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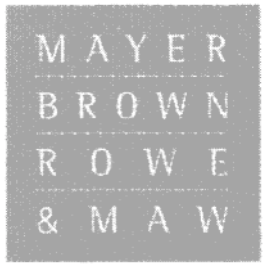

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Assessment of Damages Under the Australian Trade Practices Act

Peter Gillies[1]

Introduction

The Trade Practices Act provides for recovery of damages[2] by persons in defined cases of contravention of the Act. Sections 82 and 87 are the core provisions.

Section 82 provides that a 'person who suffers loss or damage by conduct of another person that was done in contravention of a provision of Parts IV, IVB or V or s 51 AC may recover the amount of loss or damage by action against that other person or against any person involved in the contravention'.

Section 87 provides for the recovery of damages by a person who 'has suffered, or is likely to suffer, loss or damage by conduct of another person that was in contravention of a provision' in one or more of the stipulated Parts in the Act (see sub-ss (1), (1A), (1B) and (2)). (Section 87 also provides for the making of such other remedial orders, as the court considers appropriate.) The compensation to be awarded to 'the person who suffered the loss or damage' is equivalent to 'the amount of the loss or damage' (s 87(2)(d)). This language parallels that used in s 82. Section 87 has rarely been used to ground an award of damages.[3]

As has often been observed, s 82 (parallelling the common law) requires proof that the defendant has caused actual damage (although this need not be economic in nature),[4] while s 87 is satisfied with proof of causation either of actual damage or the likelihood of damage.[5]

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1 Professor of Law, Division of Law, Macquarie University, Sydney.

2 See Atkin, LJW, '"Loss or damage" under section 82 of the Trade Practices Act' (1989) 1 Bond Law Review 1, 107; D Skapinker, "'Other remedies" under the Trade Practices Act—the rise and rise of section 87' (1995) 21 Monash Law Review 188.

3 *I & L Securities Pty Ltd v HTW Valuers (Brisbane) Pty Ltd* (2000) ATPR 41–779 at 41–203 (McPherson, Pincus and Thomas JJA, Moynihan SJA and Atkinson J, noting that the section has only been resorted to in order to ground pecuniary payments on two occasions, including in this case).

4 See *Nixon v Slater and Gordon* (2000) ATPR 41–765 at 41–012 (Merkel J, in a case where ss 52 and 82 were used to ground damages for misleading and deceptive conduct causing damage to reputation).

5 *Wardley Australia Ltd v WA* (1992) 175 CLR 514 at 527, 545, 551; *Sellars v Adelaide Petroleum NL* (1994) 179 CLR 332 at 349; *C-Shirt Pty Ltd v Barnett Marketing and Management Pty Ltd* (1997) ATPR (Digest) 46–172 at 54–381; *Tantipech v IOOF Australia Trustees (NSW) Ltd* (1998) ATPR

Two issues raised by these provisions will be examined—causation of loss or damage, and assessment of damages.

Causation of loss or damage

Overview

Both ss 82 and 87 vest an entitlement to damages in the party who has suffered loss or damage (or, additionally in the case of s 87, who is likely to suffer loss or damage) 'by conduct of another person' that contravened a provision in the Act. The word 'by' (which is 'a curious word to use') imports a requirement that the defendant's conduct has caused the loss or damage complained of.[6] This concept of causation is not defined in the Act, but it may be viewed as 'taking up the common law practical or commonsense concept of causation' endorsed in the High Court's decision in *March v E & MH Stramare Pty Ltd,*[7] except to the extent that it is modified or supplemented by provisions in the Act.[8]

The *March* concept of causation will be commented on immediately below. Its application in the context of ss 82 and 87 raises a number of issues. An obvious one is whether the older causation principles have a role in determining ss 82 and 87 issues of causation.

The March v Stramare concept of causation

The courts have long sought to limit criminal and civil liability at the level of causation, recognising that an expansive concept of causation—one attributing causation too readily—will make liability too expansive. Thus, it has been remarked that the legal concept of causation differs from those concepts of causation encountered in such disciplines as science and philosophy because, at the end of the day, legal causation is 'primarily about attributing responsibility'.[9]

The leading High Court decision on the concept of causation is *March v E & MH Stramare Pty Ltd,*[10] which was a torts case. The concept is easily stated: in

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41–614; *Marks v GIO Australia Holdings Ltd* (1998) 196 CLR 494 at 509, 513, 545; *Callings Construction Co Pty Ltd v Australian Competition and Consumer Commission* (1998) 152 ALR 510 at 522, 532ff.

6 *Wardley Australia Ltd v Western Australia* (1992) 175 CLR 514 at 525 (Mason CJ, Dawson, Gaudron and McHugh JJ).

7 (1991) 171 CLR 506.

8 *Wardley Australia Ltd v Western Australia* (1992) 175 CLR 514 at 525.

9 *Rosenberg v Percival* (2000) 178 ALR 577 at 596.

10 (1991) 171 CLR 506.

most cases the determination of whether event A caused event B to occur is 'one of fact and, as such, to be resolved by the application of commonsense'.[11] This broad concept of the process of determining an issue of causation has been discussed or approved on numerous occasions since.[12] Most of these decisions have dealt with causation in the torts context, but they do not in terms limit their remarks on this topic to torts.

The *March* formula grapples with the inherent difficulties of trying to resolve issues of causation by resort to more refined formulas, such as the *causa sine qua non* test. In the words of McHugh J, the courts should no longer 'sanction the use of formulas which allow tribunals of fact, under the guise of using commonsense, to determine legal responsibility by applying their own idiosyncratic values'.[13] Of course, an explicit commonsense approach would also permit the court to apply its own idiosyncratic values, but the use of a broader test will at least have the virtue of making the approach more transparent, by emphasising that the determination of causation is an almost purely factual exercise, subject to the broadest of legal guidelines, namely that the determination of causation is a matter of practical commonsense, and that it is to be determined objectively and not subjectively in most (but not all)[14] cases.

Does acceptance of the *March* approach to causation make the older formulas redundant? These include the *causa sine qua non,* or 'but for' test, the notion of the *novus actus interveniens* and its associated metaphor of the ruptured causal chain, and foreseeability. Does *March* displace the more intricate doctrines associated with causation in contract and tort?

The traditional test of causation in contract, entrenched in *Hadley v Baxendale*[15] (that is, that the defendant is liable for those losses which arise naturally in the usual course, or which on an objective view were within the reasonable contemplation of the parties at the time of contracting as the probable outcome of breach), has survived *March*.[16]

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11 *Ibid* at 515, *per* Mason CJ. Similarly, see the comments of Deane J at 523, Toohey J at 525 and McHugh J at 533.

12 *Medlin v State Government Insurance Commission* (1995) 182 CLR 1; *Marks v GIO Australia Holdings Ltd* (1998) 196 CLR 494 at 512; *Chappel v Hart* (1998) 195 CLR 232 at 243–55, 268–69.

13 *March v E & MH Stramare Pty Ltd* (1991) 171 CLR 506 at 533.

14 Where a patient alleges that he or she suffered avoidable injury resulting from a medical procedure because he or she was not warned by the doctor or dentist of the risks inherent in the procedure, the test of whether the patient would have undergone the treatment had the warning been given is a subjective and not an objective one, ie, the question is whether the particular patient would have proceeded notwithstanding the warning: see *Rogers v Whitaker* (1992) 175 CLR 479; *Rosenberg v Percival* (2000) 178 ALR 577 at 582 (McHugh J), 597 (Gummow J), 616 (Kirby J).

15 (1854) 9 Ex 341.

16 Such is assumed in, eg, *Kenny & Good Pty Ltd v MGICA (1992) Ltd* (1999) 163 ALR 611 at 623, 626 (McHugh J).

The 'reasonable foresight' test approved in the torts context in *The Wagon Mound (No 1)* and *(No 2),*[17] pursuant to which loss or damage is caused by a tortious act provided that its occurrence was, on an objective view, reasonably foreseeable as a possible consequence of this act, has been modified. 'Reasonable foresight' is no longer a test of causation; rather, it merely 'marks the limits beyond which a wrongdoer will not be held responsible for damage resulting from his wrongful act'.[18] In these terms, the 'reasonable foresight test is not an exclusive test—at best it is a negative test of causation. It cannot by itself establish causation, but where causation is otherwise *prima facie* established, it can exclude it. In this tangential way, it operates to make the distinction between direct consequences, which are attributable to the contravening conduct in question, and the remote consequences, which are not.[19]

The 'but for' test is presently viewed by the courts as not being a comprehensive or exclusive test.[20] It is, however, useful if applied in a commonsense way,[21] and it can operate as an important negative criterion, but not as an exclusive test.[22] One obvious problem is that where there are two or more causal events operating, each of them sufficient to cause the loss, the 'but for' test logically operates to exclude each as a legal cause.[23]

The concept of *novus actus interveniens* can also be of use in evaluating causation, but likewise it can operate anomalously. In particular, it will often be unclear as to whether the first act has been rendered causally ineffective by the new act, or whether the first act continues to operate as an effective concurrent cause. The *novus actus* criterion, that is, cannot reliably yield sensible outcomes on a consistent basis.[24]

The present state of the law of causation, certainly in the torts context, is that the *March* commonsense analysis governs the determination of legal causation,

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17 *Overseas Tankship (UK) Ltd v Morts Dock and Engineering Co Ltd* [1961] AC 388; *Overseas Tankship (UK) Ltd v The Miller Steamship Co Pty Ltd* [1967] 1 AC 617.

18 See Mason CJ in *March v E & MH Stramare Pty Ltd* (1991) 171 CLR 506 at 510, citing *Chapman v Hearse* (1961) 106 CLR 112 at 122 and *Mahoney v J Kuschich (Demolitions) Pty Ltd* (1985) 156 CLR 522 at 528 (not an exclusive test of causation). Likewise, see *March v E & MH Stramare Pty Ltd* (1991) 171 CLR 506 at 524 (Toohey J), 525 (Gaudron J) and 534 (McHugh J).

19 That reasonable foresight still has a role is reflected in comments by Kirby and Callinan JJ in the post-*March* decision of *Kenny & Good Pty Ltd v MGICA (1992) Ltd* (1999) 163 ALR 611 at 645, deciding that the defendant was liable for a loss which was 'readily foreseeable'.

20 *March v E & MH Stramare Pty Ltd* (1991) 171 CLR 506 at 522 (Deane J); *Medlin v State Government Insurance Commission* (1995) 182 CLR 1; *Marks v GIO Australia Holdings Ltd* (1998) 196 CLR 494 at 512 (McHugh, Hayne and Callinan JJ); *Chappel v Hart* (1998) 195 CLR 232 at 255 (Gummow J), 269 (Kirby J), 283 (Hayne J); *Kenny, ibid* at 618 (Gaudron J).

21 *March v E & MH Stramare Pty Ltd* (1991) 171 CLR 506 at 533 (McHugh J).

22 See the comments in *March v E & MH Stramare Pty Ltd* (1991) 171 CLR 506 at 522 (Deane J); *Medlin v State Government Insurance Commission* (1995) 182 CLR 1; *Chappel v Hart* (1998) 195 CLR 232 at 283 (Hayne J).

23 *March v E & M H Stramare Pty Ltd* (1991) 171 CLR 506 at 516 (Mason CJ), 523 (Deane J).

24 See *March v E & MH Stramare Pty Ltd* (1991) 171 CLR 506 at 531, 535 (McHugh J, noting that it is a rule of policy and not a test; and that its application involves a value judgment).

with the older, familiar tests now relegated to the status of guidelines (to the extent that they were ever more than this)—not comprehensive tests but, at best, *prima facie* negative tests.

Given the comprehensive tenor of the *March* formula, the distinction between 'direct' and 'remote' outcomes—with the latter not being within the province of events caused in law—is no more or less relevant than hitherto. It never was, of course, a legal test of causation; rather, it does no more than raise the question of where the boundaries of legal causation end.

Does the March analysis apply to the issues of causation of loss or damage for the purposes of the Trade Practices Act?

To judge from the cases, issues of causation in the ss 82 and 87 context arise infrequently. The High Court in *Wardley Australia Ltd v Western Australia*[25] *expressed prima facie* support for the application of the *March* concept of legal causation to s 82(1), 'except to the extent [it] is modified or supplemented expressly or impliedly by the provisions of the Act'.[26] It was not necessary to resolve the issue in *Wardley*. In *Marks v GIO Australia Holdings Ltd,*[27] members of the High Court noted in an *obiter* comment that the 'but for' test of causation had been found wanting in other contexts (citing *March*), and that 'it may well be that it is not an exclusive test of causation' in the context of a claim for damages under s 52 in conjunction with s 82.[28]

Logically, the *March* analysis does apply to the determination of issues of causation in the ss 82 and 87 context. The fondamental premise of the *March* analysis is that causation cannot be resolved by a specific and conclusive formula; instead, determination is a factual and discretionary process involving practical commonsense. Exactly the same considerations apply to the determination of causation for the purposes of a statutory remedy.

A practical instance of resolving an issue of causation for the purposes of s 82 is encountered in *Marks v GIO Australia Holdings Ltd.* The High Court held that where borrowers were induced to enter into a loan contract after a misrepresentation as to future changes in the applicable interest rate, they suffered no loss in law (that is, none was caused), given that the proven circumstances were such that they would have borrowed the money in any event, and that they would not have been able to enter into an alternative agreement that was more favourable. As has just been noted, several members of the court commented on the limitations of the 'but for' test as a conclusive test. They did not resolve the instant issue of causation by reference to it,

25 (1992) 175 CLR 514.
26 *Ibid* at 525 (Mason CJ, Dawson, Gaudron and McHugh JJ).
27 (1998) 196 CLR 494.
28 *Ibid* at 513.

although had they done so the outcome would have been the same. Instead, their reasoning was consistent with the broader *March* analysis: causation was to be assessed objectively, not by reference to the hopes or expectations of a party. The fact that a misled party (as here) may have thought that it was to obtain some advantage from the transaction was not relevant, in a case where the 'contravening conduct has left the party…no worse off than it was before the contravention occurred'.[29] In this case, the misled parties had 'suffered and will suffer no loss or damage as a result of the misleading and deceptive conduct', with the result that no order could be made under ss 82 or 87.[30]

Traditional common law tests of causation (such as that applied in contracts by *Hadley v Baxendale*) have excluded consequential losses which are beyond reasonable foresight. Are losses of his type causally significant for the purposes of ss 82 and 87, and thus compensable? The question is particularly pertinent given that the most litigated provision in the Act, that is, s 52, imposes strict liability. The *March* commonsense principle may be relied upon, but there may well be a continuing explicit role for the application of the 'reasonable foresight' test as a negative, rather than a comprehensive or inclusive test of causation.[31]

Other aspects of causation

Concurrent causes

At common law, it is well established that the defendant's act does not have to be the sole cause of the loss complained of. If it is a material, although concurrent cause, and it otherwise fulfils the legal requirements of causation, it is legally sufficient. There is no reason why an issue of concurrent causation for the purposes of ss 82 and 87 should be different; a proposition recognised in the cases. The formulations differ as they do in the common law authorities: a concurrent cause is a legally sufficient cause provided that it is a 'real, essential and substantial' cause of the loss (the restrictive test), or perhaps it is sufficient if it plays some part, even if only a minor part, in contributing to the loss (the expansive test);[32] it is a sufficient cause provided

29 *Ibid* at 514, 515 (McHugh, Hayne and Callinan JJ).

