loans, with the lenders requiring precedence of payment over payment of the subordinated debt of the concessionaire (see “Introduction and background information on privately financed infrastructure projects”, ____). The extent to which the lenders will be able to enforce such subordination arrangements will depend on the rules and provisions of the laws of the country that govern the ranking of creditors in insolvency proceedings. The legal recognition of party autonomy on the establishment of contractual subordination of different classes of loans may facilitate the financing of infrastructure projects.

43. Among the issues that the legislation should address are the following: the question of the ranking of creditors; the priority between the insolvency administrator and creditors; legal mechanisms for reorganization of the insolvent debtor; special rules designed to ensure the continuity of the public service in case of insolvency of the concessionaire; and provisions on avoidance of transactions entered into by the debtor shortly before the opening of the insolvency proceedings.

44. The insolvency of a concessionaire is likely to involve creditors from more than one country or affect assets located in more than one country. It may therefore be desirable for the host country to have provisions in place that facilitate judicial cooperation, court access for foreign insolvency administrators and recognition of foreign insolvency proceedings. A suitable model that may be used by countries wishing to adopt legislation for that purpose is provided in the UNCITRAL Model Law on Cross-Border Insolvency.

11. Tax Law

45. In addition to possible tax incentives that may be generally available in the host country or that may be specially granted to privately financed infrastructure projects (see chap. II, “Government support”, ____), the general taxation regime of the host country plays a significant role in the investment decisions of private companies. Beyond an assessment of the impact of taxation in the project cost and the expected margin of profit, private investors consider questions such as the overall transparency of the domestic taxation system, the degree of discretion exercised by taxation authorities, the clarity of guidelines and instructions issued to taxpayers and the objectivity of criteria used to calculate tax liabilities. This may be a complex matter, in particular in those countries where the authority to establish or increase taxes or to enforce tax legislation has been decentralized.

46. The stability of the tax regime is crucial to the success of privately financed infrastructure projects. Many projects are highly leveraged and require a predictable cash flow. Unanticipated changes in the taxes that reduce that cash flow can have serious consequences for the project. All potential tax implications should be readily assessable throughout the life of the project. In some countries, the Government is authorized to enter into agreements with the investors for the purpose of guaranteeing the stability of the tax regime applicable to the project. However, the Government may be restrained, by constitutional law or for political reasons, from providing this type of guarantee, in which case the parties may agree on compensation or contractual revision mechanisms for dealing with cost increases due to tax changes (see also chap. V, “Infrastructure development and operation”, ____).

47. Most national tax regimes fall into one of three general categories. One approach is worldwide taxation with credits, in which all income earned anywhere is taxed in the home country and double taxation is avoided through the use of a foreign tax credit system; home country taxes are reduced by the amount of foreign taxes already paid. If this approach is used by an investor’s home country, the investor’s tax liability can be no less than it would be at home. Under a different taxation approach, the foreign income that has already been subject to foreign tax is exempt from taxation by the home country of the investor. Under a territorial approach, foreign income is exempt from home country taxation altogether. Investors in home countries that use the latter two systems of taxation would benefit from tax holidays and lower tax rates in the host country, but such tax relief would offer no incentive to an investor located in a tax haven.

48. The parties involved in the project may have different concerns over potential tax liability. Investors are usually concerned over the taxation of profits earned in the host country, taxation on payments made to contractors, suppliers, investors and lenders, and tax treatment of any capital gains (or losses) when the concessionaire is wound up. Investors may find that payments used to reduce taxes under their home country regime (such as payments for interest on borrowed funds, investigation costs, bidding costs and foreign exchange losses) may not be available in the host country, or vice versa. Since foreign tax credits are only allowed for foreign income taxes, investors need to ensure that any income tax paid in the host country satisfies the definition of income tax of their own country’s taxing authority. Similarly, the concessionaire in the host country may be treated for tax purposes as a different type of entity in the host country. In projects where the assets become the property of the Government, this may preclude deductions for depreciation under the laws of the home country.

49. One particular problem of privately financed infrastructure projects involving foreign investment is the
possibility that foreign companies participating in a project consortium may be exposed to double taxation, that is, taxation of profits, royalties and interests in their own home countries as well as in the host country. The timing of tax payments and requirements to pay withholding taxes can also pose problems. A number of countries have entered into bilateral agreements to eliminate or at least reduce the negative effects of double taxation and the existence of such agreements between the host country and the home countries of the project sponsors often plays a role in their tax considerations.

50. Ultimately, it is the cumulative effect of all taxes combined that needs to be taken into consideration. For example, there may be taxes imposed by more than one level of taxing authority; in addition to taxation by the national Government, the concessionaire may also face municipal or provincial taxes. There may also be certain levies other than income taxes, which are often are due and payable before the concessionaire has earned any revenues. These include sales taxes, sometimes referred to as "turnover taxes", value-added taxes, property taxes, stamp duties and import duties. Sometimes special provisions can be made to offer relief from these payments as well.

12. Environmental protection

51. Environmental protection encompasses a wide variety of issues, ranging from handling of wastes and hazardous substances to relocation of persons displaced by large land-use projects. It is widely recognized that environmental protection is a critical prerequisite to sustainable development. Adhering to treaties relating to the protection of the environment may help to strengthen the international regime of environmental protection. A large number of international instruments have been developed in the past decades to establish common international standards. These include the following: Agenda 21 and the Rio Declaration on Environment and Development, adopted by the United Nations Conference on Environment and Development in 1992; the World Charter for Nature (General Assembly resolution 37/7 of 28 October 1982); the Basel Convention on the Control of Transboundary Movement of Hazardous Wastes and Their Disposal of 1989; the Convention on Environmental Impact Assessment in a Transboundary Context of 1991; and the Convention on the Protection and Use of Transboundary Watercourses and International Lakes of 1992.

52. Environmental protection legislation is likely to have a direct impact on the implementation of infrastructure projects at various levels and environmental matters are among the most frequent causes of disputes. Environmental protection laws may include various requirements, such as the consent by various environmental authorities, evidence of no outstanding environmental liability, assurances that environmental standards will be maintained, commitments to remedy environmental damage and notification requirements. These laws often require prior authorization for the exercise of a number of business activities, which may be particularly stringent for some types of infrastructure (e.g. waste water treatment, waste collection, the coal-fired power sector, power transmission, roads and railways). Authorizations and licences are often required for undertaking construction work or for installing certain physical structures. The denial of an environmental licence may constitute an unsurmountable obstacle to the execution of the whole project.

53. It is therefore advisable to ensure the highest possible degree of clarity in provisions concerning the tests that may be applied by the environmental authorities, the documentary and other requirements to be met by the applicants, the conditions under which licences are to be issued and the circumstances that justify the denial or withdrawal of a licence. Particularly important are provisions that guarantee the applicant's access to expeditious appeals procedures and judicial recourse, as appropriate. It may also be advisable to ascertain to the extent possible, prior to the final award of the project, whether the conditions for obtaining such a licence are met. In some countries, special government agencies or advocacy groups may have the right to institute legal proceedings to seek to prevent environmental damage, which may include the right to seek the withdrawal of a licence deemed to be inconsistent with applicable environmental standards. In some of those countries, it has been found useful to involve representatives of the public in the proceedings that lead to the issuance of environmental licences. The legislation may also establish the range of penalties that may be imposed and specify the parties that may be held responsible for the damage.

54. Further issues under the host country's environmental laws may arise when the concessionaire takes over an existing infrastructure facility, in particular where the question of responsibility for environmental damage caused by government-owned industry prior to privatization has not been clarified. Private investors may be reluctant to take over an existing infrastructure or purchase shares in public utilities that may be called upon in the future to compensate for or remedy environmental damage caused by the enterprise before it was privatized. It may therefore be advisable to establish mechanisms for compensating the private investors for liability incurred as a result of environmental damage caused during the period of government operation.

13. Consumer protection laws

55. A number of countries have special rules of law on consumer protection. Consumer protection laws vary greatly from country to country, both in the way they are organized and in their substance. Nevertheless, consumer protection laws often include provisions such as favourable time limits for asserting claims and enforcing contractual rights; special rules for the interpretation of contracts whose terms are not usually negotiated
with the consumer (sometimes referred to as “adhesion contracts”); extended warranties in favour of consumers; special termination rights; access to simplified dispute settlement instances; or other protective measures. From the concessionaire’s perspective, it is important to consider whether the host country’s laws on consumer protection may limit or hinder the concessionaire’s ability to enforce, for instance, its right to obtain payment for the services provided, to adjust prices or to discontinue services to customers who fail to pay for the services.

14. Anti-corruption measures

56. The investment and business environment in the host country may also be enhanced by measures to fight corruption in the administration of government contracts. The rules covering the functioning of contracting authorities and the monitoring of public contracts should be reviewed and, where such rules do not exist, appropriate legislation and regulations should be developed and adopted to ensure the required degree of transparency and integrity. Simplicity and consistency, coupled with the elimination of unnecessary procedures that prolong the administrative procedures or make them cumbersome, are additional elements to be taken into consideration in this context.

57. It is furthermore particularly important for the host country to take effective and concrete action to combat all forms of corruption, bribery and related illicit practices, in particular to pursue effective enforcement of existing laws prohibiting bribery.

58. The enactment of laws that incorporate international agreements and standards on integrity in the conduct of public business may represent a significant step in that direction. Important standards are contained in two resolutions of the United Nations General Assembly: resolution 51/59 of 12 December 1996, by which the Assembly adopted the International Code of Conduct for Public Officials, and resolution 51/191 of 16 December 1996, by which it adopted the United Nations Declaration against Corruption and Bribery in International Commercial Transactions. Other important instruments include the Inter-American Convention against Corruption, adopted by the Organization of American States at the Specialized Conference for Consideration of the Draft Inter-American Convention against Corruption, held at Caracas in 1996, and the Convention on Combating Bribery of Foreign Public Officials in International Business Transaction of 1997, which was negotiated under the auspices of the Organization for Economic Cooperation and Development.

D. INTERNATIONAL AGREEMENTS

59. In addition to the internal legislation of the host country, privately financed infrastructure projects may be affected by international agreements entered into by the host country. The implications of certain international agreements are discussed briefly below.

1. Membership in multilateral financial institutions

60. Membership in multilateral financial institutions such as the World Bank, the International Development Association, the International Finance Corporation, the Multilateral Investment Guarantee Agency and the regional development banks may have a direct impact on privately financed infrastructure projects in various ways. Firstly, the host country’s membership in those institutions is typically a requirement in order for projects in the host country to receive financing and guarantees provided by those institutions. Second, the rules on financing and guarantee instruments provided by those institutions typically contain a variety of terms and conditions of direct relevance for the terms of the project agreement and the loan agreements negotiated by the concessionaire (e.g. clause of negative pledge of public assets and provision of counter-guarantees in favour of the multilateral financial institution). Finally, multilateral financial institutions usually follow a number of policy objectives whose implementation they seek to ensure in connection with projects supported by them (e.g. adherence to internationally acceptable environmental standards; long-term sustainability of the project beyond the initial concession period; transparency and integrity in the selection of the concessionaire and the disbursement of their loans).

2. General agreements on trade facilitation and promotion

61. A number of multilateral agreements have been negotiated to promote free trade at the global level. The most notable of those agreements have been negotiated under the auspices of the General Agreement on Tariffs and Trade and later the World Trade Organization (WTO). Those agreements may contain general provisions on trade promotion and facilitation of trade in goods (e.g. a most-favoured-nation clause, prohibition of the use of quantitative restrictions and other discriminatory trade barriers) and on the promotion of fair trade practices (e.g. prohibition of dumping and limitations on the use of subsidies). Some specific agreements are aimed at the removal of barriers for the provision of services by foreigners in the contracting States or promoting transparency and eliminating discrimination of suppliers in public procurement. Those agreements may be relevant for national legislation on privately financed infrastructure projects that contemplates restrictions on the participation of foreign companies in infrastructure projects or establishes preferences for national entities or for the procurement of supplies on the local market.

3. International agreements on specific industries

62. In the context of the negotiations on basic telecommunications concluded as part of the General Agreement on Trade in Services (GATS), a number of States
members of WTO representing most of the world market for telecommunication services have made specific commitments to facilitate trade in telecommunication services. It should be noted that all WTO member States (even those that have not made specific telecommunication commitments) are bound by the general GATS rules on services, including specific requirements dealing with most-favoured-nation treatment, transparency, regulation, monopolies and business practices. The WTO telecommunication agreement adds sector- and country-specific commitments to the overall GATS agreement. Typical commitments cover the opening of various segments of the market, including voice telephony, data transmission and enhanced services, to competition and foreign investment. Legislators of current or prospective WTO member States should thus ensure that the country’s telecommunication laws are consistent with the GATS agreement and their specific telecommunication commitments.

63. Another important sector-specific agreement at the international level is the Energy Charter Treaty, concluded at Lisbon on 17 December 1994 and in force since 16 April 1998, which has been enacted to promote long-term cooperation in the energy field. The Treaty provides for various commercial measures such as the development of open and competitive markets for energy materials and products and the facilitation of transit and access to and transfer of energy technology. Furthermore, the Treaty aims at avoiding market distortions and barriers to economic activity in the energy sector and promotes the opening of capital markets to encourage the flow of capital in order to finance trade in materials and products. The Treaty also contains regulations about investment promotion and protection: equitable conditions for investors, monetary transfers related to investments, compensation for losses due to war, civil disturbance or other similar events and compensation for expropriation.

A/CN.9/458/Add.9

Chapter VIII. SETTLEMENT OF DISPUTES

CONTENTS

LEGISLATIVE RECOMMENDATIONS ........................................... (1)-(4)

NOTES ON LEGISLATIVE RECOMMENDATIONS ......................... 1-82

A. General remarks .......................................................... 1-3

B. Disputes between the contracting authority and the concessionaire .......... 4-64
   1. General remarks ..................................................... 4-10
   2. Negotiation .......................................................... 11-12
   3. Conciliation ........................................................ 13-20
   4. Proceedings before a referee or a dispute review board ............... 21-29
   5. Arbitration .......................................................... 30-59
   6. Judicial proceedings ............................................... 60-64

C. Settlement of commercial disputes ................................... 65-76
   1. General remarks ..................................................... 65-66
   2. Specific types of contracts and disputes .................................. 67-76

D. Disputes involving other parties .................................... 77-82
   1. Disputes between the concessionaire and its customers ............... 77-79
   2. Procedures for solving disagreements between the regulatory body and the concessionaire .................. 80-82
LEGISLATIVE RECOMMENDATIONS

Disputes between the contracting authority and the concessionaire (see paras. 4-64)

(1) The host country may wish to consider:
   (a) Reviewing and, as appropriate, removing unnecessary statutory limitations to the contracting authority's freedom to agree to dispute settlement mechanisms regarded by the parties as suited to the needs of the project;
   (b) Reviewing its legislation on the question of sovereign immunity and indicate the extent to which the contracting authority may or may not raise a plea of sovereign immunity, both as a bar to the commencement of arbitral or judicial proceedings as well as a defence against enforcement of the award or judgement.

Settlement of commercial disputes (see paras. 65-76)

(2) The host country may wish to make provisions recognizing the concessionaire's freedom to choose the appropriate mechanisms for settling commercial disputes among the project sponsors, or disputes between the concessionaire and its lenders, contractors, suppliers and other business partners.

Disputes involving other parties (see paras. 77-82)

(3) The host country may wish to consider the desirability of making available special simplified and efficient mechanisms (including arbitration and conciliation) for the settlement of disputes between the concessionaire and its consumers or users of the infrastructure facility.

(4) The host country may wish to adopt legislative provisions that:
   (a) Establish transparent procedures whereby the concessionaire may request a review of regulatory decisions by an independent and impartial body;
   (b) Set forth the grounds on which a request for review may be based and the availability of court review.

NOTES ON LEGISLATIVE RECOMMENDATIONS

A. GENERAL REMARKS

1. An important factor for the implementation of privately financed infrastructure projects is the legal framework in the host country for the settlement of disputes. Investors, contractors and lenders will be encouraged to participate in projects in countries where they have the confidence that any disputes arising out of contracts forming part of the project will be resolved fairly and efficiently. By the same token, efficient procedures for avoiding disputes or settling them expedi-

tiously will facilitate the exercise of the contracting authority's monitoring functions and reduce the overall cost of the regulatory process.

2. Privately financed infrastructure projects typically require the establishment of a network of interrelated contractual relationships between different parties. Legislative solutions regarding the settlement of disputes arising in the context of these projects must take account of the diversity of relations, and in particular of the fact that the variety of contracts and parties involved may call for different dispute settlement methods depending on the type of contract and parties involved. The legislative considerations underlying any regulation of dispute settlement mechanisms would depend on the types of agreements and contracts and the characteristics of disputes that may arise therefrom. The various agreements and contracts may be divided into three broad categories:

   (a) Agreements between the project company and the contracting authority and other governmental agencies.

   The central instrument in an infrastructure project is the project agreement between the host Government and the concessionaire. The project agreement is in many countries subject to a legal regime often referred to as "administrative law", while in other countries the agreement is in principle governed by the law of contract as supplemented by special provisions developed for Government contracts for the provision of public services. This regime may have implications for the dispute settlement mechanism that the parties to the project agreement may be able to agree upon;

   (b) Commercial contracts and agreements concerning the implementation of the project. These contracts usually include at least the following: (i) Contracts between parties holding equity in the project company (e.g. shareholders' agreements, agreements regarding the provision of additional financing or arrangements regarding voting rights); (ii) Financing and related agreements, which involve, apart from the project company, parties such as commercial banks, governmental lending institutions, international lending institutions and export credit insurers; (iii) Construction contract or contracts between the project company and a contractor, which itself may be a consortium of contractors, equipment suppliers and providers of services; (iv) Contract or contracts between the project company and the party who operates and maintains the project facility; and (v) Contracts for the supply of goods and services needed for the operation and maintenance of the facility;

   (c) Contracts between the project company or the operating or maintenance company on the one hand and the users of the facility on the other. These users may include, for example, a State-owned utility company that purchases electricity or water from the project company so as to resell it to the ultimate users; commercial companies, such as airlines or shipping lines contracting for the use of the airport or port; or individual persons paying for the use of a toll road.

3. The types of contracts mentioned above in (b) are generally considered commercial contracts to which, as regards disputes settlement clauses, general rules re-
B. DISPUTES BETWEEN THE CONTRACTING AUTHORITY AND THE CONCESSIONAIRE

1. General remarks

4. Disputes that arise under the project agreement frequently present problems that do not often exist in disputes arising under other types of contracts. This is due to the complexity of infrastructure projects, the fact that they are to be performed over a long period of time and involve a high level of public interest and the fact that a number of enterprises may participate in the construction and in the operational phases. In addition, disputes under project agreements may concern highly technical matters connected with the construction processes, the technology incorporated in the works and the conditions for operating the facility. Disputes that arise under the project agreement must be settled speedily in order not to disrupt the construction of the facility or the provision of the relevant services. These considerations ought to be taken into account by the parties in determining the dispute settlement mechanisms to be provided in the project agreement.

5. The issue that most frequently gives rise to disputes under the project agreement is whether a party has failed to perform its contractual obligations and, if so, the legal consequences of its failure. However, other questions often arise for which it is advisable to provide an appropriate settlement mechanism in the project agreement. For example, the project agreement may provide for its terms to be changed or supplemented in certain circumstances. Questions may arise as to whether those circumstances have occurred and, if so, how the contractual terms should be changed or supplemented (see chap. V, “Infrastructure development and operation”, __). The project agreement may also provide for the contracting authority to give its consent to certain actions by the concessionaire. If the contracting authority improperly withholds its consent, the question may arise whether an arbitral tribunal or court can substitute its own consent for that of the withholding party. Questions may also arise whether interim measures should be taken pending the final settlement of the dispute.

6. Under some legal systems, courts and arbitrators are not competent to change or supplement contractual terms or to substitute their own consent for a consent improperly withheld by a party. Under other legal systems, courts and arbitrators may do so only if they are expressly so authorized by the parties. Under yet other legal systems, arbitrators may do so but courts may not. Where the law applicable to the contract or to the proceedings does not permit courts or arbitrators to change contractual terms, the parties may wish to provide other means of changing certain terms, when it is feasible to do so. For example, they may provide for the prices charged by the concessionaire to change automatically by means of an index clause under certain circumstances (see chap. V, “Infrastructure development and operation”, __). They may provide for other contractual terms to be changed or supplemented by means of procedures before a third party, such as a referee or a dispute review board (see paras. 21-29). Where courts or arbitrators do not have the power to substitute their consent for a consent improperly withheld by a party, the project agreement may provide that a party may withhold its consent only upon specified grounds, and that, in the absence of those grounds, the consent is deemed to be given. Courts or arbitrators would then have to decide only whether the specified grounds existed.

7. In general, it is desirable for the parties initially to attempt to settle their disputes through negotiation (see paras. 11-12). The parties could, if they so desired, continue to negotiate even after other means of dispute settlement had been initiated. In some cases in which the parties have referred a dispute to conciliation (see paras. 13-20) and arbitral or judicial proceedings are thereafter initiated, they might still find it useful to continue with the conciliation. Also, disputes may arise under a project agreement that are not within the legal competence of courts or arbitral tribunals or that cannot conveniently be settled in arbitral or judicial proceedings (for example, disputes of a technical nature that need to be resolved more speedily than is possible in arbitral or judicial proceedings).

8. In practice, it has been found useful for disputes arising under project agreements to be settled by arbitration: a process by which parties refer disputes that might arise between them or that have already arisen for binding decision by one or more independent and impartial persons (arbitrators) selected by them (see paras. 30-59). In general, arbitral proceedings may be initiated only on the basis of an arbitration agreement. The arbitral award is usually enforceable in a manner similar to a court decision. In the absence of an arbitration agreement, disputes between the parties will have to be settled in judicial proceedings (see paras. 60-64).

9. In considering which method or methods of dispute settlement to provide in the project agreement, the par-
ties should ascertain, in particular, the scope of the authority that may be exercised by judges, arbitrators, a referee or a dispute review board under the law applicable to the procedures. They should also consider the extent to which a decision of a referee or dispute review board, arbitral award or judicial decision is enforceable in the countries of the parties. The fact that the contracting authority is often an agency of the Government may also be a factor influencing the method of dispute settlement to be provided.

10. Parties to a complex and long-term contractual relationship such as a project agreement sometimes agree on composite dispute-settlement clauses designed to prevent, to the extent possible, disputes from arising and to foster reaching agreed solutions and efficient dispute-settlement methods, when disputes nevertheless arise. Such clauses typically provide for a sequential series of steps starting with an early warning to the other party of issues that may develop into a dispute unless the parties take action to prevent them. When a dispute does occur the parties are required to exchange information and to discuss the dispute with a view to identifying a resolution. If the parties are unable to resolve the dispute themselves, then either party may require participation of an independent and impartial conciliator to assist them to find an acceptable resolution. If the assistance of a conciliator is not requested, then either party may request the assistance of the previously agreed panel entrusted with dispute-settlement powers. As to such a panel, it may be agreed that assistance will first be sought from the chairman of the panel; if the dispute cannot be so resolved, either party may submit the dispute to the full panel or the panel itself may decide to consider the dispute. Only if the steps previously mentioned do not lead to a resolution, either party may commence arbitration or court proceedings, as provided in the dispute settlement clause.

2. Negotiation

11. The most satisfactory method of settling disputes is usually by negotiation between the parties. An amicable settlement reached through negotiation may avoid disruption of the business relationship between the contracting authority and the concessionaire. In addition, it may save the parties the considerable cost and the generally greater amount of time normally required for the settlement of disputes by other means.

12. Even though the parties may wish to attempt to settle their disputes through negotiation before invoking other means of dispute settlement, it may not be desirable for the project agreement to prevent a party from initiating other means of settlement until a period of time allotted for negotiation has expired. Furthermore, if the project agreement provides that other dispute-settlement proceedings may not be initiated during the negotiation period, it is advisable to permit a party to initiate other proceedings even before the expiry of that period in certain cases, e.g. where a party states in the course of negotiations that it is not prepared to negotiate any longer, or where the initiation of arbitral or judicial proceedings before the expiry of the negotiation period is needed in order to prevent the loss or prescription of a right. It is advisable for the project agreement to require a settlement reached through negotiation to be reduced to writing.

3. Conciliation

13. If the parties fail to settle a dispute through negotiation, but wish nevertheless to avoid arbitral or judicial proceedings, they may attempt to do so through a process in which a third person is assisting the parties to reach a settlement, often by proposing solutions for their consideration. “Conciliation” or “mediation” are among the expressions that are frequently used for such non-adversarial proceedings. Conciliation differs from negotiations between the parties in that a conciliation is conducted by a third independent and impartial person, whereas in settlement negotiations between the parties no such third independent and impartial person is involved. The difference between conciliation and arbitral or judicial proceedings is that conciliation is voluntary in that both parties participate in it only to the extent that, and as long as, they both agree. Sometimes, however, the parties are committed by agreement to strive for a settlement during a specified period of time after the commencement of conciliation proceedings or until an event such as a written statement refusing to settle and declaring the conciliation as terminated. A further difference is that a conciliation ends either in a settlement of the dispute or it ends unsuccessfully, whereas the arbitral tribunal or the court, if there is no settlement, imposes a binding decision on the parties. Conciliation is being increasingly practised in various parts of the world. In many countries a number of private and public bodies have been established offering conciliation services to interested parties.

14. Conciliation is non-adversarial and fosters an amicable atmosphere, which makes it more likely that the parties in dispute will preserve or reestablish a good business relationship between them than in arbitral or judicial proceedings. Conciliation may even improve a business relationship, since the negotiations in the conciliation proceedings, joint fact-finding and the ultimate agreement of the parties may go beyond the confines of the dispute that gave rise to the conciliation and may result in a modified contractual relationship that is better adapted to the commercial reality. Because conciliation makes it possible to preside with certain formalities that must be observed in arbitral or judicial proceedings, conciliation proceedings are likely to be more speedy and inexpensive than arbitral or judicial proceedings.

15. If the parties provide for conciliation in the contract, they will have to settle a number of procedural questions in order to increase the chance of a settlement and to avoid some of the potential disadvantages of conciliation, which are mentioned below. Settling such procedural questions is greatly facilitated by the incorporation into the contract, by reference, of a set of conciliation rules such as the
UNCITRAL Conciliation Rules. Some countries have adopted legislation that is designed to facilitate the use of conciliation in commercial disputes.

16. A potential disadvantage of conciliation is that, if the conciliation were to fail completely, the money and time spent on it would have been wasted. That disadvantage might be reduced to some extent if the project agreement does not require the parties to attempt conciliation prior to initiating arbitral or judicial proceedings, but merely permit a party to initiate conciliation proceedings. Conciliation would thus take place in cases where there exists a real likelihood of reaching an amicable settlement.

17. Another potential difficulty may arise from the fact that in conciliation proceedings the parties typically express suggestions and views regarding proposals for a possible settlement, make admissions or indicate their willingness to settle. If, despite such efforts, the conciliation does not result in a settlement and the parties initiate judicial or arbitral proceedings, those views, suggestions, admissions or indications of willingness to settle might be used to the detriment of the party who made them. This possibility may discourage parties from actively trying to reach a settlement during conciliation proceedings, which would reduce the usefulness of conciliation. In order to address the problem, some rules (e.g. art. 20 of the UNCITRAL Conciliation Rules) contain a stipulation according to which the parties undertake not to rely on or introduce as evidence in any subsequent arbitral or judicial proceedings (i) views expressed or suggestions made by the other party in respect of a possible settlement of the dispute; (ii) admissions made by the other party in the course of the conciliation proceedings; (iii) proposals made by the conciliator; (iv) the fact that the other party had indicated its willingness to accept a proposal for settlement made by the conciliator. In order to foster conciliation as a method of settling disputes and to ensure that the described difficulties do not arise, some States have adopted legislative provisions restricting the introduction of certain evidence relating to conciliation proceedings into subsequent judicial or arbitral proceedings.

18. A party may be reluctant to actively strive for a settlement in conciliation proceedings if it has to take into account the possibility that, if the conciliation is not successful, the conciliator might be appointed as counsel of the other party or as an arbitrator. The conciliator’s awareness of certain facts occurring during conciliation (e.g. proposals for settlement and admissions) might prove to be prejudicial for the party who made them. This is the reason behind stipulations found in some standard conciliation rules (e.g. art. 19 of the UNCITRAL Conciliation Rules) to the effect that the parties and the conciliator undertake that the conciliator will not act as an arbitrator or as a representative or counsel of a party in any arbitral or judicial proceedings in respect of a dispute that is the subject of the conciliation proceedings; furthermore, the parties undertake that the parties will not present the conciliator as a witness in any such proceedings. Some jurisdictions, with a view to promoting and facilitating conciliation, have enacted legislative provisions limiting the possibility of a conciliator acting in a related subsequent dispute as counsel, an arbitrator or a witness.

19. Nevertheless, prior knowledge on the part of the arbitrator might be regarded by the parties as advantageous, in particular because that knowledge will allow the arbitrator to conduct the case more efficiently. If this is so, the parties may prefer that the conciliator be appointed as an arbitrator in the subsequent arbitral proceedings. In order to overcome any objection based on assertions of prejudice in those cases, some jurisdictions have adopted laws expressly allowing a conciliator, subject to agreement of the parties, to serve as an arbitrator.

20. A further potential disadvantage of conciliation is the possibility that a party would not live up to the settlement reached in conciliation proceedings. Thus, the attractiveness of conciliation would be increased if a settlement reached during a conciliation would be enforceable similarly as an arbitral award, so that a party to the settlement would not be compelled to initiate adversarial arbitral or judicial proceedings in order to enforce the settlement. A way of making a settlement enforceable may be for the parties to appoint the conciliator as an arbitrator and limit the arbitral proceedings to recording the settlement in the form of an arbitral award on agreed terms (as provided for, e.g. in art. 34(1) of the UNCITRAL Arbitration Rules). A possible obstacle to this approach, however, may arise in legal systems in which, once a settlement has been reached and the dispute thereby eliminated, it is not possible to institute arbitral proceedings. In order to deal with this obstacle, some jurisdictions have adopted laws that establish the enforceability of settlement agreements reached in conciliation. One possible legislative solution may be to provide that the written settlement agreement should, for the purposes of its enforcement, be treated as an arbitral award and may be enforced as such. Another solution may be for legislation to expressly permit the parties to the settlement, despite the disappearance of the dispute, to commence arbitration and obtain from the arbitrator, who may be the former conciliator, an award on agreed terms.

4. Proceedings before a referee or a dispute review board

21. The parties may wish to consider providing for certain types of disputes to be settled by a third party (referred to
in the Guide as a "referee") or by a board of experts appointed by both parties. These boards of experts are often referred to, for example, as "dispute review boards", "concession referee boards" or "dispute adjudication boards". Proceedings before a referee or a dispute review board can be quite informal and expeditious, and tailored to suit the characteristics of the dispute that they are called upon to settle. In such a process, the parties may be free to accept or reject the suggestions of the referee or dispute review board and to initiate judicial or arbitral proceedings at any time, especially if such initiation is needed in order to prevent the loss or prescription of a right. The appointment of a referee or dispute review board may prevent misunderstandings or differences between the parties from developing into formal disputes requiring settlement in arbitral or judicial proceedings.

22. Where these procedures are used, if a dispute arises which the parties have been unable to resolve by discussion, either party can refer the dispute to the referee or dispute resolution board for a recommendation or adjudication. Such referral triggers an evaluation by the referee or dispute review board, which is done in an informal manner, typically by discussion with the parties during a regular site visit. The referee or the board controls the discussion, but each party is given an opportunity to state its views, and the referee or dispute review board is free to ask questions, and to request documents and other evidence. The board then meets privately and seeks to reach a unanimous recommendation or adjudication. Typically, according to the contract provisions establishing the referee or the dispute review board mechanism, the decision of the referee or dispute resolution board is not automatically binding on the parties, but they may stipulate that the decision becomes binding unless one or both parties refer the dispute to arbitration or initiate judicial proceedings.

23. A few international organizations and trade associations have developed rules concerning the use of a referee or a dispute review board in the settlement of disputes, but those rules generally deal with only some aspects of the matter. Many legal systems do not regulate proceedings before a referee. Others regulate them only to a very limited extent. It should also be noted that the law applicable to the proceedings may provide only limited legal safeguards to ensure that the proceedings are conducted impartially and with due care. In addition, under many legal systems, the decision by the referee or dispute review board, while binding as a contract, does not constitute an executory title, since it does not have the status of an arbitral award or a judicial decision. For these reasons, if the parties contemplate providing for proceedings before a referee or dispute review board, it will be necessary for them to settle various aspects of those proceedings in the project agreement. The main issues to be provided are discussed below.

24. The composition of the dispute review board may vary in the different stages of the project. Each board member should be experienced in the type of project, and in contract interpretation and administration for such projects, and should undertake to remain impartial and independent of the parties. In the construction phase, for instance, these persons may be furnished with periodic reports on the progress of construction and informed immediately of differences arising between the parties on matters connected with the construction. They may meet with the parties on the site, either at regular intervals or when the need arises, to consider differences that have arisen and to suggest possible ways of resolving those differences.

25. It would be desirable for the project agreement to delimit as precisely as possible the authority conferred upon the referee or dispute review board. It may specify the functions to be performed by the referee or dispute review board, and the type of issues with which they may deal. It is desirable to restrict the authority of the referee or dispute review board to issues of a predominantly technical character. A possible way of expressing such a restriction in the contract is to include a list of technical issues with which the referee or dispute review board are authorized to deal.

26. With regard to the nature of their functions, the project agreement might authorize the referee or dispute review board to make findings of fact and to order interim measures. The project agreement might also authorize them to change or supplement terms of the project agreement when they may be permitted to do so under the law applicable to the project agreement (see para. 6). The parties may wish to consider whether the referee or dispute review board should be authorized to decide on the substance of certain types of disputes (e.g. disputes as to whether completion tests or performance tests were successful, or as to grounds asserted by the concessionaire for objecting to a variation ordered by the contracting authority), or whether the settlement of those disputes should be left to arbitrators or courts.

27. To the extent they are permitted to do so by the law applicable to the proceedings, the parties might wish to deal in the project agreement with the relationship between proceedings before a referee or dispute review board and proceedings before a court or arbitral tribunal. For example, the project agreement might provide that disputes within the scope of the authority of the referee or dispute review board must first be submitted to it for resolution and that arbitral or judicial proceedings cannot be initiated until the expiration of a specified period of time after submission of the dispute to the referee or dispute review board. The project agreement should further clarify whether the recommendation or adjudication of the dispute review board is admissible as evidence in any subsequent arbitral or judicial proceedings.

28. The law governing arbitral or judicial proceedings may determine the extent to which the parties may authorize arbitrators or a court to review a decision of the referee or dispute review board. Excluding such review has the advantage that the decision of the referee or dispute review board would be immediately final and binding. However, permitting such a review gives the parties greater assurance that the decision will be correct. The advantages of both approaches may be
combined to some extent by providing that the decision by the referee or dispute review board is binding on the parties unless a party initiates arbitral or judicial proceedings within a short specified period of time after the decision is rendered. If they are permitted to do so, the parties might specify that findings of fact made by a referee or dispute review board cannot be challenged in arbitral or judicial proceedings. The project agreement might also obligate the parties to implement a decision by the referee concerning interim measures or a decision on the substance of certain specified issues; if the parties fail to do so, they will be considered as having failed to perform a contractual obligation.

29. Procedures before referees or dispute review boards have been used in conjunction with adversary dispute settlement mechanisms, such as arbitration. These procedures are being increasingly used in countries where government agencies are by law restricted to resolving contractual disputes by court litigation. Early clauses on referees or dispute review boards did not have provisions making their recommendations binding. In practice, however, the combination of the persuasive force of unanimous recommendations by independent experts agreed by the parties led both contracting authorities and project companies to accept voluntarily the recommendations rather than litigate. Apart from avoiding potentially protracted litigation, the parties often take into account the potential difficulty of overcoming what might be regarded by the court or arbitral tribunal as a powerful recommendation, as it had been made by independent experts familiar with the project from the outset, and was based on contemporaneous observation of the project prior to, and at the time of, the dispute having first arisen.

5. Arbitration

(a) Considerations as to whether to conclude arbitration agreement

30. There are various reasons why arbitration is frequently used for settling disputes arising under privately financed infrastructure projects. Arbitral proceedings may be structured by the parties so as to be less formal than judicial proceedings and better suited to the needs of the parties and to the specific features of the disputes likely to arise under the project agreement. The parties can choose as arbitrators persons who have expert knowledge of the particular type of project. They may choose the place where the arbitral proceedings are to be conducted. They can also choose the language or languages to be used in the arbitral proceedings. Where parties agree to arbitration, neither party submits to the courts of the country of the other party, except to the extent the courts of the place of arbitration may be called upon to intervene in the arbitral process. Arbitral proceedings may be less disruptive of business relations between the parties than judicial proceedings. The proceedings and arbitral awards can be kept confidential, while judicial proceedings and decisions usually cannot. Arbitral proceedings tend to be more expeditious and, in view of their finality, often less costly than judicial proceedings. While some legal systems provide for summary judicial proceedings for certain types of disputes (usually disputes involving relatively small sums of money) many disputes arising in connection with a privately financed infrastructure project will not qualify for settlement under such proceedings. Finally, as a result of international conventions that assist in the recognition and enforcement of foreign arbitral awards, those awards are frequently recognized and enforced more easily than foreign judicial decisions (see also paras. 56-59).