30 *Ibid* at 516.

31 Note the comment in *Wardley Australia Ltd v Western Australia* (1992) 175 CLR 514 at 526, *per* Mason CJ, Dawson, Gaudron and McHugh JJ, raising the issue of whether the condition of foreseeability applicable to claims for consequential damages for negligent misrepresentations inducing the purchase of property, is applicable to a claim for consequential damage under s 82(1). They did not consider that it was necessary to resolve it on this occasion. If s 52 was relied upon to ground a claim for damages in a case where a defendant was alleged to have caused a loss by negligently inducing the plaintiff to enter into a contract for purchase, the common law requirement of reasonable foresight that governs determination of whether a duty of care existed in the first place would not govern application of s 52, given that the provision imposes strict liability.

32 See *Australian Protective Electronics Pty Ltd v Pabflow Pty Ltd* (1996) ATPR 41–524 at 42–737 (Parker J), and note the cases cited there.

that it had some substantial rather than negligible effect;[33] or it is sufficient if it was a real and effective cause.[34]

Can the plaintiff's own conduct rupture the causal chain?

On the assumption that a causal link between the defendant's conduct and the plaintiff's loss or damage can otherwise be established, can the plaintiff's conduct—most obviously, his or her failure to protect his or her own interests—have the consequence that the causal does not exist in law? To employ the familiar (if non-technical) metaphor—is the causal chain ruptured?

In practice, the issue arises in situations of misrepresentation which induces a party to act in such a way that a financial loss is suffered, as in the classic s 52 case of a misrepresentation inducing purchase. In an extreme case, where the misrepresentee knows that the representation is false, or learns of its falsity before contracting, the situation is not one of operative misrepresentation, and the causal link is not present even *prima facie*. The more problematic case is one where, perhaps, the misepresentee is negligent in protecting his or her interests.

In this latter class of case, the authorities support the proposition that in an extreme case the misrepresentee's lack of care may rupture the causal chain; but the hurdle for the plaintiff is very high. On one formulation, if the facts are that 'an applicant is so negligent in protecting his own interests', with the result that a proper view is that 'the representation complained of was not in the circumstances a real inducement to his entering into a contract', then 'the element of causation between the misrepresentation and damage will have been severed by the intervention of the negligence of the applicant'.[35] Similar sentiments are found in other cases in this context.[36] In none of them was the plaintiff's alleged negligence sufficient to destroy any causal link otherwise apparent. In *Campomar Sociedad, Limitada v Nike International Ltd,*[37] a Full Bench of the High Court confirmed that there was no general proposition of law that 'intervention of an erroneous assumption between conduct and any misconception destroys a necessary chain of causation with the consequence that the conduct itself cannot properly be described as misleading or deceptive or as being likely to mislead or deceive'.[38] The case involved a claim of passing off and s 52, it being alleged that the defendant had used a trade mark

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33 *Como Investments Pty Ltd (In Liq) v Yenald Nominees Pty Ltd* (1977) ATPR 41–550 at 43–619 (Burchett, Ryan and RD Nicholson JJ).

34 *Embo Holdings Pty Ltd v Camm* (1998) ATPR (Digest) 46–184 at 50–333 (Millane JR).

35 *Argy v Blunts & Lane Cove Real Estate* (1990) ATPR 41–015 at 51–281 (Hill J).

36 *O'Hara v Williams* (1996) ATPR (Digest) 46–156 at 53–322; *Embo Holdings Pty Ltd v Camm* (1998) ATPR (Digest) 46–184 at 50–333 (Millane JR); *Hill v Tooth & Co Ltd* (1998) ATPR 41–649 at 41–219. *Pavich v Bobra Nominees Pty Ltd* (1988) ATPR (Digest) 46–039; and see *Henville v Walker* (2001) 206 CLR 459.

37 (2000)169 ALR 677.

38 *Ibid* at 705, citing *Taco Co of Australia Inc v Taco Bell Pty Ltd* (1982) 42 ALR 177 at 352 (Deane and Fitzgerald JJ).

in marketing goods with the consequence that the prospective purchasers of the defendant's goods had been misled into thinking that the goods were manufactured and marketed by the applicant. One of the issues raised was the familiar one of what test of believability was to be applied in a fact situation where s 52 was relied upon to ground liability where the target of misleading conduct was a class of consumers. Is it sufficient for liability that unreasonably gullible members of the class would have been misled, or is the test more robust? The formulas tend to revolve around notions of the ordinary, or reasonable, members of the class. This is reflected in a passage in *Campomar,* one which also recognises that in very unusual cases extreme credulity (and by implication, gross negligence in failing to protect one's interests) may destroy an otherwise extant causal link:

> …in an assessment of the reactions or likely reactions of the 'ordinary' or 'reasonable' members of the class of prospective purchasers of a mass-marketed product for general use, such as athletic sportswear or perfumery products, the court may well decline to regard as controlling an application of s 52 those assumptions which are extreme or fanciful.[39]

(In the instant case, the court held the trial judge was not wrong in finding that the conduct in question was misleading.)

The passage deals with the assessment of the reactions of a class of consumers; but it is consistent with earlier authority that when the misleading conduct targets an individual or a smaller group in the context of a specific transaction, an extreme or fanciful reaction from the target—such as might happen where the latter is grossly neglectful of his or her own interests—can dissipate a *prima facie* causal link. The conclusion that this has happened will rarely be drawn, as the history of litigation in the ss 52, 82 class of case makes clear. This is because these provisions reflect a public interest in preventing misleading and deceptive conduct in trade or commerce.[40] Thus in the average case, attributing 'a certain level of rashness or carelessness' to an applicant will not dispel a finding of causation where the facts clearly show a 'sufficient nexus between the misleading and deceptive conduct and damage' to establish liability under s 52 and damages under ss 82 or 87.[41]

As a consideration of this class of cases reflects, issues of causation for the purposes of s 52 and s 82 (and s 87) respectively, tend to merge. In theory they are separate: where s 52 is concerned, the issue is whether the misleading or deceptive conduct (or conduct likely to mislead or deceive) caused the person targeted to act in error, while the s 82 causation issue is whether there is a causal link between the target's acting in error and the loss or damage complained of. In practice, in the normal case the issue will be whether there is

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39 *Ibid* at 705.
40 See the comment by Einfeld J in *Hill v Tooth & Co Ltd* (1998) ATPR 41–649 at 41–219.
41 *Ibid.*

a causal link between the misleading conduct and the loss or damage complained of, an inquiry which will examine the factual continuum between these events. Whether the issues of causation are examined in two consecutive stages, or as one overarching stage, will normally make no difference: '…the ultimate issue is one of causation of loss or damage and the outcome should be the same.'[42]

Assessment of damages

Overview

Section 82, it has been noted, grounds damages only where a person has suffered loss or damage, that is, actual loss or damage, although this damage or loss need not be economic in nature.[43] A person can also seek damages under s 87 for either loss or damage, or where loss or damage is a likely outcome of the defendant's breach of the Act. As noted, damages have rarely been awarded under s 87;[44] rather, the section is normally relied upon to ground some other remedy.

Where a person who is merely exposed to the likelihood of loss or damage seeks damages under s 87, the provision is silent as to any broad principle of assessment (in contrast to s 87(2)(d), which provides for damages equal to the amount of an actual loss). In principle, damages can be sought for the likelihood of loss, but s 87 perhaps contemplates that in such an event some other remedy will be sought, such as an order voiding a contract, in whole or part (sub-s (2)(a)), or an order varying a contract or arrangement (sub-s (2)(b)), and so on (the list of possible orders in sub-s (2) is non-exhaustive).[45]

In an appropriate case, the court can make orders under both ss 82 and 87, if this is needed.[46] Or a court can make an order under s 87 in preference to s 82, even one for damages, where this is required in the interests of justice (see p 17, below).

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42 *Australian Protective Electronics Pty Ltd v Pabflow Pty Ltd* (1996) ATPR 41–524 at 42–736 (Parker J).

43 *Nixon v Slater and Gordon* (2000) ATPR 41–765 at 41–013 (damages awarded under s 82 in respect of a contravention of s 52 causing damage to reputation).

44 *I & L Securities Pty Ltd v HTW Valuers (Brisbane) Pty Ltd* (2000) ATPR 41–779 at 41–203.

45 See the discussion in *Collings Construction Co Pty Ltd v ACCC* (1998) 152 ALR 510 at 520ff, and the authorities cited there, while noting that these comments now need to be read in light of *Marks v GIO Australia Holdings Ltd* (1998) 196 CLR 494 (which holds that in assessing damages under ss 82 and 87, the court is not bound to reason by analogy with one or another of the common law damages assessment regimes applying in contracts and torts).

46 *Marks v GIO Australia Holdings Ltd, ibid, per* Kirby J, noting that such is made clear by s 87(1); *Tantipech v IOOF Australia Trustees (NSW) Ltd* (1998) ATPR 41–614 at 40–741 (damages coupled with order relieving from liability under a lease); *Moorna Constructions (NSW) Pty Ltd v Denmatu Pty Ltd* (1998) ATPR 41–616 (damages under s 82 coupled with order for rescission of lease under s 87).

A person who loses an opportunity for commercial benefit in consequence of another's contravention of the Act can get damages under s 82, but, as it will be seen below, this does not involve recovery for a likely loss—the lost opportunity must have an actual value.

Principles of assessment—does the common law guide assessment?

Where loss or damage is suffered the award of damages is the sum needed to compensate for 'the amount of the loss or damage' (ss 82, 87(2)(d)). A question which arose early in the construction of these broad provisions, was whether common law principles afforded a guide to the task of damages assessment pursuant to this statutory formulation. For a number of years, the courts proceeded on the basis that the principles of damages assessment applied at common law, principally in the torts context, were to be resorted to in construction of these words, although subject to the qualification that the court was not bound to apply torts principles. A subsidiary issue (if indeed the torts principles are *de facto* to be applied in construing the damages provisions in the Act) has been: is there ever a role for the application of the principles of damages assessment applied in contracts cases?

Most of the reported cases have involved actions for contraventions of s 52, which prohibits corporations in trade or commerce from engaging in conduct that is misleading or deceptive or which is likely to mislead or deceive, in conjunction with the damages provisions in ss 82 and 87.

The preference for resorting to common law principles in applying s 82 was reflected in comments in the High Court's decision in *Gates v City Mutual Life Assurance Society Ltd.*[47] The case involved an unsuccessful claim for, *inter alia,* breach of s 52, by an insured in respect of a statement made by the insurer's agent. According to Gibbs J, actions based on ss 52 and 53 (involving misleading conduct) were analogous to actions in tort; accordingly, damages for breach of either (relying on s 82) were to be assessed by resort to the principles applicable in tort. He added that 'the acts referred to in ss 52 and 53 do not include the breach of a contract, and in awarding damages under s 82 for a breach of either of those sections, no question can arise of damages for loss of a bargain. The contractual measure of damages is therefore inappropriate in such a case'.[48] Mason, Wilson and Dawson JJ noted that in a class of case such as the present one, the court was not bound to make a definitive choice between the contracts and torts measure of damages so that one applied to the exclusion of the other; however, 'there is much to be said for the view that the measure of damages in tort is appropriate in

47 (1986) 160 CLR 1.
48 *Ibid* at 6.

most, if not all, Part V cases, especially those involving misleading or deceptive conduct and the making of false statements. Such conduct is similar both in character and effect to tortious conduct, particularly fraudulent misrepresentation and negligent misstatement'.[49]

These comments were not prescriptive as to approach, it will be noted. They do, however, express a strong preference. Part V of the Trade Practices Act comprehends the consumer provisions, which range well beyond instances of misleading conduct. Most of the provisions target conduct which does not necessarily involve the formation of a contract between complainant and defendant, although equally, fact situations disclosing their contravention may in a particular case have involved the formation of a contract between these parties. In contrast, ss 69ff do envisage contract formation, because they operate to imply stipulated terms into consumer contracts for the sale of goods. Section 74 implies certain warranties into contracts for the supply of services to a consumer.

In its decision of *Wardley Australia Ltd v The State of Western Australia,*[50] which involved a claim for damages for misleading conduct in contravention of s 52, Mason CJ, Dawson, Gaudron and McHugh JJ were of the opinion that where damages for economic loss or damage were sought under s 82, in reliance on a breach of s 52, it was not true that these damages were necessarily to be assessed by reference to the principles applied in cases of deceit or negligent misstatement, viz, torts principles. Where breaches of Parts IV or V were concerned, 'the common law measure of damages will in many cases be an appropriate guide, though it will always be necessary to look at the provisions of the Act with a view to ascertaining the existence of any relevant statutory intention'. In a case such as the present, the damages could be assessed by reference to those applied in a case of deceit. It was unnecessary to express a view as to whether the condition of foreseeability, applicable in a case of negligent misrepresentation inducing the purchase of property, would apply to a claim for consequential damages under s 82(1).[51] Brennan J was of the opinion that a claim for damages pursuant to s 52, in conjunction with s 82 damages, were usually to be assessed by reference to torts principles (those applying in the case of deceit or negligent misrepresentation as appropriate).[52]

As in the case of *Gates,* the non-prescriptive preference in *Wardley* was for the application of the appropriate torts principles in assessing damages, certainly in respect of ss 52 and 82 claims. A similar approach was taken in other

49 *Ibid* at 14.
50 (1992) 175 CLR 514.
51 *Ibid* at 526.
52 *Ibid* at 534.

decisions, most of them involving claims for misleading conduct in contravention of s 52, inducing the purchase of a business or property.[53] In such cases, the standard approach has been that in 'an action for damages for deceit for inducing a person to enter a contract of purchase, which is an action …closely analogous to an action for damages for breach of s 52, the courts have consistently held that the proper measure of damages is the difference between the real value of the thing acquired as at the date of acquisition and the price paid for it'.[54]

In an uncommon application of s 52, damages were awarded for misleading conduct causing injury to reputation. The court held that the damages to be awarded were to be assessed by reference to the principles governing damages assessment for the common law tort of defamation.[55]

The High Court's decision in *Marks v GIO Australia Holdings Pty Ltd*[56] is consistent with the non-prescriptive approach to assessment. The case also involved a claim for damages in reliance on s 52 in conjunction with s 82 (a claim which was unsuccessful, given that causation of damage or loss could not be established). According to Gaudron J, 'there is no basis for thinking that relief under s 82 is to be confined by analogy either with actions in contract or in tort',[57] a view expressed by other members of the court.[58] Nonetheless, the common law could aid in assessing damages for contravention of s 52—'very often the amount of loss or damage caused by contravention of s 52 will coincide with what would have been allowed in an action for deceit'—subject to the qualification that the analogy should not be pressed to the point of permitting recovery for contravention of s 52 only those damages which would be recoverable for deceit.[59]

Cases since *Marks* have been consistent with this approach—assessment of damages payable pursuant to s 82 based on a contravention of s 52 is not constrained by any requirement to follow contracts or torts principles, but nonetheless, 'very often the amount of the loss or damage caused by a contravention of s 52…will coincide with the damages recoverable in an action at common law for deceit'.[60]

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53 *Kizbeau Pty Ltd v WG & B Pty Ltd* (1995) 184 CLR 281 at 290 (apply deceit principles); *Gentry Bros Pty Ltd v Wilson Brown & Associates Pty Ltd* (1996) ATPR 41–460; *O'Hara v Williams* (1996) ATPR (Digest) 46–156 at 53–324 (apply deceit principles); *Australian Protective Electronics Pty Ltd v Pabflow Pty* Ltd (1996) ATPR 41–524 at 42–743; *Embo Holdings Pty Ltd v Camm* (1998) ATPR (Digest) 46–184 at 50–334 (apply deceit principles); *Thompson v Ice Creameries of Australia Pty Ltd* (1998) ATPR 40–673 at 40–704ff.

54 *Kizbeau, ibid* at 291 (Brennan, Deane, Dawson, Gaudron and McHugh JJ).

55 *Nixon v Slater and Gordon* (2000) ATPR 41–765 at 41–013 (Merkel J).

56 (1998) 196 CLR 494.

57 *Ibid* at 503.

58 *Ibid* at 510 (McHugh, Hayne and Callinan JJ), 529 (Gummow J).

59 *Ibid* at 512 (McHugh, Hayne and Callinan JJ).

60 *Kenny & Good Pty Ltd v MGICA (1992) Ltd* (1999) 163 ALR 611 at 646 (Kirby and Callinan JJ); *Radferry Pty Ltd v Starborne Holdings Pty Ltd* (1998) ATPR (Digest) 46–189.

The current judicial orthodoxy may be summarised. Where damages are to be assessed pursuant to s 82, the courts may resort to common law principles of damages assessment as a guide. But the common law analogies are truly only a guide—'a servant not a master'.[61] In particular, where damages are sought for breach of s 52 or one of its cognates, such as in the standard case of a misleading statement inducing a purchase, the principles of the tort of deceit are a guide. Logically, this will be so whether the misleading conduct was innocent, negligent or advertent, given that s 52 and cognates do not require proof of fault. The authority on the assessment of damages for contraventions of the Act is overwhelmingly focused on breaches of s 52 and like provisions. Authority on the assessment of damages for contraventions of other provisions is sparse. Consistent with the approach to assessment of damages for breaches of s 52, common law principles may afford a guide to damages assessment for breaches of other provisions in the Act. Three members of the court in *Gates v City Mutual Life Assurance Society Ltd,*[62] it has been seen, remarked that there is 'much to be said for the view that the measure of damages in tort is appropriate in most, if not all, Part V cases, especially [but not exclusively] those involving misleading or deceptive conduct'.[63] Like reasoning could be applied to the analogous provisions in Parts IVA (Unconscionable Conduct) and VA (Liability of Manufacturers and Importers for Defective Goods). Where they have been litigated, the tendency has been to seek remedies other than damages in the case of contraventions of Part IV.

The decisions reveal little enthusiasm for resort to the rules governing assessment of damages in contracts in preference to torts in assessing damages under the Act, but in appropriate cases, that is, where the gist of a complaint under the Act is loss of a contractual bargain, contract principles may play a role.

Applying torts principles

On the assumption that the principles governing assessment of damages in tort are *prima facie* a guide to assessment of damages for contravention of the Act, it follows that damages are to be assessed on the basis that the party who has suffered loss is to be put in the position he or she would have enjoyed had the contravening conduct (parallelling the tortious act) which has caused this loss not occurred. In contrast, the damages for breach of contract are assessed on the basis that the plaintiff is to be put in the position that he or she would have been in had the contract been duly performed by the defendant.[64] Both

61 *Marks v GIO Australia Holdings Ltd* (1998) 196 CLR 494 at 529 (Gummow J).
62 (1986) 160 CLR 1.
63 *Ibid* at 14 (Mason, Wilson and Dawson JJ).
64 *Robinson v Harman* (1848) 1 Ex 850 at 855; 154 ER 363 at 365. See the comments of Mason, Wilson and Dawson JJ in *Gates v City Mutual Life Assurance Society Ltd* (1986) 160 CLR 1 at 11ff, contrasting the application of contracts and torts principles to the assessment of damages.

damages regimes permit the recovery of reliance losses, including expenditure incurred. The contracts principles also permit the recovery of loss of bargain or expectation losses.[65] Does the torts regime preclude loss of a prospective profit?

Authority supports the notion that lost profits, or a loss of a commercial opportunity of value, are recoverable in an action against a tortfeasor. This is implicit in the basic formulation of principles governing assessment of damages in torts. If the tortious conduct has deflected the plaintiff from pursuing a realisable profit, then damages—which are to be assessed on the basis of placing this party in the position he or she would have enjoyed had the tort not been committed—must necessarily be assessed in such a way as to capture the value of this (lost) opportunity.[66]

Where those principles of damages assessment applicable in the context of the tort of deceit are concerned, it is clear that a loss of opportunity for profit is compensable (see 3.4.1, below).

Moreover, whether or not torts principles are invoked specifically, a line of cases directly on ss 82 and 87 recognises that damages for contravention of the act are to be assessed to capture a loss of commercial opportunity (see p 15, below).

Loss of commercial opportunity

Where a contravention of the Act has caused a loss of commercial profit, or other commercial opportunity, the cases are unanimous in holding that such an opportunity is to be reflected in the damages assessed. The cases have, as noted, concerned alleged breaches of s 52, in the context of misleading representations inducing a contract of purchase. This has not always been the case, however.

Applying the deceit analogy

Where deceit principles have been applied by analogy, the courts have approved recovery of lost profits. *Prima facie,* as has been noted at p 10 above, the measure of damages in a case of tortious deceit involving a contract of purchase induced by misrepresentation is the difference, at the time of contract, of the real value of the thing purchased and the price actually paid. More specifically, the plaintiff is 'entitled to recover as damages a sum representing the prejudice, or disadvantage, he has suffered in consequence of his altering his position under the inducement of the

65 *Gates, ibid* at 12.

66 *Ibid* at 12–13; likewise see the comment in *Australian Protective Electronics Pty Ltd v Pabflow Pty Ltd* (1996) ATPR 41–524 at 42–744 (Parker J, Kennedy and Murray JJ concurring); *Thompson v Ice Creameries of Australia Pty Ltd* (1998) ATPR 41–611 at 40–704 (Lehane J).

fraudulent misrepresentations made by the defendant'.[67] This formulation clearly permits the recovery of foreseeable consequential loss, including a profit opportunity which has value.[68]

In this context, the tortious approach resembles contracts in permitting recovery of an expectation loss, save that where torts principles are relied upon in assessing damages in respect of a contract of purchase induced by fraud, it is for the plaintiff to establish that he or she 'could or would have entered into the different contract' which would have yielded the profit.[69]

Where the damages capture the difference between the price paid and the actual price (such as where the purchaser of a business agrees to pay more than otherwise because the vendor overstates its profitability), events subsequent to the purchase may be looked at when relevant to assessing the true value of the purchase.[70]

Whether or not deceit principles are resorted to in applying s 82 in conjunction with s 52, the fundamental issue is the same—what damage flowed from (that is, was caused by) the misleading conduct in issue.[71]

Loss of commercial opportunity recoverable independently of deceit analogy

While the deceit analogy has commonly been resorted to in assessing damages in the standard case of a vendor's misrepresentation inducing a purchase at an inflated price, authority prior to *Marks* made it clear that s 82 operates to recover a loss of commercial opportunity occasioned by a contravention of the Act. The leading case of *Sellars v Adelaide Petroleum NL*[72] involved a misrepresentation which induced the plaintiffs to enter into a contract on certain terms which was less favourable than the contract which would have been concluded had it not been for the misrepresentation. Some of the plaintiffs were directors of Adelaide Petroleum. The contract in question provided, *inter alia,* for the sale of their shares in Adelaide Petroleum. The situation was less typical of cases in this general class, in that a vendor complained of misrepresentation. The court held that where a contravention of s 52 caused an economic or financial loss, including a lost opportunity or chance of economic value, this loss was assessable under s 82.[73] As s 82 permits the recovery of actual loss only, the lost opportunity had to have some economic value.[74]

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67 *Toteff v Antonas* (1952) 87 CLR 647 at 650, *per* Dixon J, approved in *Gates v City Mutual Life Assurance Society Ltd* (1986) 160 CLR 1 at 12 (Mason, Wilson and Dawson JJ).
68 *Gates, ibid* at 12.
69 *Ibid* at 13.
70 *Kizbeau Pty Ltd v WG & B Pty Ltd* (1995) 184 CLR 281.
71 *Kenny & Good Pty Ltd v MGICA (1992) Ltd* (1999) 163 ALR 611 at 647 (Kirby and Callinan JJ).
72 (1994) 179 CLR 332.
73 *Ibid* at 348–49 (Mason CJ, Dawson, Toohey and Gaudron JJ).
74 *Ibid.*

According to standard civil law principles, the plaintiff had to prove on the balance of probabilities: (1) causation of (2) loss or damage. The latter is demonstrated by showing that 'the contravening conduct caused the loss of a commercial opportunity which had *some* value (not being a negligible value)'.[75] How is this value to be assessed? The task of assessing the lost opportunity self-evidently will frequently be difficult. (It would, for example, be impossible to prove, according to the civil standard, precisely how much the plaintiff celebrity has lost as a result of having his or her name and photograph being used without authority in a marketing campaign.)[76] The plaintiff does not need to prove the value according to the civil standard. In assessing the value, the court is to have regard to the 'degree of probabilities or possibilities'. This approach was more likely to yield fair compensation, while the 'all or nothing' outcome posited by the application of the civil standard of proof to the task of assessment, would lead to overcompensation or undercompensation.[77] This approach reflects the standard general law principle that difficulty in assessing damages is not a bar to their award.[78] Just as a contravention causing a loss of a commercial opportunity of some value warrants damages under s 82, so also does a contravention which diminishes this opportunity, thereby inflicting loss.[79]

Mitigation of loss

Both in contract and tort, it is established that damages otherwise payable to a plaintiff will be reduced where he or she has failed to take reasonable steps to mitigate his or her loss, where it is possible to do so.

The authorities accept that a parallel mitigation principle governs the application of s 82 (and by implication, s 87, where it is sought to ground damages under it).[80] The defendant has the burden of establishing failure to mitigate.[81]

A failure to mitigate might take the form of continuing with a retail lease, entered into in consequence of a material misrepresentation by a lessor or agent

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75 *Ibid* at 355.

76 The facts alleged in the s 52 case of *Talmax Pty Ltd v Telstra Corporation Ltd* (1996) ATPR 41–535 at 42–829 (Fitzgerald P, Davies JA and Moynihan J).

77 *Sellars v Adelaide Petroleum NL* (1994) 179 CLR 332 at 356.

78 That difficulty in assessing damages is not a bar to their assessment was instanced in *Accohs Pty Ltd v RA Bashford Consulting Pty Ltd* (1997) ATPR (Digest) 46–176 at 54–412. See also *C-Shirt Pty Ltd v Barnett Marketing and Management Pty Ltd* (1997) ATPR (Digest) 46–172 at 54–380 (plaintiff failed to prove actual loss, in a claim for damages pursuant to ss 52, 82).

79 *Talmax Pty Ltd v Telstra Corporation Ltd* (1996) ATPR 41–535 at 42–829 (Fitzgerald P, Davies JA and Moynihan J).

80 *Hubbards Pty Ltd v Simpson Ltd* (1982) ATPR 40–295; *Thompson v Ice Cream Eateries of Australia Pty* Ltd (1998) ATPR 41–611 at 40–709; *Embo Holdings Pty Ltd v Camm* (1998) ATPR (Digest) 46–184 at 50–337; cf *Pavich v Bobra Nominees Pty Ltd* (1988) ATPR (Digest) 46–039.

81 *Embo, ibid.*

as to the existence of facts making the proposed venture more attractive than it really was, after learning of the true facts.[82]

The reported decisions lend little support to the proposition that a plaintiff's contributory negligence may be relied upon to reduce damages otherwise payable pursuant to s 82, by analogy with the tort of negligence. This issue will be further discussed, below.

It is possible, however, that a plaintiff's failure to protect his or her own interests in a case of misrepresentation may have the consequence that the defendant's misrepresentation cannot be viewed as being an inducement of the plaintiff's entering into the subject transaction, and thus an effective cause of the damage suffered, so that no damages will be payable under s 82. This issue has been examined at pp 10–13, above.

Can damages be reduced where the applicant's conduct has partially caused the loss or damage suffered?

Can the court awarding damages under s 82 reduce damages on account of conduct on the part of the applicant, where this conduct has been a partial cause of the loss or damage suffered by the applicant? This conduct might, for example, take the form of what in tortious terms would be regarded as contributory negligence, or it could take another form. Two situations may be distinguished for present purposes: (a) where the defendant's conduct is a material cause of the whole of the loss or damage in question and (b) where the defendant's conduct is not a material cause of the damage, or is not a material cause of a divisible part of the overall damage. In either such case, an applicant's conduct may fall for assessment if it is *prima facie* a causal factor in the damage suffered.