31. On the other hand, an arbitral award may be set aside in judicial proceedings. The initiation of those proceedings will prolong the final settlement of the dispute. However, under most legal systems, an arbitral award may be set aside only on a limited number of grounds, for example that the arbitrators lacked authority to decide the dispute, that a party could not present its case in the arbitral proceedings, that the rules applicable to the appointment of arbitrators or to the arbitral procedure were not complied with, or that the award was contrary to public policy.

(b) Authority to agree on arbitration

32. There are two possible limits to the freedom to agree to arbitration: one arising from the subject matter to be submitted to arbitration and another one arising from the governmental character of a party to the arbitration agreement. In many legal systems, the traditional position has been that the Government and its agencies may not agree to arbitration. This position has often been restricted to mean that it does not apply to public enterprises with an industrial or commercial character which, in their relations with third parties, act pursuant to private law or commercial law.

33. As noted earlier (see chap. I, “General legislative considerations”), in some legal systems belonging to the civil law tradition, the provision of public services is governed by a body of law known as “administrative law”, which governs a wide range of governmental functions. In many of those countries there are special provisions for the settlement of disputes arising out of government contracts; in particular there may exist prohibitions for the government agencies to agree to arbitration to the exclusion of court jurisdiction. Such restrictions may extend to a varying degree to a range of governmental entities encompassing the legislative, administrative and executive branches. However, there may be differences between a contract entered into by a governmental department and one that is entered into by a government-owned corporation. Also to be taken into consideration is the constitutional division of powers within the host country. In some countries, certain matters fall within the exclusive jurisdiction of a subsidiary political division (i.e. a state or province), whereas two or more political divisions may share jurisdiction in respect of other matters. It may not be
possible for one of these governmental divisions to preclude the application of laws that govern matters within the jurisdiction of another division.

34. Limitations to the freedom to agree on arbitration may also relate to the legal nature of the project agreement. Under civil law systems with a special category of administrative law, there may be provisions that classify the project agreements as administrative contracts, with the consequence that they are governed by the administrative law of the host State. Under other legal systems, similar prohibitions may be expressly included in legislation or judicial precedents directly applicable to project agreements. But even where there is no overt prohibition, the same result may be achieved by established contract practices in the area of privately financed infrastructure projects, usually based on legislative rules or regulations. For example, legislation may stipulate that governmental contracts are required to adhere to certain standard forms of contract, which may contain standard clauses, including a standard dispute settlement clause which stipulates the jurisdiction of the courts of the host country. Therefore, regardless of the type of legal regime under consideration, it is important to determine whether a project agreement will be classified as a governmental contract subject to certain rules, as a private commercial contract subject to the same rules as any other such type of contract, or whether there are special rules that apply to project agreements in general (see also chapter IV, "The project agreement", ____).

35. For countries that wish to allow the use of arbitration for the settlement of disputes arising in connection with privately financed infrastructure projects, it is important to remove possible legal obstacles and to provide a clear authorization for domestic contracting authorities to agree to arbitrate their disputes. The absence of a clear legislative authority to agree on arbitration may give rise to questions as to the validity of the arbitration agreement and cause delay in the settlement of possible disputes. Dealing with allegations of invalidity of an arbitration agreement will in the first instance be in the hands of the arbitral tribunal which will have to decide the validity of the allegation. If the arbitral tribunal finds that the arbitration agreement has been validly concluded despite any subsequent defence that the contracting authority had no authorization to conclude it, the question may reappear at the recognition and enforcement stage before a court in the host country or before a court of a third country where the award is to be recognized or enforced.

36. With regard, in particular, to infrastructure projects involving foreign investors, it may be noted that a framework for the settlement of disputes between the contracting authority and foreign companies participating in a project consortium may be provided by a bilateral investment treaty or by adherence to the Convention on the Settlement of Investment Disputes between States and Nationals of Other States (Washington, 1965). The Convention, which has thus far been adhered to by 139 States, established the International Centre for the Settlement of Investment Disputes (ICSID). ICSID provides facilities for the conciliation and arbitration of disputes between member countries and investors who qualify as nationals of other member countries. recourse to ICSID conciliation and arbitration is voluntary. However, once the parties to a contract or dispute have consented to arbitration under the ICSID Convention, neither can unilaterally withdraw its consent. All ICSID members, whether or not parties to the dispute, are required by the Convention to recognize and enforce ICSID arbitral awards. ICSID is an autonomous international organization with close links with the World Bank.

\[c\] Provisions of arbitration agreement

(i) Scope of arbitration agreement and mandate of arbitral tribunal

37. In general, arbitral proceedings may be conducted only on the basis of an agreement by the parties to arbitrate. The agreement may be reflected either in an arbitration clause included in the project agreement or in a separate arbitration agreement concluded by the parties before or after a dispute has arisen. Since it may be more difficult to reach an agreement to arbitrate after a dispute has arisen, it is advisable either to include an arbitration clause in the project agreement or to enter into a separate arbitration agreement at the time of entering into the contract. However, under some legal systems, an agreement to arbitrate is procedurally and substantively fully effective only if it is concluded after a dispute has arisen.

38. It would be advisable for the project agreement to indicate what disputes are to be settled by arbitration. For example, the arbitration clause may stipulate that all disputes arising out of or relating to the project agreement or the breach, termination or invalidity thereof are to be settled by arbitration. In some cases, the parties may wish to exclude from that wide grant of jurisdiction certain disputes that they do not wish to be settled by arbitration.

39. If permitted under the law applicable to the arbitral proceedings, the parties may wish to authorize the arbitral tribunal to order interim measures pending the final settlement of a dispute. However, under some legal systems, arbitral tribunals are not empowered to order interim measures even if so authorized by the parties. Under other legal systems, where interim measures can be ordered by an arbitral tribunal, in many cases they cannot be enforced, although also unenforceable measures are not without practical value. In those cases, it may be preferable for the parties to rely on a court to order interim measures. Under many legal systems, a court may order interim measures even if the dispute is to be or has been submitted to arbitration.

40. It is desirable for the arbitration agreement to obligate the parties to implement arbitral decisions, including decisions ordering interim measures. The ad-
vantage of including such an obligation in the project agreement is that under some legal systems, where an arbitral award is not enforceable in the country of a party, a failure by the party to implement an award when obligated to do so by the contract might be treated in judicial proceedings as a failure by the party to perform a contractual obligation.

41. If judicial proceedings are instituted in respect of a dispute covered by an arbitration agreement that is recognized to be valid, upon a timely request the court will normally refer the dispute to arbitration. However, the court may retain the authority to order interim measures and will normally be entitled to control certain aspects of arbitral proceedings (e.g. to decide on a challenge to arbitrators) and to set aside arbitral awards on certain grounds (see paras. 56-59).

(ii) Type of arbitration and appropriate procedural rules

42. The parties are able to select the type of arbitration that best suits their needs. It is desirable that they agree on appropriate rules to govern their arbitral proceedings. There is a wide range of arbitration systems available, with varying degrees of involvement of permanent bodies (e.g. an arbitration institution, professional or trade association or chamber of commerce) or third persons (e.g. a chief officer of a court of arbitration or of a chamber of commerce). At one end of the spectrum is the pure ad hoc type of arbitration, which does not involve a permanent body or third person in any way. This means, in practical terms, that no outside help is available (except, perhaps, from a national court) if, for example, less difficulties are encountered in the appointment or challenge of an arbitrator. Moreover, any necessary administrative arrangements have to be made by the parties or the arbitrators themselves. At the other end of the spectrum there are arbitrations fully administered and supervised by a permanent body, which may review terms of reference and the draft award and may revise or make recommendations as to the form of the award.

43. Between these two types of arbitration there is a considerable variety of arbitration systems, all of which involve an appointing authority (or at least a system for the appointment of the appointing authority, as provided for by the UNCITRAL Arbitration Rules). These systems differ as to the administrative services that they provide. The essential, although not necessarily exclusive, function of an appointing authority is to compose or assist in composing the arbitral tribunal (e.g. by appointing the arbitrators, deciding on challenges to an arbitrator or replacing an arbitrator). Administrative or logistical services, which may be offered as a package or separately, could include the following: forwarding written communications of a party or the arbitrators; assisting the arbitral tribunal in organizing hearings and other meetings (including notifying the participants; providing, or arranging for, meeting rooms for hearings or deliberations of the arbitral tribunal; arranging for maintaining a record of hearings and for interpretation during hearings and possibly translation of documents); assisting in filing or registering the arbitral award, when required; holding deposits and administering accounts relating to fees and expenses; and providing other secretarial or clerical assistance.

44. Unless the parties opt for pure ad hoc arbitration, they may wish to agree on the body or person to perform the functions that they require. Among the factors worthwhile considering in selecting an appropriate body or person are the following: willingness to perform the required functions; competence, in particular in respect of international matters; appropriateness of fees measured against the extent of services requested; seat or residence of the body or person and possible restriction of its services to a particular geographic area. The latter point should be viewed in conjunction with the probable or agreed place of arbitration. However, certain functions (e.g. appointment) need not necessarily be performed at the place of arbitration, and certain arbitral institutions are prepared to provide services in countries other than those where they are located.

45. In most cases, the arbitral proceedings will be governed by the law of the State where the arbitration takes place. Many States have laws regulating various aspects of arbitral proceedings. Some provisions of these laws are mandatory; others are non-mandatory. In selecting the place of arbitration, the parties may wish to consider the extent to which the law of a place under consideration recognizes the special needs and features of international commercial arbitration and, in particular, whether it allows the parties to tailor the procedural rules to meet their particular needs and wishes while at the same time ensuring that the proceedings are fair and efficient. A trend in this direction, discernible from modern legislation in a good number of jurisdictions, is being enhanced and fortified by the UNCITRAL Model Law on International Commercial Arbitration, which was adopted in 1985.

46. Since the arbitration laws of some States are not necessarily suited to the particular features and needs of international commercial arbitration, and since, in any case, those laws do not contain rules settling all procedural questions that may arise in relation to arbitral proceedings, the parties may wish to agree on a set of arbitration rules to govern arbitral proceedings. When the parties choose to have their arbitration administered by an institution, the institution usually requires the parties to use the rules of that institution, and would refuse to administer a case if the parties have modified provisions of those rules that the institution regards as fundamental to its arbitration system. Many arbitral institutions offer a choice of two or sometimes more sets of rules and usually allow the parties to modify the rules, in particular

those rules that do not interfere with the administration of the arbitration by the institution. If the parties are not required by an institution to use a particular set of arbitration rules or to choose among specified sets of rules, or if they choose ad hoc arbitration, they are free to choose a set of rules themselves. In selecting a set of procedural rules, the parties may wish to consider its suitability for international cases and the acceptability of the procedures contained in them.

47. Of the many arbitration rules promulgated by international organizations or arbitral institutions, the UNCITRAL Arbitration Rules\(^3\) deserve particular mention. These Rules have proven to be acceptable in different legal, social and economic systems and are widely known and used in all parts of the world. Parties may use them in pure ad hoc arbitrations as well as in arbitrations involving an appointing authority with or without the provision of additional administrative services. A considerable number of arbitration institutions in all regions of the world have either adopted these Rules as their own institutional rules for international cases or have offered to act as appointing authority. Most of them will provide administrative services in cases conducted under the UNCITRAL Arbitration Rules.

(iii) Practical matters to be settled by parties

48. The provisions on arbitration in the project agreement or in a separate arbitration agreement should also deal with a number of practical matters, such as: the number of arbitrators who are to comprise the arbitral tribunal; the procedures for appointing the arbitrators; the place where the proceedings are to be held and where the arbitral award is to be issued; the language to be used in the arbitral proceedings.

49. Where a model clause accompanies the arbitration rules or is suggested by an arbitral institution, adoption of that clause by the parties enhances the certainty and effectiveness of the arbitration agreement. Some model clauses, such as the one accompanying the UNCITRAL Arbitration Rules, suggest that the parties settle these practical matters by agreement.

(d) Particular issues concerning the implementation of arbitration agreements

50. If it is found desirable to allow the parties the freedom to choose the dispute settlement mechanism, including arbitration, it is advisable to consider whether express legislative authority is required. Such express authority would be needed where, given the tradition of exclusive court jurisdiction in matters of governmental concessions, arbitration is not permitted or it may be uncertain whether the parties to a project agreement are free to agree to arbitration.

(i) Sovereign immunity

51. When arbitration is allowed and agreed upon between the parties to the project agreement, the implementation of an agreement to arbitrate may be frustrated or hindered if the State entity is able to plea State immunity, either as a bar to the commencement of arbitral proceedings or as a defence against recognition and enforcement of the award. Sometimes the law on this matter is not clear, which may raise concerns with the investors and the party concluding a contract with the contracting authority that an agreement to arbitrate might not be effective. In order to allay such possible concerns, it is advisable to review the law on this topic and indicate the extent to which the contracting authority may raise a plea of sovereign immunity.

52. Applying concepts of private law to the extent they may be applied to the question whether State immunity may be raised as a bar to the commencement of arbitral proceedings, or applying principles developed in legislation and case law of some States, an agreement to arbitrate may be regarded as a waiver of the State immunity.

53. Even if the award has been issued against the contracting authority it may raise a plea of immunity from execution against State property. There is a diversity of approaches to the question of State immunity from execution. For example, under some national laws immunity does not cover State entities engaged in commercial activity. In other national laws a link is required between the property to be attached and the claim in that, for example, immunity cannot be pleaded in respect of funds allocated for economic or commercial activity governed by private law upon which the claim is based or that immunity cannot be pleaded with respect to assets set aside by the State to pursue its commercial activities. In some States it is considered that it is for the State to prove that the assets to be attached are in non-commercial use.

54. In some contracts involving entities that might plea sovereign immunity, clauses have been included to the effect that the State waives its right to plea sovereign immunity. Such consent or waiver might be contained in an international agreement or the consent may be limited to recognizing that certain property is used or intended to be used for commercial purposes. Such written clauses have been used inasmuch as it is not clear whether the conclusion of an arbitration agreement and participation in arbitral proceedings by the State entity constitutes an implied waiver of sovereign immunity from execution.

55. The legislator may wish to review its laws on this matter and, to the extent considered advisable, clarify in which areas State entities may not plea sovereign immunity.

(ii) Enforceability of the award

56. The effectiveness of an agreement to arbitrate depends also on legislation governing the recognition and enforcement of arbitral awards. These legislative provisions have been harmonized by the Convention on the Recognition and Enforcement of Foreign Arbitral Awards (New York, 1958), which, inter alia, deals with the recognition of an arbitration agreement and the grounds on which the court may refuse to recognize or enforce an award. The Convention has been adhered to by a large number of countries and is widely regarded as providing an acceptable and balanced regime for the recognition and enforcement of arbitral awards. The fact that the host country is a party to the Convention is likely to be seen as a crucial element in assessing the legal certainty of binding commitments and of the reliability of arbitration as a method for solving disputes by arbitration with parties from the country.

57. According to its article I, the Convention applies to the recognition and enforcement of awards "made in the territory of a State other than the State where the recognition and enforcement of such awards are sought". Thus, if the place of arbitration is in the host country, the courts of that country will normally not apply the Convention to awards made there even if the host country is a party to the Convention. The applicability of a recognition and enforcement regime other than that of the Convention may be seen as a factor increasing the uncertainty of arbitration as a dispute settlement mechanism. In order to avoid that uncertainty, the project company may be interested in reaching an agreement with the contracting authority that any arbitration take place in a country other than the host country.

58. In order to increase the attractiveness of the host country as the venue for arbitration, the legislator may decide to adopt a regime for the recognition and enforcement of arbitral awards made in the State that is essentially the same as the regime set forth in the Convention. Such a regime is contained in the UNCITRAL Model Law on International Commercial Arbitration, which is closely modelled on the 1958 New York Convention and which applies to all awards whether they have been made in the enacting State or in a foreign State. The internationally harmonized wording of the relevant provisions of the Model Law will increase the transparency of the law in the host country on this point.

59. The applicability in the host country of the 1958 New York Convention and the regime modelled on that Convention for the awards not covered by the Convention does not eliminate all possibilities of frustrating recognition and enforcement of an award issued in the host country. This is because a party may apply to the courts of the place where the award has been made to set aside the award. The effectiveness of arbitration will thus also depend on the legislative regime for the setting aside of awards in the country where the arbitration takes place. If that regime in the host country is seen as unsatisfactory, in particular if it allows an award to be set aside for reasons that go beyond those widely regarded as acceptable for international commercial arbitration, a party might, for that reason, wish to agree on a place of arbitration outside the host country. In order to reassure all parties and in particular private investors that an award made in the host country will not be set aside for exorbitant reasons, the host country may wish to consider adopting a regime that is widely regarded as appropriate for international commercial cases. Such a regime is contained in the UNCITRAL Model Law on International Commercial Arbitration.

6. Judicial proceedings

60. Apart from the question of how the matter is regulated by law, in considering whether any dispute should be resolved in judicial proceedings or whether an arbitration agreement should be entered into, factors typically taken into account by the parties include, for example, their confidence that the courts competent to decide a dispute will be unbiased and that the dispute will be resolved without inordinate delay. The efficiency of the national judicial system and the availability of forms of judicial relief that are adequate to disputes that might arise under the project agreement are additional factors to be taken into account. A potential for delay in court proceedings may arise in particular from the possibilities of recourse against a court decision. Furthermore, in view of the fact that infrastructure projects usually involve highly technical and complex issues, the parties will also consider the implications of using arbitrators selected for their particular knowledge and experience as compared to the judicial system which is typically not based on the idea that a dispute should be entrusted to a judge that has the specific prior knowledge or experience in the area where the dispute arose. Another consideration may be the confidentiality of arbitration proceedings, relative informality of arbitral procedures, and the possibly greater flexibility arbitrators may have in awarding appropriate remedies, all of which may be beneficial for preserving and developing the long-term relationship implicit in project agreements.

61. The contracting authority may see several reasons for leaving any dispute to be resolved by the courts of the host country. Those courts are familiar with the law of the country, which often includes specific legislation directly applicable to the project agreement. Furthermore, the contracting authority and other governmental agencies of the host country that might be involved in the dispute may prefer local courts because of the familiarity with the court procedures and the language of the proceedings. It may also be considered that, to the extent project agreements involve issues of public
policy and the protection of public interest, State courts are in a better position to give them proper effect.

62. However, such a view by the contracting authority is often not shared by the project company, investors, financiers and other private parties involved in the project. These parties may be concerned that a court of the host country might be biased in favour of the contracting authority or that in court proceedings short-term policies or political considerations might prevail over the legitimate interests of the private investors. They may also consider that arbitration is preferable to judicial proceedings because arbitration, being to a larger degree subject to agreement of the parties than judicial proceedings and not subject to lengthy appeals, is in a position to resolve a dispute more efficiently. Another reason may be that a number of persons on the side of the project company may not be familiar with the language of the court proceedings, which would be a hindrance in their participation in court proceedings.

63. Some countries, including those with a tradition of exclusive jurisdiction of courts in issues arising from governmental concessions, have concluded that there are no compelling reasons of public interest for not allowing the parties to the project agreement to agree on the dispute settlement mechanism they consider the most appropriate. In some countries it was also found that allowing the parties to choose the dispute settlement mechanism helped to attract foreign investment for the development of its infrastructure.

64. However, according to other laws, agreement to arbitrate is not allowed, with the result that the provisions on competence of courts of the host country apply. In countries where Government contracts are subject to such a special regime, it may be advisable for the legislature to review the adequacy of the provisions on dispute settlement for privately financed infrastructure projects.

C. SETTLEMENT OF COMMERCIAL DISPUTES

1. General remarks

65. In addition to the project agreement, there are various other contracts involved in a privately financed infrastructure project. The legislative considerations underlying any regulation of dispute settlement mechanisms would depend on the types of contract and the characteristics of disputes that may arise therefrom. These contracts would typically include the following: (a) agreements and corporate instruments entered into by project sponsors; (b) financing and related agreements; (c) construction contracts; (d) operation and maintenance contracts; (e) contracts for the supply of goods and services needed for the operation and maintenance of the facility.

66. It is generally accepted in national laws that parties to commercial transactions, and in particular international commercial transactions, are free to agree on the forum that will decide in a binding decision any dispute that may arise from those transactions. In international transactions, arbitration has become the preferred method, whether or not it is preceded by, or combined with, conciliation. As to contracts usually forming part of privately financed infrastructure transactions, in many countries the parties are free to subject disputes to arbitration, to select the place of arbitration and to determine whether or not any arbitration case should be administered by an arbitral institution. This is true in particular for the types of contracts mentioned in the preceding paragraph. These contracts are generally considered commercial agreements to which, as regards disputes settlement clauses, general rules regarding commercial contracts are applicable. Governments wishing to establish a hospitable legal climate for privately infrastructure projects would be advised to review their laws with respect to these contracts so as to eliminate any uncertainty regarding the freedom of the parties to agree to dispute settlement mechanisms of their choice.

2. Specific types of contracts and disputes

(a) Agreements and corporate instruments entered into by project sponsors

67. These agreements may include, in addition to the instruments of incorporation of the project company, for example, various shareholders’ agreements, agreements regarding the provision of additional financing or arrangements regarding voting rights. Parties to these instruments and agreements typically have a strong tendency to resolve their disputes by voluntary conciliation rather than in formal arbitral or court proceedings.

(b) Financing and related agreements

68. Since only a minor part of financing is provided directly by project sponsors and the rest is obtained from various lenders and investors, a number of credit agreements, export credit arrangements and other financing instruments are entered into with parties such as commercial banks, governmental lending institutions, international lending institutions and export credit insurers. The lenders pay particular attention to legal certainty, enforceability of financial obligations as well as to legal validity of security arrangements. Lenders have a tendency of favouring agreements that submit any disputes arising out of these agreements to the court jurisdiction of international financial centres. However, lending instruments in some privately financed infrastructure projects have provided for arbitration as a method for settling these types of disputes.

(c) Construction contracts

69. Contracts for the construction of the facility are often concluded by the project company on a turnkey basis,
either with one contractor or a consortium of contractors, under a single contract or several contracts. Members of the consortium of contractors may in turn enter into a number of additional agreements among themselves regarding, for example, the supply of equipment and the provision of various services.

70. Experience shows that construction contracts are particularly prone to disputes and these disputes present problems that do not often exist in other types of contract. This is due, for example, to the technical complexity of these contracts, the number of different enterprises that participate in the construction, need for variations or far-reaching consequences of mistakes.

71. It is often desirable for disputes arising under construction contracts to be settled by arbitration. However, certain disputes that may arise under the construction contracts are not within the legal competence of courts or arbitral tribunals or cannot conveniently be settled in arbitral or judicial proceedings (for example, disputes of a technical nature that need to be resolved more speedily than is possible in arbitral or judicial proceedings). The parties may wish to provide for such disputes to be dealt with by a third party, such as a referee or a dispute review board (see also paras. 21-29).

72. Disputes involving several enterprises may arise in connection with the construction. For example, where the project company alleges that the construction is defective, it may be uncertain which of several contractors engaged by it is liable. If the project company pursues individual claims against each contractor and those claims are settled in separate proceedings by different courts or arbitrators, those proceedings may result in inconsistent decisions. This could occur even if the same law governs all of the contracts and could result, for example, from the application of different procedural rules or from different evaluations of the relevant evidence. Settlement of all related claims in the same proceedings could prevent inconsistent decisions, facilitate the taking of evidence, and reduce costs. However, multi-party proceedings tend to be more complicated and less manageable, and a party may find it more difficult to plan and present its case in such proceedings. Many legal systems provide means for disputes involving several parties to be settled in the same multi-party judicial proceedings. In order to enable disputes involving several enterprises to be settled in multi-party judicial proceedings, it may be desirable for all contracts entered into by the project company for the construction of the works to contain a clause conferring exclusive jurisdiction on a court which has the power to conduct multi-party proceedings. It is more difficult to structure multi-party proceedings when arbitration is to be used for the settlement of disputes. However, some of the benefits of multi-party proceedings might be achieved if the same arbitrators were appointed to settle disputes arising under all contracts concerning the construction of the works.

73. Under some legal systems, a party seeking to consolidate arbitral proceedings before one single arbitral tribunal may file an application for that purpose to a court. In most of those legal systems such an application must be based on the consent of all parties concerned. In some of these jurisdictions, application for consolidation can be made to the arbitral tribunal or tribunals concerned. The requested arbitral tribunals may confer with each other with a view to making consistent orders for consolidation. If an order for consolidation is not made, or if inconsistent provisional orders by the arbitral tribunals involved are made, any party may apply to the court, which will decide on consolidation. In most legal systems that contain specific provisions on this matter, a consolidation order can be made where there is a common question of law or fact, that the rights to relief claimed arise out of the same transaction or that for some other reason a consolidation order is desirable.

(d) Contract or contracts between the project company and the party who operates and maintains the project facility

74. Disputes arising from contracts for the operation and maintenance of the project facility frequently present problems that do not often exist in disputes arising under other types of contracts. This is due to their complexity, the fact that they are to be performed over a long period of time and the fact that a number of enterprises may participate in the operation and maintenance of the project. In addition, there is a strong public interest in the timely and proper performance of these contracts. Disputes under these contracts often concern highly technical matters connected with the construction processes and with the technology incorporated in the project. It is particularly important that they be settled speedily in order not to disrupt the maintenance of the facility or the provision of the public service. These considerations ought to be taken into account by the parties in determining the most suitable dispute settlement mechanisms.

75. As with disputes that relate to the construction phase, disputes arising in connection with the operation of the infrastructure, too, may involve several enterprises and the earlier considerations concerning multi-party proceedings would also apply mutatis mutandis in this context (see paras. 72-73).

(e) Contracts for the supply of goods and services needed for the operation and maintenance of the facility

76. Contracts for the supply of goods and services needed for the operation and maintenance of the facility, as usual commercial contracts, do not pose any particular considerations in the context of privately financed infrastructure projects. However, to the extent that a governmental agency of the host country is a party to any of these contracts, considerations similar to those concerning disputes between the contracting au-
authority and the concessionaire (see paras. 4-64) may also be relevant in this context.

D. DISPUTES INVOLVING OTHER PARTIES

1. Disputes between the concessionaire and its customers

77. Depending on the type of project, the concessionaire’s customers may include various persons and entities, such as, for example, a government-owned utility company that purchases electricity or water from the concessionaire so as to resell it to the ultimate users; commercial companies, such as airlines or shipping lines contracting for the use of the airport or port; or individual persons paying for the use of a toll road. The considerations and policies regarding contracts with the end-purchasers of the goods or services supplied by the project company depend on who are the parties to those contracts. If the end-users are utility companies or commercial enterprises, the parties would settle any disputes by methods usual in trade contracts, including arbitration. If, however, the users are consumers, i.e. individual persons acting in their non-commercial capacity, special considerations may apply. For example, in some countries it was considered desirable to establish by law an obligation to make available to consumers special simplified and efficient mechanisms for settling disputes with the operator of the facility. Where such special mechanisms exist, it is often provided that the mechanisms are optional without prejudice to the consumers’ access to courts.

78. In some countries provisions exist regulating disputes between providers of public services, such as utilities, and purchasers or users of those services. Such special regulation is typically limited to certain industrial sectors and applies to purchases of goods or services by individual consumers; the regulation, for example, provides an obligation of the supplier to establish a mechanism for receiving and dealing with complaints by individual consumers and in some cases also for simplified methods for settling disputes. These methods may include arbitration and conciliation. Typically, such mechanisms are optional for the consumer and do not preclude resort by the aggrieved persons to courts. Where the purchasers or users are commercial entities, it is usually considered that there is no need for specific regulation of the settlement of disputes.

79. The need for such special provisions in the area of privately financed infrastructure projects and the nature of dispute settlement mechanisms provided for depend on considerations such as the types of goods or services involved, the entities or persons purchasing them and the policies underlying various industrial sectors. It therefore appears advisable to leave any such regulation to sector specific laws or to regulations issued pursuant to such laws.

2. Procedures for solving disagreements between the regulatory body and the concessionaire

80. As noted earlier (see chap. V, “Infrastructure development and operation”, ___), during the operational phase of the project the project company will have to comply with a wide variety of conditions and standards for the operation and maintenance of the facility, which are spelled out in the law, regulations or the project agreement. In addition to those obligations, many countries have established a regulatory regime whereby the contracting authority or an independent regulatory body exercises an oversight function over the operation of the facility and the compliance by the project company with the various conditions, standards and decisions taken by the regulatory body. Such regulatory regimes are usually established for particular industrial sectors, such as power generation, water treatment and sanitation or public transportation.

81. The main features of various regulatory systems, institutional mechanisms and regulatory procedures, including the issue of autonomy of the regulatory body vis-à-vis the Government, have been discussed elsewhere in the Guide (see chap. I, “General legislative considerations”, __). Irrespective of whether the primary regulatory decisions are made by a governmental department (such as a ministry) or an independent regulatory body, there is a need for a mechanism whereby the operator of the facility may request a review of regulatory decisions in case of disagreements between the regulatory body and the operator. As with the whole regulatory process, a high degree of transparency and credibility is essential. To be credible, the review should be entrusted to an entity that is independent from the regulatory body taking the original decision, from the political authorities of the host country and from the regulated companies.

82. In many legal systems, review of decisions of regulatory bodies is in the jurisdiction of courts. However, if there are concerns over the judicial process of review (e.g. as regards possible delays or the capacity of courts to make evaluations in complex economic issues involved in regulatory decisions) it may be more appropriate to entrust review functions to another body, at least in the first instance, before a final recourse to courts. In some countries, requests for review are considered by a high-level cross-sectoral independent oversight body. There are also countries where requests for review are heard by a panel composed of persons holding specified judicial and academic functions. As to the grounds on which a request for review may be based, in many cases there are limits, in particular as to the right of the appellate body to substitute its own discretionary assessment of facts for the assessment of the body whose decision is being reviewed.
IV. COORDINATION AND COOPERATION

A. International Standby Practices (ISP98): Report of the Secretary-General

(A/CN.9/459) [Original: English]

1. By letter of 3 March 1999 (reproduced in annex I), the Director of the Institute of International Banking Law and Practice, Inc. requested the Commission to consider endorsing for worldwide use the new Rules on International Standby Practices (ISP98). The original text of ISP98, in English or French, is contained in annex IV. Translations into other languages are currently being prepared by the International Chamber of Commerce (ICC), which has endorsed the text and issued it as ICC publication No. 590.

2. As stated on the cover of that publication, “ISP98 fills an important gap in the market place. Though standby letters of credit have similarities with commercial letters of credit and other financial instruments, there are significant differences in scope and practice. Moreover, it is recognized that the ICC’s Uniform Customs and Practice for Documentary Credits (UCP), which is internationally accepted for commercial letters of credit, is not appropriate for all forms of standbys. A new set of Rules was required for this workhorse of commerce and finance, which, in terms of value, exceeds commercial credits by a ratio of 5:1.

“ISP98 reflects a distillation of practices from a wide range of standby users—bankers, merchants, rating agencies, corporate treasurers, credit managers, government officials and banking regulators. Like the UCP for commercial credits, ISP98 is destined to become the standard for the use of standbys in international transactions.”

3. By way of general background, it may be noted that the subject of documentary credits and bank guarantees has been a topic in which the Commission has taken an interest since the time of its inception. The Commission endorsed the 1962 version of the Uniform Customs and Practice for Documentary Credits at its second session, the 1974 version at its eighth session, the 1983 version at its seventeenth session and the 1993 version at its twenty-seventh session.

4. In view of the close link between ISP98 and the 1995 United Nations Convention on Independent Guarantees and Stand-by Letters of Credit, the Secretary of the Commission participated in the preparation of ISP98 so as to ensure consistency between these two supplementary texts. His prologue to the ICC publication is reproduced in annex III. Additional information on the reasons for the preparation of ISP98 and about its salient features may be deduced from the preface contained in annex II.

ANNEX I

Letter of Professor James E. Byrne, Director of the Institute of International Banking Law and Practice, Inc


These private rules of practice are intended to apply to standby letters of credit. The idea to prepare such rules was conceived during the deliberations of the UNCITRAL Working Group on International Contract Practices, which resulted in the United Nations Convention on Independent Guarantees and Standby Letters of Credit. These rules were deliberately formulated to complement the Convention whose use is recommended in their Official Preface. The ISP98 drafting process itself was undertaken in regular consultation with the UNCITRAL Secretariat and the Institute has used occasions to promote ISP98 as an opportunity also to promote adoption of the Convention.

ISP98 became effective 1 January 1999. It has been endorsed by the International Financial Services Association and the ICC Commission on Banking Technique and Practice, and issued as ICC publication No. 590. It is currently being used and promoted by major banks, which issue standby letters of credit, and is expected to become the world standard within the next few years.

Because of the close links between ISP98 and the United Nations Convention, and due to UNCITRAL’s past practice of endorsing similar rules of practice, such as UCP500 and INCOTERMS 1990, the Institute formally requests that the Commission consider endorsement of the ISP.
The International Standby Practices (ISP98) reflects generally accepted practice, custom, and usage of standby letters of credit. It provides separate rules for standby letters of credit in the same sense that the Uniform Customs and Practice for Documentary Credits (UCP) and the Uniform Rules for Demand Guarantees (URDG) do for commercial letters of credit and independent bank guarantees.

The formulation of standby letter of credit practices in separate rules evidences the maturity and importance of this financial product. The amounts outstanding of standbys greatly exceed the outstanding amounts of commercial letters of credit. While the standby is associated with the United States of America where it originated and where it is most widely used, it is truly an international product. Non-US bank outstandings have exceeded those of US banks in the United States alone. Moreover, the standby is used increasingly throughout the world.

Standbys are issued to support payment, when due or after default, of obligations based on money loaned or advanced, or upon the occurrence or non-occurrence of another contingency.

For convenience, standbys are commonly classified descriptively (and without operative significance in the application of these rules) based on their function in the underlying transaction or other factors not necessarily related to the terms and conditions of the standby itself. For example:

A “Performance Standby” supports an obligation to perform other than to pay money, including for the purpose of covering losses arising from a default of the applicant in completion of the underlying transactions.

An “Advance Payment Standby” supports an obligation to account for an advance payment made by the beneficiary to the applicant.

A “Bid Bond/Tender Bond Standby” supports an obligation of the applicant to execute a contract if the applicant is awarded a bid.

A “Counter Standby” supports the issuance of a separate standby or other undertaking by the beneficiary of the counter standby.

A “Financial Standby” supports an obligation to pay money, including any instrument evidencing an obligation to repay borrowed money.

A “Direct Pay” Standby supports payment when due of an underlying payment obligation typically in connection with a financial standby without regard to a default.

An “Insurance Standby” supports an insurance or reinsurance obligation of the applicant.

A “Commercial Standby” supports the obligations of an applicant to pay for goods or services in the event of non-payment by other methods.

In the past, many standbys have been issued subject to the UCP even though it was intended for commercial letters of credit. The UCP reinforced the independence and documentary character of the standby. It also provided standards for examination and notice of dishonour and a basis to resist market pressures to embrace troublesome practices such as the issuance of standbys without expiration dates.

Despite these important contributions, it has long been apparent that the UCP was not fully applicable nor appropriate for standbys, as is recognized in UCP 500, Article 1, which provides that it applies “to the extent to which they may be applicable.” Even the least complex standbys (those calling for presentation of a draft only) pose problems not addressed by the UCP. More complex standbys (those involving longer terms or automatic extensions, transfer on demand, requests that the beneficiary issue its own undertaking to another, and the like) require more specialized rules of practice. The ISP fills these needs.

The ISP differs from the UCP in style and approach because it must receive acceptance not only from bankers and merchants, but also from a broader range of those actively involved in standby law and practice—corporate treasurers and credit managers, rating agencies, government agencies and regulators, and indenture trustees as well as their counsel. Because standbys are often intended to be available in the event of disputes or applicant insolvency, their texts are subject to a degree of scrutiny not encountered in the commercial letter of credit context. As a result, the ISP is also written to provide guidance to lawyers and judges in the interpretation of standby practice.

Differences in substance result either from different practices, different problems, or the need for more precision. In addition, the ISP proposes basic definitions should the standby permit or require presentation of documents by electronic means. Since standbys infrequently require presentation of negotiable documents, standby practice is currently more conducive to electronic presentations, and the ISP provides definitions and rules encouraging such presentations. The development of S.W.I.F.T. message types for the ISP is anticipated.