The High Court held in *I & L Securities Pty Ltd v HTW Valuers (Brisbane) Pty Ltd,*[83] overruling a decision of a Full Bench of the Queensland Court of Appeal, that where an applicant seeks damages under s 82, and this applicant is partially responsible for the loss complained of, s 87 cannot be resorted to so as to reduce the damages payable by the defendant.

The plaintiff moneylender had lost money when lending on the faith of the defendant valuer's wrong valuation of the security property. The trial judge found that the loss was caused by two independent causes—the wrong valuation and the moneylender's own poor work in assessing the credit worthiness of the borrower. The trial judge viewed the defendant as being two thirds responsible for the loss, and reduced the damages otherwise payable accordingly, by one third. The trial judge analogised the situation to one of

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82 *Baillieu Knight Frank (Gold Coast) Pty Ltd v Susan Pender Jewellery Pty Ltd* (1997) ATPR 41–542 at 43–525 (a failure to mitigate was not established on the facts).

83 (2002) 192 ALR 1.

contributory negligence. The Court of Appeal upheld this judgment, but on a different basis. In the appellate court's view, damages otherwise payable pursuant to s 82 could in a case such as the present (where the applicant was partially responsible for its loss) be reduced by resort to s 87. This was so even though the applicant had not sought damages pursuant to s 87, but only s 82. In the court's view, s 87 vested a discretion in the court to make such an order for reduction of damages in the interests of justice, notwithstanding that the defendant was liable under s 82 to make good the whole of the loss. This discretion was implicit in the provision in s 87(1) which provides that the court may 'make such order or orders as it thinks appropriate [against the person contravening the Act] if the Court considers that the order or orders concerned will compensate the [person who has suffered loss or damage] in whole *or in part* for the loss or damage or will prevent or reduce the loss or damage' (emphasis added).

In its majority (six:one) decision, the High Court held that there was no warrant for qualifying the operation of s 82 in this way, having regard to the terms of s 82, which is a self-contained remedial provision.[84] It was sufficient for recovery of damages compensating for the whole of the loss or damage, that the defendant's conduct was a material cause (but not necessarily the sole cause) of the loss or damage.[85] It followed that s 82 did not permit damages to be reduced where the applicant by contributory negligence had partially caused its loss.[86] The present legal position as confirmed in this decision does produce potential unfairness, as Kirby J noted in his dissent,[87] and as Callinan J noted in his judgment as part of the majority.[88] A defendant's act need only be a material cause and not a major cause, but the defendant is still liable pursuant to s 82 for the whole of the loss or damage in question.

In *I & L Securities Pty Ltd v HTW Valuers (Brisbane) Pty Ltd* the defendant was held to be liable for the whole of the damage because its conduct was a material cause of the whole of this (indivisible) damage.[89] The decision recognises, however, that where the defendant's conduct is either not a material cause of the damage, or is not a material cause of a divisible part of the overall damage, the defendant is not liable pursuant to s 82 to compensate the applicant for this damage.[90] This is logical, because s 82 (echoing common law doctrine) only compensates loss or damage caused by the defendant's contravening

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84 *Ibid* at 6 (Gleeson CJ), 15 (Gaudron, Gummow and Hayne JJ), 27 (McHugh J), 52 (Callinan J), cf 35ff (Kirby J).

85 *Ibid* at 8 (Gleeson CJ), 15 (Gaudron, Gummow and Hayne JJ), 27 (McHugh J), 51 (Callinan J).

86 *Ibid* at 12 (Gaudron, Gummow and Hayne JJ), 20 (McHugh J), 52 (Callinan J, but noting that such an outcome was unfair).

87 *Ibid* at 35ff. Kirby J referred to the possibility that the equitable doctrine of contribution could have been invoked by the defendant to effect a reduction of damages—at 38.

88 *Ibid* at 52.

89 *Ibid* at 8 (Gleeson CJ), 15 (Gaudron, Gummow and Hayne JJ), 27 (McHugh J), 55 (Callinan J).

90 *Ibid* at 6 (Gleeson CJ), 16 (Gaudron, Gummow and Hayne JJ), 21 (McHugh J), and see 40 (Kirby J).

conduct. This competing and independent causal event may take the form of negligence or other conduct on the part of the applicant. This class of case is illustrated in *Collins Marrickville Pty Ltd v Henjo Investments Pty Ltd.*[91] The applicant purchased a restaurant, in consequence of the defendant's misleading representations. The court held that trading losses that occurred after the applicant had commenced running the business, were not attributable to the defendant's misrepresentation. As they were not caused by the defendant's contravening conduct they were not compensable pursuant to s 82.[92]

It follows that on present authority, if the defendant's conduct has caused the damage complained of for the purposes of s 82, there is no scope for the application of contributory negligence or any analogous doctrine to effect a reduction of damages.

Contribution

Where two persons are jointly and severally liable in damages pursuant to ss 82 or 87, on account of a breach of, say, s 52 of the Act, and one is sued, may he or she seek contribution from the other pursuant to the equitable doctrine of contribution? The matter is not settled.[93] Present authority, as it will be noted below, implicitly supports the idea that the doctrine of contribution may be resorted to in appropriate cases where one or more of the defendants is made liable pursuant to the Act. To the extent that damages are sought only under s 87 (which would be rare) the discretion given to the court to mould a remedy would permit it to in effect if not in form apply contribution principles.

Contribution fell for consideration in relation to the Trade Practices Act in *Burke v LFOT Pty Ltd.*[94] LFOT (along with T, who had aided and abetted its breach) was held liable in damages pursuant to s 82 after it was found that it had induced H to purchase a property by a representation which breached s 52. LFOT and T sought contribution from B, H's solicitor, who had acted for H in

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91 (1987) ATPR 40–822.

92 Likewise, see *Tefbao Pty Ltd v Stannic Securities Pty Ltd* (1993) 118 ALR 565; *Mehta v Commonwealth Bank of Aust* (1990) Aust Torts Reports 81–046; *Henville v Walker* (2001) 206 CLR 459 (where the High Court by majority held on the facts that the principle did not apply, and rather, the defendant's conduct was a cause of the totality of the loss, even as there were other contributing factors).

93 See the comment by Gaudron ACJ and Hayne J in *Burke v LFOT Pty Ltd* (2002) 187 ALR 612 at 617 (noting that in the particular circumstances it was unnecessary to further explore the issue of how doctrines of equitable contribution operate in relation to the provisions of Part VI of the Act); McHugh J in the same decision at 625, where it was left open that contribution might be applied to relieve a person from liability under the Trade Practices Act; and that by Kirby J in *I & L Securities Pty Ltd v HTW Valuers (Brisbane) Pty Ltd* (2002) 192 ALR 1 at 38 (perhaps envisaging that a case could be made for the application of equitable contribution in this context). As it will be noted below, the *Burke* decision lends implicit support to the application of the general law doctrine of contribution in the context of the Trade Practices Act.

94 *Burke, ibid.*

relation to the purchase. LFOT and T established that B had acted negligently in not detecting H's misrepresentation, in breach of his contractual duty. The basis of LFOT's and T's liability, therefore, was statutory (ss 52 and 82 of the Act), and B's was contractual. After consideration by the Full Federal Court, the matter was remitted to the trial judge, who held that LFOT and T were liable in damages pursuant to s 82, and that B was liable pursuant to the doctrine of contribution to pay 50% of these damages. In a majority judgement the High Court held that B was not liable to contribute. A factor of obvious significance was that the order for the payment of damages by LFOT in effect was one that it must disgorge its ill-gotten gain, that is, the difference between the sale price and the (lower) true value of the premises. It did not thereby suffer any net burden or loss. The order for 50% contribution would therefore have advantaged LFOT relative to the position that it would have enjoyed if it had never contravened s 52.

The majority varied in their reasoning. Gaudron and Hayne JJ considered that having regard to the fact that B was less culpable than LFOT and T, and that his conduct was of reduced causal significance compared with theirs, it was not appropriate to require contribution from B. This was because contribution required that that the responsibility of the party be from whom contribution is sought be 'of the same nature and to the same extent', notions apt to include consideration of the relative degrees of culpability and causal responsibility.[95] B was also entitled to an indemnity from LFOT and T, if he had been induced by their misrepresentation not to make further enquiries. This reasoning does not preclude the application of the doctrine of contribution in relation to the Trade Practices Act remedies, in appropriate circumstances.[96] McHugh J likewise considered that B was not obliged to contribute, because his obligations were not of the same nature and to the same extent as that of LFOT and T[97]. There was no common interest between B and the other two, of a type which would make it inequitable for one party alone to bear the whole of the burden.[98] For B to contribute would be, in effect, to enrich LFOT and T unjustly.[99] It was also relevant that the conduct of LFOT and T induced B to act in error. Callinan J considered that B was not under an obligation to contribute, because there was no relevant mutuality of rights and obligations inter se.[100] Further, LFOT and T did not have clean hands. They had misled and deceived B, and for him to be required to contribute would be inequitable.[101] He commented obiter that if the tests for

95 *Ibid* at 616–617, citing *BP Petroleum Development Ltd v Esso Petroleum Co Ltd* ([1987] SLT 345 at 348.
96 The issue was not necessary to determine—*Burke, ibid* at 617 (Gaudron ACJ and McHugh J).
97 *Ibid* at 625.
98 *Ibid* at 624, 626.
99 *Ibid* at 627.
100 *Ibid* at 651.
101 *Ibid* at 652.

contribution were satisfied, then contribution could be ordered whether the formal legal obligations of the parties derived from the same statute or different statutes or a combination of statute and general law.[102] In his dissenting judgment, Kirby J commented that the terms of the Act did not expel the doctrine of contribution.[103]

In none of these judgments is there any indication that the doctrine of contribution is inapplicable to ccases where one party is or both (or several) parties are liable to pay damages in consequence of a breach of the Trade Practices Act. Pointedly, none of the majority judgments justified the determination that B was not liable to contribute, on this basis (and Kirby J's dissenting judgment envisaged that contribution can be ordered in a case where one of the parties' liability sources from common law and the others' derives from the Act).

Conclusion

The common law is relevant to the construction of s 82 (and where relevant s 87) in respect of issues of both the causation of loss or damage and the assessment of damages. In so far as causation is concerned, in the normal case, and in the absence of contrary provision in the Act, the minimalist legal concept of causation enunciated in *March v Stramare* is logically to be applied in ss 82 and 87 cases. The policy basis of the *March* formula is the same whether the causation issue is encountered in a common law or statutory context. The older common law tests of causation are at best negative criteria of causation, setting a limit on the scope of causation in law. The 'reasonable foresight' test in particular, perhaps, has a continuing and limiting role. It is potentially particularly important in the very common s 52 cases, where liability is strict, and where the scope of a party's liability cannot be limited by a requirement of fault. The consequence is that the defendant's liability is already prospectively of very broad ambit. In contrast, the liability of a defendant in tort is limited by a fault requirement. In particular, the tort of negligence in its application to negligent misstatements (which would often need to be resorted to in the absence of s 52) limits prospective liability at the threshold by imposing limits on the duty of care, especially so in cases of negligent misrepresentation. The result is that in this class of case (in contrast to s 52 actions involving careless misstatements), the defendant's liability is controlled at the levels of duty of care and fault as well as causation.

Where assessment of damages is concerned, ss 82 and 87, when resorted to in order to ground damages, are not to be interpreted as importing common law principles. Inevitably, though, common law analogies, drawn especially but not

102 *Ibid* at 652.
103 *Ibid* at 638.

exclusively from the torts context, are a pervasive if informal aid in applying these provisions. An issue straddling both topics—causation and assessment—is that of the effect of contributory negligence by the misrepresentee in a case of misrepresentation, where (as will almost always be the case) the negligence is not such as to compel the conclusion that the defendant's conduct did not induce the transaction complained of. It has been noted that although causation may be extant, the mitigation principle may nevertheless effect a reduction in the damages assessed. It is arguably anomalous that where an applicant's contributory negligence or other fault has contributed materially to his or her loss, the defendant's liability for damages will not (subject to limited exceptions) be subject to reduction.

Fraud, the Prime Exception to the Autonomy Principle in Letters of Credit

Alan Davidson[1]

Introduction

In international law, the greatest achievement of uniformity has been the law relating to letters of credit. International Banks in 175 countries operate their letters of credit under the Uniform Customs and Practice for Documentary Credits (UCP) sponsored by the International Chamber of Commerce (ICC). 'This worldwide uniformity is due to the general acceptance of the [UCP] sponsored by the ICC'.[2] The UCP 'has, without a shred of doubt, become the cornerstone of the law pertaining to letters of credit'.[3] The UCP has grown 'from a set of practices followed only by the most important banks in western countries to a *truly universal normative usage*'.[4] The latest revision by the ICC of the UCP was finalised in 1993 and is referred to as the UCP 500.[5] Historically, the merchants rather than the lawyers have developed the rules concerning letters of credit through their usages. To ensure the continued popularity of the UCP and the counterparts, the Uniform Commercial Code (UCC) Art 5 and also International Standby Practices (ISP98), the drafters must be attentive in their review, ensuring practical relevance for the commercial parties.

The management of international business is nothing more than the management of international risk. The development of the various steps and methods in the financing of international business has been directed with this 'risk' concept in the minds of the merchants. The seller's concern is to maximise security for the goods supplied and minimise delay in payment; the

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2 'Conflict of laws issues relating to letters of credit: An English perspective', extracted from C Cheng (ed), *Clive M Schmitthoff's Select Essays on International Trade Law,* Martimus Nijhoff Publishers/ Graham & Trotman London, 573.

3 Ellinger, EP, 'The uniform customs—their nature and the 1983 revision' [1984] LMCLQ 578. In the past decade a number of other competing regimes have emerged, such as the International Standby Practices (ISP98) and the US UCC, Art 5.

4 Kozolchyk, B, *Bernard Spencer Wheble (1904–1998) In Memoriam,* 1999 Annual Survey of Letter of Credit Law and Practice, Institute of International Banking Law & Practice Inc, Montgomery Village, MD, 18, 21; emphasis added.

5 From the brochure number allocated by the ICC.

buyer's concern is to maximise the profit whilst ensuring delivery of the goods or of the documents of title to the goods.

Devlin J held, in *Midland Bank v Seymour,* that 'the confirmed letter of credit is designed to give the seller the security he wants before he ships the goods'.[6] Letters of credit have become such an integral part of international trade that they have been described as 'the lifeblood of international commerce'.[7] The courts recognise the importance of treating letters of credit like cash:

> Thrombosis will occur if, unless fraud is involved, the courts intervene and thereby disturb the mercantile practice of treating rights thereunder (of letters of credit) as being equivalent to cash in hand.[8]

Once the exporter and buyer reach agreement, the buyer instructs the Issuing Bank, usually in the buyer's country, to open a letter of credit in favour of the exporter. The Issuing Bank typically arranges with the Advising Bank (sometimes termed the Paying Bank)[9] in the exporter's country to negotiate, accept or pay upon delivery of the documents and on other conditions. These documents would usually include transport documents, such as a bill of lading, commercial invoices, inspection and insurance certificates. It is the Advising Bank that communicates the arrangements to the exporter. The Advising Bank may *confirm* the letter of credit (Confirming Bank) by undertaking a direct obligation to pay the exporter. The bank then pays strictly in accordance with the instructions, on presentment of the documents by sight payment, deferred payment, acceptance or by negotiation of a bill of exchange.[10] The dominant aim of this procedure is to bridge the period between the shipment and the time in obtaining payments against documents.[11]

The bank's dilemma

Ex turpi causa non oritur actio

The backbone of the letter of credit is the autonomy principle. The autonomy principle dictates that banks deal with documents and are not concerned with nor bound by any underlying contract.[12] The doctrine of strict compliance

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6 [1955] 2 Lloyd's Rep 147 at 165.

7 Donaldson LJ in *Intraco Ltd v Notis Shipping Corporation of Liberia: The Bhoja Trade* [1981] 2 Lloyd's Rep 256 at 257.

8 *Ibid.*

9 Sometimes termed the Accepting Bank or Negotiating Bank.

10 UCP 500, Art9.

11 *TD Bailey, Son & Co v Ross T Smith & Co Ltd* (1940) 56 TLR 825 at 828 (Lord Wright).

12 The principle is well established in common law, rules of practice and rules of law, eg, UCP 500, Art 3, contains the embodiment of this principle that credits are separate from the sales or other contracts on which they may be based. '[B]anks are in no way concerned with or bound by such contracts.' ISP98, Rule 1.07, provides: '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.' UCC, Art 5–103(d): 'Rights and obligations of an issuer to a beneficiary or a nominated person under a letter of credit are independent of the existence, performance, or non-performance of a

compliments the autonomy principle providing the standard of compliance of the documents presented.

Nevertheless, the Paying Bank[13] faces a dilemma when it receives a compliant presentation as well as conflicting pressure or instructions from the applicant not to honour that presentation. What should be a bank's response where the applicant, in all likelihood the Issuing Bank's customer, informs the bank of an irregularity in the underlying contract and instructs the bank not the honour the presentation? Assume further that the documents presented comply with the terms of the letter of credit. To what extent should it matter whether the complaint relates to quantity, such as a 1% or 10% shortfall, or even the delivery of empty containers? Should the bank be concerned about the quality, such as an inferior but usable product, or perhaps even complete rubbish? Should it matter to the bank whether or not the beneficiary was involved in these irregularities, knowing or otherwise? Does the doctrine of strict compliance require the bank to pay, thus rewarding the perpetrator and perhaps amounting to unjust enrichment? The answer to this last question must be emphatically in the negative.[14]

As early as 1765,[15] the courts recognised the fraud exception to letters of credit. However, the value of a letter of credit as an instrument diminishes if the exception is used too readily or abused.[16] The courts have been sensitive to this concern and have kept the exception within certain bounds. Unfortunately, various jurisdictions have taken different approaches. The courts have used a broad spectrum of words to describe the level of fraud necessary to attract relief, such as: proven, gross, material, established, clearly established, outright, obvious, egregious, clear, of such a character, strong and *prima facie,* sufficient, sufficiently grave, intentional, active, actual and serious.[17]

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contract or arrangement out of which the letter of credit arises.' UCC, Art 5–108(f): 'An issuer is not responsible for…the performance or non-performance of the underlying contract, arrangement, or transaction.' UN Convention on Independent Guarantees and Standby Letters of Credit, Art 3, is headed 'Independence of undertaking' and provides: '…an undertaking is independent where the guarantor/issuer's obligation to the beneficiary is not…dependent upon the existence or validity of any underlying transaction, or upon any other undertaking…'; URDG, Art 2(b), provides that: 'Guarantees by their nature are separate transactions from the contract(s) or tender conditions on which they may be based, and Guarantors are in no way concerned with or bound by such contract(s)…'

13 Typically the Paying Bank may be the Issuing Bank or the Confirming Bank.

14 See Wunnicke, B, Wunnicke, D and Turner, PS, *Standby and Commercial Letters of Credit,* 1996, New York: Wiley, 158.

15 See *Pillans v Van Mierop* (1765) 3 Burr 1663 at 1666; 97 ER 1035.

16 The autonomy principle and related doctrine of strict performance form the foundation that makes the letter of credit a valuable commercial instrument. Lord Denning in *Power Curber International Ltd v National Bank of Kuwait* [1981] 1 WLR 1233 describes that value, stating that: 'It is vital that every bank which issues a letter of credit should honour its obligations. The bank is in no way concerned with any dispute that the buyer may have with the seller…It ranks as cash and must be honoured.' The purpose of utilising banks is to secure mutual advantage to both parties—to be of advantage to the seller to be given 'what has been called in the authorities a "reliable paymaster"', who can sue, and of advantage to the buyer in that he can make arrangement with his bankers; *Soproma SpA v Marine & Animal By-Products Corporation* [1966] 1 Lloyd's Rep 367 at 385 (McNair J).

17 Each of these terms and case examples is referred to in this paper.

The rules of practice, such as the UCP 500 and International Standby Practices (ISP98), have intentionally left the matter of fraud to the courts.[18] Banks sometimes avoid the dilemma by insisting and often aiding the applicant in obtaining a court injunction to restrain payment. In this way the bank does not take the blame nor financial responsibility for refusing to honour the presentation.[19] This paper examines this prime exception to the autonomy principle, the level and standard of fraud applicable and concludes by proposing a potential course of action.

Exceptions to the autonomy principle

Letters of credit are not immune from the usual principles which can void contracts or have them set aside. That fraudulent conduct, typically by the beneficiary, is an exception to the autonomy principle is well established and recognised by all authorities. In the words of the ICC, 'there is an exception… in many jurisdictions, namely abuse of rights, or fraud. The ambit of this exception and the ensuing consequences for the beneficiary and/or the nominated bank may differ from one local jurisdiction to another. It is up to the courts to fairly protect the interests of all *bona fide* parties concerned'.[20] Some authorities mistakenly refer to the fraud exception as the sole exception.[21] In the context of stopping payment notwithstanding the presentation of documents which on their face are in order, there are a number of issues, albeit less significant than the fraud exception. These issues include illegality,[22]

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18 See below.

19 Cf *Bank of Canton Ltd v Republic National Bank of New York* 509 F Supp 1310 (1980).

20 ICC Banking Commission, 'Latest queries answered by the ICC Banking Commission' (1997) 3(2) Documentary Credits Insight 6.

21 Eg, May, J, 'Letters of credit—the fraud exception' (2000) 3 Verulam Buildings Banking Law Newsletter; Ellinger, after analysing the autonomy principle, gives one exception, stating that '[i]n one case' the banker may be justified in refusing to accept of the documents, namely 'when the banker knows them to be fraudulent': Ellinger, EP, *Documentary Letters of Credit—A Comparative Study,* 1970, Singapore: University of Singapore Press, 190; Wunnicke and Wunnicke, *op cit,* fn 14. On the other side, see generally Fellinger, GA, 'Letters of credit: the autonomy principle and the fraud exception' (1990) 2 Journal of Banking and Finance Law 4.

22 Eg, Aston J in *Pillans v Van Mierop* (1765) 3 Burr 1663 at 1666; 97 ER 1035 at 1041 stated, 'if there be a turpitude or *illegality* in the consideration of a note, it will make it void, and may be given in evidence: but here nothing of that kind appears, nor any thing like fraud in the plaintiffs' (emphasis added). His Honour thus made the first mention of the illegality exception. In *Old Colony Trust Co v Lawyers' Title & Trust Co* 297 F 2d 152 (2nd Cir 1924), the court stated that 'when the issuer of a letter of credit knows that a document, although correct in form, is, in point of fact, false *or illegal,* he cannot be called upon to recognize such a document as complying with the terms of a letter of credit' (emphasis added). The international sanctions against Iraq in the 1990s resulted in a number of disputes. See Baraes, JG and Byrne, JE, 'Letters of credit: 1996 cases' (1998) Annual Survey of Letter of Credit Law and Practice, Institute of International Banking Law & Practice Inc, Montgomery Village, MD 12. See Dolan, JF, *The Law of Letters of Credit—Commercial and Standby Credits,* 2nd edn. 1991, Boston: Warren. Gorham & Lamont, Chapter 7.

insolvency,[23] injunctive relief,[24] government intervention, consumer laws[25] and attachment.[26] Nevertheless, as fraud remains particularly active, indeed rampant, in the commercial world, it is the fraud exception which has been a leading topic for discourse.

Fraud

> *Men were deceivers ever…*
> *The fraud of men was ever so,*
> *Since summer first was leafy*
> (William Shakespeare)[27]
>
> *When men are pure, laws are useless, when men are corrupt, laws are broken.*[27a]

Fraud unravels all. This maxim is rooted in common law and equitable tradition. In the letter of credit case of *United City Merchants v Royal Bank of Canada,* Lord Diplock stated:

> The exception of fraud on the part of the beneficiary seeking to avail himself of the credit is a clear application of the maxim *ex turpi causa non oritur actio* or, if plain English is to be preferred, 'fraud unravels all'. The courts will not allow their process to be used by a dishonest person to carry out the fraud.[28]

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23 Eg, see Barnes and Byrne, *ibid* at 12, 21. The receiver may attempt to disaffirm the letter of credit obligation whilst retaining the collateral security of the applicant. The typical position is that where an applicant is insolvent, a payment made to the Issuing Bank within the preference period cannot be clawed back as a preference, eg, *Baja Boats Inc v Northern Life Insurance Co* 203 BR 71 (1996) and *Martin v Westfall Township* 197 BR 31 (1996). Moreover, security and collateral held by the bank for the express purpose of the letter of credit is not claimable by the estate. See *In re Ben Franklin Retail Store Inc* 195 BR 455 (1996). See also Neidle, JL and Bishop, W, 'Commercial letters of credit: effect of suspension of Issuing Bank' (1932) 32 Columbia Law Review 1.

24 Eg, Thodos, N, 'Mareva injunction, attachment and the independence principle: balancing the interests' (1995) 6 Journal of Banking and Finance Law and Practice 101. '[T]here is no doubt that… Mareva injunctions…are available against a beneficiary once the beneficiary has a chose in action under the letter of credit. All that is necessary at law to trigger a Mareva injunction on a letter of credit is a good arguable case and a real risk of the dissipation of the beneficiary's assets…' (at 118).

25 Eg, the Trade Practices Act 1974 (Cth), s 51A A, has been judicially cited as further erosion of the autonomy principle. Section 51A A contains a prohibition against acting unconscionably. *Olex Focas Pty Ltd v Skodaexport Co Ltd* [1998] 3 VR 380 at 404 (Young J): 'The effect of the statute, applying as it does to international trade and commerce, is to work a substantial inroad into the well-established common law autonomy of letters of credit and performance bonds and other bank guarantees.'

26 'On the basis of black letter law there is no doubt that…attachment [is] available against a beneficiary once the beneficiary has a chose in action under the letter of credit… All that is necessary to allow attachment is successful compliance with the relevant courts 'rules.' Thodos, *op cit,* fn 24, 118; Dolan, *op cit,* fn 22, Chapter 7.

27 *Much Ado About Nothing,* Balthasar—Act II Scene iii.

27a Attributed to Benjamin Disraeli—also known as Lord Beaconsfield.

28 [1983] AC 168 at 184; see also *London General Omnibus v Holloway* [1912] 2 KB 72 at 81; Sarna, L, 'Letters of credit: electronic credits and discrepancies' (1990) 4 Banking and Finance Law Review 149 at 153–54.

Fraud 'vitiates everything', including judgments and orders of the court.[29] Where a transaction has been spoilt by fraud, that fraud will continue to taint the transaction for as long as negotiations continue and into whatever ramifications it may extend.[30] The courts will prevent the fraudster, and even innocent persons, from deriving any benefit, unless such innocent persons have given consideration.[31] This approach is applicable to the letter of credit.[32]

The classic statement of fraud from the common law world comes from *Derry v Peek:*[33] that fraud exists 'when it is shown that a false representation has been made (1) knowingly, or (2) without belief in its truth, or (3) recklessly, careless whether it be true or not'.[34] Fraud includes equitable fraud. In equity, the term 'fraud' not only embraces actual fraud but other conduct which falls below the standard demanded in equity. There is no exhaustive definition of equitable fraud, although the field covered includes the fields of undue influence and unconscionability.

In 1893, Lord Esher in *Leivre v Gould*[35] held: '…a charge of fraud is such a terrible thing to bring against a man that it cannot be maintained in Court unless it is shown he had a wicked mind.' Specifically, in letters of credit context, Ventris considers that an accusation of fraud 'is one of the most serious which can be made in English litigation and has to be specially pleaded'.[36]

Pre-Sztejn

That the fraud exception to the autonomy principle in the letter of credit transaction was known well before *Sztejn,* there is no doubt.[37] It is inherent in

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29 McDonnell, DL and Monroe, JG, *Kerr on the Law of Fraud and Mistake,* 7th edn, 1952, London: Sweet & Maxwell, 3.

30 See *Reynell v Sprye* (1852) 1 DM G 660 at 697; *Smith v Kay* (1859) 7 HLC 750 at 775.

31 Eg, see *Scholefield v Templer* (1859) Johns 155; 4D & J429; *Tophamp v Duke of Portland (1863)* 1 DJ & s 517 at 569 (Turner LJ); *Morley v Lougham* [1893] 1 Ch 736 at 757; *Schneider v Heath* (1813) 3 Camp 506; *Boyd v Forest* [1911] SC 33 at 61; *London and General Omnibus Co Ltd v Holloway* [1912] 2 KB 72 at 81; *Lazarus Estates Ltd v Beasely* [1956] 1 QB 702.