The ISP, like the UCP for commercial letters of credit, simplifies, standardizes, and streamlines the drafting of standbys, and provides clear and widely accepted answers to common problems. There are basic similarities with the UCP because standby and commercial practices are fundamentally the same. Even where the rules overlap, however, the ISP is more precise, stating the intent implied in the UCP rule, in order to make the standby more dependable when a drawing or honour is questioned.
Like the UCP and the URDG, the ISP will apply to any independent undertaking issued subject to it. This approach avoids the impractical and often impossible task of identifying and distinguishing standbys from independent guarantees and, in many cases, commercial letters of credit. The choice of which set of rules to select is, therefore, left to the parties—as it should be. One may well choose to use the ISP for certain types of standbys, the UCP for others, and the URDG for still others. While the ISP is not intended to be used for dependent undertakings such as accessory guarantees and insurance contracts, it may be useful in some situations in indicating that a particular undertaking which might otherwise be treated as dependent under local law is intended to be independent.

For the ISP to apply to a standby, an undertaking should be made subject to these Rules by including language such as (but not limited to):

This undertaking is issued subject to the International Standby Practices 1998.

or

Subject to ISP98.

Although the ISP can be varied by the text of a standby, it provides neutral rules acceptable in the majority of situations and a useful starting point for negotiations in other situations. It will save parties (including banks that issue, confirm, or are beneficiaries of standbys) considerable time and expense in negotiating and drafting standby terms.

The ISP is designed to be compatible with the United Nations Convention on Independent Guarantees and Stand-by Letters of Credit (which represents a useful and practical formulation of basic standby and independent guarantee law) and also with local law, whether statutory or judicial, and to embody standby letter of credit practice under that law. If these rules conflict with mandatory law on issues such as assignment of proceeds or transfer by operation of law, applicable law will, of course, control. Nonetheless, most of these issues are rarely addressed by local law and progressive commercial law will often look to the practice as recorded in the ISP for guidance in such situations, especially with respect to cross-border undertakings. As a result, it is expected that the ISP will complement local law rather than conflict with it.

The ISP is intended to be used also in arbitration as well as judicial proceedings (such as the expert-based letter of credit arbitration system developed by the International Center for Letter of Credit Arbitration (ICLOCA Rules or general commercial ICC arbitration) or with alternative methods of dispute resolution. Such a choice should be made expressly and with appropriate detail. At a minimum, it can be made in connection with the clause relating to ISP98—for example This undertaking is issued subject to ISP98, and all disputes arising out of it or related to it are subject to arbitration under ICLOCA Rules (1996).

Although translations of the ISP into other languages are envisioned and will be monitored for integrity, the English text is the official text of the ISP in the event of disputes.

The ISP is the product of the work of the ISP Working Group under the auspices of the Institute of International Banking Law & Practice, Inc. which interacted with hundreds of persons over a five year period, and has benefited from comments received from individuals, banks, and national and international associations. In particular, the participation of the International Financial Services Association (formerly the USCIB) and the Ad Hoc Working Group under the chairmanship of Gary Collyer (which led to its endorsement by the ICC Banking Commission) is gratefully recognized. In addition, the sponsorship and support of Citibank N.A., The Chase Manhattan Bank, ABN-AMRO, Baker & McKenzie, and the National Law Center for Inter-American Free Trade is acknowledged. Perhaps the greatest significance of the ISP is that its creation marks a new chapter in the collaboration between the international banking operations community and the legal community at an international level. In this respect, the active role played in this process by the Secretariat of the United Nations Commission on International Trade Law has been invaluable.

The ISP is drafted as a set of rules intended for use in daily practice. It is not intended to provide introductory information on standbys and their uses. While it is recognized that specific rules would benefit from explanatory comments, such comments are not appended to the ISP because the resulting work would be too cumbersome for daily use. Instead, introductory materials and Official Comments are available in the Official Commentary on the International Standby Practices (ISP98). For further information on support materials and developments on the ISP and to pose queries, consult the ISP98 website: www.ISP98.com.

To address inevitable questions, to provide for official interpretation of the rules, and to ensure their proper evolution, the Institute of International Banking Law & Practice, Inc. has created a Council on International Standby Practices that is representative of the several constituencies that have contributed to the ISP and has charged it with the task of maintaining the integrity of the ISP in cooperation with the Institute, the ICC Banking Commission, the IFSA, and various supporting organizations.
ANNEX III

PROLOGUE

By Gerold Herrmann, Secretary, United Nations Commission on International Trade Law (UNCITRAL)

It was an extremely interesting and enriching experience for me to assist in drafting ISP98. This participation allowed me to witness (and now bear witness to) the very thorough and pragmatic drafting process in a superbly selected group, with representatives of all interested sectors actively involved in standby letter of credit practice such as: bankers, especially those responsible for letter of credit operations and global trade transactions, bank counsel, attorneys, academics, regulators, government officials, corporate treasurers, and likely influential beneficiaries. The treasure trove of experience and expertise and the diversity of interests and perspectives proved invaluable in determining—as was continuously done by examining concrete practical examples—whether on a given issue an operational rule would be desirable and useful and, if so, which solution would work best and reflect good practice.

Continued participation in the preparatory work has also convinced me—as, I am sure, it would have anyone else—of the special characteristics of standbys at the operational level of practical detail and usage. Their special features, in my view, not only justify but also necessitate special contractual rules designed for standbys. As the constant comparison with the UCP clearly revealed, quite a few UCP Articles are inappropriate for standbys and quite a few issues of paramount importance in standby practice are not addressed at all in the UCP. While a similar disparity in practice exists between the standby and the independent guarantee (the bank or demand guarantee European style), this seems particularly, if not exclusively, true for those types of actual use (e.g. financial standby, direct-pay standby) hitherto found only extremely rarely in guarantee practice. For this and other reasons, including firmness of the undertaking, I would not be surprised to see not only standbys but also some demand guarantees issued subject to ISP98.

For a professional unifier of law, participation in the preparatory work was particularly satisfying because of its interconnection with other harmonization and reform efforts. In addition to the concordance with revised Article 5 UCC (the letter-of-credit law of the homeland of the standby) and the similarly close contact (and personal overlap) with the 1993 UCP revision task force, I am referring in particular to UNCITRAL’s work which culminated in the adoption in 1995 by the General Assembly of the “United Nations Convention on Independent Guarantees and Stand-by Letters of Credit.” The idea of preparing special operational rules for standbys was born during the extensive debates comparing national laws as well as the two instruments to be married by that Convention. Since bride and groom were presented there in all facets and critically scrutinized by their future in-laws, UNCITRAL’s travaux preparatoires make for highly informative reading (as will future abstracts of court decisions to be published in UNCITRAL’s case collection system called CLOUT; homepage: www.un.or.at/uncitral). It was gratifying to see the group preparing ISP98 refer continuously to the UNCITRAL Convention in order to ensure complete consistency. I must admit to special gratification by overhearing one of the world’s leading letter of credit expert’s remark to his banking colleague: “The more I look at this United Nations Convention, the more I really like it.”

The above coordination or cooperation in the universal harmonization and modernization efforts is welcome and in fact crucial because of the (often neglected or ignored) interdependence between the two very different levels of legal norms: the contractual level, where such sets of rules like ISP98, UCP 500, or URDG become effective by agreement of the individual parties, and the statutory level, where internationally elaborated law like the UN Convention or domestic law (e.g. Art. 5 UCC) recognize and give full effect to the exercise of that party autonomy and regulate certain issues that can effectively be settled only at that level (e.g. standards of fraud exception, injunctive relief and other court matters). Therefore, ISP98 and the Convention supplement each other in an ideal manner and together lay the necessary basis for a smooth functioning of standby practice worldwide.
RULE 1: GENERAL PROVISIONS

Scope, application, definitions and interpretation of these Rules

1.01 Scope and application

(a) These Rules are intended to be applied to standby letters of credit (including performance, financial, and direct pay standby letters of credit);

(b) A standby letter of credit or other similar undertaking, however named or described, whether for domestic or international use, may be made subject to these Rules by express reference to them;

(c) An undertaking subject to these Rules may expressly modify or exclude their application;

(d) An undertaking subject to these Rules is hereinafter referred to as a “standby”.

1.02 Relationship to law and other Rules

(a) These Rules supplement the applicable law to the extent not prohibited by that law;

(b) These Rules supersede conflicting provisions in any other rules of practice to which a standby letter of credit is also made subject.

1.03 Interpretative principles

These Rules shall be interpreted as mercantile usage with regard for:

(a) Integrity of standbys as reliable and efficient undertakings to pay;

(b) Practice and terminology of banks and businesses in day-to-day transactions;

(c) Consistency within the worldwide system of banking operations and commerce; and

(d) Worldwide uniformity in their interpretation and application.

1.04 Effect of the Rules

Unless the context otherwise requires, or unless expressly modified or excluded, these Rules apply as terms and conditions incorporated into a standby, confirmation, advice, nomination, amendment, transfer, request for issuance, or other agreement of:

(i) the issuer;

(ii) the beneficiary to the extent it uses the standby;

(iii) any adviser;

(iv) any confirmor;

(v) any person nominated in the standby who acts or agrees to act; and

(vi) the applicant who authorizes issuance of the standby or otherwise agrees to the application of these Rules.

1.05 Exclusion of matters related to due issuance and fraudulent or abusive drawing

These Rules do not define or otherwise provide for:

(a) Power or authority to issue a standby;

(b) Formal requirements for execution of a standby (e.g. a signed writing); or

(c) Defences to honour based on fraud, abuse, or similar matters.

These matters are left to applicable law.

1.06 Nature of standbys

(a) A standby is an irrevocable, independent, documentary, and binding undertaking when issued and need not so state;

(b) Because a standby is irrevocable, an issuer’s obligations under a standby cannot be amended or cancelled by the issuer except as provided in the standby or as consented to by the person against whom the amendment or cancellation is asserted;

(c) Because a standby is independent, the enforceability of an issuer’s obligations under a standby does not depend on:

(i) the issuer’s right or ability to obtain reimbursement from the applicant;

(ii) the beneficiary’s right to obtain payment from the applicant;

(iii) a reference in the standby to any reimbursement agreement or underlying transaction; or

(iv) the issuer’s knowledge of performance or breach of any reimbursement agreement or underlying transaction;

(d) Because a standby is documentary, an issuer’s obligations depend on the presentation of documents and an examination of required documents on their face;

(e) Because a standby or amendment is binding when issued, it is enforceable against an issuer whether or not the applicant authorized its issuance, the issuer received a fee, or the beneficiary received or relied on the standby or the amendment.

1.07 Independence of the issuer-beneficiary relationship

An issuer’s obligations toward the beneficiary are not affected by the issuer’s rights and obligations toward the applicant under any applicable agreement, practice, or law.

1.08 Limits to responsibilities

An issuer is not responsible for:

(a) Performance or breach of any underlying transaction;

(b) Accuracy, genuineness, or effect of any document presented under the standby;

(c) Action or omission of others even if the other person is chosen by the issuer or nominated person; or

(d) Observance of law or practice other than that chosen in the standby or applicable at the place of issuance.

1.09 Defined terms

In addition to the meanings given in standard banking practice and applicable law, the following terms have or include the meanings indicated below:

(a) Definitions

“Applicant” is a person who applies for issuance of a standby or for whose account it is issued, and includes (i) a person...
applying in its own name but for the account of another person, or (ii) an issuer acting for its own account.

“Beneficiary” is a named person who is entitled to draw under a standby. See Rule 1.11 (c) (ii).

“Business Day” means a day on which the place of business at which the relevant act is to be performed is regularly open; and “Banking Day” means a day on which the relevant bank is regularly open at the place at which the relevant act is to be performed.

“Confirmer” is a person who, upon an issuer’s nomination to do so, adds to the issuer’s undertaking its own undertaking to honour a standby. See Rule 1.11 (c) (i).

“Demand” means, depending on the context, either a request to honour a standby or a document that makes such request.

“Document” means a draft, demand, document of title, investment security, invoice, certificate of default, or any other representation of fact, law, right, or opinion, that upon presentation (whether in a paper or electronic medium), is capable of being examined for compliance with the terms and conditions of a standby.

“Drawing” means, depending on the context, either a demand presented or a demand honoured.

“Expiration Date” means the latest day for a complying presentation provided in a standby.

“Person” includes a natural person, partnership, corporation, limited liability company, government agency, bank, trustee, and any other legal or commercial association or entity.

“Presentation” means, depending on the context, either the act of delivering documents for examination under a standby or the documents so delivered.

“Presenter” is a person who makes a presentation as or on behalf of a beneficiary or nominated person.

“Signature” includes any symbol executed or adopted by a person with a present intent to authenticate a document.

(b) Cross references

“Amendment”—Rule 2.06
“Advice”—Rule 2.05
“Approximately” (“About” or “Circa”)—Rule 3.08 (f)
“Assignment of proceeds”—Rule 6.06
“Automatic amendment”—Rule 2.06 (a)
“Copy”—Rule 4.15 (d)
“Cover instructions”—Rule 5.08
“Honour”—Rule 2.01
“Issuer”—Rule 2.01
“Multiple presentations”—Rule 3.08 (b)
“Nominated person”—Rule 2.04
“Non-documentary conditions”—Rule 4.11
“Original”—Rule 4.15 (b) and (c)
“Partial drawing”—Rule 3.08 (c)
“Standby”—Rule 1.01 (d)

“Transfer”—Rule 6.01
“Transferee beneficiary”—Rule 1.11 (c) (ii)
“Transfer by operation of law”—Rule 6.11

(c) Electronic presentations

The following terms in a standby providing for or permitting electronic presentation shall have the following meanings unless the context otherwise requires:

“Electronic record” means:

(i) a record (information that is inscribed on a tangible medium or that is stored in an electronic or other medium and is retrievable in perceivable form);

(ii) communicated by electronic means to a system for receiving, storing, re-transmitting, or otherwise processing information (data, text, images, sounds, codes, computer programs, software, databases, and the like); and

(iii) capable of being authenticated and then examined for compliance with the terms and conditions of the standby.

“Authenticate” means to verify an electronic record by generally accepted procedure or methodology in commercial practice:

(i) the identity of a sender or source; and

(ii) the integrity of or errors in the transmission of information content.

The criteria for assessing the integrity of information in an electronic record is whether the information has remained complete and unaltered, apart from the addition of any endorsement and any change which arises in the normal course of communication, storage, and display.

“Electronic signature” means letters, characters, numbers, or other symbols in electronic form, attached to or logically associated with an electronic record that are executed or adopted by a party with present intent to authenticate an electronic record.

“Receipt” occurs when:

(i) An electronic record enters in a form capable of being processed by the information system designated in the standby; or

(ii) An issuer retrieves an electronic record sent to an information system other than that designated by the issuer.

1.10 Redundant or otherwise undesirable terms

(a) A standby should not or need not state that it is:

(i) Unconditional or abstract (if it does, it signifies merely that payment under it is conditioned solely on presentation of specified documents);

(ii) Absolute (if it does, it signifies merely that it is irrevocable);

(iii) Primary (if it does, it signifies merely that it is the independent obligation of the issuer);

(iv) Payable from the issuer’s own funds (if it does, it signifies merely that payment under it does not depend on the availability of applicant funds and is made to satisfy the issuer’s own independent obligation);

(v) Clean or payable on demand (if it does, it signifies merely that it is payable upon presentation of a written demand or other documents specified in the standby);
1.11 Interpretation of these Rules

(a) These Rules are to be interpreted in the context of applicable standard practice;

(b) In these Rules, “standby letter of credit” refers to the type of independent undertaking for which these Rules were intended, whereas “standby” refers to an undertaking subjected to these Rules;

(c) Unless the context otherwise requires:

(i) “issuer” includes a “confirmer” as if the confirmer were a separate issuer and its confirmation were a separate standby issued for the account of the issuer;

(ii) “beneficiary” includes a person to whom the named beneficiary has effectively transferred drawing rights (“transferee beneficiary”);

(iii) “including” means “including but not limited to”;

(iv) “A or B” means “A or B or both”; “either A or B” means “A or B, but not both”; and “A and B” means “both A and B”;

(v) words in the singular number include the plural, and in the plural include the singular; and

(vi) words of the neuter gender include any gender;

(d) (i) use of the phrase “unless a standby otherwise states” or the like in a rule emphasizes that the text of the standby controls over the rule;

(ii) absence of such a phrase in other rules does not imply that other rules have priority over the text of the standby;

(iii) addition of the term “expressly” or “clearly” to the phrase “unless a standby otherwise states” or the like emphasizes that the rule should be excluded or modified only by wording in the standby that is specific and unambiguous; and

(iv) while the effect of all of these Rules may be varied by the text of the standby, variations of the effect of some of these Rules may disqualify the standby as an independent undertaking under applicable law;

(e) The phrase “stated in the standby” or the like refers to the actual text of a standby (whether as issued or effectively amended), whereas the phrase “provided in the standby” or the like refers to both the text of the standby and these Rules as incorporated.

RULE 2: OBLIGATIONS

2.01 Undertaking to honour by issuer and any confirmer to beneficiary

(a) An issuer undertakes to the beneficiary to honour a presentation that appears on its face to comply with the terms and conditions of the standby in accordance with these Rules supplemented by standard standby practice;

(b) An issuer honours a complying presentation made to it by paying the amount demanded of it at sight, unless the standby provides for honour:

(i) by acceptance of a draft drawn by the beneficiary on the issuer, in which case the issuer honours by:

(a) timely accepting the draft; and

(b) thereafter paying the holder of the draft on presentation of the accepted draft on or after its maturity;

(ii) by deferred payment of a demand made by the beneficiary on the issuer, in which case the issuer honours by:

(a) timely incurring a deferred payment obligation; and

(b) thereafter paying at maturity;

(iii) by negotiation, in which case the issuer honours by paying the amount demanded at sight without recourse;

(c) An issuer acts in a timely manner if it pays at sight, accepts a draft, or undertakes a deferred payment obligation (or if it gives notice of dishonour) within the time permitted for examining the presentation and giving notice of dishonour;

(d) (i) a confirmer undertakes to honour a complying presentation made to it by paying the amount demanded of it at sight or, if the standby so states, by another method of honour consistent with the issuer’s undertaking;

(ii) if the confirmation permits presentation to the issuer, then the confirmer undertakes also to honour upon the issuer’s wrongful dishonour by performing as if the presentation had been made to the confirmer;

(iii) if the standby permits presentation to the confirmer, then the issuer undertakes also to honour upon the confirmer’s wrongful dishonour by performing as if the presentation had been made to the issuer;

(e) An issuer honours by paying in immediately available funds in the currency designated in the standby unless the standby states it is payable by:

(i) payment of a monetary unit of account, in which case the undertaking is to pay in that unit of account; or

(ii) delivery of other items of value, in which case the undertaking is to deliver those items.

2.02 Obligation of different branches, agencies, or other offices

For the purposes of these Rules, an issuer’s branch, agency, or other office acting or undertaking to act under a standby in a capacity other than as issuer is obligated in that capacity only and shall be treated as a different person.

2.03 Conditions to issuance

A standby is issued when it leaves an issuer’s control unless it clearly specifies that it is not then “issued” or “enforceable”. Statements that a standby is not “available”, “operative”, “effective”, or the like do not affect its irrevocable and binding nature at the time it leaves the issuer’s control.
2.04 Nomination

(a) A standby may nominate a person to advise, receive a presentation, effect a transfer, confirm, pay, negotiate, incur a deferred payment obligation, or accept a draft; 
(b) Nomination does not obligate the nominated person to act except to the extent that the nominated person undertakes to act; 
(c) A nominated person is not authorized to bind the person making the nomination.

2.05 Advice of standby or amendment

(a) Unless an advice states otherwise, it signifies that:
   (i) the adviser has checked the apparent authenticity of the advised message in accordance with standard letter of credit practice; and
   (ii) the advice accurately reflects what has been received; 
(b) A person who is requested to advise a standby and decides not to do so should notify the requesting party.

2.06 When an amendment is authorized and binding

(a) If a standby expressly states that it is subject to “automatic amendment” by an increase or decrease in the amount available, an extension of the expiration date, or the like, the amendment is effective automatically without any further notification or consent beyond that expressly provided for in the standby. (Such an amendment may also be referred to as becoming effective “without amendment”); 
(b) If there is no provision for automatic amendment, an amendment binds:
   (i) the issuer when it leaves the issuer’s control; and
   (ii) the confirmer when it leaves the confirmer’s control, unless the confirmer indicates that it does not confirm the amendment; 
(c) If there is no provision for automatic amendment:
   (i) the beneficiary must consent to the amendment for it to be binding; 
   (ii) the beneficiary’s consent must be made by an express communication to the person advising the amendment unless the beneficiary presents documents which comply with the standby as amended and which would not comply with the standby prior to such amendment; and
   (iii) an amendment does not require the applicant’s consent to be binding on the issuer, the confirmer, or the beneficiary; 
(d) Consent to only part of an amendment is a rejection of the entire amendment.

2.07 Routing of amendments

(a) An issuer using another person to advise a standby must advise all amendments to that person; 
(b) An amendment or cancellation of a standby does not affect the issuer’s obligation to a nominated person that has acted within the scope of its nomination before receipt of notice of the amendment or cancellation; 
(c) Non-extension of an automatically extendable (renewable) standby does not affect an issuer’s obligation to a nominated person who has acted within the scope of its nomination before receipt of a notice of non-extension.

RULE 3: PRESENTATION

3.01 Complying presentation under a standby

A standby should indicate the time, place and location within that place, person to whom, and medium in which presentation should be made. If so, presentation must be so made in order to comply. To the extent that a standby does not so indicate, presentation must be made in accordance with these Rules in order to be complying.

3.02 What constitutes a presentation?

The receipt of a document required by and presented under a standby constitutes a presentation requiring examination for compliance with the terms and conditions of the standby even if not all of the required documents have been presented.

3.03 Identification of standby

(a) A presentation must identify the standby under which the presentation is made; 
(b) A presentation may identify the standby by stating the complete reference number of the standby and the name and location of the issuer or by attaching the original or a copy of the standby; 
(c) If the issuer cannot determine from the face of a document received that it should be processed under a standby or cannot identify the standby to which it relates, presentation is deemed to have been made on the date of identification.

3.04 Where and to whom complying presentation made

(a) To comply, a presentation must be made at the place and any location at that place indicated in the standby or provided in these Rules; 
(b) If no place of presentation to the issuer is indicated in the standby, presentation to the issuer must be made at the place of business from which the standby was issued; 
(c) If a standby is confirmed, but no place for presentation is indicated in the confirmation, presentation for the purpose of obligating the confirmer (and the issuer) must be made at the place of business of the confirmer from which the confirmation was issued or to the issuer; 
(d) If no location at a place of presentation is indicated (such as department, floor, room, station, mail stop, post office box, or other location), presentation may be made to:
   (i) the general postal address indicated in the standby; 
   (ii) any location at the place designated to receive deliveries of mail or documents; or
   (iii) any person at the place of presentation actually or apparently authorized to receive it.

3.05 When timely presentation made

(a) A presentation is timely if made at any time after issuance and before expiry on the expiration date; 
(b) A presentation made after the close of business at the place of presentation is deemed to have been made on the next business day.

3.06 Complying medium of presentation

(a) To comply, a document must be presented in the medium indicated in the standby;
must be presented as a paper document, unless only a demand is required, in which case:

(i) a demand that is presented via S.W.I.F.T., tested telex, or other similar authenticated means by a beneficiary that is a S.W.I.F.T. participant or a bank complies; otherwise

(ii) a demand that is not presented as a paper document does not comply unless the issuer permits, in its sole discretion, the use of that medium;

(c) A document is not presented as a paper document if it is communicated by electronic means even if the issuer or nominated person receiving it generates a paper document from it;

(d) Where presentation in an electronic medium is indicated, to comply a document must be presented as an electronic record capable of being authenticated by the issuer or nominated person to whom it is presented.

3.07 Separateness of each presentation

(a) Making a non-complying presentation, withdrawing a presentation, or failing to make any one of a number of scheduled or permitted presentations does not waive or otherwise prejudice the right to make another timely presentation or a timely representation whether or not the standby prohibits partial or multiple drawings or presentations;

(b) Wrongful dishonour of a complying presentation does not constitute dishonour of any other presentation under a standby or repudiation of the standby;

(c) Honour of a non-complying presentation, with or without notice of its non-compliance, does not waive requirements of a standby for other presentations.

3.08 Partial drawing and multiple presentations; amount of drawings

(a) A presentation may be made for less than the full amount available ("partial drawing");

(b) More than one presentation ("multiple presentations") may be made;

(c) The statement "partial drawings prohibited" or a similar expression means that a presentation must be for the full amount available;

(d) The statement "multiple drawings prohibited" or a similar expression means that only one presentation may be made and honoured but that it may be for less than the full amount available;

(e) If a demand exceeds the amount available under the standby, the drawing is discrepant. Any document other than the demand stating an amount in excess of the amount demanded is not discrepant for that reason;

(f) Use of "approximately", "about", "circa", or a similar word permits a tolerance not to exceed 10 per cent more or 10 per cent less of the amount to which such word refers.

3.09 Extend or pay

A beneficiary’s request to extend the expiration date of the standby or, alternatively, to pay the amount available under it:

(a) Is a presentation demanding payment under the standby, to be examined as such in accordance with these Rules; and

(b) Implies that the beneficiary:

(i) consents to the amendment to extend the expiry date to the date requested;

(ii) requests the issuer to exercise its discretion to seek the approval of the applicant and to issue that amendment;

(iii) upon issuance of that amendment, retracts its demand for payment; and

(iv) consents to the maximum time available under these Rules for examination and notice of dishonour.

3.10 No notice of receipt of presentation

An issuer is not required to notify the applicant of receipt of a presentation under the standby.

3.11 Issuer waiver and applicant consent to waiver of presentation rules

In addition to other discretionary provisions in a standby or these Rules, an issuer may, in its sole discretion, without notice to or consent of the applicant and without effect on the applicant’s obligations to the issuer, waive:

(a) The following Rules and any similar terms stated in the standby which are primarily for the issuer’s benefit or operational convenience:

(i) treatment of documents received, at the request of the presenter, as having been presented at a later date (Rule 3.02);

(ii) identification of a presentation to the standby under which it is presented (Rule 3.03 (a));

(iii) where and to whom presentation is made (Rule 3.04 (i), (ii), and (iv)), except the country of presentation stated in the standby; or

(iv) treatment of a presentation made after the close of business as if it were made on the next business day (Rule 3.05 (b)).

(b) The following Rule but not similar terms stated in the standby:

(i) a required document dated after the date of its stated presentation (Rule 4.06); or

(ii) the requirement that a document issued by the beneficiary be in the language of the standby (Rule 4.04);

(c) The following Rule relating to the operational integrity of the standby only in so far as the bank is in fact dealing with the true beneficiary:

acceptance of a demand in an electronic medium (rule 3.06 (b)).

Waiver by the confirmer requires the consent of the issuer with respect to paragraphs (b) and (c) of this Rule.

3.12 Original standby lost, stolen, mutilated, or destroyed

(a) If an original standby is lost, stolen, mutilated, or destroyed, the issuer need not replace it or waive any requirement that the original be presented under the standby;

(b) If the issuer agrees to replace an original standby or to waive a requirement for its presentation, it may provide a replacement or copy to the beneficiary without affecting the applicant’s obligations to the issuer to reimburse, but, if it does so, the issuer must mark the replacement or copy as such. The issuer may, in its sole discretion, require indemnities satisfactory to it from the beneficiary and assurances from nominated persons that no payment has been made.
RULE 4: EXAMINATION

4.01 Examination for compliance

(a) Demands for honour of a standby must comply with the terms and conditions of the standby;

(b) Whether a presentation appears to comply is determined by examining the presentation on its face against the terms and conditions stated in the standby as interpreted and supplemented by these Rules which are to be read in the context of standard standby practice.

4.02 Non-examination of extraneous documents

Documents presented which are not required by the standby need not be examined and, in any event, shall be disregarded for purposes of determining compliance of the presentation. They may without responsibility be returned to the presenter or passed on with the other documents presented.

4.03 Examination for inconsistency

An issuer or nominated person is required to examine documents for inconsistency with each other only to the extent provided in the standby.

4.04 Language of documents

The language of all documents issued by the beneficiary is to be that of the standby.

4.05 Issuer of documents

Any required document must be issued by the beneficiary unless the standby indicates that the document is to be issued by a third person or the document is of a type that standard standby practice requires to be issued by a third person.

4.06 Date of documents

The issuance date of a required document may be earlier but not later than the date of its presentation.

4.07 Required signature on a document

(a) A required document need not be signed unless the standby indicates that the document must be signed or the document is of a type that standard standby practice requires to be signed;

(b) A required signature may be made in any manner that corresponds to the medium in which the signed document is presented;

(c) Unless a standby specifies:

(i) the name of a person who must sign a document, any signature or authentication will be regarded as a complying signature;

(ii) the status of a person who must sign, no indication of status is necessary.

(d) If a standby specifies that a signature must be made by:

(i) a named natural person without requiring that the signer’s status be identified, a signature complies that appears to be that of the named person;

(ii) a named legal person or government agency without identifying who is to sign on its behalf or its status, any signature complies that appears to have been made on behalf of the named legal person or government agency;

(iii) a named natural person, legal person, or government agency requiring the status of the signer be indicated, a signature complies which appears to be that of the named natural person, legal person, or government agency and indicates its status.

4.08 Demand document implied

If a standby does not specify any required document, it will still be deemed to require a documentary demand for payment.

4.09 Identical wording and quotation marks

If a standby requires:

(a) A statement without specifying precise wording, then the wording in the document presented must appear to convey the same meaning as that required by the standby;

(b) Specified wording by the use of quotation marks, blocked wording, or an attached exhibit or form, then typographical errors in spelling, punctuation, spacing, or the like that are apparent when read in context are not required to be duplicated and blank lines or spaces for data may be completed in any manner not inconsistent with the standby; or

(c) Specified wording by the use of quotation marks, blocked wording, or an attached exhibit or form, and also provides that the specified wording be “exact” or “identical”, then the wording in the documents presented must duplicate the specified wording, including typographical errors in spelling, punctuation, spacing and the like, as well as blank lines and spaces for data must be exactly reproduced.

4.10 Applicant approval

A standby should not specify that a required document be issued, signed, or counter-signed by the applicant. However, if the
standby includes such a requirement, the issuer may not waive the requirement and is not responsible for the applicant’s withholding of the document or signature.

4.11 Non-documentary terms or conditions

(a) A standby term or condition which is non-documentary must be disregarded whether or not it affects the issuer’s obligation to treat a presentation as complying or to treat the standby as issued, amended, or terminated;

(b) Terms or conditions are non-documentary if the standby does not require presentation of a document in which they are to be evidenced and if their fulfillment cannot be determined by the issuer from the issuer’s own records or within the issuer’s normal operations;

(c) Determinations from the issuer’s own records or within the issuer’s normal operations include determinations of:

(i) when, where, and how documents are presented or otherwise delivered to the issuer;

(ii) when, where, and how communications affecting the standby are sent or received by the issuer, beneficiary, or any nominated person;

(iii) amounts transferred into or out of accounts with the issuer; and

(iv) amounts determinable from a published index (e.g. if a standby provides for determining amounts of interest accruing according to published interest rates);

(d) An issuer need not re-compute a beneficiary’s computations under a formula stated or referenced in a standby except to the extent that the standby so provides.

4.12 Formality of statements in documents

(a) A required statement need not be accompanied by a solemnity, officialization, or any other formality;

(b) A standby term or condition which is non-documentary need not be in negotiable form unless the standby so states.

(c) The beneficiary’s signature.

(d) If a separate demand is required, it must contain:

(i) A demand for payment from the beneficiary directed to the issuer or nominated person;

(ii) A date indicating when the demand was issued;

(iii) The amount demanded; and

(iv) The beneficiary’s signature;

(c) A demand may be in the form of a draft or other instruction, order, or request to pay. If a standby requires presentation of a “draft” or “bill of exchange”, that draft or bill of exchange need not be in negotiable form unless the standby so states.

4.14 Name of acquired or merged issuer or confirmer

If the issuer or confirmer is reorganized, merged, or changes its name, any required reference by name to the issuer or confirmer in the documents presented may be to it or its successor.

4.15 Original, copy, and multiple documents

(a) A presented document must be an original;

(b) Presentation of an electronic record, where an electronic presentation is permitted or required, is deemed to be an “original”;

(c) (i) a presented document is deemed to be an original unless it appears on its face to have been reproduced from an original;

(ii) a document which appears to have been reproduced from an original is deemed to be an original if the signature or authentication appears to be original;

(d) A standby that requires presentation of a “copy” permits presentation of either an original or copy unless the standby states that only a copy be presented or otherwise addresses the disposition of all originals;

(e) If multiples of the same document are requested, only one must be an original unless:

(i) “duplicate originals” or “multiple originals” are requested in which case all must be originals; or

(ii) “two copies”, “two-fold”, or the like are requested in which case either originals or copies may be presented.

4.16 Demand for payment

(a) A demand for payment need not be separate from the beneficiary’s statement or other required document;

(b) If a separate demand is required, it must contain:

(i) a demand for payment from the beneficiary directed to the issuer or nominated person;

(ii) a date indicating when the demand was issued;

(iii) the amount demanded; and

(iv) the beneficiary’s signature;

(c) If multiples of the same document are requested, only one must be an original unless:

(i) “duplicate originals” or “multiple originals” are requested in which case all must be originals; or

(ii) “two copies”, “two-fold”, or the like are requested in which case either originals or copies may be presented.

4.17 Statement of default or other drawing event

If a standby requires a statement, certificate, or other recital of a default or other drawing event and does no specify content, the document complies if it contains:

(a) A representation to the effect that payment is due because a drawing event described in the standby has occurred;

(b) A date indicating when it was issued; and

(c) The beneficiary’s signature.

4.18 Negotiable documents

If a standby requires presentation of a document that is transferable by endorsement and delivery without stating whether, how, or to whom endorsement must be made, then the document may be presented without endorsement, or, if endorsed, the endorsement may be in blank and, in any event, the document may be issued or negotiated with or without recourse.
4.19 Legal or judicial documents

If a standby requires presentation of a government-issued document, a court order, an arbitration award, or the like, a document or a copy is deemed to comply if it appears to be:

(i) issued by a government agency, court, tribunal, or the like;
(ii) suitably titled or named;
(iii) signed;
(iv) dated; and
(v) originally certified or authenticated by an official of a government agency, court, tribunal, or the like.

4.20 Other documents

(a) If a standby requires a document other than one whose content is specified in these Rules without specifying the issuer, data content, or wording, a document complies if it appears to be appropriately titled or to serve the function of that type of document under standard standby practice;

(b) A document presented under a standby is to be examined in the context of standby practice under these Rules even if the document is of a type (such as a commercial invoice, transport documents, insurance documents or the like) for which the Uniform Customs and Practice for Documentary Credits contains detailed rules.

4.21 Request to issue separate undertaking

If a standby requests that the beneficiary of the standby issue its own separate undertaking to another (whether or not the standby recites the text of that undertaking):

(a) The beneficiary receives no rights other than its rights to draw under the standby even if the issuer pays a fee to the beneficiary for issuing the separate undertaking;

(b) Neither the separate undertaking nor any documents presented under it need be presented to the issuer; and

(c) If originals or copies of the separate undertaking or documents presented under it are received by the issuer although not required to be presented as a condition to honour of the standby:

(i) the issuer need not examine, and, in any event, shall disregard their compliance or consistency with the standby, with the beneficiary’s demand under the standby, or with the beneficiary’s separate undertaking; and

(ii) the issuer may without responsibility return them to the presenter or forward them to the applicant with the presentation.

RULE 5: NOTICE, PRECLUSION, AND DISPOSITION OF DOCUMENTS

5.01 Timely notice of dishonour

(a) Notice of dishonour must be given within a time after presentation of documents which is not unreasonable:

(i) notice given within three business days is deemed to be not unreasonable and beyond seven business days is deemed to be unreasonable;

(ii) whether the time within which notice is given is unreasonable does not depend upon an imminent deadline for presentation;

(iii) the time for calculating when notice of dishonour must be given begins on the business day following the business day of presentation;

(iv) unless a standby otherwise expressly states a shortened time within which notice of dishonour must be given, the issuer has no obligation to accelerate its examination of a presentation;

(b) (i) the means by which a notice of dishonour is to be given is by telecommunication, if available, and, if not, by another available means which allows for prompt notice;

(ii) if notice of dishonour is received within the time permitted for giving the notice, then it is deemed to have been given by prompt means;

(c) Notice of dishonour must be given to the person from whom the documents were received (whether the beneficiary, nominated person, or person other than a delivery person) except as otherwise requested by the presenter.

5.02 Statement of grounds for dishonour

A notice of dishonour shall state all discrepancies upon which dishonour is based.

5.03 Failure to give timely notice of dishonour

(a) Failure to give notice of a discrepancy in a notice of dishonour within the time and by the means specified in the standby or these rules precludes assertion of that discrepancy in any document containing the discrepancy that is retained or re-presented, but does not preclude assertion of that discrepancy in any different presentation under the same or a separate standby;

(b) Failure to give notice of dishonour or acceptance or acknowledgement that a deferred payment undertaking has been incurred obligates the issuer to pay at maturity.

5.04 Notice of expiry

Failure to give notice that a presentation was made after the expiration date does not preclude dishonour for that reason.

5.05 Issuer request for applicant waiver without request by presenter

If the issuer decides that a presentation does not comply and if the presenter does not otherwise instruct, the issuer may, in its sole discretion, request the applicant to waive non-compliance or otherwise to authorize honour within the time available for giving notice of dishonour but without extending it. Obtaining the applicant’s waiver does not obligate the issuer to waive non-compliance.

5.06 Issuer request for applicant waiver upon request of presenter

If, after receipt of notice of dishonour, a presenter requests that the presented documents be forwarded to the issuer or that the issuer seek the applicant’s waiver:

(a) No person is obligated to forward the discrepant documents or seek the applicant’s waiver;

(b) The presentation to the issuer remains subject to these Rules unless departure from them is expressly consented to by the presenter; and

(c) If the documents are forwarded or if a waiver is sought:

(i) the presenter is precluded from objecting to the discrepancies notified to it by the issuer;

(ii) the issuer is not relieved from examining the presentation under these Rules;

(iii) the issuer is not obligated to waive the discrepancy even if the applicant waives it; and
(iv) the issuer must hold the documents until it receives a response from the applicant or is requested by the presenter to return the documents, and if the issuer receives no such response or request within ten business days of its notice of dishonour, it may return the documents to the presenter.

5.07 Disposition of documents

Dishonoured documents must be returned, held, or disposed of as reasonably instructed by the presenter. Failure to give notice of the disposition of documents in the notice of dishonour does not preclude the issuer from asserting any defence otherwise available to it against honour.

5.08 Cover instructions/transmittal letter

(a) Instructions accompanying a presentation made under a standby may be relied on to the extent that they are not contrary to the terms or conditions of the standby, the demand, or these Rules;

(b) Representations made by a nominated person accompanying a presentation may be relied upon to the extent that they are not contrary to the terms or conditions of a standby or these Rules;

(c) Notwithstanding receipt of instructions, an issuer or nominated person may pay, give notice, return the documents, or otherwise deal directly with the presenter;

(d) A statement in the cover letter that the documents are discrepant does not relieve the issuer from examining the presentation for compliance.

5.09 Applicant notice of objection

(a) An applicant must timely object to an issuer’s honour of a non-complying presentation by giving timely notice by prompt means;

(b) An applicant acts timely if it objects to discrepancies by sending a notice to the issuer stating the discrepancies on which the objection is based within a time after the applicant’s receipt of the documents which is not unreasonable;

(c) Failure to give a timely notice of objection by prompt means precludes assertion by the applicant against the issuer of any discrepancy or other matter apparent on the face of the documents received by the applicant, but does not preclude assertion of that objection to any different presentation under the same or a different standby.

RULE 6: TRANSFER, ASSIGNMENT, AND TRANSFER BY OPERATION OF LAW

Transfer of drawing rights

6.01 Request to transfer drawing rights

Where a beneficiary requests that an issuer or nominated person honour a drawing from another person as if that person were the beneficiary, these Rules on transfer of drawing rights (“transfer”) apply.

6.02 When drawing rights are transferable

(a) A standby is not transferable unless it so states;

(b) A standby that states that it is transferable without further provision means that drawing rights:

(i) may be transferred in their entirety more than once;

(ii) may not be partially transferred; and

(iii) may not be transferred unless the issuer (including the confirmer) or another person specifically nominated in the standby agrees to and effects the transfer requested by the beneficiary.

6.03 Conditions to transfer

An issuer of a transferable standby or a nominated person need not effect a transfer unless:

(a) It is satisfied as to the existence and authenticity of the original standby; and

(b) The beneficiary submits or fulfils:

(i) a request in a form acceptable to the issuer or nominated person including the effective date of the transfer and the name and address of the transferee;

(ii) the original standby;

(iii) verification of the signature of the person signing for the beneficiary;

(iv) verification of the authority of the person signing for the beneficiary;

(v) payment of the transfer fee; and

(vi) any other reasonable requirements.

6.04 Effect of transfer on required documents

Where there has been a transfer of drawing rights in their entirety:

(a) A draft or demand must be signed by the transferee beneficiary; and

(b) The name of the transferee beneficiary may be used in place of the name of the transferor beneficiary in any other required document.

6.05 Reimbursement for payment based on a transfer

An issuer or nominated person paying under a transfer pursuant to rule 6.03 (a), (b) (i) and (b) (ii) is entitled to reimbursement as if it had made payment to the beneficiary.

ACKNOWLEDGEMENT OF ASSIGNMENT OF PROCEEDS

6.06 Assignment of proceeds

Where an issuer or nominated person is asked to acknowledge a beneficiary’s request to pay an assignee all or part of any proceeds of the beneficiary’s drawing under the standby, these Rules on acknowledgement of an assignment of proceeds apply except where applicable law otherwise requires.

6.07 Request for acknowledgement

(a) Unless applicable law otherwise requires, an issuer or nominated person:

(i) is not obligated to give effect to an assignment of proceeds which it has not acknowledged; and

(ii) is not obligated to acknowledge the assignment;

(b) If an assignment is acknowledged:

(i) the acknowledgement confers no rights with respect to the standby to the assignee who is only entitled to the proceeds assigned, if any, and whose rights may be affected by amendment or cancellation; and

(ii) the rights of the assignee are subject to:

(a) The existence of any net proceeds payable to the beneficiary by the person making the acknowledgement;
(b) Rights of nominated persons and transferee beneficiaries;
(c) Rights of other acknowledged assignees; and
(d) Any other rights or interests that may have priority under applicable law.

6.08 Conditions to acknowledgement of assignment of proceeds

An issuer or nominated person may condition its acknowledgement on receipt of:

(a) The original standby for examination or notation;
(b) Verification of the signature of the person signing for the beneficiary;
(c) Verification of the authority of the person signing for the beneficiary;
(d) An irrevocable request signed by the beneficiary for acknowledgement of the assignment that includes statements, covenants, indemnities, and other provisions which may be contained in the issuer’s or nominated person’s required form requesting acknowledgement of assignment, such as:

   (i) the identity of the affected drawings if the standby permits multiple drawings;
   (ii) the full name, legal form, location, and mailing address of the beneficiary and the assignee;
   (iii) details of any request affecting the method of payment or delivery of the standby proceeds;
   (iv) limitation on partial assignments and prohibition of successive assignments;
   (v) statements regarding the legality and relative priority of the assignment; or
   (vi) right of recovery by the issuer or nominated person of any proceeds received by the assignee that are recoverable from the beneficiary;

(e) Payment of a fee for the acknowledgement; and
(f) Fulfilment of other reasonable requirements.

6.09 Conflicting claims to proceeds

If there are conflicting claims to proceeds, then payment to an acknowledged assignee may be suspended pending resolution of the conflict.

6.10 Reimbursement for payment based on an assignment

An issuer or nominated person paying under an acknowledged assignment pursuant to Rule 6.08 (a) and (b) is entitled to reimbursement as if it had made payment to the beneficiary. If the beneficiary is a bank, the acknowledgement may be based solely upon an authenticated communication.

TRANSFER BY OPERATION OF LAW

6.11 Transferee by operation of law

Where an heir, personal representative, liquidator, trustee, receiver, successor corporation, or similar person who claims to be designated by law to succeed to the interests of a beneficiary presents documents in its own name as if it were the authorized transferee of the beneficiary, these Rules on transfer by operation of law apply.

6.12 Additional document in event of drawing in successor’s name

A claimed successor may be treated as if it were an authorized transferee of a beneficiary’s drawing rights in their entirety if it presents an additional document or documents which appear to be issued by a public official or representative (including a judicial officer) and indicate:

(a) That the claimed successor is the survivor of a merger, consolidation, or similar action of a corporation, limited liability company, or other similar organization;
(b) That the claimed successor is authorized or appointed to act on behalf of the named beneficiary or its estate because of an insolvency proceeding;
(c) That the claimed successor is authorized or appointed to act on behalf of the named beneficiary because of death or incapacity; or
(d) That the name of the named beneficiary has been changed to that of the claimed successor.

6.13 Suspension of obligations upon presentation by successor

An issuer or nominated person which receives a presentation from a claimed successor which complies in all respects except for the name of the beneficiary:

(a) May request in a manner satisfactory as to form and substance:

   (i) a legal opinion;
   (ii) an additional document referred to in Rule 6.12 (Additional document in event of drawing in successor’s name) from a public official;
   (iii) statements, covenants, and indemnities regarding the status of the claimed successor as successor by operation of law;
   (iv) payment of fees reasonably related to these determinations; and
   (v) anything which may be required for a transfer under Rule 6.03 (Conditions to transfer) or an acknowledgement of assignment of proceeds under Rule 6.08 (Conditions to Acknowledgement of Assignment of Proceeds);

but such documentation shall not constitute a required document for purposes of expiry of the standby;

(b) Until the issuer or nominated person receives the requested documentation, its obligation to honour or give notice of dishonour is suspended, but any deadline for presentation of required documents is not thereby extended.

6.14 Reimbursement for payment based on a transfer by operation of law

An issuer or nominated person paying under a transfer by operation of law pursuant to Rule 6.12 (Additional document in event of drawing in successor’s name) is entitled to reimbursement as if it had made payment to the beneficiary.

RULE 7: CANCELLATION

7.01 When an irrevocable standby is cancelled or terminated

A beneficiary’s rights under a standby may not be cancelled without its consent. Consent may be evidenced in writing or by an action such as return of the original standby in a manner which
implies that the beneficiary consents to cancellation. A beneficiary’s consent to cancellation is irrevocable when communicated to the issuer.

7.02 Issuer’s discretion regarding a decision to cancel

Before acceding to a beneficiary’s authorization to cancel and treating the standby as cancelled for all purposes, an issuer may require in a manner satisfactory as to form and substance:

(a) The original standby;

(b) Verification of the signature of the person signing for the beneficiary;

(c) Verification of the authorization of the person signing for the beneficiary;

(d) A legal opinion;

(e) An irrevocable authority signed by the beneficiary for cancellation that includes statements, covenants, indemnities, and similar provisions contained in a required form;

(f) Satisfaction that the obligation of any confirmer has been cancelled;

(g) Satisfaction that there has not been a transfer or payment by any nominated person; and

(h) Any other reasonable measure.

RULE 8: REIMBURSEMENT OBLIGATIONS

8.01 Right to reimbursement

(a) Where payment is made against a complying presentation in accordance with these Rules, reimbursement must be made by:

(i) an applicant to an issuer requested to issue a standby; and

(ii) an issuer to a person nominated to honour or otherwise give value;

(b) An applicant must indemnify the issuer against all claims, obligations, and responsibilities (including attorney’s fees) arising out of:

(i) the imposition of law or practice other than that chosen in the standby or applicable at the place of issuance;

(ii) the fraud, forgery, or illegal action of others; or

(iii) the issuer’s performance of the obligations of a confirmer that wrongfully dishonours a confirmation;

(c) This Rule supplements any applicable agreement, course of dealing, practice, custom or usage providing for reimbursement or indemnification on lesser or other grounds.

8.02 Charges for fees and costs

(a) An applicant must pay the issuer’s charges and reimburse the issuer for any charges that the issuer is obligated to pay to persons nominated with the applicant’s consent to advise, confirm, honour, negotiate, transfer, or to issue a separate undertaking;

(b) An issuer is obligated to pay the charges of other persons:

(i) if they are payable in accordance with the terms of the standby; or

(ii) if they are the reasonable and customary fees and expenses of a person requested by the issuer to advise, honour, negotiate, transfer, or to issue a separate undertaking, and they are unrecovered and unrecoverable from the beneficiary or other presenter because no demand is made under the standby.

8.03 Refund of reimbursement

A nominated person that obtains reimbursement before the issuer timely dishonours the presentation must refund the reimbursement with interest if the issuer dishonours. The refund does not preclude the nominated person’s wrongful dishonour claims.

8.04 Bank-to-bank reimbursement

Any instruction or authorization to obtain reimbursement from another bank is subject to the International Chamber of Commerce standard rules for bank-to-bank reimbursements.

RULE 9: TIMING

9.01 Duration of standby

A standby must:

(a) Contain an expiry date; or

(b) Permit the issuer to terminate the standby upon reasonable prior notice or payment.

9.02 Effect of expiration on nominated person

The rights of a nominated person that acts within the scope of its nomination are not affected by the subsequent expiry of the standby.

9.03 Calculation of time

(a) A period of time within which an action must be taken under these Rules begins to run on the first business day following the business day when the action could have been undertaken at the place where the action should have been undertaken;

(b) An extension period starts on the calendar day following the stated expiry date even if either day falls on a day when the issuer is closed.

9.04 Time of day of expiration

If no time of day is stated for expiration, it occurs at the close of business at the place of presentation.

9.05 Retention of standby

Retention of the original standby does not preserve any rights under the standby after the right to demand payment ceases.

RULE 10: SYNDICATION/PARTICIPATION

10.01 Syndication

If a standby with more than one issuer does not state to whom presentation may be made, presentation may be made to any issuer with binding effect on all issuers.

10.02 Participation

(a) Unless otherwise agreed between an applicant and an issuer, the issuer may sell participations in the issuer’s rights against the applicant and any presenter and may disclose relevant applicant information in confidence to potential participants;

(b) An issuer’s sale of participations does not affect the obligations of the issuer under the standby or create any rights or obligations between the beneficiary and any participant.
B. Uniform Rules for Contract Bonds (URCB): Report of the Secretary-General

(A/CN.9/459/Add.1) [Original: English]

1. By letter of 27 April 1999 (reproduced in annex I), the Secretary General of the International Chamber of Commerce (ICC) requested the Commission to give its formal recognition and endorsement to the Uniform Rules on Contract Bonds (URCB). The original text of the URCB, in English, French or Spanish, is reproduced in annex III.

2. As stated in the Foreword to the URCB, “Due to a need in the insurance industry for a uniform set of rules applicable internationally to contract bonds creating obligations of an accessory nature, the ICC Commission of Insurance undertook to elaborate the ICC Uniform Rules for Contract Bonds.”

3. For further background information on the URCB, the Introduction and General notes from the ICC publication are set out at annex II.

ANNEX I

Letter of Ms Maria Livanos Cattaui, Secretary-General of the International Chamber of Commerce

As you may be aware, several years ago ICC published a set of Uniform Rules for Contract Bonds (URCB). I write to ask that UNCITRAL give its formal recognition and endorsement to these rules. ICC is seeking similar endorsements from the World Bank, the European Union (EU) and the Inter-American Development Bank.

The URCB deal with Conditional Guarantees, so-called accessory bonds, which relate directly to the underlying contract that is being guaranteed for performance purposes.

Today, the URCB exist in several languages (including English, Spanish, French, Italian, Icelandic, Japanese, Chinese and Korean). The Government of Japan, the International Federation of Consulting Engineers (FIDIC), the Institution of Electrical Engineers (IEE), the International Credit Insurance Association (ICIA), the Association of International French Contractors (SEFI), and the Panamerican Surety Association (PASA), among others, have adopted the URCB as a recommended standard for bonds issued by their members.

The use of URCB as a global framework for bonds will provide the desired uniformity in the domain of security forms, and thus help to promote international trade. We firmly believe that this new model form will be of benefit to the entire business community. Its recognition by public institutions will assist private contracting and facilitate the export and freedom of contracting worldwide.

ANNEX II

ICC UNIFORM RULES FOR CONTRACT BONDS

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INTRODUCTION

These Uniform Rules have been drawn up by an ICC Working Party of members representing the Commission on Insurance and the building and engineering industry for worldwide application in relation to Contract Bonds, being those bonds creating obligations of an accessory nature, where the liability of the Surety or Guarantor arises and is conditional upon an established default on the part of a Contractor (defined in these Rules as the Principal) under the Contract which is the subject matter of the relevant Bond. The Rules set out below will therefore apply where the intention of the parties is that the obligations of the Guarantor will depend upon the duties or liabilities of the Principal under the relevant Contract.
Bonds governed by the ICC Rules set out below are intended to operate so as to confer upon the Beneficiary in each instance security for the performance or execution of contract obligations or payment of any sums which may fall due to the Beneficiary as a result of any breach of obligation or default by the Principal under the Contract. The Bond is intended to ensure that, subject to its financial limits, either the obligations set out in the Contract will be performed or executed, or that upon default, the Beneficiary will recover any sum properly due notwithstanding the insolvency of the Principal or the Principal’s failure for any other reason to satisfy or discharge its liability. Accordingly, where a Bond governed by these Rules is in force, the Beneficiary will have the additional assurance of the Guarantor’s accessory obligations to ensure that the judgement or award of any competent court or arbitral tribunal is satisfied.

The relationship of the parties under a Bond governed by these Rules number 524 differs from that arising under the ICC Uniform Rules for Demand Guarantees number 458 (the Demand Rules). Where the intention is that the Beneficiary is to obtain security for the obligations of the Principal arising pursuant to the Contract but that the Guarantor’s liability shall only arise in case of an established default under that Contract, these Rules should be selected.

General

These Rules are intended to provide a clear and concise scheme to regulate the nature of obligations arising under Bonds and claims procedure. Because the nature of a Bond regulated by these Rules is that the obligations of the parties are related directly to and depend upon the obligations of the parties arising under the Contract, the Rules do not contain detailed provisions dealing with documentary requirements or the problem of unfair calling. In the event of a dispute arising as to the liability of a Guarantor, the Rules contemplate that such dispute will be determined by reference to the Contract. The Guarantor and the Principal are protected in that liability will arise only where default is established. The Beneficiary is protected by the assurance that any judgement or award will be discharged by the Guarantor if the Principal fails to do so.

The Uniform Rules for Contract Bonds number 524 set out below shall apply where expressly incorporated by the parties in accordance with their detailed provisions. These new Rules depend for their success upon their use by the international business community. The ICC recommends the use of these new Rules which will help to secure uniformity of practice in the operation and enforcement of Bonds.

ANNEX III

ICC UNIFORM RULES FOR CONTRACT BONDS

[Original: English, French, Spanish]

issued as ICC publication No. 524,
adopted by the ICC Executive Board on 23 April 1993,
come into effect on 1 January 1994

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Contents

<table>
<thead>
<tr>
<th>Article</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>Scope and application</td>
<td>1</td>
</tr>
<tr>
<td>Definitions</td>
<td>2</td>
</tr>
<tr>
<td>Form of bond and liability of the guarantor to the beneficiary</td>
<td>3</td>
</tr>
<tr>
<td>Release and discharge of guarantor</td>
<td>4</td>
</tr>
<tr>
<td>Return of the Bond</td>
<td>5</td>
</tr>
<tr>
<td>Amendments and variations to and of the contract and the Bond and extensions of time</td>
<td>6</td>
</tr>
<tr>
<td>Submission of claims and claims procedure</td>
<td>7</td>
</tr>
<tr>
<td>Jurisdiction and settlement of disputes</td>
<td>8</td>
</tr>
</tbody>
</table>
Article 1

Scope and application

(a) These Rules shall be known as the “Uniform Rules for Contract Bonds” and shall apply to any Bond which states that these Rules shall apply, or otherwise incorporates these Rules by reference and, for such purposes, it shall suffice that the Bond incorporates a reference to these Rules and the publication number.

(b) If there shall be any conflict in the construction or operation of the obligations of any parties under a Bond between the provisions of these Rules and such Bond, or mandatory provisions of the Applicable Law regulating the same, the provisions of the Bond or, as the case may be, the mandatory provisions of the Applicable Law shall prevail.

Article 2

Definitions

In these Rules, words or expressions shall bear the meanings set out below and be construed accordingly

Advance Payment Bond

A Bond given by the Guarantor in favour of the Beneficiary to secure the repayment of any sum or sums advanced by the Beneficiary to the Principal under or for the purposes of the Contract, where such sum or sums is or are advanced before the carrying out of works, the performance of services or the supply or provision of any goods pursuant to such Contract.

Beneficiary

The party in whose favour a Bond is issued or provided.

Bond

Any bond, guarantee or other instrument in writing issued or executed by the Guarantor in favour of the Beneficiary pursuant to which the Guarantor undertakes on Default, either:

(i) to pay or satisfy any claim or entitlement to payment of damages, compensation or other financial relief up to the Bond Amount; or

(ii) to pay or satisfy such claim or entitlement up to the Bond Amount or at the Guarantor’s option to perform or execute the Contract or any Contractual Obligation.

In either case where the liability of the Guarantor shall be accessory to the liability of the Principal under the Contract or such Contractual Obligation and such expression shall without limitation include Advance Payment Bonds, Maintenance Bonds, Performance Bonds, Retention Bonds and Tender Bonds.

Bond Amount

The sum inserted in the Bond as the maximum aggregate liability of the Guarantor as amended, varied or reduced from time to time or, following the payment of any amount in satisfaction or partial satisfaction of a claim under any Bond, such lesser sum as shall be calculated by deducting from the sum inserted in the Bond the amount of any such payment.

Contract

Any written agreement between the Principal and the Beneficiary for the carrying out of works, the performance of services or the supply or provision of any goods.

Contractual Obligation

Any duty, obligation or requirement imposed by a clause, paragraph, section, term, condition, provision or stipulation contained in or forming part of a Contract or tender.

Default

Any breach, default or failure to perform any Contractual Obligation which shall give rise to a claim for performance, damages, compensation or other financial remedy by the Beneficiary and which is established pursuant to paragraph j of Article 7.

Expiry Date

Either (a) the date fixed or the date of the event on which the obligations of the Guarantor under the Bond are expressed to expire or (b) if no such date is stipulated, the date determined in accordance with Article 4.

Guarantor

Any Person who shall issue or execute a Bond on behalf of a Principal.

Maintenance Bond

A Bond to secure Contractual Obligations relating to the maintenance of works or goods following the physical completion or the provision thereof, pursuant to a Contract.

Performance Bond

A Bond to secure the performance of any Contract or Contractual Obligation.

Person

Any company, corporation, firm, association, body, individual or any legal entity whatsoever.

Principal

Any Person who (i) either (a) submits a tender for the purpose of entering into a Contract with the Beneficiary or (b) enters into a Contract with the Beneficiary and (ii) assumes primary liability for all Contractual Obligations thereunder.

Retention Bond

A Bond to secure the payment of any sum or sums paid or released to the Principal by the Beneficiary before the date for payment or release thereof contained in the Contract.

Tender Bond

A Bond in respect of a tender to secure the payment of any loss or damage suffered or incurred by the Beneficiary arising out of the failure by the Principal to enter into a Contract or provide a Performance Bond or other Bond pursuant to such tender.

Writing and Written

Shall include any authenticated tele-transmissions or tested electronic data interchange (“EDI”) message equivalent thereto.
Subject to any contrary provision of the Bond, the Expiry Date for the purposes of an Advance Payment Bond, a Main- tenance Bond, a Retention Bond and a Tender Bond shall be as follows:

(a) Subject to any contrary provision in the Bond and the provi- sions of paragraph (b) of this Article 4, the Expiry Date shall be six months from the latest date for the performance of the Contract or the relevant Contractual Obligations thereunder, as the case may be.

(b) Subject to any contrary provision of the Bond, the Expiry Date for the purposes of an Advance Payment Bond, a Maintenance Bond, a Retention Bond and a Tender Bond shall be as follows:

(i) in the case of an Advance Payment Bond, the date on which the Principal shall have carried out works, supplied goods or services or otherwise performed Contractual Obligations having a value as certified or otherwise determined pursuant to the Contract equal to or exceeding the Bond Amount;

(ii) in the case of a Maintenance Bond, six months after either the date stipulated by the Contract or, if no date has been specified for the termination of the Principal’s maintenance obligations, the last day of the applicable warranty period or defects liability period under the Contract;

(iii) in the case of a Retention Bond, six months after the date stipulated by the Contract for the payment, repayment or release of any retention monies;

(iv) In the case of a Tender Bond, six months after the latest date set out in the tender documents or conditions for the submission of tenders.

(c) Where the Expiry Date falls on a day which is not a Business Day, the Expiry Date shall be the first following Business Day. For the purpose of these Rules “Business Day” shall mean any day on which the offices of the Guarantor shall ordinarily be open for business.

(d) A Bond shall terminate and, without prejudice to any term, provision, agreement or stipulation of the Bond, any other agreement or the Applicable Law providing for earlier release or discharge, the liability of the Guarantor shall be discharged absolutely and the Guarantor shall be released upon the Expiry Date whether or not the Bond shall be returned to the Guarantor, save in respect of any claim served in accordance with Article 7.

(e) Notwithstanding the provisions of paragraph (d) of this Article 4, the Bond may be cancelled at any time by the return of the Bond itself to the Guarantor or by the service upon and delivery or transmission to the Guarantor of a release in writing duly signed by an authorized representative of the Beneficiary, whether or not accompanied by the Bond and/or any amendment or amendments thereto.

(f) The Guarantor shall promptly inform the Principal of any payment made under or pursuant to the Bond and of the cancellation, release or discharge thereof or any reduction in the Bond Amount where the same shall not already have been communicated.

Article 5

Return of the Bond

The Bond shall immediately after release or discharge under these Rules be returned to the Guarantor, and the retention or possession of the Bond following such release or discharge shall not of itself operate to confer any right or entitlement thereunder upon the Beneficiary.

Article 6

Amendments and variations to and of the contract and the Bond and extensions of time

(a) The Bond shall, subject to the Bond Amount and the Expiry Date, apply to the Contract as amended or varied by the Principal and the Beneficiary from time to time.

(b) A Tender Bond shall be valid only in respect of the works and contract particulars set out or described in the tender documents at the Effective Date, and shall not apply beyond the Expiry Date or in any case where there shall be any substantial or material variation of or amendment to the original tender after the Effective Date, unless the Guarantor shall confirm, in the same manner as set out in paragraph (c) of this Article 6, that the Tender Bond so applies or the Expiry Date has been extended.

(c) Any amendment to a Bond, including without limitation the increase of the Bond Amount or the alteration of the Expiry Date, shall be in writing duly signed or executed by author- ised representatives of each of the Beneficiary, the Principal and the Guarantor.
Article 7

Submission of claims and claims procedure

(a) A claim under a Bond shall be in writing and shall be served upon the Guarantor on or before the Expiry Date and by no later than the close of the Business Day at the Guarantor’s principal place of business set out in the Bond, on the Expiry Date.

(b) A claim submitted by authenticated tele-transmission, EDI, telex or other means of telefax facsimile or electronic transmission shall be deemed to be received on the arrival of such transmission.

(c) A claim delivered to the Guarantor’s principal place of business set out in the Bond shall, subject to proof of delivery, be deemed to be served on the date of such delivery.

(d) A claim served or transmitted by post shall, subject to satisfactory proof of delivery by the Beneficiary, be deemed to be served upon actual receipt thereof by the Guarantor.

(e) The Beneficiary shall, when giving notice of any claim by telefax or other tele-transmission or EDI, also send a copy of such claim by post.

(f) Any claim shall state brief details of the Contract to identify the same, state that there has been a breach or default and set out the circumstances of such breach or default and any request for payment, performance or execution.

(g) Upon receipt of a claim from the Beneficiary, the Guarantor shall send notice in writing to the Principal of such claim as soon as reasonably practicable and before either (a) making any payment in satisfaction or partial satisfaction of the same or (b) performing the Contract or any part thereof pursuant to a Contractual Obligation.

(h) The Beneficiary shall, upon written request by the Guarantor, supply to the Guarantor such further information as the Guarantor may reasonably request to enable it to consider the claim, and shall provide copies of any correspondence or other documents relating to the Contract or the performance of any Contractual Obligations and allow the Guarantor, its employees, agents or representatives to inspect any works, goods or services carried out or supplied by the Principal.

(i) A claim shall not be honoured unless

(i) a Default has occurred; and

(ii) the claim has been made and served in accordance with the provisions of paragraphs a-f of Article 7 on or before the Expiry Date.

(j) Notwithstanding any dispute or difference between the Principal and the Beneficiary in relation to the performance of the Contract or any Contractual Obligation, a Default shall be deemed to be established for the purposes of these Rules:

(ii) if the Bond does not provide for the issue of a certificate of Default under paragraph (i) or (ii) shall not restrict the rights of the parties to seek or require the determination of any dispute or difference arising under the Contract or the Bond or the review of any certificate of Default or payment made pursuant thereto by a court or tribunal of competent jurisdiction.

(k) A copy of any certificate of Default issued under j (i) or (ii) shall be given by the Guarantor to the Principal and the Beneficiary forthwith.

(l) The Guarantor shall consider any claim expeditiously and, if such claim is rejected, shall immediately give notice thereof to the Beneficiary by authenticated tele-transmission or other telefax, facsimile transmission, telex, cable or EDI, confirming the same by letter, setting out the grounds for such refusal including any defences or other matters raised under paragraph d of Article 3.

Article 8

Jurisdiction and settlement of disputes

(a) The Applicable Law shall be the law of the country selected by the parties to govern the operation of the Bond and, in the absence of any express choice of law, shall be the law governing the Contract and any dispute or difference arising under these Rules in relation to a Bond shall be determined in accordance with the Applicable Law.

(b) All disputes arising between the Beneficiary, the Principal and the Guarantor or any of them in relation to a Bond governed by these Rules shall, unless otherwise agreed, be finally settled under the Rules of Conciliation and Arbitration of the International Chamber of Commerce by one or more arbitrators appointed in accordance with the said Rules.

(c) If the Bond shall exclude the operation of the arbitration provisions of this Article 8, any dispute between the parties to the Bond shall be determined by the courts of the country nominated in the Bond, or, if there is no such nomination, the competent court of the Guarantor’s principal place of business or, at the option of the Beneficiary, the competent court of the country in which the branch of the Guarantor which issued the Bond is situated.
V. INTERNATIONAL COMMERCIAL ARBITRATION

Possible future work in the area of international commercial arbitration:
note by the secretariat

(A/CN.9/460) [Original: English]

CONTENTS

INTRODUCTION .................................................. 1-3

I. SUMMARY OF PROPOSALS .................................... 4-7

II. POSSIBLE TOPICS FOR CONSIDERATION BY THE COMMISSION ...... 8-144
   A. Conciliation ........................................ 8-19
   B. Requirement of written form for arbitration agreement ............. 20-31
   C. Arbitrability ......................................... 32-34
   D. Sovereign immunity ..................................... 35-50
   E. Consolidation of cases before arbitral tribunals .................... 51-61
   F. Confidentiality of information in arbitral proceedings ............ 62-71
   G. Raising claims for the purpose of set-off ........................ 72-79
   H. Decisions by “truncated” arbitral tribunals .......................... 80-91
   I. Liability of arbitrators ................................... 92-100
   J. Power by the arbitral tribunal to award interest .................. 101-106
   K. Costs of arbitral proceedings ................................ 107-114
   L. Enforceability of interim measures of protection .................. 115-127
   M. Discretion to enforce an award that has been set aside in the State of origin .... 128-144

INTRODUCTION

1. The Commission, during its thirty-first session, held on 10 June 1998 a special commemorative New York Convention Day in order to celebrate the fortieth anniversary of the Convention on the Recognition and Enforcement of Foreign Arbitral Awards (New York, 10 June 1958). In addition to representatives of States members of the Commission and observers, some 300 invited persons participated in the event. The opening speech was made by the Secretary-General of the United Nations. In addition to speeches by former participants in the diplomatic conference that adopted the Convention, leading arbitration experts gave reports on matters such as the promotion of the Convention, its enactment and application. Reports were also given on matters beyond the Convention itself, such as the interplay between the Convention and other international legal texts on international commercial arbitration and on practical difficulties that were encountered in practice but were not addressed in existing legislative or non-legislative texts on arbitration.¹

2. In reports presented at that commemorative conference, various suggestions were made for presenting to the Commission some of the problems identified in practice so as to enable it to consider whether any work by the Commission would be desirable and feasible.

3. The Commission, with reference to the discussions at the New York Convention Day, considered that it would be useful to engage in a consideration of possible future work in the area of arbitration at its thirty-second session in

1999. It requested the Secretariat to prepare for the current session a note that would serve as a basis for the considerations of the Commission. It was noted by the Commission that, in addition to the considerations at the New York Convention Day, considerations at other international conferences of arbitration practitioners (such as the Congress of the International Council for Commercial Arbitration, Paris, 3-6 May 1998) might be taken into account in the preparation of the note. The present note has been prepared pursuant to that request.

I. SUMMARY OF PROPOSALS

4. The present document briefly discusses certain issues and problems identified in arbitral practice in order to facilitate a discussion in the Commission as to whether it wishes to put any of those issues on its work programme. The issues discussed include certain aspects of conciliation proceedings; the legislative requirement of a written form for the arbitration agreement; arbitralability; sovereign immunity; consolidation of more than one case into one arbitral proceeding; confidentiality of information in arbitral proceedings; raising claims in arbitral proceedings for the purpose of set-off; decisions by “truncated” arbitral tribunals; liability of arbitrators; power by the arbitral tribunal to award interest; costs of arbitral proceedings; enforceability of interim measures of protection; and discretion to enforce an award that has been set aside in the State of origin. Any other issues pertaining to the law of arbitration may be raised at the session of the Commission for possible consideration by the Commission.

5. The Commission may wish to consider the desirability of preparing uniform provisions on any of those issues, possibly indicating whether further work should be towards a legislative text (such as a model legislative provision or a treaty) or a non-legislative text (such as a model contractual rule). Even if ultimately no uniform solutions would be prepared, an in-depth discussion by delegates from all major legal, social and economic systems represented in the Commission or its Working Group would be useful in that it would provide welcome information to users of arbitration worldwide about the difficulties that have emerged in practice and the possible solutions to such difficulties.

6. In considering its future work in this area, the Commission may wish to take note of the fact that the Working Party on International Legal and Commercial Practice of the Economic Commission for Europe (ECE) has been discussing various issues relating to the Convention on International Commercial Arbitration (Geneva, 1961), including its possible revision. While no decision has yet been made as to whether the Convention should be revised, or the thrust of any revision, the ideas tentatively discussed include the possibility of a revision that would increase the utility of the Convention for existing and potential new signatories. In view of the potential universal interest of the discussions in the ECE Working Party, and in view of the connection between those discussions and any future work in the area of arbitration to be decided by the Commission, the Commission may wish to request the Secretariat to follow closely the considerations in the ECE Working Party and report about those considerations to the Commission or its Working Group.

7. Should the Commission decide to include on its work programme any of the issues mentioned in this document or any issue raised at the session of the Commission, it may wish to request the Secretariat to prepare studies, in cooperation with relevant international organizations, and perhaps to prepare first tentative proposals for consideration by the Commission or one of its Working Groups.

II. POSSIBLE TOPICS FOR CONSIDERATION

BY THE COMMISSION

A. Conciliation

8. The term “conciliation” is used here to refer to proceedings in which an independent and impartial person is assisting parties in dispute to reach a settlement. Conciliation differs from negotiations between the parties (which typically take place after a dispute has arisen) in that a conciliation is conducted by a third independent and impartial person, whereas in settlement negotiations between the parties no such third independent and impartial person is involved. The difference between conciliation and arbitration is that conciliation is purely voluntary in that both parties participate in it only to the extent that, and as long as, they both so agree. Thus, a conciliation ends either in a settlement of the dispute or it ends unsuccessfully, whereas the arbitral tribunal, if there is no settlement, imposes a binding decision on the parties.

9. Conciliation proceedings in the above sense are envisaged and dealt with in a number of rules of arbitral institutions, as well as in the UNCITRAL Conciliation Rules (1980). These Rules are widely used and have served as a model for many other sets of conciliation rules. In practice, such conciliation proceedings are referred to by various expressions, including “mediation”.

10. Conciliation is being increasingly practised in various parts of the world, including regions where until several years ago it was not commonly used. This trend is reflected, inter alia, in the establishment of a number of private and public bodies offering conciliation services to interested parties. This trend, and a growing desire in different regions of the world to promote conciliation as a method of dispute settlement, has given rise to discussions calling for internationally harmonized legal solutions designed to facilitate conciliation. Ideas raised in such discussions are summarized below.

I. Admissibility of certain evidence in subsequent judicial or arbitral proceedings

11. In conciliation proceedings, the parties typically express suggestions and views regarding proposals for a pos-
sible settlement, make admissions or indicate their willingness to settle. If, despite such efforts, the conciliation does not result in a settlement and the parties initiate judicial or arbitral proceedings, those views, suggestions, admissions or indications of willingness to settle might be used to the detriment of the party who made them. This possibility may discourage parties from actively trying to reach a settlement during conciliation proceedings, which may greatly reduce the usefulness of conciliation.

12. In order to address the above problem, the UNCITRAL Conciliation Rules contain a rule in article 20, which reads as follows:

“The parties undertake not to rely on or introduce as evidence in arbitral or judicial proceedings, whether or not such proceedings relate to the dispute that is the subject of the conciliation proceedings:

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

“(b) Admissions made by the other party in the course of the conciliation proceedings;

“(c) Proposals made by the conciliator;

“(d) The fact that the other party had indicated his willingness to accept a proposal for settlement made by the conciliator.”