32 See Byrne, JE, 'Commercial fraud: an overview' (1996) Annual Survey of Letter of Credit Law and Practice, Institute of International Banking Law & Practice Inc, Montgomery Village, MD, 34; Colleran, JA, 'Letter of credit fraud—who suffers? How can it be overcome?', 1996 Annual Survey of Letter of Credit Law and Practice, Institute of International Banking Law & Practice Inc, Montgomery Village, MD 1997, 40.

33 (1889) 14 App Cas 337 at 374 (Lord Herschell).

34 In *Peek v Gurney* (1873) LR 6 HL 377 at 403, Lord Cairns considered that fraud existed where there was a partial statement of fact in such a manner that the withholding of what is not stated 'makes that which is stated absolutely false'.

35 [1893] 1QB 491at 498.

36 Ventris, FM, *Bankers Documentary Credits,* 3rd edn, 1990, London: Lloyd's of London, 155.

37 See generally McCurdy, WE, 'Commercial letters of credit' (1922) 35 Harvard Law Review 539 at 583–84. See also Columbia Law Review Notes, 'Commercial letters of credit' (1921) 21 Columbia Law Review 176 at 180, stating that in a letter of credit situation '(i)f the buyer could show fraud on the part of the seller…an injunction might be granted'.

the undertaking of the beneficiary that the documents tendered will be both genuine and honest and the Paying Bank does not expect to receive documents which are forged or fraudulent.[38] *Sztejn v J Henry Schroder Banking Corp*[39] *(Sztejn)* is regarded as the foundation case on the fraud exception (see pp 32–33). The first lawsuit involving a letter of credit was *Pillans v Van Mierop*[40] in 1765. In that case, the court referred to the 'engagement' of the letter of credit, the fraud exception and the application of *lex mercatoria*.[41]

The *Pillans* case dealt with a mixture of bills of exchange and letters of credit matters. Their Honours, Lord Mansfield, Wilmont and Aston JJ, discussed the status of letters which passed between the plaintiffs and the defendants. On one construction, the plaintiffs requested the defendants to accept the arrangement to pay on bills. This was not carried out by placing a signed acceptance on the bill nor even sighting the bill beforehand. The defendants agreed by letter to honour the plaintiff's bill to be drawn on account of one White. However, Lord Mansfield in particular noted that the letters related to future credit: 'All letters of credit relate to future credit; not to debts before incurred;… A bill can not be accepted before it is drawn.'[42] In this context, their Honours, notably Lord Mansfield, discussed the application of letter of credit principles, regarding the letters as instructions to give credit accepted by the defendants.[43]

Their Honours made the first statements regarding fraud as an exception to the letters of credit, albeit *obiter*. Lord Mansfield stated:

> I was then of the opinion, that Van Mierop and Hopkins were bound by their letter; unless there was some fraud upon them…nor did I see any fraud.[44]
>
> Here, Pillans and Rose trusted to this undertaking: and there is no fraud.[45]
>
> [Counsel for the defendants] said, there was a fraudulent concealment of facts …this concealment of circumstances is sufficient to vitiate the contract.[46]
>
> If there be no fraud, it is a mere question of law.[47]

38 See Thayer, PH, 'Irrevocable credits in international commerce: their legal effects' (1937) 37 Columbia Law Review 1326 at 1335.
39 (1941) 31 NY Supp 2d 631.
40 (1765) 3 Burr 1663; 97 ER 1035 (Lord Mansfield): 'All letters of credit relate to future credit; not to debts incurred before.' Interestingly, some commentators list *Robbim v Bingham* 4 Johns 476, NY (1809) as the earliest case on letters of credit, a view which may be explained as an American bias.
41 See also *Mason v Hunt* (1779) 1 Doug 297; 99 ER 192, another judgment of Lord Mansfield.
42 (1765) 3 Burr 1663 at 1668; 97 ER 1035 at 1037,
43 Lord Mansfield also discussed the common law contract principle of consideration.
44 (1765) 3 Burr 1663 at 1666; 97 ER 1035 at 1036.
45 *Ibid.*
46 *Ibid* at 1668; at 1037.
47 *Ibid* at 1669; at 1038.

Wilmont and Aston JJ made similar acknowledgements on the role of fraud in the transaction where the former observed, 'I see no sort of fraud'.[48] Aston J stated, 'if there be a turpitude or illegality in the consideration of a note, it will make it void, and may be given in evidence: but here nothing of that kind appears, nor any thing like fraud in the plaintiffs'.[49]

Sztejn referred to three cases in making its statement that the distinction between a breach of warranty and fraud 'is supported by authority and reason'.[50] *Sztejn* relied for the most part on the case *Old Colony Trust Co v Lawyers' Title & Trust Co*[51] *(Old Colony Trust).* In that case the letter of credit called for, among other documents, a warehouse receipt evidencing the fact that the goods were housed in the stipulated warehouse. The Beneficiary tendered a document described as a warehouse receipt; however, the issuer knew that the goods were still on board the ship. The court dismissed the Beneficiary's action for payment, stating:

> Obviously, when the issuer of a letter of credit knows that a document, although correct in form, is, in point of fact, false or illegal, he cannot be called upon to recognize such a document as complying with the terms of a letter of credit.[52]

The two other cases referred to by *Sztejn* were *Higgins v Steinhardter*[53] and *Société Metallurgique d'Aubrives & Villerupt v British Bank for Foreign Trade*[54] *(Société Metallurgique).*

Higgins v Steinhardter involved a shipment of walnuts transported in December 1918. The beneficiary procured a bill of lading 'falsely stating' that the shipment was made on 30 October 1918. The court considered that the plaintiff only authorised the letter of credit to apply to a shipment made before 7 November. Without using the word 'fraud', the court permitted an exception to the position where the 'bill of lading was in fact false as to the time of shipment' and considered such an act as 'proximate cause of any risk of loss by

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48 *Ibid* at 1673; at 1040.

49 *Ibid* at 1666; at 1041. Aston J thus made the first mention of the other significant exception, namely illegality.

50 (1941) 31 NY Supp 2d 631 at 635.

51 297 F 2d 152 (2nd Cir 1924).

52 *Ibid* at 158. Comment has been made that this statement is *obiter.* The reason for this comment is that the decision of the court is most likely based on the court's approach that the warehouse receipt failed to comply with the terms of the letter of credit. Given this discrepancy, it would be unnecessary to decide further the issue of fraud and illegality. However, the better view is that the decision was made in the alternative and that the *ratio* of the case includes the significant issue of fraud and illegality.

53 106 Misc 168 1919; 175 NYS 279 1919.

54 (1922) LI LR 168, KBD. Interestingly, the relatively modern case of *Contronic Distributors Pty Ltd and Bank of New South Wales* (1984) 3 NSWLR 110 at 115 cited *Sztejn, Old Colony Trust and Société Metallurgique* and only one 'modern' case as authority for the fraud exception in New South Wales.

the issuance of drafts against said credit'.[55] Clearly the facts recognised the fraud exception without making a direct specific reference.[56]

Société Metallurgique[57] involved an irrevocable letter of credit. The plaintiffs contracted to sell 610 tons of pig iron, fob, from Antwerp to England. The parties agreed to change the documents to weight receipts and invoices, instead of shipping documents and invoices. The goods were received before the invoices. There were five instalments. Payment was made on the first set of documents; however, one Mr Ford instructed the bank not to pay on second, third, fourth or fifth set of documents. 'Mr Ford, having received complaints from his customers, told his bank…not to pay against documents any more…on the grounds that there was no evidence on them that this was a high-grade foundry pig iron.' The presenter 'returned to his office and made out a fresh invoice in those terms, and then went back with it and demanded his money, and again the bank refused'.[58]

Bailhache J stated that he would not expect or think that business people would not anticipate the weight receipts to show the quality or refer to it at all. His Honour stated that in actions against banks dealing with dishonour where there is an allegation that the goods are not in order, 'the question of quality only comes in on one or other of two ways':

> First of all, did the person presenting misdescribe the goods in such a way as to be guilty of *fraud*? If that were so, then the bank in refusing to pay would be justified.[59]

The 1925 case of *Maurice O'Meara Co v National Park Bank*[60] concerned a shipment of paper of a specified tensile strength. The plaintiff presented documents which on their face complied. The defendant bank refused to pay because there had 'arisen a reasonable doubt regarding the quality of the newsprint paper'.[61] The majority judgment did not suggest a fraud exception, other than forgery. The majority stated that if the documents presented were 'proper documents, then it [the bank] was absolutely bound to make payment under the letter of credit'.[62] However, the dissenting judgment of Cardozo J discussed a range of behaviour which would permit the bank to refuse payment. Cardozo J implies fraud as an exception, but specifically refers to the situation

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55 106 Misc 168 (1919); 175 NYS 279 (1919) at 280.

56 In referring to the *Higgins* case, *Sztejn* made mention that it was distinguished in *Frey & Son Inc v ER Sherburne Co* 193 App Div 849; 184 NYS 661 (NYSC 1920) in which the court says nothing about fraud, just that in regard to the *Higgins* case, 'We are of the opinion that the facts appearing in that case did not warrant the granting of an injunction'.

57 (1922) LI LR 168, KBD.

58 *Ibid* at 169.

59 *Ibid* at 170 (emphasis added). The second 'way' relates to misdescription of goods and has no bearing on the issue of fraud.

60 146 NE 636 (NYCA 1925).

61 *Ibid* at 639.

62 *Ibid.*

where there is a total lack of consideration in the underlying contract. In this regard, Cardozo J goes too far and his judgment covers behaviour which would be regarded today as being entirely separate from the bank's obligation.

Sztejn

Sztejn v J Henry Schroder Banking Corporation[63] is regarded as the leading case on the fraud exception to the autonomy principle,[64] although interestingly the case proceeded on an underlying procedural assumption.[65]

Chester Charles Sztejn was a buyer based in the United States. He negotiated with Transea Traders Ltd, of Lucknow, India, to purchase a quantity of hog bristles. Sztejn applied for an irrevocable letter of credit to be issued by Schroder. Transea Traders Ltd loaded 50 cases of material on board a steamship and secured a bill of lading and the usual invoices. The Chartered Bank, located at Cawnpore, India, was the correspondent bank. Transea Taders Ltd delivered the required documents to Chartered Bank. The crates were not filled with hog bristles, but with 'cowhair, other worthless material, and rubbish'.[66] Prior to payment being made to the Chartered Bank by Schroder, Sztejn applied for declaratory and injunctive relief.

Shientag J, of the New York Supreme Court, first restated the importance of the autonomy principle. His Honour considered the principle to be 'well established' and that the Issuing Bank makes agreement 'to pay upon presentation of documents, not goods'. Shientag J regarded the principle as 'necessary to preserve the efficiency of the letter of credit as an instrument for the financing of trade'. His Honour prefaced the subsequent statements, recognising the fraud exception, by stating that any interference with the autonomy principle would be 'most unfortunate' as it would impact on a chief purpose of the letter of credit to furnish the seller with prompt payment for the merchandise. His Honour expressed specific concern to protect business transactions and avoid going behind the documents or entering into

63 (1941) 31 NY Supp 2d 631.

64 See generally, Ellinger, *op cit,* fn 21, 190–96; Dolan, *op cit,* fn 22, 7.29–7.83; Wunnicke, Wunnicke and Turner, *op cit,* fn 14, 159–60: the *Banco Santander* case (2000) 15 JIBL 22; May, *op cit*, fn 21.

65 The *Sztejn* case was a procedural matter: a motion by the defendant on the grounds that the facts did not disclose a cause of action. The court had to assume the facts to be true for the purpose of the hearing. This included the fact that the 'Advising Bank' (the correspondent bank, namely Chartered Bank) was not a holder in due course. So whether or not it would be, or should be, was not argued or examined. It may well be that the bank must be a holder in due course and that it should be paid as such, notwithstanding the fraud. However, the matter remains moot and the case remains pivotal in letter of credit legal history and development. Shientag J noted, 'For the purposes of this motion, the allegations of the complaint must be deemed established and "every intendment and fair inference is in favor of the pleading"…it must be assumed that Transea was engaged in a scheme to defraud the plaintiff and Schwarz, that the merchandise shipped by Transea is worthless rubbish and that the Chartered Bank is not an innocent holder of the draft for value but is merely attempting to procure payment of the draft for Transea's account' (at 633).

66 (1941) 31 NY Supp 2d 631 at 633.

controversies between the buyer and the seller regarding the quality of the merchandise shipped.[67]

Shientag J further distinguished the case before him as one involving fraud by the Beneficiary, and appropriately noted the case was not a mere breach of warranty. His Honour ruled that where the seller's fraud has been called to the bank's attention before the drafts and documents have been presented for payment, the autonomy principle[68] should not be extended to protect an unscrupulous seller.[69]

> Although our courts have used broad language to the effect that a letter of credit is independent of the primary contract between the buyer and seller, that language was used in cases concerning alleged breaches of warranty; no case has been brought to my attention on this point involving an intentional fraud on the part of the seller which was brought to the bank's notice with the request that it withhold payment of the draft on this account. The distinction between a breach of warranty and active fraud on the part of the seller is supported by authority and reason.[70]

The fraud standard

> (F)raudulent presentations under LCs (have not) abated.[71]

Allegation of fraud versus proven fraud

It is insufficient to merely include an allegation of fraud in the pleadings requesting the court injunction. Some cases have required 'proven' fraud.[72] However, a wide range of terms has been used by the courts to describe the level of fraudulent conduct necessary and appropriate to vitiate the 'chief characteristic' of the letter of credit, namely, 'its *absolute reliability* in the hands of the seller'.[73] These terms include proven, gross, material, established, clearly established, outright, obvious, egregious, clear, of such a character, strong and *prima facie,* sufficient, sufficiently grave, intentional, active, actual and serious.[74]

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67 *Ibid.*
68 *Ibid.* Shientag J uses the expression 'principle of independence'.
69 *Ibid* at 634. Shientag J repeated his view on fraud as an exception in *Ashbury & Ocean Grove Park Bank v National City Bank of New York* (1942) 35 NYS 2d 985 at 988.
70 *Ibid* at 634–35.
71 Byrne, JE, 'Overview of letter of credit law and practice in 1997' (1998) Annual Survey of Letter of Credit Law and Practice, Institute of International Banking Law & Practice Inc, MD 3,10.
72 Eg, see *Gerald Metals Inc v UBS AG* (Conn Sup Ct 1999) LEXIS 2901.
73 *Aspen Planners Ltd v Commerce Masonary & Forming Ltd* (1979) 100 DLR (3d) 546 at 548 (Henry J) (emphasis added).
74 The terms are referred to throughout this paper.