13. If the parties use no conciliation rules or use rules that do not contain a provision such as article 20 of the UNCITRAL Conciliation Rules, under many legal systems the parties may be affected by the above-described problem. Even if the parties have agreed on a rule such as the one contained in article 20, it may not be certain that the agreement concerning evidence will be given full effect. In order to assist the parties in such situations, some jurisdictions have adopted laws designed to prevent the introduction of certain evidence relating to previous conciliation proceedings into subsequent judicial or arbitral proceedings.

2. Role of conciliator in other adversary proceedings

14. A party may be reluctant to actively strive for a settlement in conciliation proceedings if it has to take into account the possibility that, if the conciliation is not successful, the conciliator might be appointed as counsel of the other party or as an arbitrator. The conciliator’s awareness of certain facts occurring during conciliation (e.g. proposals for settlement and admissions) might prove to be prejudicial for the party who made them. This is the reason behind the provision of article 19 of the UNCITRAL Conciliation Rules, which reads as follows:

“The parties and the conciliator undertake that the conciliator will not act as an arbitrator or as a representative or counsel of a party in any arbitral or judicial proceedings in respect of a dispute that is the subject of the conciliation proceedings. The parties also undertake that they will not present the conciliator as a witness in any such proceedings.”

15. Some jurisdictions have included similar provisions in their legislation. In some cases, however, prior knowledge on the part of the arbitrator might be regarded by the parties as advantageous (in particular because that knowledge will allow the arbitrator to conduct the case more efficiently); in such cases, the parties may actually prefer that the conciliator be appointed as an arbitrator in the subsequent arbitral proceedings. In order to overcome any objection based on assertions of prejudice in those cases, some jurisdictions have adopted laws expressly allowing a conciliator, subject to agreement of the parties, to serve as an arbitrator.

3. Enforceability of settlement agreements

16. One of the major potential disadvantages of conciliation is the possibility that the time and money spent for the conciliation will be in vain if the parties do not reach a settlement. It has often been said that the attractiveness of conciliation would be greatly increased if a settlement reached during a conciliation would have executory force so that a party to the settlement would not be compelled to litigate in order to achieve what has been agreed upon. Admittedly, obtaining an executory title in court proceedings would likely be less protracted if the claim is based on a settlement as compared to the case where there has been none. Nevertheless, the prospect of litigation in order to enforce a settlement reduces the attractiveness of conciliation.

17. A possible way of obtaining an executory title would be for the parties who have reached a settlement to appoint the conciliator as an arbitrator and limit the arbitration proceedings to recording the settlement in the form of an arbitral award on agreed terms (as provided for, e.g. in art. 34(1) of the UNCITRAL Arbitration Rules (1976)). A possible obstacle to this approach, however, may arise in a number of legal systems in which, once a settlement has been reached and the dispute has thereby been eliminated, it is not possible to institute arbitral proceedings.

18. In light of the above, some jurisdictions have adopted laws that establish the enforceability of settlement agreements reached in conciliation proceedings. Such laws provide, for example, that the written settlement agreement should, for the purposes of its enforcement, be treated as an arbitral award and may be enforced as such. Another possible solution may be for legislation to expressly permit the parties to the settlement, despite the disappearance of the dispute, to commence arbitration and obtain from the arbitrator (who may be the former conciliator) an award on agreed terms.

4. Conclusion

19. The Commission may wish to consider whether, with a view to encouraging and facilitating conciliation, it would be useful for it to consider preparing harmonized legislative model provisions that would deal with questions such as the admissibility of evidence submitted during conciliation in subsequent arbitration or court proceedings; any role that
a conciliator might play in subsequent arbitral proceedings; and the conditions under which a settlement reached during conciliation proceedings may be treated as an executory title.

B. Requirement of written form for arbitration agreement

20. Article II(2) of the Convention on the Recognition and Enforcement of Foreign Arbitral Awards states as follows:

“The term ‘agreement in writing’ shall include an arbitral clause in a contract or an arbitration agreement, signed by the parties or contained in an exchange of letters or telegrams.”

Article 7(2) of the UNCITRAL Model Law on International Commercial Arbitration (1985) provides that:

“The arbitration agreement shall be in writing. An agreement is in writing if it is contained in a document signed by the parties or in an exchange of letters, telex, telegrams or other means of telecommunication which provide a record of the agreement, or in an exchange of statements of claim and defence in which the existence of an agreement is alleged by one party and not denied by another. The reference in a contract to a document containing an arbitration clause constitutes an arbitration agreement provided that the contract is in writing and the reference is such as to make that clause part of the contract.”

21. Problems arising from the requirement that arbitration agreements be in written form have often been described as difficult and frustrating. It is at the stage of recognition or denial of an effective agreement to arbitrate that tensions can still be seen between the courts and the arbitral process. It has also been said that the harmonization of interpretation of article II(2) of the Convention should have priority for a better functioning of the Convention. However, before discussing this issue, this note will consider first the issue of the requirement of “written form” for an arbitration agreement and its compatibility with the increased use of electronic commerce.

1. Arbitration agreement “in writing” and electronic commerce

22. The question as to whether electronic commerce is an acceptable means of concluding valid arbitration agreements should pose no more problems than have been created by the increased use of telex and telecopy or facsimile. The above-cited article 7(2) of the UNCITRAL Model Law expressly validates the use of any means of telecommunication “which provides a record of the agreement”, a wording which would cover most common uses of electronic mail or electronic data interchange (EDI) messaging.

23. As to the New York Convention, it is generally accepted that the expression in article II(2) “contained in an exchange of letters or telegrams” should be interpreted broadly to include other means of communication, particularly telex (to which facsimile could nowadays be added). The same teleological interpretation could be extended to cover electronic commerce. Such an extension would also be in line with the decision taken by the Commission when it adopted the UNCITRAL Model Law on Electronic Commerce together with its Guide to Enactment in 1996. However, further study might be needed to determine whether interpretation of article II(2) of the New York Convention by reference to either the UNCITRAL Model Law on Arbitration or the UNCITRAL Model Law on Electronic Commerce would be likely to gain wide international consensus and should be recommended by the Commission as a workable solution in respect of this issue and also for dealing with the more general issues of form requirements.

2. “Exchange of letters or telegrams” as form requirement

24. The problem arises from the combination of the question of form and the way the arbitration agreement comes about (i.e. its formation), expressed by the expression “exchange of letters or telegrams”, which is found both in the Convention and in the Model Law. This expression lends itself to an overly literal interpretation in the sense of a mutual exchange of writings. A tacit acceptance would be, in principle, not sufficient. Neither would be a purely oral agreement.

25. Fact situations that have posed serious problems under the Convention, and require at least very extensive, teleological interpretation of the Model Law include the following: tacit or oral acceptance of a written purchase order or of a written sales confirmation; an orally concluded contract referring to written general conditions (e.g. oral reference to a form of salvage); or, certain brokers’ notes, bills of lading and other instruments or contracts transferring rights or obligations to non-signing third parties.

For example, the Swiss Federal Tribunal observed that “[article II(2)] must be interpreted in the light of [the actual Convention]... Compagnie de Navigation et Transports S.A. v. MSC (Mediterranean Shipping Company) S.A., 16 January 1995, 1st civil division of Swiss Federal Tribunal; relevant excerpts in (1995) 13 Association suisse de l’arbitrage, Bulletin, pp. 503-511, at p. 508.

The Guide to Enactment (which was drafted with the New York Convention and other international instruments in mind) provides that “the Model Law [on Electronic Commerce] may be useful in certain cases as a tool for interpreting existing international conventions and other international instruments that create legal obstacles to the use of electronic commerce, for example by prescribing that certain documents or contractual clauses be made in written form. As between those States parties to such international instruments, the adoption of the Model Law [on Electronic Commerce] as a rule of interpretation might provide the means to recognize the use of electronic commerce and obviate the need to negotiate a protocol to the international instrument involved.” (See Guide to Enactment of the UNCITRAL Model Law on Electronic Commerce, para. 6).

This question raises more general concerns regarding the compatibility of electronic commerce with the legal regime established by a series of international conventions that contain mandatory requirements for the use of written documents. An inventory of such instruments was prepared by the United Nations Economic Commission for Europe (Trade/R.1096/Rev.1), together with a recommendation that work might be undertaken by UNCITRAL to identify possible solutions to those concerns.
parties (i.e., third parties who were not party to the original agreement). Examples of such transfers to third parties include the following: universal transfer of assets (successions, mergers, demergers and acquisitions of companies); specific transfer of assets (transfer of contract or assignment of receivables or debts, novation, subrogation, stipulation in favour of a third party (stipulation pour autrui)); or, in the case of multiple parties, or groups of contracts or groups of companies, implicit extension of the application of the arbitration agreement to persons who were not expressly parties thereto.6

26. Courts have reached rather disparate decisions in those situations, often reflective of their general attitude towards arbitration. In the great majority of cases, they have been able to hold the parties to their agreement. However, under existing case law, it has been noted, for example, that an arbitration clause in a sales or purchase confirmation will meet the written form requirement of article II(2) of the Convention only if: (a) the confirmation is signed by both parties; or (b) a duplicate is returned, whether signed or not; or possibly (c) the confirmation is subsequently accepted by means of another communication in writing from the party who received the confirmation to the party who dispatched it. Conditions such as these are no longer in accord with international trade practice.

27. Various means of solving the above-mentioned problems might be envisaged at the legislative level. One possible solution, on which the Commission might wish to request further study, would rely on the UNCITRAL Model Law on Arbitration as a tool for interpreting the New York Convention. Such a solution might require possible amendments or additions to the current text of the Model Law; should it be amended, a range of alternative approaches might be considered.

28. One possible approach, in line with recent legislative developments in a number of countries, would be to include a list of instruments or factual situations where arbitration agreements would be validated despite the lack of an exchange of documents. Such a list might include, for example, the use of bills of lading or other instruments and situations listed above.

29. A broader solution would be to validate arbitration agreements entered into in the absence of an exchange of documents where the applicable law did not impose any form requirement on the main contract. Language might be considered along the lines of a proposal made during the preparation of article 7(2) of the Model Law as follows: “An arbitration agreement also exists when one party to a contract refers in its written offer, counter-offer or contract confirmation to general conditions, or uses a contract form or standard contract, containing an arbitration clause and the other party does not object, provided that the applicable law recognizes formation of contracts in such manner.”7 That proposal had been rejected “since it raised difficult problems of interpretation.”8 However, in support of such an approach, it has been suggested on several occasions, as well as at the “New York Convention Day” in 1998, that article 7(2) should be amended so as to widen the definition of writing (for example to cover situations when parties conclude a contract on the basis of one party’s standard conditions with an arbitration clause that is not signed by one party nor is there any exchange of documents which could bring the arbitration clause within the definition of writing).9 It might be objected that there may be specific reasons why a party would wish to refuse a specific provision, particularly a stipulation as important as a waiver of the right to go to court. However, that objection might sufficiently be taken care of through the possibility granted to the refusing party to object to the arbitration clause. In order to find a suitable rule for universal use, more discussion and study is needed of proposals made during the preparation of the Model Law and especially of the various solutions developed in recent national laws.

30. The most radical solution might be to amend the Model Law to establish total freedom with respect to the form of the arbitration agreement. Such freedom would even validate oral arbitration agreements. It might be objected, however, that allowing oral agreements would lead to uncertainty and litigation.

31. The solution of relying on a possibly amended version of the Model Law as a tool for interpreting article II(2) of the New York Convention (without amending or revising that Convention) might not bring about a sufficient level of certainty and uniformity, particularly as regards oral agreements, which courts would, in all likelihood, be reluctant to accept in a number of countries. A second solution could be to rely on the more-favourable-law provision of article VII of the Convention. That solution could be pursued only if article II(2) were no longer to be interpreted as a uniform rule establishing the minimum requirement of writing but would instead be understood as establishing the maximum requirement of form. If article II(2) were to be interpreted as establishing a uniform rule, a reference to article VII for the purpose of alleviating the form requirement would be possible only where the national law provides a full enforcement mechanism since the Convention becomes inapplicable in toto.10 In that case, possible additions to the Model Law might need to include express provisions for recognition and enforcement of arbitral awards based on agreements meeting the more liberal form requirement—a solution that would have to be dealt with in the wider context of a possible chapter on enforcement. Further study of the two possible interpretations of article II(2) may be found appropriate by the Commission.

C. Arbitrability

32. In some States the commercial subject matters that are reserved to the courts are determined by case law only, while in other States they are determined by various

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statutes, for instance, those dealing with anti-trust or unfair competition, securities, intellectual property, labour or company law. Various States have included in their arbitration law a general provision going beyond the traditional formula of “what parties may compromise on or dispose of” to cover, for example, “any claim involving an economic interest”. Uncertainty about, and differences among definitions of, which disputes are arbitrable may cause considerable difficulties in practice.

33. One way of approaching the problem may be to attempt to reach a worldwide consensus on a list of non-arbitrable issues. If that does not seem feasible, it may be considered whether it would be desirable to agree on a uniform provision setting out three or four issues that are generally considered non-arbitrable and then call upon States to list immediately thereafter any other issues deemed non-arbitrable by that State. Such an approach of channelled information, as used in article 5 of the UNCITRAL Model Law on International Commercial Arbitration, would provide certainty and easy access to information about those restrictions.

34. In searching for the best approach that would be workable worldwide and that would provide the desired degree of certainty and transparency, one would face a dilemma. The more general the formula, the greater would be the potential risk of divergent interpretation by courts of different States; the more detailed the list, the greater would be the risk of non-acceptance by States and, to the extent the list would be accepted, the greater would be the risk of solidifying matters and thus impeding further development towards limiting the realm of non-arbitrability. Nevertheless, a considered attempt seems desirable since the result of a worldwide discussion would in itself be revealing and useful.

D. Sovereign immunity

35. When a private party initiates arbitral proceedings against a State, it runs the risk that the State may decline to participate on the grounds of sovereign immunity. Or, the private party may try to seek recognition and enforcement of an arbitral award against the State and encounter the plea of sovereign immunity at that stage. Since arbitration arises out of an agreement, the question to be addressed is whether the State can rely on the defence of sovereign immunity where it has previously entered into an agreement to arbitrate with the other party.

1. Sovereign immunity in arbitral proceedings

(a) International law

36. A review of various international instruments as well as national legislation in many States suggests that a State may enter into a binding arbitration agreement or that agreement by a State to arbitrate international commercial disputes implies waiver of its sovereign immunity.

37. A number of international and regional instruments contain a provision to the effect that States are bound to recognize agreements to arbitrate. For example, the European Convention on International Commercial Arbitration (Geneva, 1961) provides that in matters to which the Convention applies “legal persons considered by the law which is applicable to them as ‘legal persons of public law’ have the right to conclude valid arbitration agreements” (art. II(1)).

38. Another such instrument is the European Convention on State Immunity, which states in article 12(1):

“Where a Contracting State has agreed in writing to submit to arbitration a dispute which has arisen or may arise out of a civil or commercial matter, that State may not claim immunity from the jurisdiction of a court of another Contracting State on the territory or according to the law of which the arbitration has taken or will take place in respect of any proceedings relating to:

“(a) the validity or interpretation of the arbitration agreement,
“(b) the arbitration procedure,
“(c) the setting aside of the award, unless the arbitration agreement otherwise provides.”


40. It may be noted also that in 1976 the Asian-African Legal Consultative Committee (AALCC) recommended that UNCITRAL consider preparing a protocol to the New York Convention clarifying, inter alia, that “where a governmental agency is a party to a commercial transaction in

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“If a State enters into an agreement in writing with a foreign natural or juridical person to submit to arbitration differences relating to a commercial transaction, that State cannot invoke immunity from jurisdiction before a court of another State which is otherwise competent in a proceeding which relates to:

“(i) the constitution or appointment of the arbitral tribunal, or
“(ii) the validity, or interpretation of the arbitration agreement; 
“(b) the arbitration procedure; or
“(c) the setting aside of the award; unless the arbitration agreement otherwise provides.”
13 Reproduced in (1983) 22 International Legal Materials 287. Article III states as follows:

“2. An implied waiver may be made inter alia:

“(b) by agreeing in writing to submit a dispute which has arisen, or may arise, to arbitration in the forum State or in a number of States which may include the forum State. In such an instance a foreign State shall not be immune with respect to proceedings in a tribunal of the forum State which relate to:

“(i) the constitution or appointment of the arbitral tribunal, or
“(ii) the validity, or interpretation of the arbitration agreement or the award, or
“(iii) the arbitration procedure, or
“(iv) the setting aside of the award.”
which it has entered into an arbitration agreement, it should not be able to invoke sovereign immunity in respect of an arbitration pursuant to that agreement”.  

(b) National Laws

41. The first attempts by national legislatures to codify rules on sovereign immunity began in the 1970s and since then several States have enacted foreign sovereign immunity legislation. A few of these laws contain provisions similar to those in the international instruments noted above. In other States, the same result is achieved by providing that a foreign Government enjoys immunity from the courts of the legislating State, subject to certain exceptions; one such exception is where the foreign Government has entered into an arbitration agreement. It has also been legislated that if a party to the arbitration agreement is a State, it cannot rely on its own law in order to contest its capacity to be a party to an arbitration or the arbitrability of a dispute covered by the arbitration agreement. In yet other States, the rules on sovereign immunity have evolved through case law.

2. Sovereign immunity in enforcement of arbitral awards

(a) International law

42. After having successfully obtained an arbitral award against a State, the claimant may encounter a plea of sovereign immunity by the State when seeking enforcement of the award.

43. As regards the New York Convention, which provides for a general obligation to recognize as binding foreign arbitral awards, some commentators are of the view that the text and travaux préparatoires would support the position that a State which has agreed to submit to arbitration is required to comply with the resulting arbitral award and cannot plead immunity.

44. In the Convention on the Settlement of Investment Disputes Between States and Nationals of Other States (Washington, 1965), despite the requirement on the part of States to recognize as binding and to enforce awards rendered pursuant to that Convention, sovereign immunity is specifically preserved. Article 54(1) of the Convention states as follows:

“(1) Each Contracting State shall recognize an award rendered pursuant to this Convention as binding and enforce the pecuniary obligations imposed by that award within its territories as if it were a final judgment of a court in that State ...”.

However, article 55 states that:

“Nothing in Article 54 shall be construed as derogating from the law in force in any Contracting State relating to immunity of that State or of any foreign State from execution.”

45. In the view of some, if the generally accepted principle is that, by entering into an agreement to arbitrate, a foreign State has waived any right to claim sovereign immunity, then it should follow that such waiver extends also to the enforcement of the arbitral award. It is noted that otherwise there would be little point in applying the waiver principle to engage in arbitral proceedings, if the State against which the award is made can later avoid enforcement proceedings by yet another plea of sovereign immunity. Others argue that refusal by a foreign State to honour an arbitral award constitutes a separate act by the State, so that sovereign immunity can be raised again, or possibly for the first time, as a defence to the enforcement proceedings.

46. Most national legal systems distinguish between waiver of immunity from jurisdiction and waiver of immunity from execution. As a consequence, in some cases, agreement by a State to submit to arbitration may not be sufficient to imply consent to the jurisdiction of the court in the State where enforcement is being sought, nor to imply consent to execution. The requirement for express consent is set out in articles 7 and 18(2) of the International Law Commission’s draft Articles on Jurisdictional Immunities of States and their Property. What these draft provisions clarify is that waiver of sovereign immunity will be considered to have been made if the State has given its consent to the jurisdiction and its consent to execution.15

47. Another basis for the exclusion of the sovereign immunity defence from execution proceedings is where the property that is sought to be attached as a result of execution is property that is used in commercial activities by the foreign State. This exception is outlined in the provisions of article 18(1) of the draft Articles of the International Law Commission, which follow below.16 The draft Articles also specify certain categories of property that are exempt from attachment.17

14Draft article 7 states as follows:

“1. A State cannot invoke immunity from jurisdiction in a proceeding before a court of another State with regard to a matter or case if it has expressly consented to the exercise of jurisdiction by the court with regard to the matter or case:

“(a) by international agreement;

“(b) in a written contract; or

“(c) by a declaration before the court or by a written communication in a specific proceeding.

2. Agreement by a State for the application of the law of another State shall not be interpreted as consent to the exercise of jurisdiction by the courts of that other State.”

Draft article 18(2) states as follows:

“2. Consent to the exercise of jurisdiction under article 7 shall not imply consent to the taking of measures of constraint under paragraph 1, for which separate consent shall be necessary.”

15This exception follows from the general principle that a governmental entity which engages in a commercial activity, as opposed to a governmental activity, is not immune from suit. There are several international instruments that contain provisions to that effect (e.g. art. 7(1) of the European Convention on State Immunity). It is also a common provision in national laws, and there is considerable jurisprudence discussing means for differentiating “governmental activity” from “commercial activity”.

16The categories that are exempt from attachment as outlined in article 19 include: property used or intended for use for the purposes of the various diplomatic missions of the State, or for military purposes; property of the central bank or similar authority; property forming part of the cultural heritage of the State or part of an exhibition of scientific, cultural or historic interest.
Article 18(1)

“1. No measures of constraint, such as attachment, arrest and execution, against property of a State may be taken in connection with a proceeding before a court of another State unless and except to the extent that:

“(a) the State has expressly consented to the taking of such measure as indicated:

“(i) by international agreement;

“(ii) by an arbitration agreement or in a written contract; or

“(iii) by a declaration before the court or by a written communication after a dispute between the parties has arisen;

“(b) the State has allocated or earmarked property for the satisfaction of the claim which is the object of that proceeding; or

“(c) the property is specifically in use or intended for use by the State for other than government non-commercial purposes and is in the territory of the State of the forum and has a connection with the claim which is the object of the proceeding or with the agency or instrumentality against which the proceeding was directed.”

(b) National laws

48. Only a few States have enacted enforcement provisions specific to arbitral awards. For example, in one law it is stated that where the foreign State is a party to an arbitration agreement, that State is not immune in a proceeding for the enforcement of an award made pursuant to the arbitration. Under the law of another State, the plaintiff cannot levy execution to enforce an arbitral award against a foreign State’s property unless that State has consented to the property being used or intended for commercial purposes.

49. It is more common for the legislation to address enforcement of judgments of all kinds, without specific reference to arbitral awards. The approach usually follows one of two theories. One is the absolute theory, which prohibits attachment of foreign State property of any kind without consent of that State. The more common and modern approach is based on the restrictive theory, which prohibits attachment under more limited circumstances. There is variation, however, in its application. In some laws, the “State” is defined narrowly, so as to exclude State trading entities or State entities engaged in commercial activities. Most legislation also excludes immunity when the State has given its consent to execution or attachment, and in some laws such consent is construed to cover an implied as well as an express waiver. Some States do not permit enforcement against foreign State property located in the State where enforcement is being sought unless there is a sufficient jurisdictional connection. Other States require a link between the property to be attached and the claim. Most States accept that certain categories of State property must remain non-attachable, similar to the categories outlined in article 19 of the draft Articles of the International Law Commission referred to above.

3. Conclusion

50. Given that the matter of State immunity remains under consideration by the International Law Commission, and given that the General Assembly has decided to establish a working group of the Sixth Committee to consider outstanding substantive issues related to the Draft Articles of the International Law Commission at its fifty-fourth session, beginning in 1999, the Commission may wish to request the Secretariat to monitor that work and to report on the outcome of those discussions.

E. Consolidation of cases before arbitral tribunals

51. Sometimes it may be desirable to consolidate into one arbitral proceeding two or more arbitral cases based on different arbitration agreements. For the purposes of the present discussion, consideration is being given only to those situations involving possible consolidation of two or more proceedings where the proceedings to be consolidated take place or are to take place in the same State. Although consolidation may also be desirable in some instances where the arbitral proceedings take place in different States, those situations raise additional issues of international cooperation between national courts, which are beyond the scope of the present discussion.

52. Consolidation may be considered desirable in a variety of situations. The most usual situations are those where more than one arbitration arises out of the same set of facts or involves the same parties. One example is where there exists an arbitration agreement between a purchaser of industrial works and its general contractor, and other arbitration agreements exist between the general contractor and its various subcontractors to which the purchaser is not a party. An occurrence that brings about arbitration between one set of parties often precipitates arbitration between the other parties. In such a situation, one or more of the parties may wish these related arbitral proceedings to be joined.

53. One of the advantages of consolidation is avoidance of inconsistent decisions. Where more than one arbitral tribunal deliberates on matters arising out of the same set of facts, it is possible for each tribunal to arrive at a different conclusion. In the example given above, if the parties were to arbitrate separately after a problem in a project under construction, it is conceivable that one tribunal may find that the general contractor is not responsible while another tribunal may find that none of the subcontractors is responsible. Yet, the facts may indicate that the purchaser of the industrial works should be entitled to recover its loss from at least one of the parties. Another possible advantage of consolidation is efficiency. If one arbitration tribunal can hear all of the parties and their expert witnesses, and then review all of the evidence, this might avoid duplication, reduce costs and save time for all of those involved.

54. An important difference should be noted between those situations where the parties have agreed upon consolidation, whether in the arbitration agreement or other-
wise, and those where they have not. In cases where parties have already agreed, they may require assistance in order to implement the agreement; for example, the terms for consolidation may not have been stipulated, the parties may be unable to agree on the selection of the tribunal, or they may be in a deadlock in respect of other issues. On the other hand, one or more of the parties in this situation may not wish to have the related disputes considered in consolidated proceedings (e.g. in order to maintain confidentiality or for reasons of procedural tactics). It may thus occur that in some cases the multiple parties involved agree that the different disputes should be considered in consolidated proceedings while in other cases such agreement may not exist.

55. It has been suggested that the objective of legislative efforts should be limited to facilitating implementation of agreements to consolidate cases. Others believe that legislation should go further and authorize courts to order consolidation when, in the view of the court, this appears appropriate even in the absence of agreement between the parties.

1. Current legislative solutions

56. A review of the legislation indicates that the power of a competent authority to order consolidation is not covered by any international instruments relevant to international arbitration. At the time the UNCITRAL Model Law on Arbitration was being drafted, there was general agreement that the Model Law should not deal with problems of consolidation in multi-party disputes. While it was agreed that parties had the freedom to conclude consolidation agreements when, in the view of the court, this appears appropriate even in the absence of agreement between the parties.

(a) Authority to compel consolidation without agreement of parties

57. In the reviewed examples of national laws in which consolidation is addressed, only in two cases does the legislation authorize the court to order consolidation, even if not all the parties involved agree that the cases should be consolidated. In one of those States, the authority to compel consolidation applies only to domestic arbitrations; for this authority to apply to international arbitrations, the parties must first have elected by written agreement to “opt-in” to the domestic regime that contains the court-ordered consolidation provisions. In the other State, the parties can by agreement “opt-out” of the provision. After all of the parties and arbitrators have been given an opportunity to express an opinion on a party’s request for consolidation, the court may grant the request wholly or partly or reject it. If the proceedings are to be consolidated and the parties cannot agree on the tribunal or the procedural rules, the court is to so decide.

(b) Authority to assist parties in consolidating cases based on agreement of parties

58. The more usual approach among countries that have enacted legislative provisions on consolidation, however, is to support party autonomy and to assist parties that have already agreed to consolidate their proceedings. Most of the legislation requires either that such agreement has to have been expressed in the arbitration agreement or otherwise, or, that the application is to be brought with the consent of all of the parties.

59. Under most of the legislation reviewed, the application for consolidation is to be made to a court. In some jurisdictions, application for consolidation can be made to the arbitral tribunal or tribunals concerned. The requested arbitral tribunals may confer with each other with a view to making consistent orders for consolidation. If an order for consolidation is not made, or if inconsistent provisional orders by the arbitral tribunals involved are made, any party may apply to the court, which will decide on consolidation.

60. Most of the legislation reviewed provides that a consolidation order can be made where there is a common question of law or fact, that the rights to relief claimed arise out of the same transaction or that for some other reason a consolidation order is desirable.

2. Conclusion

61. The Commission may wish to consider whether the question of consolidation of arbitral proceedings is an area that merits further study with a view to the possibility of preparing model legislative provisions. If so, the Secretariat might be requested to explore, in particular, the practical experience with consolidation provisions in national laws and issues such as whether legislative recognition of the enforceability of consolidation agreements is required; whether arbitral tribunals and courts ought to be specifically empowered to facilitate consolidation of related arbitration agreements, with the consent of parties, regarding matters such as the selection of the arbitral tribunal that will continue, the terms of consolidation, and the applicable procedures; and, whether the tribunals involved ought to be specifically empowered to confer with each other on these matters.

F. Confidentiality of information in arbitral proceedings

62. Significant international discussion of the issue of confidentiality of arbitral proceedings in recent years, in part sparked by the decision of the High Court of Australia in the case of *Esso v Plowman*, has led to an appreciation that parties’ requirements for the confidentiality of proceedings may not be adequately protected by arbitration.

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rules or by national arbitration laws. Prior to that time, it was generally assumed that if the privacy of arbitration proceedings was protected, such as by the provisions of procedural rules, confidentiality would also be protected. On that basis, confidentiality was not specifically addressed in either arbitral rules or national laws. The UNCITRAL Arbitration Rules, for example, provide that hearings shall be in camera unless the parties agree otherwise and that the award can be made public only with the consent of both parties. The UNCITRAL Model Law on International Commercial Arbitration, on the other hand, does not address either privacy or confidentiality.

63. While ensuring the privacy of proceedings does not necessarily also ensure confidentiality, privacy assists by limiting the number of people who have access to the arbitration hearing. Arbitration rules generally address the issue of privacy of the proceedings. While such rules also increasingly address the issue of confidentiality and the case law of a few jurisdictions specifically recognizes confidentiality as an implied condition of the agreement to arbitrate, confidentiality is not generally addressed in national laws, except in a very few instances. Where confidentiality is specifically protected, there is no single approach to the scope of the obligation of confidentiality in terms of the information that is to be treated as confidential, the persons to whom the obligation attaches, or permissible exceptions to prohibitions on disclosure and communication.

1. Current provisions on confidentiality

64. A survey of the arbitration rules and the very few national laws that address confidentiality indicates a variety of approaches. One approach to formulating a confidentiality provision that could apply to all classes of cases has been to include a general provision that material produced for, or generated by, an arbitration cannot be disclosed to third parties without the consent of the other party or leave of the court. Another approach has adopted a more detailed provision which addresses the parameters of the duty of confidentiality including, for example, (i) the material or information that is to be kept confidential; (ii) the persons to whom the duty of confidentiality is to extend and how it is to be applied; and (iii) permissible exceptions to prohibitions on disclosure and communication.

65. In terms of the material or information that is to be kept confidential, some provisions include a general description of “facts or other information relating to the dispute or arbitral proceedings”. Other provisions adopt a more particular description of the information to be covered and include various categories of information that are accorded different treatment. These categories include, for example, reference to the evidence given by a party or a witness; written and oral arguments; the fact that the arbitration is taking place; the identity of the arbitrators; the contents of the award; communications between parties themselves or their advisors prior to, or in the course of, the arbitration; and, information that is inherently confidential, such as trade secrets and commercial-in-confidence information.

66. As to the persons to whom the duty of confidentiality is to extend, a range of persons are covered such as the arbitrators; the staff of the arbitration institution, where the arbitration is institutional; parties and their agents; witnesses, including experts; counsel and advisers. Since the duty may not be able to be applied to all of these persons in the same way, one approach requires arbitrators and parties’ representatives, and perhaps witnesses, to sign a confidentiality agreement. Another approach regarding witnesses is to require the party calling the witness to guarantee that the witness observes the same degree of confidentiality as that required of the party. Some provisions also deal with the period for which the duty of confidentiality continues to apply.

67. Some of the circumstances in which disclosure of information is permitted have included those where the parties consent to disclosure; where the information is in the public domain; where disclosure is required by law or a regulatory body; where there is a reasonable necessity for the protection of a party’s legitimate interests; and, where it is in the interests of justice or in the public interest. While the scope of some of these exceptions may be susceptible of clear definition and application, others, such as disclosure of information “in the public interest”, are generally regarded as requiring some careful consideration. It has been suggested, for example, that a balance may need to be struck between a genuine public interest in the information in question and threatened disclosure of commercially sensitive information as a means of putting one party under pressure to settle.

68. Some provisions also deal with special conditions which attach to the disclosure by virtue of the time at which disclosure occurs. If information is to be disclosed, for example, during the arbitration proceedings, one approach has been to require that notice of the disclosure be given both to the arbitral tribunal and the other party. Where disclosure occurs once the arbitration has concluded, only notice to the other party may be relevant.

69. Notwithstanding provisions protecting confidentiality of the arbitral award, some institutional rules include a provision that allows for aggregated statistics to be published, or even information on individual proceedings to be made available, provided the information disclosed does not enable individual parties or circumstances to be identified. Consent of the institution is a usual requirement.

2. Conclusion

70. On the basis that current protection may not be adequate, opinion is divided on how the confidentiality of arbitral proceedings can be ensured. One approach suggests that the difficulty of defining the scope of a general duty of confidentiality makes it difficult to address the issue at all. Others, including the High Court of Australia in Esso v Plowman, suggest that parties to an arbitration can expressly provide in their arbitration agreement for absolute or specific levels of confidentiality to apply. Yet another approach is to suggest that arbitral rules should include provisions on confidentiality, while a further approach suggests that what might be needed is a model legislative
provision. In all of these cases, the emphasis has been placed upon the importance for international commercial arbitration of uniformity of treatment and widespread coverage.

71. The Commission may wish to consider whether the issue of confidentiality needs to be further examined and, in particular, whether further protection may be needed in the form of a model legislative provision. If so, the Secretariat might be requested to explore the options for protecting confidentiality and, in particular, the scope of the protection that may need to be afforded in terms, for example, of the material or information that is to be kept confidential, the persons to whom the duty of confidentiality is to extend and how it is to be applied, and permissible exceptions to prohibitions on disclosure and communication.

G. Raising claims for the purpose of set-off

72. It frequently occurs in arbitral practice that the respondent in an arbitration case, in reacting to the statement of claim, in addition to responding to the particulars of the statement of claim, invokes a claim that the respondent has against the claimant. The respondent may invoke such a claim in two ways. Firstly, it may raise a counter-claim, which is to be treated by the arbitral tribunal essentially in the same manner as if it were an original claimant’s demand and is to be decided upon independently of the decision on, and irrespective of the outcome of, the claimant’s demand. Thus, for example, if the claimant’s demand is dismissed, the arbitral tribunal is still called upon to decide on the counter-claim.

73. Second, the respondent may invoke its claim not as a counter-claim but as a defence for the purpose of a set-off. In such a case, the defence, to the extent it is admissible, is to be decided upon only if and to the extent the claimant’s demand is founded. If the claimant’s demand is unfounded, there is no need for the arbitral tribunal to consider the claim relied upon for the purpose of a set-off.

74. An issue that often arises in practice is under what conditions may the arbitral tribunal take into consideration a disputed claim relied on for the purpose of a set-off. The question that has given rise to divergent answers and controversy is whether the arbitral tribunal is competent to consider the merits of a claim raised for the purpose of a set-off if the claim is not covered by the arbitration agreement covering the principal claim (but may be covered by a different arbitration agreement or may not be covered by any arbitration agreement).

1. Current solutions

75. The question may be settled by agreement of the parties. There are arbitration rules which allow the arbitral tribunal to consider claims for the purpose of a set-off even if the claim is not covered by the arbitration agreement covering the principal claim. For example, article 27 of the International Arbitration Rules of the Zurich Chamber of Commerce (1989) provides that the arbitral tribunal also has jurisdiction over a set-off defence if the claim that is set off does not fall under the arbitration clause, and even if there exists another arbitration clause or a jurisdiction clause for that claim.

76. The UNCITRAL Arbitration Rules take a more restrictive position in that the respondent may rely on a claim for the purpose of a set-off if the claim arises out of the same contract (art. 19). The Rules do not state expressly that the set-off claim must be covered by the same arbitration agreement as the main claim. If the parties have modelled the arbitration agreement on the model arbitration clause which appears in the footnote to article 1 of the Rules (and have thereby submitted to arbitration the disputes arising out of the contract), both the principal claim and the claim invoked for the purpose of a set-off would be covered by the same arbitration agreement. If, however, the arbitration agreement covering the principal claim does not cover the set-off claim, the question will arise also under the UNCITRAL Arbitration Rules whether the arbitral tribunal has the competence to consider the set-off claim that is not covered by the arbitration agreement.

77. The UNCITRAL Model Law on International Commercial Arbitration does not address the question expressly. The analytical commentary on the draft text of the Model Law, which was prepared by the Secretariat, takes the position that, if the respondent raises a claim for the purpose of a set-off (or as a counter-claim), the claim must not exceed the scope of the arbitration agreement. The commentary adds that this restriction, while not expressed in the article, seems self-evident in view of the fact that the jurisdiction of the arbitral tribunal is based on, and given within the limits of, that agreement.

78. Views have since been expressed that the arbitral tribunal’s competence to consider claims by way of a set-off should under certain conditions extend beyond the contract from which the principal claim arises. The reasons cited are procedural efficiency and the desirability of eliminating disputes between the parties; such reasons are said to carry weight in particular when both parties are merchants or when the principal claim and the claim invoked for the purpose of a set-off have arisen from economically related contracts.

2. Conclusion

79. The Commission may wish to consider whether the issue merits further study. The questions to be studied may include, for example, the question whether the competence of the arbitral tribunal to deal with claims raised by way of a set-off can appropriately be left to arbitration rules or whether an appropriate legislative rule would be desirable.

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21The relevant part of the model arbitration clause reads: “Any dispute, controversy or claim arising out of or relating to this contract ... shall be settled by arbitration in accordance with the UNCITRAL Arbitration Rules as at present in force” [emphasis added].

H. Decisions by “truncated” arbitral tribunals

80. It follows from laws and rules on arbitration that arbitrators, having agreed to act in that capacity, have a right and a duty to participate in the proceedings and the deliberations of the arbitral tribunal and to sign the arbitral award. Such a right and a duty is also implicit or expressly provided for in the agreement by which an arbitrator accepts the appointment.

81. It sometimes happens that an arbitrator, in particular a party-appointed arbitrator, resigns or refuses to participate in the proceedings or the deliberations of the arbitral tribunal. Most national laws and arbitration rules contain provisions addressing that situation. Generally, it is provided that the arbitrator who fails to act is to be replaced by a substitute arbitrator; usually it is provided that the rules governing the appointment of the substitute arbitrator are those applicable to the appointment of the arbitrator being replaced (e.g. art. 14(1) of the UNCITRAL Model Law on International Commercial Arbitration).

82. Irrespective of the reason for resignation or inaction of an arbitrator, an arbitrator’s failure to act and the appointment of a substitute arbitrator is likely to cause delay, costs and inconvenience. One notable reason for considerable additional cost and delay is the possible need for repeating the hearings that were held before the substitute appointment (see, e.g. art. 14 of the UNCITRAL Arbitration Rules).

83. Particularly problematic are cases where resignation or refusal to cooperate occurs at a late stage of the proceedings and the grounds therefor are seen by the other two arbitrators, or by the arbitral institution administering the case, as lacking justification. Because of the potential disruption to arbitral proceedings, a source of special concern are cases where resignation or refusal to cooperate occurs as a result of collusion between a party and the arbitrator appointed by that party. Such collusion may be motivated by a desire to cause delay, thwart the proceedings, and thereby deprive the other party of its legitimate rights under the arbitration agreement.

84. Failure to act by the arbitrator may give rise to liability of the arbitrator for breach of his or her contractual or statutory duties. Such liability is an issue between the aggrieved party and the arbitrator and falls outside the dispute that is being considered within the arbitration in which the failure to act has occurred. If the issue results in a dispute, it would normally be decided by a court unless there is an arbitration agreement between the arbitrator and the party pursuing the claim against the arbitrator.

85. Notwithstanding such liability of the arbitrator, the arbitrator’s failure to participate may also be dealt with in the context of the arbitral proceedings in which the arbitrator ceases to participate. As a rule, there is little difficulty caused where the refusal to cooperate occurs after the arbitral tribunal has concluded its deliberations on the substance of the award and the failure to cooperate is limited to the arbitrator’s refusal to sign the award. The solution that is generally accepted in laws and arbitration rules is that the signatures of the majority of all members of the arbitral tribunal suffices, provided that the reason for any omitted signature is stated (art. 31(1) of the UNCITRAL Model Law; a similar rule is contained, for instance, in art. 32(4) of the UNCITRAL Arbitration Rules).

86. The question that has in recent years given rise to lively discussions among practitioners is whether—when an arbitrator resigns late in the proceedings, perhaps after evidence has been taken and arguments heard—the two remaining arbitrators are permitted to complete the proceedings and render an award.3 Such decisions by the two remaining arbitrators are often referred to as “truncated tribunal” decisions.

87. In the discussions of this issue, an assessment that has been frequently expressed is that in both civil law and common law countries courts would respect awards by truncated tribunals if the parties had agreed to that procedure. In addition, it has been said that prudent parties who wish to avoid difficulties will therefore choose rules that permit two arbitrators to continue the proceedings and render an award, in the absence of the third, when the majority determines that it is in the interest of fair and orderly arbitration to do so. A view has also been expressed that it would be hard to imagine that, even in the absence of an express rule or agreement, a modern court in a State that otherwise has a public policy of supporting international commercial arbitration would invalidate an award issued by a majority of the arbitrators because a party-appointed arbitrator, in an effort to frustrate the arbitration, chose to absent himself at a late stage of the proceedings, or refused to participate in deliberations or to sign an award. This view is based on the assumption that national laws that refer to participation by three arbitrators should be interpreted as having been satisfied when all three have had a fair and equal opportunity to participate. It has also been suggested that, as a practical matter, once it is made clear that a party-appointed arbitrator cannot succeed in preventing the issuance of an award by absenting himself or herself from the proceedings or the deliberations, the underlying problem is likely to disappear.3 Differing views have also been expressed cautioning against a statutory authorization for a truncated tribunal to decide in its discretion. Arguments have been advanced that a party should not be responsible for misbehaviour of the arbitrator appointed by that party, and that a discretionary right to proceed as a truncated tribunal might be problematic when, after an arbitrator resigns, the other two arbitrators act improperly in the interest of one of the parties.

I. Current non-legislative and legislative solutions

88. In light of these discussions, some arbitral institutions have adopted rules that determine the conditions under which a truncated tribunal may validly proceed and make


24Ibid., pp. 28 and 29.
an award. For example, the International Arbitration Rules of the American Arbitration Association (1991) provide in article 11:

"1. If an arbitrator on a three-person tribunal fails to participate in the arbitration, the two other arbitrators shall have the power in their sole discretion to continue the arbitration and to make any decision, ruling or award, notwithstanding the failure of the third arbitrator to participate. In determining whether to continue the arbitration or to render any decision, ruling or award without the participation of an arbitrator, the two other arbitrators shall take into account the stage of the arbitration, the reason, if any, expressed by the third arbitrator for such nonparticipation, and such other matters as they consider appropriate in the circumstances of the case. In the event that the two other arbitrators determine not to continue the arbitration without the participation of the third arbitrator, the administrator on proof satisfactory to it shall declare the office vacant, and a substitute arbitrator shall be appointed pursuant to the provisions of Article 6, unless the parties otherwise agree.

"2. If a substitute arbitrator is appointed, the tribunal shall determine at its sole discretion whether all or part of any prior hearings shall be repeated.”

89. Provisions of essentially the same import have been incorporated into other sets of international arbitration rules, such as, for example, The Permanent Court of Arbitration Optional Rules for Arbitrating Disputes between two Parties of which only one is a State (1993), (art. 13(3)) and the World Intellectual Property Organization (WIPO) Arbitration Rules (1994), (art. 32).

90. The issue has been addressed by few national laws on arbitration. One approach has been to include in legislation the substance of the above-described solutions in arbitration rules. Another approach has been more restrictive: while in principle the law recognizes the freedom of the parties to agree on how decisions by truncated tribunals are to be dealt with, it restricts the possibility of the parties to grant the remaining arbitrators permission to proceed without the non-cooperating arbitrator to those cases where the arbitrator refuses to take part in the vote on a decision. It is further provided that the parties are to be given advance notice of the intention to make an award without the arbitrator who refuses to participate in the vote. In the case of other decisions, the law provides that the parties need only be informed, subsequent to the decision, of the arbitrator’s refusal to participate in the vote.

2. Conclusion

91. The Commission may wish to discuss the potential detrimental consequences of bad-faith withdrawals of arbitrators from arbitral proceedings on the practice of international commercial arbitration and, in that context, it may consider questions such as: (a) the extent to which the parties should be able by agreement to put beyond doubt the validity of an award issued by a truncated tribunal; (b) whether it would be desirable for the Commission to formulate a model solution for an agreement of the parties on decisions by truncated tribunals; and (c) whether it would be desirable for laws on international commercial arbitration to deal with the issue and, if so, whether a model legislative solution should be prepared by the Commission. If the Commission should decide that the issue should be further considered, it may wish to request the Secretariat to prepare a study in which it would set out various possible solutions for consideration by the Commission.

I. Liability of arbitrators

92. In preparatory work for the UNCITRAL Model Law on International Commercial Arbitration, there was general agreement that the liability of arbitrators could not appropriately be included in the Model Law.25

93. National arbitration laws, including a number of laws enacting the Model Law, have added provisions dealing with liability of the arbitrator. These provisions differ on whether arbitrators should be immune from professional liability and on the parameters of the immunity. There is a tendency amongst common law jurisdictions to equate arbitrators with judges and extend an equivalent immunity, and amongst civil law jurisdictions to focus on arbitrators’ contractual function as experts. Nevertheless, there is considerable diversity even within the same legal families, and no clear line of distinction can be drawn between the approaches taken by each.

1. Current legislative provisions

94. A number of national arbitration laws, including some enacting the Model Law, include provisions dealing with immunity of arbitrators, but there are considerable variations in the scope and extent of the immunity. Many of the countries that have adopted specific provisions in the arbitration laws, which give effect to the Model Law, are common law jurisdictions.

95. Some of the provisions included in these laws exclude liability for any act or omission in connection with the arbitration, except where the act or omission is shown to have been in bad faith, or done dishonestly, or where there has been conscious and deliberate wrongdoing. Another approach is to provide that the arbitrator is not liable for negligence in respect of anything done or omitted to be done in the capacity of arbitrator; in some cases an exception is added for cases where there has been fraud or malice. In one instance, an arbitrator is not liable for any mistake in law, fact or procedure made in the course of the arbitral proceedings or in the making of the arbitral award. Some laws adopt the opposite approach of not seeking to limit liability, but specifying that an arbitrator may be liable for losses incurred by reason of delay or failure to comply with the arbitrator’s obligations.

96. The parties to whom the exclusion may apply varies widely. In some cases, the immunity applies only to the liability of the arbitrator, while in others, this immunity is extended to employees and agents of the arbitrator and to advisers of the arbitrators and to experts. Other laws further extend the immunity to those who may be involved in appointing an arbitral tribunal and those who may carry out administrative tasks in connection with the arbitration proceedings, as well as to their employees and agents. The terms of the exceptions to immunity, in all of these laws, are the same for arbitrators and the extended classes of persons.

97. In other jurisdictions, principally civil law jurisdictions, the contractual nature of the service performed by the arbitrator is emphasized and the arbitrator would be liable for failure to fulfil the terms of the reference. This would include failure to perform with reasonable diligence; failure to make the award within the contractual or legal time limit; putting the parties at the risk of the award being annulled; bias; negligence; breach of secrecy of the arbitral proceedings; as well as every instance of fraud, misrepresentation, corruption and gross negligence. In some jurisdictions, the making of the award attracts particular immunity because of the quasi-judicial nature of the function being performed. In some cases, liability can be limited in the contract between the arbitrator and the parties to the arbitration, although this may not exclude liability for gross negligence or wilful misconduct.

98. In some common law jurisdictions, arbitrators may enjoy a high level of immunity more akin to a judge, while in others a distinction is drawn between those acts of an arbitrator that are adjudicatory, and thus entitled to this high standard of immunity, and those acts that are unrelated to any adjudicatory function and thus subject to civil liability.

2. Conclusion

99. There are considerable differences between arbitration laws and rules in their treatment of the issue of liability, and the extent of civil liability of arbitrators may vary according to a number of factors, such as (a) the choice of procedural rules governing the proceedings; (b) the law governing the contract between the arbitrator and the parties; (c) the nationality of the arbitrators; and (d) the place where the proceedings are conducted. Given these issues, any treatment of the question of the liability of arbitrators is likely to require careful consideration.

100. Since a universally acceptable formula may assist the process of arbitration, and provide greater certainty for both arbitrators and arbitrating parties, the Commission may wish to consider whether the question of liability needs to be further examined. In considering the need for further treatment of liability of arbitrators, it may be useful to review in detail the manner in which the issue is currently treated, as well as proposals made by organizations or commentators.

J. Power by the arbitral tribunal to award interest

101. Providing an explicit authorization for the arbitrator to award interest was not considered during the preparation of the UNCITRAL Model Law on International Commercial Arbitration. Since that time, uncertainty in some jurisdictions as to the power of arbitrators to award interest has spread, particularly in the common law world, and a number of jurisdictions have added specific provisions dealing with the power to award interest to laws adopting the Model Law.

I. Current legislative solutions

102. The provisions dealing with the power to award interest that have been adopted in national laws vary greatly in scope, particularly as regards the level of detail and the issues included. At its simplest, the legislation authorizes the tribunal to award interest, except where the parties have agreed otherwise.

103. Some jurisdictions go beyond the basic power and address other matters. In terms of the sum that may attract interest, some laws limit this to the amount of the award, which might be specified as including interest and costs. Another approach is to provide that the arbitral tribunal may order interest to be paid on the whole or any part of the award. In other cases, a distinction may be drawn, in terms of the sum upon which interest is payable, between money awarded by the tribunal in the proceedings and money claimed in, and outstanding at the commencement of the proceedings, but paid before the award is made. Some jurisdictions limit the application of the interest provision and specify, for example, that it does not authorize the arbitrator to award interest on interest, and does not apply in relation to any amount upon which interest is payable as of right, whether by virtue of an agreement or otherwise.

104. A number of laws address the time from which interest may be awarded. One approach limits this to the period commencing from the date of the award, while other laws provide that interest also may be awarded for the whole or any part of the period between the date the cause of action arises and the date of the award, while a further approach provides for interest from the date of the award to the date of payment of the award. Some laws also include the times at which interest should be paid.

105. As to the rate of interest, a number of laws leave it up to the tribunal to determine a reasonable rate or reasonable commercial rate. Other laws specify that the rate should be the same rate as that applying to a judgement or, in some cases, a particular rate is fixed. A more elaborate rule provides that the rate of interest should be “the average bank short-term lending rate to prime borrowers prevailing for the currency of payment at the place for payment, or where no such rate exists at that place, then the same rate in the State of the currency of payment”.

26 UNIDROIT Principles of International Commercial Contracts (UPICC), Article 7.4.9.
2. Conclusion

106. The Commission may wish to consider whether the question of the power of the arbitral tribunal to award interest is one that merits further study with a view to preparing a model legislative provision. In that context, it may also consider whether such further study should cover any of the details of the power as illustrated by the enactments referred to above, including (a) the sum upon which interest may be charged; (b) the period for which interest is payable, both before and after the award is made; (c) the type (simple or compound) and the rate of interest to be applied; and (d) other issues such as the time at which interest is to be paid.

K. Costs of arbitral proceedings

107. In preparatory work for the UNCITRAL Model Law on International Commercial Arbitration, there was widespread support for the view that questions concerning the fees and costs of arbitration were not appropriate matters to be dealt with in a model law. It was left open for States to provide for court control concerning fees and costs and, for example, to allow for readjustment of utterly unreasonable fees.27 Since completion of the Model Law, however, a number of Model Law enactments have added provisions on the arbitral tribunal’s power to fix and allocate costs and fees. These laws often differ in substance and particularly as to the detail of the power and the scope of related issues.

1. Current legislative provisions

(a) What may be included as “costs”

108. Legislation adopting the Model Law is varied as to what is included within the meaning of “costs”. Some laws adopt a general description, referring simply to the “costs of the arbitration”, and may include a reference to the fees and expenses of the arbitrator or arbitrators or to those costs incurred by the parties and necessary for the proper pursuit of their claim or defence. Other laws adopt a more comprehensive approach, specifying the items to be included, such as (a) fees of the arbitrator and tribunal; (b) costs of accommodation, travel and administrative support during the arbitration proceedings; (c) costs of evidence, both factual and expert; (d) costs of legal advice and representation; and (e) other expenses incurred in connection with the arbitration.

(b) Apportionment and liability for costs

109. Laws enacting the Model Law generally provide that the arbitral tribunal has the discretion to decide which of the parties is to pay the costs of the arbitration and in what proportions, taking into account what is reasonable in the circumstances of the case. However, there are variations. Some laws distinguish between fees and expenses of the arbitrator and other costs of the arbitration, stipulating that the parties are jointly and severally liable for payment of the arbitrators’ fees and expenses. Other laws provide a default rule that, where costs are not dealt with in the award and there is no additional award addressing the costs of arbitration, each party is responsible for its own legal and other expenses and for an equal share of the fees and expenses of the tribunal. One law directly addresses the situation where there is an offer of settlement which is rejected. If the settlement offer reflects the final award of the tribunal, the tribunal is authorized to take this into account when awarding costs and expenses.

(c) Related issues

110. Court review and assistance—A number of laws deal with aspects of court review and assistance, authorizing the courts to adjust arbitrators’ fees and expenses, including ordering repayment of excessive amounts; and to determine recoverable costs, including fees and expenses of the arbitral tribunal, where the arbitral tribunal does not do so or where a party does not consent to the tribunal making that determination.

111. Incomplete awards—Some laws provide that where the award does not provide for payment of costs of the arbitration, parties may apply to the arbitral tribunal or, in some cases, the court, for a determination as to costs.

112. Limitation of recoverable costs—In some jurisdictions, parties are free to agree what costs of the arbitration are recoverable or they may apply to the tribunal or court to make such a determination. In addition, the arbitral tribunal may be authorized to limit recoverable costs to a specified amount, subject to possible variations.

113. Interpretation or correction costs—A number of laws stipulate that the arbitral tribunal may not charge additional fees for interpretation, correction or completion of its award.

2. Conclusion

114. The Commission may wish to consider whether the power to award costs is sufficiently covered by arbitration rules or national laws or whether the conduct of international commercial arbitration would be facilitated by providing a uniform rule. In that context, the Commission might wish to consider the scope of such a rule and whether, in addition to the power to award costs, additional issues as indicated above should be covered.

I. Enforceability of interim measures of protection

115. According to many sets of arbitration rules, an arbitral tribunal may, at the request of a party, order interim measures intended to preserve the status quo until the arbitral award is made. Such measures are referred to by expressions such as “interim measures of protection”,

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“provisional orders”, “interim awards”, “conservative measures” or “preliminary injunctive measures”. For example, article 26(1) of the UNCITRAL Arbitration Rules provides as follows:

“At the request of either party, the arbitral tribunal may take any interim measures it deems necessary in respect of the subject-matter of the dispute, including measures for the conservation of the goods forming the subject matter in dispute, such as ordering their deposit with a third person or the sale of perishable goods.”

116. Interim measures of protection, often not defined in rules providing for their issuance, can encompass a wide variety of measures including: orders for not removing goods or assets from a place or jurisdiction; preserving evidence; selling goods; and, posting a monetary guarantee. An interim measure may be imposed for the duration of the arbitration or it may be of a more temporary nature and expected to be modified as matters evolve. The measure may be in the form of an order by the arbitral tribunal or in the form of an interim “award”.

117. The question often discussed by practitioners is the enforceability of such measures, both in the State where the arbitration is taking place and in other States. The need for enforceability is usually supported by the argument that a final award may be of little value to the successful party if, in the meantime, action or inaction on the part of a recalcitrant party has rendered the outcome of the proceedings largely useless (e.g. by dissipating assets or removing them from the jurisdiction). It has been noted that, therefore, an interim order can be at least as or even more important than an award.28

118. There are, however, also views querying whether interim measures issued by the arbitral tribunal should be enforceable. It has been said that, as a practical matter, parties tend to comply with such measures anyway, for example, in order to avoid responsibility for costs caused by the failure to implement the measure, or because they are reluctant to displease the arbitral tribunal. In addition, if interim measures are treated as executory titles, there would be a need to apply to them provisions (the same as or similar to those governing the setting aside of arbitral awards) designed to cure certain serious violations of procedure, which would overly formalize the process. However, in response, it has been said that there are many cases where the party refuses to comply with the interim measure without regard to the potential adverse consequences, such as responsibility for costs. Furthermore, the provisions on judicial enforcement of interim measures, including the prerogatives of the court in the enforcement process, may reflect the interim nature of the measures and do not necessarily have to be the same as the rules governing the enforceability of final awards.

119. Some propose that arbitrating parties in need of interim measures should resort to the judicial process, as is possible under many national laws. However, in response, it is pointed out that this may pose certain difficulties. For example, obtaining a measure may be a lengthy process, in particular, because the court may require arguments on the issue or because the court decision is open to appeal. Furthermore, the courts of the place of arbitration may not have effective jurisdiction over the parties or the assets; since arbitrations are often conducted in a “neutral” territory that has little or nothing to do with the subject-matter in dispute, a court in another jurisdiction may have to be approached with a request to consider and issue a measure. Moreover, in some jurisdictions a party may not be able to request the court to issue an interim measure of protection on the ground that the parties, by concluding an arbitration agreement, are deemed to have excluded the courts from intervening in the dispute.

120. It is therefore argued that resources would be used more efficiently if parties were able to make their requests for enforceable interim measures directly to the arbitral tribunal, rather than to the court, as the tribunal is already familiar with the case and is usually more technically apprised of the subject-matter.

1. Current legislative solutions

(a) New York Convention

121. Sometimes arbitral tribunals issue interim measures of protection in the form of interim awards. Such a possibility is expressly envisaged, for example, in article 26(2) of the UNCITRAL Arbitration Rules. This raises the question whether the Convention on the Recognition and Enforcement of Foreign Arbitral Awards covers also such interim awards. As the Convention does not define the term “award”, it is not clear whether the Convention applies to interim awards as well. The prevailing view, confirmed also by case law in some States, appears to be that the Convention does not apply to interim awards.

(b) UNCITRAL Model Law

122. The UNCITRAL Model Law on International Commercial Arbitration expressly deals in article 17 with the power of the arbitral tribunal to order such interim measure of protection as it may consider necessary and also to require a party to provide appropriate security in connection with such measure. The Model Law, however, is silent on the matter of enforcement.

123. When during the preparation of the Model Law the substance of article 17 was considered by the Working Group, it contained a sentence that “if enforcement of any such interim measure becomes necessary, the arbitral tribunal may request [a competent court][the Court specified in article V] to render executory assistance”.29 Under one view in the Working Group, executory assistance by courts was considered desirable and should be available. Under another view, which the Working Group adopted after de-

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liberation, the sentence was to be deleted since it dealt in an incomplete manner with a question of national procedural law and court competence and was unlikely to be accepted by many States. It was understood by the Working Group, however, that the deletion of the sentence should not be read as a preclusion of executory assistance in those cases where a State was prepared to render such assistance under its procedural law.30

(c) National laws

124. In respect of enforceability of interim measures issued by an arbitral tribunal, a variety of approaches have been taken by legislatures. In many States the legislation is silent on this point. In others, including some of those that have incorporated article 17 of the Model Law empowering the arbitral tribunal to order interim measures of protection, there are express provisions for enforcement of those interim measures. For example, in one case a clause has been added so that the court may, at the request of a party, permit enforcement of the interim measure ordered by the tribunal, unless application for a corresponding interim measure has already been made to a court. In a few States, the legislation stipulates that the provisions modelled on chapter VIII of the Model Law on recognition and enforcement of awards (arts. 35 and 36) apply also to orders made under the provision modelled on article 17 of the Model Law.

125. As regards the powers that have been granted to the court enforcing an interim measure issued by the arbitral tribunal, a variety of approaches can also be noted. In at least one State, it is provided that the court may review the basis of the interim order made by the tribunal. In a few other cases, it is stated that the court is to give preclusive effect to the findings of fact made by the tribunal. In one country, the law provides that the court may recast the order issued by the arbitral tribunal if necessary for the purpose of enforcing the measure; in addition the court may, upon request, repeal or amend its decision to permit enforcement.

126. One of the concerns with respect to court-ordered enforcement of measures issued by an arbitral tribunal may be the liability where there has been an abuse of rights. For such a case, it has been provided in one national law, for example, that if a measure ordered by the arbitral tribunal proves to have been unjustified from the outset, the party who obtained its enforcement is obliged to compensate the other party for damage resulting from the enforcement of such measure. It is further provided that such a claim for compensation may be put forward in the pending arbitral proceedings.

2. Conclusion

127. The Commission may wish to consider whether the question of enforceability of interim measures of protection ordered by an arbitral tribunal should be further studied by the Secretariat. The Secretariat might be requested to explore the relevant practice in international commercial arbitration and court practice, and, with regard to the desirability and feasibility of uniform legislative provisions, to present first tentative solutions for consideration by the Commission.

M. Discretion to enforce an award that has been set aside in the State of origin

128. After an arbitral award is made, the claimant may seek enforcement of the award either before the courts in the State where the award was made (“State of origin”) or before the courts in another State where the debtor has assets (“State of enforcement”). Where, however, the award is set aside (or “annulled” or “vacated”) by the competent court in the State of origin, the enforcement of the award in the State of origin would not be possible. The party seeking enforcement may then try to have the award enforced by a court in another State. The issue that faces the court in the State of enforcement is whether there are any circumstances that allow the court to enforce the award, disregarding the fact that the award has been set aside in the State of origin.

I. Current legislative solutions

(a) New York Convention

129. The Convention on the Recognition and Enforcement of Foreign Arbitral Awards provides a list of grounds on which enforcement of an arbitral award may be refused. One of those is where “the award has not yet become binding on the parties, or has been set aside or suspended by a competent authority of the country in which, or under the law of which, that award was made” (art. V(1)(e)).

130. What has been under discussion among practitioners and in academic circles is whether, and the degree to which, such refusal to enforce based on article V(1)(e) of the Convention is discretionary. Discussions have centred around whether the court in the State of enforcement has authority to take into consideration the grounds on which the original award was set aside, or, whether the request for enforcement must necessarily be refused.

131. Some of the discussion has been precipitated by the language of article V(1). It has been said that use of the words “enforcement ... may be refused” implies some discretion on the part of the competent authority to refuse enforcement. However, it has also been said that, when read together with the word “only” (i.e. “enforcement ... may be refused ... only if ...”), a different interpretation may be derived. Consequently, it is said to be unclear whether enforcement is to be refused in every case where an award has been set aside.

132. It has been said that article VII(1) of the Convention may also provide an option for enforcement that avoids taking into account the decision to set aside the
award. Under what is referred to as the “more-favourable-right” provision, a party may seek enforcement of a foreign arbitral award in a State on the basis of other treaties or the domestic law of that State. Without having to comment on the merits of the decision to set aside by the court in the State of origin, the court in the State of enforcement would be able to determine that, on the basis of its own domestic law, the award should be enforced. One of the criticisms of this approach, however, is that if States are thereby encouraged to adopt individualized criteria for the enforcement of foreign arbitral awards, this will defeat the objectives of harmonization and unification of domestic laws.

(b) 1961 European Convention

133. Enforcement of awards that have been set aside has also been addressed in the European Convention on International Commercial Arbitration (Geneva, 1961). Under article IX(1), if an award has been set aside by a court in the State of origin, this shall constitute a ground for the refusal of enforcement by the court in another State only if the reasons for the setting aside are among those outlined; these are essentially the same as the grounds given in article V(1)(e) through (d) of the New York Convention. Therefore, under the European Convention, the court in the State of enforcement is bound to enforce the award, if it was set aside in the State of origin on grounds other than those in article IX(1) of the European Convention. Furthermore, article IX(2) limits application of article V(1)(e) of the New York Convention, as follows:

“In relations between Contracting States that are also parties to the [New York Convention], paragraph 1 of this Article limits the application of Article V(1)(e) of the New York Convention solely to the cases of setting aside set out under paragraph 1 above.”

134. Article 36(1) of the UNCITRAL Model Law provides the grounds for refusing recognition or enforcement of an arbitral award, which are essentially the same as the provisions in article V(1) of the New York Convention; in particular, article 36(1)(v) includes the provision that enforcement of the award may be refused if the “award has not yet become binding on the parties or has been set aside or suspended by a court of the country in which, or under the law of which, the award was made”.

135. Article 34(2) of the Model Law provides the grounds on which an arbitral award may be set aside; the first four of the grounds (in art. 34(2)(a)(i) to (iv)) parallel the first four grounds for refusing recognition and enforcement (in art. 36 (1)(a)(i) to (iv), modelled on article V(1)(a) to (d) of the New York Convention). Article 34(2)(b) also provides that an arbitral award may be set aside if the court finds that (i) the subject-matter of the dispute is not capable of settlement by arbitration under the law of the State of origin or (ii) the award is in conflict with the public policy of the State of origin.

(d) Policy considerations

136. In light of recent case law, a more general discussion has developed as to whether, as a matter of principle, the setting aside of an award in the State of origin should be an absolute bar to its enforcement in another State. Some of the arguments advanced in the discussion are summarized below.

137. “The award no longer exists”—According to one theory, an award that has been set aside is no longer in existence and therefore cannot be enforced in any other jurisdiction. This theory, however, has been criticized on the grounds that the existence of an award—as an expression of a contract between the parties—cannot be assumed to be a matter for the exclusive determination by the courts in the State where it was rendered. The criticism follows the approach common to most questions that involve a conflict of laws; if a forum properly establishes jurisdiction, a matter can be determined as valid in accordance with the laws of that forum despite lacking validity under the laws of another.

138. “Convention not to be circumvented”—If the Convention is interpreted so that an award that has been set aside by a competent authority in the State of origin cannot be enforced anywhere else, some fear that the intentions of the Convention would be circumvented. It has been said that one of the purposes of the Convention is to liberate the international arbitral process from domination by the law of the place of arbitration. If the choice of the place of arbitration affects the ultimate outcome due to certain grounds for setting aside that are peculiar to that place, then this goal cannot be met. It is possible to envision a situation where an award is set aside for reasons that are unusual or egregious. A party whose award has been so set aside would be deprived of any remedy to have this situation rectified if such an award could not be enforced elsewhere. Some argue that to interpret article V(1)(e) so as to abso-

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Footnotes:

1. The provisions of article VII(1) of the Convention are as follows:

   “1. The provisions of the present Convention shall not affect the validity of multilateral or bilateral agreements concerning the recognition and enforcement of arbitral awards entered into by the Contracting States nor deprive any interested party of any right he may have to avail himself of the provisions in article V(1) of the New York Convention solely to the cases of setting aside set out under paragraph 1 above.”

2. The provisions of article IX(1) of the Convention are as follows:

   “1. The setting aside in a Contracting State of an arbitral award covered by this Convention shall only constitute a ground for the refusal of recognition or enforcement in another Contracting State where such setting aside is not in accordance with the agreement of the parties or failing such agreement, with the provisions of Article IV of this Convention.”
olutely prevent enforcement of awards set aside in the State of origin may result in the enforcement of foreign awards having been made even more difficult than in the absence of the Convention.

139. “Excessive court interference to be avoided”—Another argument, which, however, could be used by either side of the debate, is that excessive court interference in arbitration should be avoided. This could support the position that the decision to set aside the award in the State of origin should not be revisited by a second court in the State of enforcement. On the other hand, it could also support the position that, where there has been excessive interference by the court in the State of origin, the court in the State of enforcement should be enabled to disregard that decision and enforce the award.

140. “Forum shopping”—It has been suggested that if the courts of jurisdictions other than that of the place of arbitration are able to decide on a discretionary basis as to whether to refuse enforcement of an award set aside by the court in the State of origin, it may encourage parties to seek out those jurisdictions where the likelihood of enforcement is known to be more favourable. This may also lead to the situation where the party in whose favour the arbitral award was made can seek enforcement of that award in as many countries as will exercise jurisdiction, thereby putting the other party to the expense of defending against enforcement, without end. In other words, it would be impossible for a party against whom an award was unjustly made and which ought to be set aside on internationally recognized grounds, to obtain an annulment valid worldwide.

141. “Res judicata; need to avoid inconsistent results”—The court in the State where enforcement is sought may be reluctant to comment upon whether the award ought or ought not to have been set aside by the court in the State of origin. This reluctance is considered beneficial for maintaining mutual respect for the authority of the judiciary. It is also pointed out that an interpretation of the Convention that permits the court in the State of enforcement discretion to refuse to enforce an award results in double judicial control. The question of enforcement of the arbitral award has already been determined by the court in the State of origin; enabling a second court to revisit this decision means that a matter which has already been settled by one court will be re-litigated in another forum. This, it is argued, is contrary to basic principles of law and the resultant inefficiency does not serve well the interests of international commercial arbitration. Some also express the concern that encouraging the court in the State of enforcement to revisit the grounds for setting aside may lead to inconsistent judicial decisions. One type of inconsistency would arise where an award set aside, and as a result regarded as inexistent in one jurisdiction, would be enforced in another jurisdiction. Another, more complex, type of inconsistency may arise when, after the award has been set aside in the State of origin but enforced in another State, a reconstituted arbitral tribunal in the State of origin issues an award that is essentially different from the first award and this second award is then presented for enforcement in the State where the first award has been enforced. The court in the State of enforcement would thus be faced with requests to enforce opposing awards. Although such a case may be rare, it has occurred in practice.

142. “Expectation of the parties not to be circumvented”—Parties that have agreed on the State in which the arbitral proceeding are to take place can presume to have, by their own choice, elected to be subject to the laws of that particular forum; accordingly, it is argued, to enable the courts of another State to disregards a setting aside order by a court in the State of origin would circumvent the will of the parties. Some even suggest that the parties may have deliberately chosen the place of arbitration where awards are susceptible to being set aside on grounds particular to that jurisdiction and may have an expectation that such decisions will not be disregarded by the courts of another State. Others consider it to be much more likely that the parties to an arbitral award will not have anticipated the forum-specific or egregious grounds for setting aside the award.

143. “Redundancy of article V(1)(e)” —It has been suggested that the reasons for setting aside should be categorized according to whether they are in conformity with internationally accepted standards. The intention is to differentiate between “international standards” and “local standards”.

International standards would comprise those consistent with paragraphs (a) through (d) of article V(1) of the Convention and article 34(2)(a) of the UNCITRAL Model Law. Under this proposal, only setting aside decisions based on an international standard would constitute grounds to refuse enforcement of foreign arbitral awards; setting aside based on any other ground would not preclude enforcement of the award in another jurisdiction. This approach, it is argued, upholds the intentions of the Convention by allowing an arbitral award to be enforced anywhere, unless that award has been legitimately set aside on internationally recognized grounds. In response, it has been pointed out that if the only grounds for a refusal to enforce an award that has been set aside is whether the award was set aside for reasons that are internationally accepted, then subparagraph (e) is thereby made redundant. It is argued that, as this result could not have been the intention of the Convention, paragraph (e) must provide a separate reason for the courts of the State of enforcement to refuse a request to enforce an award that has already been set aside.

2. Conclusion

144. The Commission may wish to consider whether international commercial arbitration would be facilitated by an undertaking that would seek to clarify the circumstances, if any, under which an arbitral award that has been set aside by a court in the State of origin can be enforced in another State.

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VI. INSOLVENCY LAW

Possible future work in the area of insolvency law: proposal by Australia
(A/CN.9/462/Add.1) [Original: English]

INTRODUCTION

1. Australia proposes that the United Nations Commission on International Trade Law (UNCITRAL) establish a Working Group to develop a model law on corporate insolvency to foster and encourage the adoption of effective national corporate insolvency regimes.

2. In light of regional financial crises, it is clear that there is a serious and urgent need to strengthen national insolvency regimes, not only as a means of crisis prevention but also of crisis management. In this regard, the Australian Prime Minister’s Task Force on International Financial Reform has indicated that strong and efficient insolvency regimes are essential for addressing the financial difficulties of debt-ridden firms before accumulated corporate difficulties result in an economy-wide crisis.

3. Australia considers that the valuable work UNCITRAL has already undertaken in the area of insolvency through the development of a Model Law on Cross-Border Insolvency, should be further progressed and enhanced, as a matter of high priority, by undertaking work on a model national corporate insolvency law.

4. The benefits of effective insolvency laws are widely recognized and accepted by most nations. Effective insolvency laws and processes are one of the primary means for maintaining financial discipline and ensuring efficient resource allocation in an economy. They provide a predictable legal process for addressing the financial difficulties of troubled firms before their accumulated financial difficulties lead to an economy-wide payments crisis and thus contribute to crisis prevention. They also provide the necessary framework for the efficient restructuring or orderly liquidation of troubled firms. They reduce creditors’ aggregate losses resulting from borrower non-performance by fostering cooperation among creditors when they are confronted by borrowers in financial difficulty. They seek to balance the rights and interests of affected parties by apportioning the burdens of insolvency in a manner consistent with a country’s economic and social goals (such as the preservation of employment opportunities and the protection of members of the labour force). Insolvency laws also enhance corporate governance and corporate morality. They commonly allow for private creditors to replace the management of troubled firms and in this way create powerful incentives for prudent corporate behaviour. They permit an examination to be made of the circumstances giving rise to the insolvency and the conduct of officers of a company in its failure, perhaps revealing culpable behaviour on the part of those responsible for the company’s failure, unfair dispositions of assets or property that is potentially recoverable.