It has been well established that allegations of fraud can only be made on clear and specific averments. In *Gillespie v Russel,*[75] Lord President McNeill stated that 'a party laying an action on that ground is bound to set forth in very explicit terms, the fraud of which he complains'. His Lordship considered the application before the court to be sufficient, being 'perfectly clear and explicit in statement'. In a subsequent case, his Lordship stated:

> If an action is laid upon misrepresentation, the misrepresentation itself must be set forth…[N]o person accused of fraudulent misrepresentation can be bound to go to trial, unless he is told what the fraudulent misrepresentation is that he is said to have made.[76]

Similarly, in *Shedden v Patrick,* Lord Fullerton stated:

> It is not enough for a party, founding a reduction on the head of fraud, to state that fraud has been committed… The party…must state in what the fraud consists, and what the acts are from which the existence of fraud is to be inferred.[77]

In *Thomson & Co v Pattison, Elder & Co,* Lord President Robertson stated:

> Fraud is a personal matter, and can only be committed by an individual… Now, this record does not allege acts complained of against any individual at all. Accordingly, it is not by a mere euphemism that this case differs from and falls short of a case of fraud.[78]

Review of the fraud standard and the (UCP)

The UCP 500 makes no mention of the fraud exception.[79] Taken literally, the UCP 500 requires the bank to pay regardless of the extent of any fraud. However, the drafters have recognised the courts' role in applying the fraud exception as a matter of local law and have intentionally left the matter out of the UCP. The ISP98 does make mention of the fraud exception, but only to mention that a defence based on fraud is left to the applicable law.[80]

Edward Owen Engineering Ltd v Barclays Bank International Ltd[81] (*Edward Owen* case) is often cited as the leading modern case on the fraud exception in letter of credit.[82] At first instance, Kerr J raised the level of fraud necessary to

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75 (1856) 18 D 677 at 682.
76 *Drummond's Trustees v Melville* (1861) 23 D 450 at 462.
77 (1852) 14 D 721 at 725; 1 Macq 535 at 539.
78 (1895) 22 R 432 at 436.
79 No mention is made by any of the earlier versions of the UCP.
80 ISP98, Rule 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 (eg, a signed writing); or (c) defenses based on fraud, abuse, or similar matters. These matters are left to applicable law'.
81 [1977] 3 WLR 764; [1978] 1 All ER 976 (Kerr J), CA (Lord Denning MR, Browne LJ, Geoffrey Lane J).

interfere with the Paying Bank's obligation to pay to 'cases of obvious fraud to the knowledge of the banks'.

> Lord Denning recognises the importance of the bank's obligation to pay: It has been long established that when a letter of credit is issued and confirmed by a bank, the bank must pay it if the documents are in order and the terms of the credit are satisfied. Any dispute between the buyer and seller must be settled between themselves. The bank must honour the credit.

Lord Denning cites *Malas v British Imex Industries Ltd*[83] with approval. In that case, Jenkins LJ described the banker's role as 'an absolute obligation to pay' irrespective of any underlying contractual arrangement, and explained the letters of credit as an 'elaborate commercial system'. Jenkins LJ stated 'it would be wrong for this court in the present case to interfere with that established practice'.[84] The buyer complained that the goods called for by the contract of sale had not been delivered. Injunctions to enjoin an Issuing Bank from honouring a draft under a letter of credit were refused on the ground that fraud had not been established.

Having explained the general principle, Lord Denning referred to the fraud exception where there existed 'established or obvious fraud to the knowledge of the bank',[85] and later where 'the documents are forged or that the request for payment is made fraudulently in circumstances when there is no right to payment'.[86]

Lord Denning expressly adopted the *dicta* of Kerr J in *RD Harbottle (Mercantile) Ltd v National Westminster Bank Ltd*:[87]

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82 Eg, the *Edward Owen case* is described by Hollingworth J as 'the definitive case on letters of credit'; *CDN Research & Development Ltd v Bank of Nova Scotia* (No 2) (1981) 32 OR (2d) 578; 122 DLR (3d) 485.

83 [1958] 2 QB 127; 1 All ER 262.

84 *Ibid* at 129; at 263. Jenkins LJ then added, '(i)t has also to be remembered that a vendor of goods selling against a confirmed letter of credit is under the assurance that nothing will prevent him for *[sic]* receiving the price. That is no mean advantage when goods manufactured in one country are being sold in another. Furthermore, vendors are often re-selling goods bought from third parties. When they are doing that, and when they are being paid by a confirmed letter of credit, their practice…is to finance the payments necessary to be made to their suppliers against the letter of credit. That system of financing these operations, as I see it, would break down completely if a dispute between the vendor and the purchaser were to have the effect of "freezing", if I may use the expression, the sum in respect of which the letter of credit was opened'.

85 Lord Denning then referred to the exception's origin in *Sztejn's* case.

86 [1978] 1 All ER 976 at 981–82.

87 [1977] 2 All ER 862 at 870; 3 WLR 752 at 761. Denning further quotes *Howe Richardson Scale Co Ltd v Polimex-Cekop* (1977) Court of Appeal Transcript 270; [1978] 1 Lloyd's Rep 161: '…the obligation of the bank is to perform that which it is required to perform by that particular contract, and that obligation does not in the ordinary way depend on the correct resolution of a dispute as to the sufficiency of performance by the seller to the buyer or by the buyer to the seller as the case may be under the sale and purchase contract; the bank here is simply concerned to see whether the event has happened on which its obligation to pay has arisen.'

> First, this is not a case of an established fraud at all…all these issues turn on contractual disputes. They are a long way from fraud, let alone established fraud… It is only in exceptional cases that the courts will interfere with the machinery of irrevocable obligations assumed by banks. They are the lifeblood of international commerce. Such obligations are regarded as collateral to the underlying rights and obligations between the merchants at either end of the banking chain. Except possibly in clear cases of fraud of which the banks have notice, the courts will leave the merchants to settle their disputes under the contracts… The courts are not concerned with their difficulties to enforce such claims; these are risks which the merchants take… The machinery and commitments of banks are on a different level. They must be allowed to be honoured, free from interference by the courts. Otherwise trust in international commerce could be irreparably damaged.

Browne LJ, in the *Edward Owen case,* noted that Lord Denning had approved his comments in *Bank Russo-Iran v Gordan Woodroffe & Co.*[88] Browne LJ explained the fraud exception as applying where the documents are presented by the beneficiary and are forged or fraudulent, the bank is entitled to refuse payment if the bank finds out before payment, and is entitled to recover the money as paid under a mistake of fact if it finds out after payment.[89] Browne LJ added that it is not enough to allege fraud, 'it must be "established", and in such circumstances I should say very clearly established'.[90]

Geoffrey Lane J, in the *Edward Owen* case, described the standard of fraud justifying a bank not complying with the demand[91] as 'clear and obvious to the bank'. On the facts of the case, Geoffrey Lane J said it was insufficient if there was merely suspicion or the possibility of sharp practice, and found nothing approaching true evidence of fraud or anything which made fraud obvious or clear to the bank. 'Thus there is nothing, it seems to me, which casts any doubt on the bank's *prima facie* obligation to fulfil its duty under the two tests which I have set out.'[92]

Several cases, for example *Sztejn* and *United Bank Ltd v Cambridge Sporting Goods Corp,*[93] illustrate the difficulty of distinguishing between a case of false documents and a case of fraudulent shipment covered by documents which accurately describe the goods called for.

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88 (1972) *The Times,* 4 October.
89 See fn 105, below.
90 [1978] 1 All ER 976 at 984.
91 *Ibid.* Geoffrey Lane J said that the exception applies equally to demands made under a performance guarantee or letter of credit (at 986).
92 *Ibid* at 986.
93 360 NE 2d 943 (NYCA 1976), see below.

In a number of English cases, reference to the fraud exception has been expressed in terms of documentary fraud.[94] Such decisions are a clear expression that *Sztejn* extends to fraud in the documents. Lord Denning MR, in the *Edward Owen* case,[95] put the matter in simple terms, stating 'the request for payment is made fraudulently in circumstances when there is no right to payment'.

The bank may dishonour where 'a drawdown would amount to an outright fraudulent practice by the beneficiary'.[96] For example, the fraud defence does not permit dishonour even if a legitimate dispute exists concerning whether the goods conform to the underlying contract, but only where the goods are 'so obviously defective that the representation of shipment is plainly false'.[97] In *3Com Corp v Banco Do Brasil* SA,[98] the appellant argued that a statement concerning the name in which invoices were to be issued and the name of the subsequent payee of a draft amounted to fraudulent conduct. On the facts the court considered that a 'legitimate dispute' existed concerning the meaning of the statement, as the statement was 'arguably ambiguous with respect to whether it contemplates invoices issued to a third party' but for which another is liable. The statements were 'by no means an "outright fraudulent practice"'.[99]

More recently, in *Jeri-Jo Knitwear v Gulf Garments Industry,*[100] the Appellate Division of the New York Supreme Court stated that as the plaintiff had not demonstrated 'actual, intentional fraud in the underlying commercial transaction independent of any claim regarding non-conforming goods…and an award, of the equitable relief sought upon a lesser showing would subvert the salutary business purpose of a letter of credit'.

The Ontario High Court, in *Aspen Planners Ltd v Commerce Masonary & Forming Ltd,*[101] considered the question whether the court should intervene to prevent the contractor from exercising its right to payment by the bank or to prevent the bank from discharging its obligation to pay the contractor. The court declined, stating that it is 'a matter between the contractor and the bank—by reason of the dispute between the plaintiff and the contractor under the building contract'.[102] The court was concerned not to interfere with what it described as

94 See, eg, *Etablissement Esefka Int'l Anstalt v Central Bank of Nigeria* [1979] 1 Lloyd's Rep 445 at 447–48.
95 [1977] 3 WLR 764; [1978] 1 All ER 976.
96 *Recon Optical Inc v Government of Israel* 816 F 2d 854, 858 (2nd Cir 1987).
97 *3Com Corp v Banco Do Brasil SA* 171 F 3d 739 at 745; WL 15261 (2nd Cir NY 1999). This case involved a standby letter of credit for $250,000 subject to the UCP 500.
98 171 F 3d 739 1999; WL 15261 (2nd Cir NY 1999).
99 *Ibid* at 748. The court attributed its quote to *Recon Optical Inc v Government of Israel* 816 F 2d 854 (2d Cir 1987).
100 WL 93591 (NY 1999).
101 (1979) 100 DLR (3d) 546 (Henry J).
102 *Ibid* at 547.

the 'chief characteristic' of the letter of credit, namely 'its *absolute reliability* in the hands of the seller who is entitled, in the absence of fraud known to the bank, on presentation of the proper documents to receive payment for goods he has shipped or delivered regardless of any dispute between himself and the buyer'.[103]

The Supreme Court of Canada, in *Bank of Nova Scotia v Angelica-Whitewear Ltd*[104] (*Angelica-Whiterear* case) noted that the English and American decisions differed on the extent to which the fraud exception to the autonomy principle applied. In the English authorities, the letter of credit must be honoured unless false documents are fraudulently presented by the Beneficiary and the fraud is clearly established to the knowledge of the Issuing Bank at the time of the presentation of documents.[105] In the American authorities, the principle has been expanded to include fraud in the underlying contract, for example where rubbish is delivered in place of the contract goods and the letter of credit is still called on. The Supreme Court of Canada agreed with the American approach that the fraud exception should extend to fraud in the underlying transaction. The court stated that the fraud exception applies in the underlying transaction where it is 'of such a character as to make the demand for payment under the credit a fraudulent one'.[106] In the court's view, 'the fraud exception to the autonomy of a documentary credit should extend to any act of the beneficiary of a credit the effect of which would be to permit the beneficiary to obtain the benefit of the credit as a result of fraud'.[107]

In *CDN Research & Development Ltd v Bank of Nova Scotia* (No 1) *(CDN Research (No 1)),*[108] five pieces of fire fighting equipment were delivered to Iran. The letter of credit had been issued to guarantee the delivery. Notwithstanding delivery the letter of credit was called on. Galligan J issued an injunction stating that the plaintiff had made out 'a strong *prima facie* case'[109] that the demand made by the Iranian Ministry of War was fraudulent.[110]

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103 *Ibid* at 548 (emphasis added).

104 (1987) 36 DLR (4th) 161 (Beetz, Estey, Chouinard, Le Dain and La Forest JJ) (Chouinard J did not take part in the judgment).

105 Eg, see *Bank Russo-Iran v Gordan Woodroffe & Co* (1972) *The Times,* 4 October. 'In my judgment, if the documents are presented by the beneficiary himself, and are forged or fraudulent, the bank is entitled to refuse payment if the bank finds out before payment, and is entitled to recover the money as paid under a mistake of fact if it finds out after payment.' (Browne LJ.)

106 (1987) 36 DLR (4th) 161 at 176.

107 *Ibid* at 177.

108 (1980) 18 CPC 62.

109 *Ibid* at 65.

110 In *Rosen v Pullen* (1981) 126 DLR (3d) 62 at 72, the Ontario High Court of Justice agreed with Gilligan J, stating: '…it is not logical to refer to 'established fraud' or "clear fraud" on an interlocutory motion where the Court has not seen or heard the parties. In my opinion Rosen has made out a good *prima facie* case of fraud. Calling upon payment of the proceeds of the letter of credit for US$100,000 within two business days of the receipt of the letter of credit, when *prima facie* she knows she is not entitled to these proceeds constitutes fraud.'

CDN Research & Development Ltd v Bank of Nova Scotia (No 2)[111] concerned the supply of three fire engines to Iraq. Three letters of credit were involved. One letter of credit was for the purchase price of $1,922,000. The supplier was entitled to 'call down' 15%, or $288,000, but had to provide a letter of credit in case delivery was not subsequently made. A third letter of credit, for $170,183, was issued by the supplier to guarantee performance: that the equipment would work satisfactorily. The fire engines were not delivered.[112] Nevertheless, the beneficiary called on the third letter of credit. The plaintiff claimed that the call must be fraudulent.[113] Hollingworth J made a finding of fraud on the presupposition that the letter of credit was irrevocable.[114] His Honour regarded his findings as constituting 'clear fraud' and held that such a standard was sufficient to enjoin payment.