5. The efficacy of insolvency laws and practices has been a recurring theme in, and major concern of, international forums, throughout the 1990s. The financial crisis in Asia and elsewhere has exposed weaknesses in the insolvency regimes and debtor-creditor laws of affected countries and in the structure of the international financial system. Effective insolvency regimes are increasingly being seen by international institutions and their members as an integral element of crisis prevention and an essential mechanism for responding to financial crises.

6. The world economy has changed beyond all recognition over the past 30 years. The growth and integration of global capital markets has created both enormous opportunities and new risks. The process of globalization and technological change has led to record growth in international monetary flows, an unprecedented expansion of investment and trade, an increased number and diversity of creditors and borrowers and increased economic interdependence. Globalization provides great opportunities for all countries to improve their standards of living. However, it can also generate new risks of instability that require all countries to pursue sound economic policies and structural reform. The soundness and credibility of insolvency laws and practices are central to the efforts of Governments and regulators to enhance the operation of the global financial system. Inefficient, antiquated or poorly designed insolvency laws and practices whose outcomes are uncertain, capricious, unfair or parochial threaten the benefits of globalization. They have the potential to seriously impede trade liberalization and deter the international flow of capital.

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415

CONCERNS ABOUT THE INTERNATIONAL FINANCIAL SYSTEM

7. The value of strong national insolvency regimes has been highlighted by a number of recent reports, including for example the Report of the Working Group on Inter-
national Financial Crises prepared for the G22, a group comprising representatives from 22 systemically significant economies that met in Washington, D.C. in April 1998 to examine issues related to the strengthening of the international financial architecture. This report considered the need to strengthen the international financial system in three areas—enhancing transparency and accountability; strengthening domestic financial systems and managing international financial crises. It concluded that strong insolvency and debtor-creditor regimes were an important means for preventing or limiting financial crises and facilitating rapid and orderly workouts from excessive indebtedness. They are essential to the orderly resolution of payments crises, particularly when corporate indebtedness is a major source of strain on a country’s macroeconomic stability. The Report commented that effective national insolvency regimes contribute to crisis prevention by providing the predictable legal framework needed to address the financial difficulties of troubled firms before the accumulated financial difficulties of the corporate sector spill over into an economy-wide payments crisis. Furthermore, the Report states that such a predictable framework is also essential to the orderly resolution of corporate financial difficulties, and thus is an essential element of any regime for orderly and cooperative crisis management. The Report endorsed eight key principles and features of insolvency regimes that were formulated in consultation with the International Federation of Insolvency Professionals (INSOL International).

TOWARDS A MODEL NATIONAL INSOLVENCY LAW

8. No specific recommendations were made in the Report of the Working Group on International Financial Crises about the means of procuring adoption of insolvency regimes consistent with the endorsed principles and features. Rather, the Working Group envisaged that the enhanced international surveillance process under consideration in a number of forums would review national insolvency regimes, and technical assistance from the International Monetary Fund and the World Bank, together with scrutiny from capital markets, should help encourage improvements. Nevertheless, the Working Group urged that consideration be given in the relevant forums to the development of additional means and incentives for encouraging the adoption of effective regimes.

9. Past efforts to address insolvency laws and policies through international forums at the global and even the regional level have met with mixed results. The harmonization of insolvency laws is problematic for several reasons. Insolvency laws often interact with other national laws and policies. The application of insolvency laws are closely related to a country’s other legal rules and statutory provisions governing property, contracts, companies, partnerships, mortgages and guarantees. In some jurisdictions they form a key part of other policy frameworks, such as protecting depositors in financial institutions, revenue collection, favouring certain categories of creditors over others (such as employees), and so on. Further, to be effective, insolvency laws must be supported by an appropriate and effective institutional framework for administration and enforcement (such as courts and tribunals, a professional and honest insolvency profession and regulators). They must be in harmony with the relevant legal, business and cultural frameworks in the local context.

10. Australia recognizes that there are significant differences in the functions, national purposes and public policy objectives of insolvency laws. Variations exist also in the national legal systems for the validity, protection and priority of security interests. It is not possible to rationalize, unify or bridge such different legal systems or adopt, without modification, a legislative regime for insolvency which is successful in one jurisdiction and assume that it will work effectively in another.

11. Nevertheless, it should be possible to crystallize from successful insolvency regimes, basic essential principles that should be reflected in a country’s insolvency laws. Australia believes it is possible to go further and outline the particular features that best give effect to the public and international policy objectives that countries seek to achieve through such laws. The development of a model law on insolvency that is flexible in its application could be a valuable supplement to other forces driving nations to progress reforms in this area.

FEATURES OF PROPOSED MODEL LAW

12. A model law or framework would not seek to harmonize insolvency laws across countries or establish uniform approaches or a “firm” set of provisions. Rather, it would contain a menu of legislative measures on various matters (such as liquidations, compromises and reorganizations), which countries could select from and modify to suit their individual circumstances. A starting point for the development of a model framework could be the key principles and features of effective insolvency regimes identified in the G22’s Report of the Working Group on International Financial Crises. The objective of the proposed UNCITRAL Working Group would be to ‘flesh out’ those principles and features by developing specific options for legislative and other measures that, if adopted, would be likely to contribute to the design of an effective insolvency regime.

13. It is envisaged that the model law would only deal with insolvency of commercial firms. It would not extend to the special rules and arrangements governing insolvency of financial institutions. There are significant policy considerations applying to the insolvency of such firms that demand special treatment.

ROLE OF UNCITRAL IN DEVELOPING A MODEL LAW ON INSOLVENCY

14. Australia considers that UNCITRAL is eminently suited to carrying out a project of this complexity and wide-ranging significance and has a proven record in a related area. In May 1997, after less than two years in development (a comparatively short time-frame for such a
task), UNCITRAL adopted the Model Law on Cross-Border Insolvency.

15. In the course of developing the Model Law, UNCITRAL formed links with other key participants in the insolvency framework. UNCITRAL consulted heavily with practitioners and held joint colloquia with judges and State officials. Participants represented a broad cross-section of nations with different cultures and legal systems. The UNCITRAL Secretariat and members are therefore already familiar with many of the national policy issues connected with insolvency. These factors would tend to support the use of UNCITRAL as a forum for developing a framework for national insolvency laws.

16. An UNCITRAL Working Group to develop a model law would not only advance agreement on what technical content should be in national approaches to insolvency systems. The very existence of a Working Group, and its resultant product, would also heighten national awareness in developing economies of the importance of the topic. That could raise the national priority given to implementing insolvency law reforms. It would also give useful international prominence to an approach to insolvency laws that could become the benchmark for multilateral transparency reporting and surveillance. It could thus assist the international roll-out of better insolvency practice.

17. In conclusion, therefore, Australia urges UNCITRAL to establish a Working Group to develop a model law on corporate insolvency to foster and encourage the adoption of effective national corporate insolvency regimes.
VII. CASE LAW ON UNCITRAL TEXTS (CLOUT)

1. The secretariat of UNCITRAL continues publishing court decisions and arbitral awards that are relevant to the interpretation or application of a text resulting from the work of UNCITRAL. For a description of CLOUT (Case Law on UNCITRAL Texts), see the Users Guide (A/CN.9/SER.C/GUIDE/1), published in 1993.

2. A/CN.9/SER.C/ABSTRACTS may be obtained from the UNCITRAL Secretariat

   UNCITRAL secretariat
   P.O. Box 500
   Vienna International Centre
   A-1400 Vienna
   Austria
   Telephone: (43-1) 26060-4060 or 4061
   Telex: 135612 uno a
   Telefax: (43-1) 26060-5813
   E-mail: unctral@unctral.org

3. They may also be accessed through the UNCITRAL homepage on the worldwide web (homepage:http:/www.uncitral.org)

4. Copies of complete texts of court-decisions and arbitral awards, in the original language, reported on in the context of CLOUT are sent by the secretariat to interested persons upon request, against a fee covering the cost of copying and mailing.
VIII. STATUS OF UNCITRAL TEXTS

Status of Conventions and Model Laws: note by the secretariat

(A/CN.9/462) [Original: English]

Not reproduced. The updated list may be obtained from the UNCITRAL secretariat or found on the Internet home page (http://www.uncitral.org).
INTRODUCTION

1. Pursuant to the decision taken at the twentieth session of the Commission (1987), training and assistance activities count among the high priorities of UNCITRAL. The training and technical assistance programme carried out by the secretariat under the mandate given by the Commission, particularly in developing countries and in countries whose economic systems are in transition, encompasses two main lines of activity: (a) information activities aimed at promoting understanding of international commercial law conventions, model laws and other legal texts; and (b) assistance to Member States with commercial law reform and adoption of UNCITRAL texts.

2. This note lists the activities of the secretariat subsequent to the issuance of the previous note submitted to the thirty-first session of the Commission (1-12 June 1998) and indicates possible future training and technical assistance activities in the light of the requests for such services from the secretariat.

I. UNCITRAL TEXTS

3. There is a continuing and significant increase in the importance being attributed by Governments, domestic and international business communities and multilateral and bilateral aid agencies to the improvement of the legal framework for international trade and investment, so badly needed in the era of globalization. UNCITRAL has an important function to play in this process because it has produced and promotes the use of legal instruments in a number of key areas of commercial law which represent internationally-agreed standards and solutions acceptable to different legal systems. Those instruments include:


(b) in the area of dispute resolution, the Convention on the Recognition and Enforcement of Foreign Arbitral Awards (New York, 1958) (a United Nations convention adopted prior to the establishment of the Commission, but actively promoted by it), the UNCITRAL Arbitration Rules, the UNCITRAL Conciliation Rules, the UNCITRAL Model Law on International Commercial Arbitration and the UNCITRAL Notes on Organizing Arbitral Proceedings;
(c) in the area of procurement, the UNCITRAL Model Law on Procurement of Goods, Construction and Services;

(d) in the area of banking, payments and insolvency, the United Nations Convention on Independent Guarantees and Stand-by Letters of Credit, the UNCITRAL Model Law on International Credit Transfers, the United Nations Convention on International Bills of Exchange and International Promissory Notes, and the UNCITRAL Model Law on Cross-Border Insolvency;

(e) in the area of transport, the United Nations Convention on the Carriage of Goods by Sea, 1978 (Hamburg Rules) and the United Nations Convention on the Liability of Operators of Transport Terminals in International Trade; and

(f) in the area of electronic commerce and data interchange, the UNCITRAL Model Law on Electronic Commerce.

4. The upsurge in commercial law reform represents a crucial opportunity for UNCITRAL to significantly further the objectives of substantial coordination and acceleration of the process of harmonization and unification of international trade law, as envisaged by General Assembly resolution 2205 (XXI) of 17 December 1966.

II. PREPARATION AND IMPLEMENTATION OF LEGISLATION

5. Technical assistance is provided to States preparing legislation based on UNCITRAL texts. Such assistance is provided in various forms, including review of preparatory drafts of legislation from the viewpoint of UNCITRAL texts, technical consultancy services and assistance in the preparation of legislation based on UNCITRAL texts, preparation of regulations implementing such legislation, comments on reports of law reform commissions as well as briefings for legislators, judges, arbitrators, procurement officials and other users of UNCITRAL texts embodied in national legislation. Another form of technical assistance provided by the secretariat consists in advising on the establishment of institutional arrangements for international commercial arbitration, including training seminars for arbitrators, judges and practitioners in this area.

6. With a view to maximizing the benefit that recipient countries derive from UNCITRAL technical assistance, the secretariat has taken steps towards increasing cooperation and coordination with development assistance agencies. Cooperation and coordination among entities providing legal technical assistance has the desirable effect of ensuring that, when United Nations system entities or outside entities are involved in providing legal technical assistance, the legal texts prepared by the Commission and recommended by the General Assembly to be considered are in fact so considered and used. The secretariat is continuing its efforts in this regard.

7. From the standpoint of recipient States, UNCITRAL technical assistance is beneficial owing to the secretariat’s accumulated experience in the preparation of UNCITRAL texts. It helps establish legal systems that not only are internally consistent, but also utilize internationally-developed trade law conventions, model laws and other legal texts. The resulting legal harmonization maximizes the ability of business parties from different States to successfully plan and implement commercial transactions, and, thus, fosters investors’ confidence.

8. States that are in the process of revising their trade legislation may wish to contact the UNCITRAL secretariat in order to obtain technical assistance and advice.

III. UNCITRAL SEMINARS AND BRIEFING MISSIONS

9. The information activities of UNCITRAL are typically carried out through seminars and briefing missions for Government officials from interested ministries (such as trade, foreign affairs, justice and transport), judges, arbitrators, practising lawyers, the commercial and trading community, scholars and other interested individuals. Seminars and briefing missions are designed to explain the salient features and utility of international trade law instruments of UNCITRAL. Information is also provided on certain important legal texts of other organizations, e.g. Uniform Customs and Practice for Documentary Credits and INCOTERMS (International Chamber of Commerce); Factoring Convention (International Institute for the Unification of Private Law (UNIDROIT)).

10. Lectures at UNCITRAL seminars are generally conducted by one or two members of the secretariat, experts from the host countries and, occasionally, external consultants. After the seminars, the UNCITRAL secretariat remains in contact with seminar participants in order to provide the host countries with the maximum possible support during the process leading up to the adoption and use of UNCITRAL texts.

11. Since the previous session, the secretariat organized seminars in a number of States. The following seminars and briefing missions were financed with resources from the Trust Fund for UNCITRAL Symposia:

- **Lusaka, Zambia** (20-22 April 1998), seminar held in cooperation with the Common Market for Eastern and Southern Africa (COMESA); attended by approximately 25 participants;

- **Yaounde, Cameroon** (27 April 1998), briefing of 40 officials of member countries of the Organization for the Harmonization of Business Law in Africa (OHADA);

- **Douala, Cameroon** (28-30 April 1998), seminar held in cooperation with the International Development Law Institute; attended by approximately 50 participants;

- **Manama, Bahrain** (12-13 May 1998), seminar held in conjunction with the Gulf Co-operation Council (G.C.C.) Commercial Arbitration Centre; attended by approximately 100 participants;

- **La Paz, Bolivia** (18 May 1998), seminar held in cooperation with the Ministry of Foreign Affairs; attended by approximately 60 participants;
Cochabamba, Bolivia (20 May 1998), seminar held in cooperation with the Chamber of Commerce; attended by approximately 50 participants;

Santa Cruz, Bolivia (22 May 1998), seminar held in cooperation with the Bolivian Institute of Foreign Commerce; attended by approximately 60 participants;

Lima, Peru (25-29 May 1998), seminar held during the Inter-American Bar Association’s XXXIV Conference; attended by approximately 80 participants;

Baku, Azerbaijan (24-25 September 1998), seminar held in cooperation with the Ministry of Trade; attended by approximately 50 participants;

Ulaanbaatar, Mongolia (21-23 October 1998), seminar held in cooperation with the Mongolian Chamber of Commerce and Industry; attended by approximately 60 participants;

Beijing, China (26-30 October 1998), seminars held in cooperation with the Ministry of Foreign Economic Cooperation and Trade, Legislation Commission of National People’s Congress, China International Economic and Trade Arbitration Commission and the China Judges College; attended by approximately 130 participants;

Bucharest, Romania (29-30 October 1998), seminar held in cooperation with the Ministry of Foreign Affairs; attended by approximately 30 participants;

Sofia, Bulgaria (2-3 November 1998), seminar held in cooperation with the Ministry of Trade and Tourism; attended by approximately 30 participants;

Shanghai, China (4-6 November 1998), briefing of 120 participants at the International Bar Association Second Asian Financial Law Seminar;

Sao Paulo, Brazil (16 November 1998), seminar held in cooperation with the International Law Association; attended by approximately 60 participants;

Brasilia, Brazil (19-20 November 1998), seminar held in cooperation with the Ministry of External Relations; attended by approximately 100 participants;

Caracas, Venezuela (24-27 November 1998), seminar held in cooperation with the Ministry of Foreign Affairs and the Civil Association for the Integration of Nations (ACIN); attended by approximately 40 participants;

Guatemala City, Guatemala (11-12 March 1999), seminar held in cooperation with the Ministry of Economy; attended by approximately 100 participants;

Mexico City, Mexico (15-17 March 1999), seminar held in cooperation with the Ministry of Foreign Affairs; attended by approximately 270 participants; and

Monterrey, Nuevo Leon, Mexico (20 March 1999), seminar held in cooperation with the Centro Jurídico para el Comercio Interamericano; attended by approximately 100 participants.

12. The following seminar was financed by the institution organizing the event or by another organization:

Buenos Aires, Argentina (30 November-1 December 1998), seminar held in cooperation with the law review La Ley; attended by approximately 100 participants.

IV. PARTICIPATION IN OTHER ACTIVITIES

13. Members of the UNCITRAL secretariat have participated as speakers in various seminars, conferences and courses, where UNCITRAL texts were presented for examination and possible adoption or use. The participation of members of the secretariat in the seminars, conferences and courses listed below was financed by the institution organizing the events or by another organization:

- Seminar on Intellectual Property, Licensing and Dispute Resolution sponsored by the World Intellectual Property Organization (WIPO) (Cairo, Egypt, 9-10 March 1998);
- Meeting on the Role of Future Receivables in Commodity Financing sponsored by the International Business Conferences (IBC) (Geneva, 3-4 April 1998);
- New German Arbitration Law and DIS-Arbitration Rules Meeting sponsored by the German Institution for Arbitration (Leipzig, Germany, 21-22 April 1998);
- Symposium on Alternative Mechanisms for the Resolution of Transnational Commercial Disputes sponsored by the Asia-Pacific Economic Cooperation (APEC) (Bangkok, Thailand, 27-28 April 1998);
- International Trade Law Post Graduate Course sponsored by the International Training Centre of the International Labour Organization (ILO) and the University Institute of European Studies (Turin, Italy, 20 May 1998);
- Opening and Conference of the Center for Transnational Law (Monster, Germany, 25 May 1998);
- Round-table Discussion on Electronic Commerce Law Reform at Bangkok sponsored by The Arbitration Office, Ministry of Justice, Thailand (Bangkok, Thailand, 28-29 May 1998);
- Communic Asia 98/Network Asia 98 International Conference sponsored by the Singapore Exhibition Services (Singapore, 1-4 June 1998);
- Workshop for Senior Central Bank Lawyers on International Bank Insolvencies sponsored by the Bank for International Settlements (Thun, Switzerland, 25-26 June 1998);
- Legal Experts Panel on Business Environment Study of Trusted Services (BESTS) sponsored by Coopers and Lybrand (Amsterdam, the Netherlands, 15-16 July 1998);
- Annual Meeting of the Swiss Arbitration Association (Basel, Switzerland, 4 September 1998);
- Inter-American Banking Law Conference sponsored by the National Law Center for Inter-American Free Trade and the Federation of Latin-American Banking Lawyers (FELEBAN) (Mexico City, Mexico, 23-26 September 1998);
- World Bank Procurement Forum (Baltimore, Maryland, United States of America, 16-18 September 1998);
- International Receivables Financing Meeting sponsored by the Max-Planck Institute for Public and International Law and the Institute of International Financial Law of the University of Mainz (Hamburg, Germany, 18-20 September 1998);
- United Nations Centre for Trade and Development (UNCTAD) Train for Trade Seminar on Electronic Commerce (Tunis, Tunisia, 26-27 October 1998);
Annual Meeting of the International Chamber of Commerce Institute of World Business Law (Paris, 29 October 1998);

Forum for International Arbitration/Irish Bar Association Seminar on the Irish Arbitration Act (Dublin, Ireland, 8 November 1998);

1998 Freshfields Arbitration Lecture (London, 10 November 1998);

Colloquium on Networks and Telecommunication Technology and Legal Change sponsored by the Governments of France and Viet Nam (Hanoi, Viet Nam, 23-26 November 1998);

Milan Bar Association Seminar on International Trade and Electronic Trade (Milan, Italy, 9 January 1999);

Chartered Institute of Arbitrators/Cairo Regional Centre for Commercial Arbitration International Entry Course and Special Fellowship Course on Arbitration (Cairo and Alexandria, Egypt, 30 January-6 February 1999);

International Arbitration Centre of the Austrian Chamber of Commerce Arbitration Seminar (Hernstein, Austria, 11 February 1999);

World Trade Organization CTD Seminar on Electronic Commerce and Development (Geneva, 19 February 1999);

New Zealand Law Conference (Rotorua, New Zealand, 6-9 April 1999);

Meeting of Steering Group on Electronic Commerce (Wellington, New Zealand, 11 April 1999);

Meeting of New Zealand Arbitration and Mediation Institute (Wellington, New Zealand, 13 April 1999);

Semi-annual Conference of Business Law Section of American Bar Association (San Francisco, California, 15-17 April 1999);

National Day of Arbitration Symposium sponsored by the Tunis Centre of Conciliation and Arbitration (Tunis, Tunisia, 26-27 April 1999);

International Development Law Institute Training Seminar (Rome, 26-27 April 1999); and

International Trade Law Post-Graduate Course sponsored by the International Training Centre of the International Labour Organization (ILO) and the University Institute of European Studies (Turin, Italy, 27 April 1999).

14. The participation of members of the UNCITRAL secretariat as speakers in the conferences listed below was financed with resources from the United Nations regular travel budget:

Arbitration Workshop and Symposium sponsored by the Institute of Transnational Arbitration of the Southwestern Legal Foundation (Dallas, Texas, 18-19 June 1998);

Commission on Banking Technique and Practice Meeting sponsored by the International Chamber of Commerce (ICC) (Paris, 6-7 April 1998);

XLII Congress of the Union Internationale des Avocats (UIA) (Nice, France, 28 August-1 September 1998);

Post-Graduate Course on International Contracts: CISG Revisited sponsored by the Inter-University Centre Dubrovnik (Dubrovnik, Croatia, 2-4 September 1998);

1998 International Bar Association Biennial Conference (Vancouver, Canada, 13-18 September 1998);

18th Annual Congress of the European Insolvency Practitioners Association (EIPA) (Oslo, Norway, 17-20 September 1998);

International Chamber of Commerce Institute Annual Meeting—Forging Trust in Electronic Commerce: Law and Dispute Resolution (Geneva, 23-25 September 1998);

International Chamber of Commerce Banking Commission (Marco Island, Florida, 8-9 October 1998);

Slovenian Law Society Annual Meeting (Portorož, Slovenia, 15-17 October 1998);

Partners for Development Meeting sponsored by the United Nations Centre for Trade and Development (UNCTAD) (Lyon, France, 9-12 November 1998); and


V. INTERNSHIP PROGRAMME

15. The internship programme is designed to give young lawyers the opportunity to become familiar with the work of UNCITRAL and to increase their knowledge of specific areas in the field of international trade law. During the past year, the secretariat has hosted seven interns from Austria, Germany, Italy, the Netherlands, Poland, Sweden, and the United States of America. Interns are assigned tasks such as basic or advanced research, collection and systematization of information and materials or assistance in preparing background papers. The experience of UNCITRAL with the internship programme has been positive. As no funds are available to the secretariat to assist interns to cover their travel or other expenses, interns are often sponsored by an organization, university, Government agency or they meet their expenses from their own means. The Commission, in this connection, may wish to invite Member States, universities and other organizations, in addition to those that already do so, to consider sponsoring the participation of young lawyers in the United Nations internship programme with UNCITRAL.

16. In addition, the secretariat occasionally accommodates requests by scholars and legal practitioners who wish to conduct research in the Branch and in the UNCITRAL Law Library for a limited period of time.

VI. FUTURE ACTIVITIES

17. For the remainder of 1999, seminars and legal-assistance briefing missions are being planned in Africa, Asia, Latin America and eastern Europe. Since the costs of training and technical assistance activities is not covered by the regular budget, the ability of the secretariat to implement these plans is contingent upon the receipt of sufficient funds in the form of contributions to the Trust Fund for UNCITRAL Symposia.

18. As it has done in recent years, the secretariat has agreed to co-sponsor the next three-month International
Trade Law Post-Graduate Course to be organized by the University Institute of European Studies and the International Training Centre of the International Labour Organization in Turin. Typically, approximately one half of the participants are drawn from Italy, with many of the remainder being drawn from developing countries. This year’s contribution from the UNCITRAL secretariat will focus on issues of harmonization of laws on international trade law from the perspective of UNCITRAL, including past and current work.

VII. FINANCIAL RESOURCES

19. The secretariat continues its efforts to devise a more extensive training and technical assistance programme to meet the considerably greater demand from States for training and assistance in keeping with the call of the Commission at the twentieth session (1987) for an increased emphasis both on training and assistance and on the promotion of the legal texts prepared by the Commission. However, as no funds for UNCITRAL seminars are provided for in the regular budget, expenses for UNCITRAL training and technical assistance activities (except for those that are supported by funding agencies such as the World Bank) have to be met by voluntary contributions to the Trust Fund for UNCITRAL Symposia.

20. Given the importance of extra-budgetary funding for the implementation of the training and technical assistance component of the UNCITRAL work programme, the Commission may again wish to appeal to all States, international organizations and other interested entities to consider making contributions to the Trust Fund for UNCITRAL Symposia, particularly in the form of multi-year contributions, so as to facilitate planning and enable the secretariat to meet the increasing demands from developing countries and States with economies in transition for training and assistance. The secretariat can be contacted for information on how to make contributions.

21. In the period under review, contributions were received from Finland, Greece and Switzerland. The Commission may wish to express its appreciation to those States and organizations that have contributed to the Commission’s programme of training and assistance by providing funds or staff or by hosting seminars.

22. In this connection, the Commission may wish to recall that, in accordance with General Assembly resolution 48/32 of 9 December 1993, the Secretary-General was requested to establish a Trust Fund for granting travel assistance to developing States members of the United Nations Commission on International Trade Law. The Trust Fund so established is open to voluntary financial contributions from States, inter-governmental organizations, regional economic integration organizations, national institutions and non-governmental organizations as well as natural and juridical persons.

23. At its thirty-first session, the Commission noted with appreciation that the General Assembly, in resolution 52/157, paragraph 10, had appealed to Governments, the relevant United Nations organs, organizations and institutions and individuals, in order to ensure full participation by all Member States in the sessions of the Commission and its working groups, to make voluntary contributions to the Trust Fund for Granting Travel Assistance to Developing States members of UNCITRAL, at their request and in consultation with the Secretary-General.

24. Since the establishment of the Trust Fund, contributions were received from Cambodia, Kenya and Singapore.

25. It is recalled that in operative paragraph 11 of resolution 51/161 of 16 December 1996, the General Assembly decided to include the Trust Funds for Symposia and Travel Assistance in the list of funds and programmes that are dealt with at the United Nations Pledging Conference for Development Activities.
Part Three

ANNEXES
I. BIBLIOGRAPHY OF RECENT WRITINGS RELATED TO THE WORK OF UNCITRAL:1 NOTE BY THE SECRETARIAT

(A/CN.9/481) [Original: English]

CONTENTS

Page
I. GENERAL ............................................................ 431
II. INTERNATIONAL SALE OF GOODS .............................. 432
III. INTERNATIONAL COMMERCIAL ARBITRATION AND CONCILIATION .................................................. 434
IV. INTERNATIONAL TRANSPORT .................................... 436
V. INTERNATIONAL PAYMENTS ...................................... 436
VI. ELECTRONIC COMMERCE ........................................ 436
VII. INDEPENDENT GUARANTEES AND STAND-BY LETTERS OF CREDIT ..................................................... 437
VIII. PROCUREMENT .................................................... 437
IX. CROSS-BORDER INSOLVENCY .................................... 437
X. RECEIVABLES FINANCING ........................................ 438
XI. INTERNATIONAL CONSTRUCTION CONTRACTS .............. 439
XII. PRIVATELY FINANCED INFRASTRUCTURE PROJECTS ...... 439
Annex. UNCITRAL legal texts ........................................ 439

I. General


In two instalments:
II in 8:927-937, 1999.

Other title information: Conventions internationales: international conventions.

A continuation of a series of reports on the activities of international organizations (here: UNCITRAL) in the field of the unification of international trade law; see previous bibliographies of recent writings related to the work of UNCITRAL (A/CN.9/...) for other reports.

Parallel title of journal: International business law journal.


Other title information: Conventions internationales: international conventions.

A continuation of a series of reports on the activities of international organizations (here: UNCITRAL) in the field of the unification of international trade law; see previous bibliographies of recent writings related to the work of UNCITRAL (A/CN.9/...) for other reports.

Parallel title of journal: International business law journal.


Includes executive summary, p. iii.
Doc. No.: UNCTAD/SDTE/BFB/2; Sales No. E.99.II.D.6.

1Case law on UNCITRAL texts (CLOUT) and bibliographical references thereto are contained in the documents series A/CN.9/SER.C/... .


Dealing with the work of UNCITRAL: Standardizing and harmonizing rules for international commercial transactions, p. 27-30.

Book designed and published by: United Nations Department of Public Information, Development and Human Rights Section. Appendix includes a list of UNCITRAL leading work products subject by subject, p. 70-71.


II. International sale of goods


Other title information from cover: Doctrina, jurisprudencia, formularios y legislación.


Includes bibliography and various annexes with international legal texts and contract forms.


Thesis (master's), Universidad Panamericana, 1996.


Title from cover.

Contains: Implementing laws of the United Nations Sales Convention (1980) at the Federal level and for all provinces. Also a study into the feasibility of accession to the limitation convention(s)/Protocol.

Other title information: Conventions internationales: international conventions.

In English and French on facing columns.

Parallel title of journal: International business law journal.


Includes bibliography of scholarly writings and web site addresses for court decisions.

Contains case references and commentary.


Includes English abstract.


This is a note to a court decision involving the United Nations Sales Convention (1980) by Bundesgerichtshof, excerpts of which were published in this journal; 45:5:385-386, Mai 1999.


Includes references to the UNCITRAL Legal Guide on Countertrade (1992).


This article derives from a paper presented to the 52nd Annual Conference of the Australasian Law Teachers’ Association, Sydney, 2-5 October 1997. Footnote, p. 236.


Gabriel, H. D. How international is the sales law of the United States? Roma: Centro di studi e ricerche di diritto comparato e straniero, 1999. 37 p. (Saggi, conferenze e seminari / Centro di studi e ricerche di diritto comparato e straniero ; 34)


Describes and analyses the law of sales under article 2 of the Uniform Commercial Code and under the United Nations Sales Convention (1980). — Preface. Includes table of cases and subject index.


One of the most authoritative (article-by-article) commentaries on the Convention provisions. A companion book is the writer’s Documentary history of the Uniform Law for International Sales.—Deventer, Neth.: Kluwer, 1989, where the background documents (“travaux préparatoires”) are reproduced.


Parallel title of journal: SA tydskrif vir handelsreg.


In Finnish.


In Korean with short abstract in English. Translation of title taken from English table of contents.

Cap. 1.I. provides an overview of the United Nations Sales Convention (1980). The rest of the book is an annotated, delocalized international sales agreement, with commentary on each term. The specific clauses are reviewed in the context of the possibility of the Convention applying to the transactions. — Introduction, p. xxvi.


III. *International commercial arbitration and conciliation*


Binder, P. M. *The UNCITRAL model law on international commercial arbitration: a commentary and international comparison of its adoption*. Peter M. Binder (Salzburg): [s.n.], 1999. 284 p.


Pace University School of Law essay submission.

Parallel title of journal: International business law journal.
In English and French on facing columns.


In Korean with short abstract in English. Translation of title taken from English table of contents.


Includes Appendix I citing international arbitration rules regarding trade usages.—Appendix II citing international arbitration statutes on trade usages.


Includes citations to revisions of arbitration laws in Europe.


Kolkey, D. M. It’s time to adopt the UNICITRAL Model Law on International Commercial Arbitration. Transnational law & contemporary problems: University of Iowa College of Law (Iowa City, IA) 8:1:3-17, spring 1998.


In Korean with short abstract in English. Translation of title taken from English table of contents.

Lourens, M. The issue of “arbitrability” in the context of international commercial arbitration. SA mercantile law journal (Kensyn).
Thesis (Master of Laws), University of Stellenbosch, 1998.
Parallel title of journal: SA tydskrif vir handelsreg.


   In two installments:


   In two parts.
   II in 8:3-4, 275-326, 1997.
   Appendix I, pp. 442-454 reproduces the Rules.


IV. International transport


V. International payments


In Spanish and French on facing columns.


Includes English abstract.


Parallel title of journal: Revue canadienne du droit de commerce.


WIPO doc.: WIPO/EC/CONF/99/SPK/24-C (September 1999)


At head of title: Instituto Nacional de Formación Profesional; INFOP.

Reproduces Spanish texts of UNCITRAL Electronic Com-


In Romanian.


Contents dealing with the work of UNCITRAL: Title IV, Dezvoltarea progresiva a dreptului comertului international = Progressive development of international trade law, p. 235-277. [Chapter 1 on Electronic commerce, p. 238-257.—ch. 2 on Privately financed infrastructure projects and BOT, p. 258-277]. Includes bibliography, p. 458-487. Also concluding remarks in English, p. 488-496.


Pejovic, C. Main legal issues in the implementation of Electronic Data Interchange (EDI) to bills of lading. European transport law: journal of law and economics (Antwerpen) 34:2:183-185, 1999.

Discusses the UNCITRAL Model Law on Electronic Commerce.


Now available in all official United Nations languages.

VII. Independent guarantees and stand-by letters of credit


Other title information: The Insight interview.

Herrmann, G. UNCITRAL Secretary Gerold Herrmann speaks on the UN convention. Documentary credit world (Montgomery Village, MD.) 3:12:31-37, December 1999.


ICC Doc. 470/864 Rev2


VIII. Procurement

* * *

IX. Cross-border insolvency


A special supplement to the May 1999 issue of International financial law review.


Includes executive summary, p. xi-xiv, bibliography, and subject index.

Doc. No.: Also published as Parliamentary Paper E 31 AM.


Principal conclusions stated in Chapter 6: The adoption by countries of the UNCITRAL Model Insolvency Law (1997) would provide an effective means to facilitate the recognition of foreign proceedings and the cooperation among courts and administrators of different countries.

Schlosser, P. Recent developments in transit-border insolvency. Roma: Centro di Studi e Ricerche di Diritto Comparato e Straniiero; 1999. 29 p. (Saggi, conferenze e seminari / Centro di studi e ricerche di diritto comparato e straniero ; 35)


Parallel title of journal: SA tydskrif vir handelsregs.

X. Receivables financing


Reproduces text of UNCITRAL document A/CN.9/466.


Untersuchungen über das Spar-, Giro- und Kreditwesen: Abt. B, Rechtswissenschaft: Schriften des Instituts für deutsches und internationales Recht des Spar-, Giro- und Kreditwesens an der Johannes Gutenberg-Universität Mainz; Bd. 120.


Parallel title in French: Actes et documents de la Dix-huitième session 30 septembre au 19 octobre 1996. Tome I. Matières diverses / édité par le Bureau Permanent de la Conférence, Conférence de La Haye de droit international privé.

In English and French on alternating pages.


XI. International construction contracts

* * *

XII. Privately financed infrastructure projects


In Romanian.
Includes bibliography, p. 458-487.
Also concluding remarks in English, p. 488-496.


ANNEX

UNCITRAL legal texts

<table>
<thead>
<tr>
<th>Short title</th>
<th>Full title</th>
</tr>
</thead>
</table>


Notes


"Ibid., Thirty-first Session, Supplement No. 17 (A/31/17), para. 57.


"Ibid., Forty-seventh Session, Supplement No. 17 (A/47/17), annex I.

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

"United Nations publication, Sales No. E.93.V.7.

"United Nations publication, Sales No. E.87.V.9.

"United Nations publication, Sales No. E.87.V.10.

"Ibid., Forty-ninth Session, Supplement No. 17 (A/49/17), annex I.

"Ibid., Fifty-second Session, Supplement No. 17 (A/52/17), annex I.


## II. CHECK-LIST OF UNCITRAL DOCUMENTS

<table>
<thead>
<tr>
<th>Document symbol</th>
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<th>Location in present volume</th>
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<td>Provisional agenda, annotations thereto and scheduling of meetings of the thirty-second session</td>
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<td>A/CN.9/458</td>
<td>Privately financed infrastructure projects: draft chapters of a legislative guide on privately financed infrastructure projects</td>
<td>Part two, III</td>
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<tr>
<td>A/CN.9/458/Add.1</td>
<td>Introduction and background information on privately financed infrastructure projects</td>
<td>Part two, III</td>
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<tr>
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<td>Chapter I. General legislative considerations</td>
<td>Part two, III</td>
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<td>Chapter II. Project risks and government support</td>
<td>Part two, III</td>
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<td>Chapter III. Selection of the concessionaire</td>
<td>Part two, III</td>
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<td>Chapter VI. End of project term, extension and termination</td>
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<td>Chapter VII. Governing law</td>
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<td>Chapter VIII. Settlement of disputes</td>
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<td>Part two, IV, B</td>
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<td>International commercial arbitration: possible future work in the area of international commercial arbitration</td>
<td>Part two, V</td>
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<td>A/CN.9/461</td>
<td>Training and technical assistance</td>
<td>Part two, IX</td>
</tr>
<tr>
<td>A/CN.9/462</td>
<td>Status of conventions and model laws</td>
<td>Part two, VIII</td>
</tr>
<tr>
<td>A/CN.9/462/Add.1</td>
<td>Insolvency law: possible future work in the area of insolvency law—Proposal by Australia</td>
<td>Part two, VI</td>
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### Restricted series

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### Information series

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### B. List of documents before the Working Group on International Contract Practices at its twenty-ninth session

#### 1. Working papers

<table>
<thead>
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<th>Location in present volume</th>
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#### 2. Restricted series

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</table>
C. List of documents before the Working Group on International Contract Practices at its thirtieth session

1. Working papers

A/CN.9/WG.II/WP.101 Provisional agenda Not reproduced


2. Restricted series


3. Information series

A/CN.9/WG.II/XXX/INF.1 List of participants Not reproduced

D. List of documents before the Working Group on Electronic Commerce at its thirty-third session

1. Working papers

A/CN.9/WG.IV/WP.75 Provisional agenda Not reproduced


2. Restricted series

A/CN.9/WG.IV/XXXIII/CRP.1 and Add. 1-13 Draft report of the Working Group on Electronic Commerce on the work of its Thirty-third session Not reproduced

3. Information series

A/CN.9/WG.IV/XXXIII/INF.1 List of participants Not reproduced

E. List of documents before the Working Group on Electronic Commerce at its thirty-fourth session

1. Working papers

A/CN.9/WG.IV/WP.78 Provisional agenda Not reproduced
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III. LIST OF UNCITRAL DOCUMENTS
REPRODUCED IN THE PREVIOUS VOLUMES
OF THE YEARBOOK

This list indicates the particular volume, year, part, chapter and page where documents relating to the work of the Commission were reproduced in previous volumes of the Yearbook; documents that are not listed here were not reproduced in the Yearbook. The documents are divided into the following categories:

1. Reports on the annual sessions of the Commission
2. Resolutions of the General Assembly
3. Reports of the Sixth Committee
4. Extracts from the reports of the Trade and Development Board, United Nations Conference on Trade and Development
5. Documents submitted to the Commission (including reports of the meetings of Working Groups)
6. Documents submitted to the Working Groups:
       International Contract Practices (as of 1979)
   (c) Working Group III: International Legislation on Shipping
       (1968 to 1978)
7. Summary records of discussions in the Commission
8. Texts adopted by Conferences of Plenipotentiaries
9. Bibliographies of writings relating to the work of the Commission

<table>
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<td>Part one, II, A</td>
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<td>Volume III: 1972</td>
<td>Part one, II, A</td>
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<td>Volume IV: 1973</td>
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<td>A/10017 (eighth session)</td>
<td>Volume VI: 1975</td>
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<td>Volume IX: 1978</td>
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<td>A/34/17 (twelfth session)</td>
<td>Volume X: 1979</td>
<td>Part one, II, A</td>
<td>11</td>
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<td>Volume XI: 1980</td>
<td>Part one, II, A</td>
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<td>A/36/17 (fourteenth session)</td>
<td>Volume XII: 1981</td>
<td>Part one, A</td>
<td>3</td>
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<td>Volume XIV: 1983</td>
<td>Part one, A</td>
<td>3</td>
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<td>Volume XV: 1984</td>
<td>Part one, A</td>
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<td>Part one, A</td>
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<td>Part one, A</td>
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<td>A/42/17 (twentieth session)</td>
<td>Volume XVIII: 1987</td>
<td>Part one, A</td>
<td>3</td>
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<td>Volume XIX: 1988</td>
<td>Part one, A</td>
<td>3</td>
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<td>Volume XX: 1989</td>
<td>Part one, A</td>
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<td>A/46/17 (twenty-fourth session)</td>
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<td>Part one, A</td>
<td>3</td>
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<td>Part one, A</td>
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<td>Part one, A</td>
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2. Resolutions of the General Assembly

<table>
<thead>
<tr>
<th>Resolution</th>
<th>Volume, year</th>
<th>Part, chapter</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>2635 (XXV)</td>
<td>Volume II: 1971</td>
<td>Part one, I, C</td>
<td>7</td>
</tr>
<tr>
<td>2766 (XXVI)</td>
<td>Volume III: 1972</td>
<td>Part one, I, C</td>
<td>7</td>
</tr>
<tr>
<td>2928 (XXVII)</td>
<td>Volume IV: 1973</td>
<td>Part one, I, C</td>
<td>8</td>
</tr>
<tr>
<td>2929 (XXVII)</td>
<td>Volume IV: 1973</td>
<td>Part one, I, C</td>
<td>8</td>
</tr>
<tr>
<td>3104 (XXVIII)</td>
<td>Volume V: 1974</td>
<td>Part one, I, C</td>
<td>10</td>
</tr>
<tr>
<td>3108 (XXVIII)</td>
<td>Volume V: 1974</td>
<td>Part one, I, C</td>
<td>10</td>
</tr>
<tr>
<td>3316 (XXIX)</td>
<td>Volume VI: 1975</td>
<td>Part one, I, C</td>
<td>6</td>
</tr>
<tr>
<td>3317 (XXIX)</td>
<td>Volume VI: 1975</td>
<td>Part three, I, B</td>
<td>297</td>
</tr>
<tr>
<td>3494 (XXX)</td>
<td>Volume VII: 1976</td>
<td>Part one, I, C</td>
<td>7</td>
</tr>
<tr>
<td>31/98</td>
<td>Volume VIII: 1977</td>
<td>Part one, I, C</td>
<td>7</td>
</tr>
<tr>
<td>31/100</td>
<td>Volume VIII: 1977</td>
<td>Part one, I, C</td>
<td>7</td>
</tr>
<tr>
<td>32/145</td>
<td>Volume IX: 1978</td>
<td>Part one, I, C</td>
<td>8</td>
</tr>
<tr>
<td>32/438</td>
<td>Volume IX: 1978</td>
<td>Part one, I, C</td>
<td>8</td>
</tr>
<tr>
<td>33/92</td>
<td>Volume X: 1979</td>
<td>Part one, I, B</td>
<td>8</td>
</tr>
<tr>
<td>33/95</td>
<td>Volume X: 1979</td>
<td>Part one, I, C</td>
<td>8</td>
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<tr>
<td>34/143</td>
<td>Volume XI: 1980</td>
<td>Part one, I, C</td>
<td>4</td>
</tr>
<tr>
<td>34/150</td>
<td>Volume XI: 1980</td>
<td>Part three, III</td>
<td>166</td>
</tr>
<tr>
<td>35/166</td>
<td>Volume XI: 1980</td>
<td>Part three, III</td>
<td>166</td>
</tr>
<tr>
<td>35/51</td>
<td>Volume XI: 1980</td>
<td>Part one, I, D</td>
<td>31</td>
</tr>
<tr>
<td>35/52</td>
<td>Volume XI: 1980</td>
<td>Part one, II, D</td>
<td>31</td>
</tr>
<tr>
<td>36/32</td>
<td>Volume XII: 1981</td>
<td>Part one, D</td>
<td>20</td>
</tr>
<tr>
<td>36/107</td>
<td>Volume XII: 1981</td>
<td>Part three, I</td>
<td>269</td>
</tr>
<tr>
<td>36/111</td>
<td>Volume XII: 1981</td>
<td>Part three, II</td>
<td>270</td>
</tr>
<tr>
<td>37/103</td>
<td>Volume XIII: 1982</td>
<td>Part three, III</td>
<td>425</td>
</tr>
<tr>
<td>37/106</td>
<td>Volume XIII: 1982</td>
<td>Part one, D</td>
<td>21</td>
</tr>
<tr>
<td>38/128</td>
<td>Volume XIV: 1983</td>
<td>Part three, III</td>
<td>275</td>
</tr>
<tr>
<td>38/134</td>
<td>Volume XIV: 1983</td>
<td>Part one, D</td>
<td>21</td>
</tr>
<tr>
<td>38/135</td>
<td>Volume XIV: 1983</td>
<td>Part one, D</td>
<td>21</td>
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<tr>
<td>39/82</td>
<td>Volume XV: 1984</td>
<td>Part one, D</td>
<td>23</td>
</tr>
<tr>
<td>40/71</td>
<td>Volume XVI: 1985</td>
<td>Part one, D</td>
<td>47</td>
</tr>
<tr>
<td>40/72</td>
<td>Volume XVI: 1985</td>
<td>Part one, D</td>
<td>47</td>
</tr>
<tr>
<td>41/77</td>
<td>Volume XVII: 1986</td>
<td>Part one, D</td>
<td>37</td>
</tr>
<tr>
<td>42/152</td>
<td>Volume XVIII: 1987</td>
<td>Part one, D</td>
<td>41</td>
</tr>
<tr>
<td>42/153</td>
<td>Volume XVIII: 1987</td>
<td>Part one, E</td>
<td>43</td>
</tr>
<tr>
<td>43/165 and annex</td>
<td>Volume XIX: 1988</td>
<td>Part one, D</td>
<td>19</td>
</tr>
<tr>
<td>43/166</td>
<td>Volume XIX: 1988</td>
<td>Part one, E</td>
<td>20</td>
</tr>
<tr>
<td>44/33</td>
<td>Volume XX: 1989</td>
<td>Part one, E</td>
<td>37</td>
</tr>
<tr>
<td>45/42</td>
<td>Volume XXI: 1990</td>
<td>Part one, D</td>
<td>18</td>
</tr>
<tr>
<td>46/56</td>
<td>Volume XXII: 1991</td>
<td>Part one, D</td>
<td>47</td>
</tr>
<tr>
<td>47/34</td>
<td>Volume XXII: 1992</td>
<td>Part one, D</td>
<td>25</td>
</tr>
<tr>
<td>48/32</td>
<td>Volume XXIV: 1993</td>
<td>Part one, D</td>
<td>39</td>
</tr>
<tr>
<td>48/33</td>
<td>Volume XXIV: 1993</td>
<td>Part one, D</td>
<td>40</td>
</tr>
<tr>
<td>48/34</td>
<td>Volume XXIV: 1993</td>
<td>Part one, D</td>
<td>40</td>
</tr>
<tr>
<td>49/54</td>
<td>Volume XXV: 1994</td>
<td>Part one, D</td>
<td>32</td>
</tr>
<tr>
<td>49/55</td>
<td>Volume XXV: 1994</td>
<td>Part one, D</td>
<td>32</td>
</tr>
<tr>
<td>50/47</td>
<td>Volume XXVI: 1995</td>
<td>Part one, D</td>
<td>57</td>
</tr>
</tbody>
</table>
3. Reports of the Sixth Committee

A/8146 Volume II: 1971 Part one, I, B  3
A/8506 Volume III: 1972 Part one, I, B  3
A/8896 Volume IV: 1973 Part one, I, B  3
A/9408 Volume V: 1974 Part one, I, B  3
A/9920 Volume VI: 1975 Part one, I, B  3
A/9711 Volume VI: 1975 Part three, I, A  297
A/10420 Volume VII: 1976 Part one, I, B  3
A/31/390 Volume VIII: 1977 Part one, I, B  3
A/32/402 Volume IX: 1978 Part one, I, B  3
A/33/349 Volume X: 1979 Part one, I, B  3
A/34/780 Volume XI: 1980 Part one, I, B  4
A/35/627 Volume XI: 1980 Part one, II, C  30
A/36/669 Volume XII: 1981 Part one, C  20
A/37/620 Volume XIII: 1982 Part one, C  20
A/38/667 Volume XIV: 1983 Part one, C  20
A/39/698 Volume XV: 1984 Part one, C  22
A/40/935 Volume XVI: 1985 Part one, C  46
A/41/861 Volume XVII: 1986 Part one, C  37
A/42/836 Volume XVIII: 1987 Part one, C  40
A/43/820 Volume XIX: 1988 Part one, C  18
A/43/405 and Add.1-3 Volume XIX: 1988 Part three, II, B  188
A/44/453 and Add.1 Volume XX: 1989 Part one, C  34
A/44/723 Volume XX: 1989 Part one, D  36
A/45/736 Volume XXI: 1990 Part one, C  18
A/46/688 Volume XXII: 1991 Part one, C  46
A/47/586 Volume XXIII: 1992 Part one, C  25
A/48/613 Volume XXIV: 1993 Part one, C  38
A/49/739 Volume XXV: 1994 Part one, C  31
A/50/640 Volume XXVI: 1995 Part one, C  57
A/51/628 Volume XXVII: 1996 Part one, C  39
A/52/649 Volume XXVIII: 1997 Part one, C  40

4. Extracts from the reports of the Trade and Development Board,
United Nations Conference on Trade and Development

A/8015/Rev.1 Volume II: 1971 Part one, I, A  3
A/8015/Rev.1 Volume II: 1971 Part two, IV  137
A/8715/Rev.1 Volume IV: 1973 Part one, I, A  3
A/9015/Rev.1 Volume V: 1974 Part one, I, A  3
A/9615/Rev.1 Volume VI: 1975 Part one, I, A  3
TD/B/6/64 Volume IX: 1978 Part one, I, A  3
A/33/15/Vol.II Volume X: 1979 Part one, I, A  3
A/36/15/Vol.II Volume XII: 1981 Part one, B  19
TD/B/930 Volume XIII: 1982 Part one, B  20
TD/B/973 Volume XIV: 1983 Part one, B  20
<table>
<thead>
<tr>
<th>Document symbol</th>
<th>Volume, year</th>
<th>Part, chapter</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>TD/B/1026</td>
<td>Volume XV: 1984</td>
<td>Part one, B</td>
<td>22</td>
</tr>
<tr>
<td>TD/B/1077</td>
<td>Volume XVI: 1985</td>
<td>Part one, B</td>
<td>46</td>
</tr>
<tr>
<td>TD/B/L.810/Add.9</td>
<td>Volume XVII: 1986</td>
<td>Part one, B</td>
<td>36</td>
</tr>
<tr>
<td>A/42/15</td>
<td>Volume XVIII: 1987</td>
<td>Part one, B</td>
<td>40</td>
</tr>
<tr>
<td>TD/B/1193</td>
<td>Volume XIX: 1988</td>
<td>Part one, B</td>
<td>18</td>
</tr>
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<td>TD/B/1234/Vol.II</td>
<td>Volume XX: 1989</td>
<td>Part one, B</td>
<td>33</td>
</tr>
<tr>
<td>TD/B/1277/Vol.II</td>
<td>Volume XXI: 1990</td>
<td>Part one, B</td>
<td>18</td>
</tr>
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<td>TD/B/39(1)/15</td>
<td>Volume XXIII: 1992</td>
<td>Part one, B</td>
<td>34</td>
</tr>
<tr>
<td>TD/B/40(1)/14 (Vol.I)</td>
<td>Volume XXIV: 1993</td>
<td>Part one, B</td>
<td>37</td>
</tr>
<tr>
<td>TD/B/41(1)/14 (Vol.I)</td>
<td>Volume XXV: 1994</td>
<td>Part one, B</td>
<td>31</td>
</tr>
<tr>
<td>TD/B/42(1)/19 (Vol.I)</td>
<td>Volume XXVI: 1995</td>
<td>Part one, B</td>
<td>56</td>
</tr>
<tr>
<td>TD/B/43/12 (Vol.I)</td>
<td>Volume XXVII: 1996</td>
<td>Part one, B</td>
<td>38</td>
</tr>
<tr>
<td>TD/B/44/19 (Vol.I)</td>
<td>Volume XXVIII: 1997</td>
<td>Part one, B</td>
<td>39</td>
</tr>
</tbody>
</table>

5. Documents submitted to the Commission (including reports of the meetings of Working Groups)

A/CN.9/38/Add.1 Volume II: 1971 Part two, II, 1 113
A/CN.9/50 and annex I-IV Volume II: 1971 Part two, I, C, 2 87
A/CN.9/54 Volume II: 1971 Part two, I, B, 1 66
A/CN.9/55 Volume II: 1971 Part two, III 133
A/CN.9/60 Volume II: 1971 Part two, IV 139
A/CN.9/64 Volume III: 1972 Part two, III 193
A/CN.9/70 and Add.2 Volume III: 1972 Part two, I, B, 1 96
A/CN.9/73 Volume III: 1972 Part two, II, B, 3 115
A/CN.9/74 and annex I Volume IV: 1973 Part two, IV, 1 137
A/CN.9/76 and Add.1 Volume IV: 1973 Part two, IV, 4 and 5 159,200
A/CN.9/77 Volume IV: 1973 Part two, II, 1 101
A/CN.9/78 Volume IV: 1973 Part two, I, B 80
A/CN.9/82 Volume IV: 1973 Part two, V 217
A/CN.9/86 Volume V: 1974 Part two, I, 1 97
A/CN.9/87 Volume V: 1974 Part two, I, 1 29
A/CN.9/88 and Add.1 Volume V: 1974 Part two, III, 1 and 2 113
A/CN.9/91 Volume V: 1974 Part two, IV 191
A/CN.9/96 and Add.1 Volume VI: 1975 Part two, IV, 1 and 2 187
A/CN.9/98 Volume VI: 1975 Part two, I, 6 114
A/CN.9/99 Volume VI: 1975 Part two, I, 1 121
A/CN.9/100, annex I-IV Volume VI: 1975 Part two, I, 1-5 49
A/CN.9/101 and Add.1 Volume VI: 1975 Part two, II, 3 and 4 137
A/CN.9/102 Volume VI: 1975 Part two, II, 5 159
A/CN.9/103 Volume VI: 1975 Part two, V 255
<table>
<thead>
<tr>
<th>Document symbol</th>
<th>Volume, year</th>
<th>Part, chapter</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>A/CN.9/104</td>
<td>Volume VI: 1975</td>
<td>Part two, VI</td>
<td>273</td>
</tr>
<tr>
<td>A/CN.9/105</td>
<td>Volume VI: 1975</td>
<td>Part two, IV, 3</td>
<td>222</td>
</tr>
<tr>
<td>A/CN.9/106</td>
<td>Volume VI: 1975</td>
<td>Part two, IV, 4</td>
<td>246</td>
</tr>
<tr>
<td>A/CN.9/107</td>
<td>Volume VI: 1975</td>
<td>Part two, VIII</td>
<td>283</td>
</tr>
<tr>
<td>A/CN.9/137</td>
<td>Volume VIII: 1977</td>
<td>Part two, V</td>
<td>289</td>
</tr>
<tr>
<td>A/CN.9/139</td>
<td>Volume VIII: 1977</td>
<td>Part two, IV, B</td>
<td>269</td>
</tr>
<tr>
<td>A/CN.9/143</td>
<td>Volume IX: 1978</td>
<td>Part two, I, C</td>
<td>105</td>
</tr>
<tr>
<td>A/CN.9/159</td>
<td>Volume X: 1979</td>
<td>Part two, I, A</td>
<td>37</td>
</tr>
<tr>
<td>A/CN.9/161</td>
<td>Volume X: 1979</td>
<td>Part two, I, C</td>
<td>40</td>
</tr>
<tr>
<td>A/CN.9/163</td>
<td>Volume X: 1979</td>
<td>Part two, II, B</td>
<td>78</td>
</tr>
<tr>
<td>A/CN.9/164</td>
<td>Volume X: 1979</td>
<td>Part two, I, D</td>
<td>48</td>
</tr>
<tr>
<td>A/CN.9/166</td>
<td>Volume X: 1979</td>
<td>Part two, III, A</td>
<td>89</td>
</tr>
<tr>
<td>A/CN.9/168</td>
<td>Volume X: 1979</td>
<td>Part two, III, C</td>
<td>100</td>
</tr>
<tr>
<td>A/CN.9/171</td>
<td>Volume X: 1979</td>
<td>Part two, IV</td>
<td>113</td>
</tr>
<tr>
<td>A/CN.9/172</td>
<td>Volume X: 1979</td>
<td>Part two, V</td>
<td>123</td>
</tr>
<tr>
<td>A/CN.9/175</td>
<td>Volume X: 1979</td>
<td>Part two, VI</td>
<td>131</td>
</tr>
<tr>
<td>A/CN.9/180</td>
<td>Volume XI: 1980</td>
<td>Part two, IV, B</td>
<td>100</td>
</tr>
<tr>
<td>A/CN.9/189</td>
<td>Volume XI: 1980</td>
<td>Part two, IV, D</td>
<td>114</td>
</tr>
<tr>
<td>A/CN.9/192 and Add.1 and 2</td>
<td>Volume XI: 1980</td>
<td>Part two, VI</td>
<td>137</td>
</tr>
<tr>
<td>Document symbol</td>
<td>Volume, year</td>
<td>Part, chapter</td>
<td>Page</td>
</tr>
<tr>
<td>-----------------</td>
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<td>------</td>
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<tr>
<td>A/CN.9/199</td>
<td>Volume XII: 1981</td>
<td>Part two, II, B</td>
<td>70</td>
</tr>
<tr>
<td>A/CN.9/200</td>
<td>Volume XII: 1981</td>
<td>Part two, II, C</td>
<td>70</td>
</tr>
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<td>A/CN.9/201</td>
<td>Volume XII: 1981</td>
<td>Part two, I, C</td>
<td>46</td>
</tr>
<tr>
<td>A/CN.9/204</td>
<td>Volume XII: 1981</td>
<td>Part two, VIII</td>
<td>263</td>
</tr>
<tr>
<td>A/CN.9/207</td>
<td>Volume XII: 1981</td>
<td>Part two, III</td>
<td>75</td>
</tr>
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<td>A/CN.9/225</td>
<td>Volume XII: 1982</td>
<td>Part two, VI, B</td>
<td>397</td>
</tr>
<tr>
<td>A/CN.9/226</td>
<td>Volume XII: 1982</td>
<td>Part two, VI, A</td>
<td>397</td>
</tr>
<tr>
<td>A/CN.9/229</td>
<td>Volume XIII: 1982</td>
<td>Part two, VI, C</td>
<td>409</td>
</tr>
<tr>
<td>A/CN.9/233</td>
<td>Volume XIV: 1983</td>
<td>Part two, III, C</td>
<td>60</td>
</tr>
<tr>
<td>A/CN.9/234</td>
<td>Volume XIV: 1983</td>
<td>Part two, IV, A</td>
<td>95</td>
</tr>
<tr>
<td>A/CN.9/240</td>
<td>Volume XIV: 1983</td>
<td>Part two, VI</td>
<td>189</td>
</tr>
<tr>
<td>A/CN.9/246 and annex</td>
<td>Volume XV: 1984</td>
<td>Part two, II, B, 1 and 2</td>
<td>189</td>
</tr>
<tr>
<td>A/CN.9/256</td>
<td>Volume XV: 1984</td>
<td>Part two, VII</td>
<td>335</td>
</tr>
<tr>
<td>A/CN.9/257</td>
<td>Volume XV: 1984</td>
<td>Part two, VI</td>
<td>333</td>
</tr>
<tr>
<td>A/CN.9/259</td>
<td>Volume XVI: 1985</td>
<td>Part two, III, A, 1</td>
<td>199</td>
</tr>
<tr>
<td>A/CN.9/261</td>
<td>Volume XVI: 1985</td>
<td>Part two, II, A</td>
<td>143</td>
</tr>
<tr>
<td>A/CN.9/262</td>
<td>Volume XVI: 1985</td>
<td>Part two, III, B, 1</td>
<td>250</td>
</tr>
<tr>
<td>A/CN.9/264</td>
<td>Volume XVI: 1985</td>
<td>Part two, I, B</td>
<td>104</td>
</tr>
<tr>
<td>A/CN.9/265</td>
<td>Volume XVI: 1985</td>
<td>Part two, V</td>
<td>351</td>
</tr>
<tr>
<td>A/CN.9/266 and Add.1 and 2</td>
<td>Volume XVI: 1985</td>
<td>Part two, II, B</td>
<td>152</td>
</tr>
<tr>
<td>A/CN.9/267</td>
<td>Volume XVI: 1985</td>
<td>Part two, IX</td>
<td>387</td>
</tr>
<tr>
<td>Document symbol</td>
<td>Volume, year</td>
<td>Part, chapter</td>
<td>Page</td>
</tr>
<tr>
<td>-----------------</td>
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<td>------</td>
</tr>
<tr>
<td>A/CN.9/268</td>
<td>Volume XVI: 1985</td>
<td>Part two, III, C</td>
<td>325</td>
</tr>
<tr>
<td>A/CN.9/269</td>
<td>Volume XVI: 1985</td>
<td>Part two, VI</td>
<td>367</td>
</tr>
<tr>
<td>A/CN.9/270</td>
<td>Volume XVI: 1985</td>
<td>Part two, VIII</td>
<td>385</td>
</tr>
<tr>
<td>A/CN.9/271</td>
<td>Volume XVI: 1985</td>
<td>Part two, VII</td>
<td>381</td>
</tr>
<tr>
<td>A/CN.9/280</td>
<td>Volume XVII: 1986</td>
<td>Part two, IV</td>
<td>221</td>
</tr>
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<td>A/CN.9/281</td>
<td>Volume XVII: 1986</td>
<td>Part two, VI</td>
<td>251</td>
</tr>
<tr>
<td>A/CN.9/293</td>
<td>Volume XVII: 1987</td>
<td>Part two, VI</td>
<td>145</td>
</tr>
<tr>
<td>A/CN.9/306</td>
<td>Volume XIX: 1988</td>
<td>Part two, IV</td>
<td>103</td>
</tr>
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<td>A/CN.9/308</td>
<td>Volume XIX: 1988</td>
<td>Part two, V, B</td>
<td>113</td>
</tr>
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<td>A/CN.9/311</td>
<td>Volume XIX: 1988</td>
<td>Part two, VIII</td>
<td>143</td>
</tr>
<tr>
<td>A/CN.9/318</td>
<td>Volume XX: 1989</td>
<td>Part two, I, C</td>
<td>69</td>
</tr>
<tr>
<td>A/CN.9/323</td>
<td>Volume XX: 1989</td>
<td>Part two, VIII</td>
<td>249</td>
</tr>
<tr>
<td>A/CN.9/324</td>
<td>Volume XX: 1989</td>
<td>Part two, VI</td>
<td>217</td>
</tr>
<tr>
<td>A/CN.9/327</td>
<td>Volume XXI: 1990</td>
<td>Part two, I, D</td>
<td>70</td>
</tr>
<tr>
<td>A/CN.9/334</td>
<td>Volume XXI: 1990</td>
<td>Part two, VI</td>
<td>267</td>
</tr>
<tr>
<td>A/CN.9/335</td>
<td>Volume XXI: 1990</td>
<td>Part two, IX</td>
<td>297</td>
</tr>
<tr>
<td>A/CN.9/338</td>
<td>Volume XXI: 1990</td>
<td>Part two, X</td>
<td>304</td>
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<td>Volume, year</td>
<td>Part, chapter</td>
<td>Page</td>
</tr>
<tr>
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<tr>
<td>A/CN.9/351</td>
<td>Volume XXII: 1991</td>
<td>Part two, VI</td>
<td>443</td>
</tr>
<tr>
<td>A/CN.9/375</td>
<td>Volume XXIV: 1993</td>
<td>Part two, I, C</td>
<td>102</td>
</tr>
<tr>
<td>A/CN.9/376 and Add.1 and 2</td>
<td>Volume XXIV: 1993</td>
<td>Part two, I, D</td>
<td>120</td>
</tr>
<tr>
<td>A/CN.9/378 and Add.1 to 5</td>
<td>Volume XXIV: 1993</td>
<td>Part two, IV, A to F</td>
<td>227</td>
</tr>
<tr>
<td>A/CN.9/379</td>
<td>Volume XXIV: 1993</td>
<td>Part two, VII</td>
<td>293</td>
</tr>
<tr>
<td>A/CN.9/384</td>
<td>Volume XXV: 1994</td>
<td>Part two, VI, A</td>
<td>245</td>
</tr>
<tr>
<td>A/CN.9/386</td>
<td>Volume XXV: 1994</td>
<td>Part two, VI, B</td>
<td>251</td>
</tr>
<tr>
<td>A/CN.9/388</td>
<td>Volume XXV: 1994</td>
<td>Part two, II, A</td>
<td>113</td>
</tr>
<tr>
<td>A/CN.9/392</td>
<td>Volume XXV: 1994</td>
<td>Part two, I, C</td>
<td>59</td>
</tr>
<tr>
<td>A/CN.9/396 and Add. 1</td>
<td>Volume XXV: 1994</td>
<td>Part two, IV</td>
<td>211</td>
</tr>
<tr>
<td>A/CN.9/400</td>
<td>Volume XXV: 1994</td>
<td>Part two, X</td>
<td>299</td>
</tr>
<tr>
<td>A/CN.9/401/Add.1</td>
<td>Volume XXV: 1994</td>
<td>Part two, IX, B</td>
<td>294</td>
</tr>
<tr>
<td>A/CN.9/403</td>
<td>Volume XXV: 1994</td>
<td>Part three, II</td>
<td>323</td>
</tr>
<tr>
<td>A/CN.9/408</td>
<td>Volume XXVI: 1995</td>
<td>Part two, I, C</td>
<td>91</td>
</tr>
<tr>
<td>A/CN.9/413</td>
<td>Volume XXVI: 1995</td>
<td>Part two, IV,A</td>
<td>207</td>
</tr>
</tbody>
</table>
6. Documents submitted to Working Groups

(a) Working Group I: Time-limits and Limitation (Prescription)

A/CN.9/WG.1/WP.9 Volume II: 1971 Part two, I, C, 1 74

(b) Working Group II

(i) International Sale of Goods

A/CN.9/WG.2/WP.15/Add.1 Volume V: 1974 Part two, I, 3 60
A/CN.9/WG.2/WP.17/Add.1 Volume V: 1974 Part two, I, 4 65
A/CN.9/WG.2/WP.17/Add.2 Volume V: 1974 Part two, I, 4 65
A/CN.9/WG.2/WP.2 and Add.1 and 2 Volume VI: 1975 Part two, I, 3 70

(ii) International Contract Practices

A/CN.9/WG.II/WP.33 and Add.1 Volume XII: 1981 Part two, I, B, 1 and 2 30
A/CN.9/WG.II/WP.37 Volume XIV: 1983 Part two, III, B, 1 51
A/CN.9/WG.II/WP.40 Volume XIV: 1983 Part two, III, D, 1 78
A/CN.9/WG.II/WP.41 Volume XIV: 1983 Part two, III, D, 2 85
A/CN.9/WG.II/WP.42 Volume XIV: 1983 Part two, III, D, 3 91
A/CN.9/WG.II/WP.44 Volume XV: 1984 Part two, I, A, 2(a) 179
A/CN.9/WG.II/WP.45 Volume XV: 1984 Part two, I, A, 2(b) 183
A/CN.9/WG.II/WP.46 Volume XV: 1984 Part two, I, A, 2(c) 187
A/CN.9/WG.II/WP.48 Volume XV: 1984 Part two, I, B, 3(a) 218
A/CN.9/WG.II/WP.49 Volume XV: 1984 Part two, I, B, 3(b) 227
(c) Working Group III: International Legislation on Shipping

A/CN.9/WG.III/WP.6 Volume IV: 1973 Part two, IV, 2 146
A/CN.9/WG.III/WP.7 Volume IV: 1973 Part two, IV, 3 155

(d) Working Group IV

(i) International Negotiable Instruments

A/CN.9/WG.IV/WP.2 Volume IV: 1973 Part two, II, 2 117
A/CN.9/WG.IV/CRP.5 Volume VI: 1975 Part two, II, 2 136
A/CN.9/WG.IV/WP.21 Volume XIII: 1982 Part two, II, A, 2(a)  72
A/CN.9/WG.IV/WP.22 Volume XIII: 1982 Part two, II, A, 2(b)  77
A/CN.9/WG.IV/WP.23 Volume XIII: 1982 Part two, II, A, 2(c)  80
A/CN.9/WG.IV/WP.25 and Add.1 Volume XIII: 1982 Part two, II, A, 2(g,h)  98
A/CN.9/WG.IV/WP.27 Volume XIII: 1982 Part two, II, B, 2 262
A/CN.9/WG.IV/WP.32 and Add.1-10 Volume XVIII: 1987 Part two, I, 2  66

(ii) International Payments

A/CN.9/WG.IV/WP.37 Volume XX: 1989 Part two, I, B  56
A/CN.9/WG.IV/WP.41 Volume XXI: 1990 Part two, I, B  42
A/CN.9/WG.IV/WP.42 Volume XXI: 1990 Part two, I, C  60
A/CN.9/WG.IV/WP.44 Volume XXI: 1990 Part two, I, E  90
A/CN.9/WG.IV/WP.47 Volume XXII: 1991 Part two, I, D, 2 193
A/CN.9/WG.IV/WP.51 Volume XXIII: 1992 Part two, II, B  47

(iii) Electronic Commerce

A/CN.9/WG.IV/WP.55 Volume XXIV: 1993 Part two, III, B  208
### Annexes

The annexes include documents related to various topics such as international economic order, cross-border insolvency, and summary records of discussions in the Commission. Each entry provides the document symbol, volume, year, part, chapter, and page number.

#### Working Group V: New International Economic Order


#### Cross-Border Insolvency


### Summary Records of discussions in the Commission

The summary records include documents such as Volume III: 1972 Supplement 1.

8. Texts adopted by Conferences of Plenipotentiaries

<table>
<thead>
<tr>
<th>Document symbol</th>
<th>Volume, year</th>
<th>Part, chapter</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>A/CONF.63/15</td>
<td>Volume V: 1974</td>
<td>Part three, I, B</td>
<td>210</td>
</tr>
<tr>
<td>A/CONF.63/17</td>
<td>Volume X: 1979</td>
<td>Part three, I</td>
<td>145</td>
</tr>
<tr>
<td>A/CONF.152/13</td>
<td>Volume XXIII: 1992</td>
<td>Part three, I</td>
<td>405</td>
</tr>
</tbody>
</table>

9. Bibliographies of writings relating to the work of the Commission

<table>
<thead>
<tr>
<th>Document symbol</th>
<th>Volume, year</th>
<th>Part, chapter</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>A/CN.9/L.20/Add.1</td>
<td>Volume II: 1971</td>
<td>Part two</td>
<td>143</td>
</tr>
<tr>
<td>(no document symbol)</td>
<td>Volume II: 1972</td>
<td>Part two</td>
<td>148</td>
</tr>
<tr>
<td>(no document symbol)</td>
<td>Volume III: 1972</td>
<td>Part two</td>
<td>311</td>
</tr>
<tr>
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<td>Volume IV: 1973</td>
<td>Part two</td>
<td>229</td>
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<td>Volume V: 1974</td>
<td>Part three, II, B</td>
<td>242</td>
</tr>
<tr>
<td>(no document symbol)</td>
<td>Volume VI: 1975</td>
<td>Part three, II, A</td>
<td>298</td>
</tr>
<tr>
<td>(no document symbol)</td>
<td>Volume VIII: 1977</td>
<td>Part three, A</td>
<td>311</td>
</tr>
<tr>
<td>(no document symbol)</td>
<td>Volume IX: 1978</td>
<td>Part three, II</td>
<td>219</td>
</tr>
<tr>
<td>(no document symbol)</td>
<td>Volume X: 1979</td>
<td>Part three, II</td>
<td>174</td>
</tr>
<tr>
<td>(no document symbol)</td>
<td>Volume XI: 1980</td>
<td>Part three, IV</td>
<td>168</td>
</tr>
<tr>
<td>(no document symbol)</td>
<td>Volume XII: 1981</td>
<td>Part three, III</td>
<td>271</td>
</tr>
<tr>
<td>(no document symbol)</td>
<td>Volume XIII: 1982</td>
<td>Part three, IV</td>
<td>426</td>
</tr>
<tr>
<td>(no document symbol)</td>
<td>Volume XIV: 1983</td>
<td>Part three, IV</td>
<td>276</td>
</tr>
<tr>
<td>(no document symbol)</td>
<td>Volume XV: 1984</td>
<td>Part three, II</td>
<td>378</td>
</tr>
<tr>
<td>A/CN.9/284</td>
<td>Volume XVI: 1985</td>
<td>Part three, III</td>
<td>511</td>
</tr>
<tr>
<td>A/CN.9/313</td>
<td>Volume XVIII: 1987</td>
<td>Part three, III</td>
<td>191</td>
</tr>
<tr>
<td>A/CN.9/382</td>
<td>Volume XXIII: 1992</td>
<td>Part three, V</td>
<td>469</td>
</tr>
<tr>
<td>A/CN.9/402</td>
<td>Volume XXIV: 1993</td>
<td>Part three, IV</td>
<td>415</td>
</tr>
<tr>
<td>A/CN.9/417</td>
<td>Volume XXV: 1994</td>
<td>Part three, IV</td>
<td>421</td>
</tr>
<tr>
<td>A/CN.9/429</td>
<td>Volume XXVI: 1995</td>
<td>Part three, IV</td>
<td>375</td>
</tr>
<tr>
<td>A/CN.9/452</td>
<td>Volume XXVIII: 1997</td>
<td>Part three, IV</td>
<td>419</td>
</tr>
</tbody>
</table>
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