On appeal, the Ontario High Court of Justice[115] questioned the finding of fraud. Smith J, referring to a 'preliminary difficulty', stated that the court was required to differentiate 'the gap between breach and fraud'.[116] The court cited with approval the *dicta* of Lord Denning in the *Edward Owen* case.[117] Lord Denning referred to 'established or obvious fraud', which Smith J, for the Divisional Court, referred to as 'clear fraud'. On this standard, Smith J questioned whether the test of 'clear fraud' 'is too high to take us beyond the interlocutory into the realm of final determination'.[118] More pertinently, his Honour expressed concern that the clear fraud standard might 'facilitate international transactions without sufficient regard for the clear signal that a refusal to enjoin may send to those who would engage unscrupulous and fraudulent activities'. If the standard was too high, a moderate level of roguish behaviour may be forthcoming, if not encouraged.[119] Smith J regarded the test in *CDN Research (No 1),* requiring a strong *prima facie* case, as appearing 'to be more apt and is less onerous than that of Lord Denning' of clear or established fraud.[120]

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111 (1981) 32 OR (2d) 578; 122 DLR (3d) 485.

112 This was due in part to the Iraq-Iran war.

113 Notably, the main letter of credit had expired on 1 December 1980. The performance letter of credit had an expiry date of 31 July 1981. One reason for the claim of fraud includes the submission that the performance letter of credit was contingent on the main letter of credit remaining in force until payment and delivery. See 122 DLR (3d) 485 at 487.

114 Hollingworth J found that the letter of credit was revocable, but proceeded to make *obiter* findings on the presupposition that it was irrevocable: 122 DLR (3d) 485 at 490–91.

115 *CDN Research & Development Ltd v Bank of Nova Scotia* (1982) 136 DLR (3d) 656, Divisional Court (Krever, Smith and Potts JJ).

116 *Ibid* at 661.

117 See above.

118 (1982) 136 DLR (3d) 656 at 662.

119 Smith J, at 662, cites *Itek Corp v First National Bank of Boston* (1981) 511 F Supp 1341, for this proposition.

120 See also *Western Surety Co v Bank of Southern Oregon* (US Dist Ct 1999) LEXIS 8863. The Oregon court held that the applicable fraud standard is 'a material fraud by the beneficiary', and that 'it is proper for the court to go beyond the documentation required by the letter of credit'. The court determined that the bank faile to produce sufficient evidence to support a claim of material fraud.

Rockwell International Systems Inc v Citibank NA[121] is one of a series of cases referred to as the Iranian cases, because of the effect of the Iraq/Iran war. The case reflects a broad view of what is encompassed by fraud in the transaction. The court stated that it must look to the circumstances surrounding the transaction to determine whether there had been an 'outright fraudulent practice'. The circumstances the court was referring to was the war, which affected and frustrated many contractual arrangements. The court regarded it as fraud where the beneficiary had acted in such a manner as to prevent the performance of the underlying contract to obtain the benefit of the letter of credit.

Cherubino Valsangiacomo v Americana Juice Imports[122] involved a contract for US$2.4 million of grape juice concentrate. The letter of credit was for US$548,352. The beneficiary provided grapes of the wrong type and colour. The Texas Appeals Court held that this did not constitute fraud. The court stated that the applicant must 'prove not merely that [the Beneficiary] provided non-conforming goods, but rather that it committed egregious, intentional fraud'. The court noted that the applicant had 'received substantial value from its transaction'. However the court stated that if the quality of the juice was substantially inferior, the court could then 'regard the entire shipment worthless [as it would] destroy the legitimate ends of the letter of credit'.[123] Additionally, the court discussed the practicality of recovery from a foreign jurisdiction as an additional consideration. The court stated that to 'temporarily enjoin payment of letters of credit in international transactions…the law requires proof that no legal remedy exists even in a relevant foreign country'.

Fraud by the beneficiary

In *United City Merchants (Investments) Ltd v Royal Bank of Canada,*[124] loading brokers for a carrier had fraudulently misrepresented on the bill of lading the date on which the goods had been received on board for shipment. This was a material requirement of the letter of credit involved. The seller, who was the beneficiary under the letter of credit, had no knowledge of the misrepresentation. The House of Lords reiterated the importance of the autonomy principle and held that the fraud exception did not extend to fraud by a third party. Lord Diplock stated:

> To this general statement of principle as to the contractual obligations of the confirming bank to the seller, there is one established exception: that is, where the seller for the purpose of drawing on the credit, fraudulently presents to the

121 719 F 2d 583(2nd Cir 1983).
122 No 13–98–272-CV (Tex App 1999).
123 Cf *Gerald Metals Inc v UBSAG* (Conn Sup Ct 1999) LEXIS 2901.
124 [1983] 1 AC 168.

> confirming bank documents that contain, expressly or by implication, material representations of fact that to his knowledge are untrue.[125]

The court in the *Angelica-Whitewear* case observed that this statement also appears to exclude fraud in the underlying transaction, although the point is not clear, as the fraud in the case was fraud with respect to a document stipulated in the letter of credit.[126] The Supreme Court of Canada is also of the view that the fraud exception should be confined to fraud by the beneficiary, considering this to be 'a reasonable limit in principle on the scope of the fraud exception'.[127]

In the US case of *Intraworld Industries Inc v Girard Trust Bank,*[128] the court stated that, in light of the autonomy principle and its importance 'to the effectuation of the purposes of the letter of credit', an injunction is only justified in narrow limited situations of fraud. Those situations involve the wrongdoing of the Beneficiary which has 'so vitiated the entire transaction that the legitimate purposes of the independence of the issuer's obligation would no longer be served'.[129] In *First Arlington National Bank v Stathis,* the court regarded the exception for 'fraud in the transaction' as 'a narrow exception'.[130]

In *3Com Corp v Banco Do Brasil SA,*[131] the Issuing Bank claimed fraudulent conduct by the beneficiary. The beneficiary made a statement of default. The applicant claimed the beneficiary knew the statement was false because the beneficiary knew that the default was of the purchasing agent and not of the applicant. The court considered that a legitimate dispute existed and that the statement could not be considered to be 'outright fraudulent practice', which the court considered would be necessary for a finding of fraud in the transaction.

Byrne argues that the court rejected a 'narrow constructionist approach' and instead sensibly looked to the policy behind the UCP, and formulated a policy consistent with that policy.[132] The policy relates to the autonomy of the letter of credit. The principle requires certainty of expression and of purpose. The court commented positively on the connection between the doctrine of strict compliance and the need to avoid ambiguity. Strict compliance can only be applied where all parties are certain of how compliance can be achieved. Byrne reminds us that the courts have often taken a legalistic approach and the

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125 *Ibid* at 183.
126 *Bank of Nova Scotia v Angelica-Whitewear Ltd* (1987) 36 DLR (4th) 161 at 173.
127 *Ibid* at 177.
128 336 A 2d 316 (Pa SC 1975).
129 *Ibid* at 324.
130 413 NE 2d 1288 (III App 1980).
131 171 F3d 739 (2nd Cir 1999).
132 Byrne, JE and Byrnes, CS (eds), 'Case summaries' (2000) Annual Survey of Letter of Credit Law and Practice, Institute of International Banking Law & Practice Inc, MD 281, 284.

'important feature' of this court's approach is that the court took a mercantile viewpoint by looking to letter of credit policy rather than traditional judicial rules of interpretation.

In *New York Life Insurance Co v Hartford National Bank & Trust Co,*[133] the court stated that it would be only in 'rare situations of egregious fraud' that the issuer of a credit would be justified in going behind 'apparently regular, conforming documents'.

In *Rosen v Pullen,*[134] the Ontario High Court of Justice analysed a number of authorities and gave a four part conclusion on the circumstances in which the fraud exception should apply:

> …the following conclusions seem to follow:
>
> 1 Except in a case where pleadings are to be relied upon as facts (as in a motion to strike a claim: the *Sztejn* case) mere allegation of fraud by a plaintiff is no reason to restrain a bank from paying upon an irrevocable letter of credit.
>
> 2 A plaintiff must prove 'established fraud', 'clear fraud' or 'a strong *prima facie* case of fraud' by the beneficiary of the irrevocable letter of credit.
>
> 3 The fraud must be known to the bank before it has made its payments. If a bank pays upon the irrevocable letter of credit without knowledge of the fraud, the bank is protected from action.
>
> 4 It does not matter at what stage before the bank has made payment that the bank is put in knowledge of the fraud: in CDN Research [No 1] the bank was told of the fraud after it had received telex demand for payment but before it actually made payment.[135]

Interlocutory injunction

The Supreme Court of Canada in the *Angelica-Whitewear* case drew a distinction between the standard of evidence on an application for an interlocutory injunction to restrain payment under a letter of credit for fraud by the beneficiary, and the standard 'to establish that a draft was improperly paid by the issuing bank after notice of alleged fraud by the beneficiary'.[136] In the former situation, strong *prima facie* case of fraud will suffice. In the latter situation, the court held that where the Issuing Bank had to exercise its own judgment whether or not to honour a draft, the test is whether the fraud was 'so established to the knowledge of the issuing bank before payment of the draft as to make the fraud clear or obvious to the bank'.[137]

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133 378 A 2d 562 at 567 (Conn SC 1977).
134 (1981) 126DLR(3d)62.
135 *Ibid* at 69.
136 (1987) 36 DLR (4th)161.
137 *Ibid.* The Supreme Court followed the principle as laid down in *Edward Owen Engineering Ltd. Barclays Bank International Ltd* [1977] 3 WLR 164; [1978] 1 All ER 976, referred to above.

The rationale behind the judicial reasoning concerns the predicament of the Issuing Bank. On an application before a court for an injunction, the usual equitable principles apply to protect all parties concerned. However, where the Issuing Bank is to make the parallel determination on an allegation of fraud, the court in reviewing the bank's decision must be cognisant of:

- the 'strict obligation of the issuing bank to honour' presentation;
- the fact that the decision must be made 'fairly promptly';
- the difficulty in forming an opinion; and
- the hazard of a lawsuit.[138]

According to the Supreme Court of Canada, 'it would in my view be unfair and unreasonable to require anything less of the customer in the way of demonstration of an alleged fraud'.[139]

In *Discount Records Ltd v Barclays Bank Ltd,*[140] of the 8,625 records ordered, only 275 were delivered in accordance with the order and the rest were not as ordered, and were either rejects or unsaleable. A letter of credit had been issued for £4,000. An application was made alleging fraud and seeking an interlocutory injunction. Although *Sztejn's* case involved the delivery substantially of rubbish, Megarry J regarded the *Sztejn* case as a matter of 'established fraud'. Megarry J noted the 'familiar English phrase "Fraud unravels all"', but considered that the case only involved an allegation of fraud and not established fraud.[141] Megarry J adds an unnecessary element by suggesting that the standard may be extended to cases of alleged fraud 'provided a sufficient case is made out'.[142] Megarry J expressed concern that the bankers' irrevocable credit should not be interfered with, 'and not least in the sphere of international banking, unless a sufficiently grave cause is shown'.[143]

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138 *Ibid* at 177–78.

139 *Ibid.* See also *Aspen Planners Ltd v Commerce Masonry & Forming Ltd* (1979) 100 DLR (3d) 546; 25 OR (2d) 167; 7 BLR 102, HC, where the Canadian High Court refused to issue injunctions on the ground that there had been no proof of fraud.

140 [1975] 1 All ER 1071.

141 *Ibid* at 1074. It has already be noted that the *Sztejn* case was a procedural matter, involving a motion by the defendant that the facts did not disclose a cause of action. The court had to assume the facts to be true for the purpose of the hearing. See fn 65, above. Hence, the fraud was established in a fictional manner. If Shientag J remitted the matter back for a hearing on the facts and that case applied the standard espoused by Megarry J, the result, although not the law, would have been different.

142 *Ibid* at 1075.

143 *Ibid.* SH Van Houtten considers a number of cases which reflect a less strict view of the fraud exception: 'Letters of credit and fraud: a revisionist view' (1984) 62 Can Bar Rev 371 at 380–81. Van Houtten cites *Dynamics Corporation of America v Citizens & Southern National Bank* 356 F Supp 991 (ND Ga 1973); *NMC Enterprises Inc v Columbia Broadcasting System Inc* 14 UCC Rep 1427 (NYSC 1974); *United Bank Ltd v Cambridge Sporting Goods Corporation* 360 NE 2d 943 (NYCA 1976), as cases where preliminary injunctions were granted to restrain an Issuing Bank from paying under a letter of credit on the ground of beneficiary fraud, and which reflect a less strict view of the fraud exception than under UCC, s 5–114. *First Arlington National Bank v Stathis* 413 NE 2d 1288 at 1289 (III App 1980) describes 'fraud in the transaction' as 'a narrow exception'.

Recovery as a factor

On a few occasions, the courts have recognised the potential difficulty in the recovery of funds or enforcement of orders in foreign jurisdictions. This has had the effect of being included as a factor in the deliberation in granting relief where the fraud exception has been argued. In *Gerald Motors Inc v UBS AG*,[144] one factor involved the court's attitude to the Chinese legal system. The court stated that the American corporation 'may well encounter significant obstacles in the Chinese judicial system…the likelihood of getting the money back once it is paid is greatly decreased'. Similar considerations were made in the Iranian cases in the 1980s.

Risk after payment by Confirming Bank

In *Banco Santander SA v Bayfern Limited,*[145] Banco Santander was the Confirming Bank under a deferred letter of credit in favour of Bayfern and duly honoured the presentation. Bayfern asked Banco Santander to make an earlier discounted payment. Banco Santander agreed, and took an assignment of the proceeds of the letter of credit only to be informed by Banque Paribas that the latter was rejecting the documents on various grounds, including forgery. Prior to the expiry date of the letter of credit, the Issuing Bank informed Banco Santander that the documents were fraudulent. Banco Santander claimed reimbursement from the Issuing Bank pursuant to UCP 500 sub-Art 14(a).[146] The issue for the court was whether the risk of fraud by the beneficiary of a confirmed deferred payment is to be borne by the Issuing Bank or the Confirming Bank. The court held that where payment by the Confirming Bank has been made before the fraud is discovered, but prior to the expiry date, the risk lies with the Confirming Bank. The court's rationale was that the authority given by the Issuing Bank in a deferred letter of credit is to pay at maturity. The request to pay earlier did not alter this risk. Furthermore, it was held that sub-Art 14(a) could not be construed so as to entitle the Confirming Bank to reimbursement for having incurred a deferred payment undertaking prior to maturity.

See also *Foreign Venture Ltd Partnership v Chemical Bank* 399 NYS 2d 114 (App Div 1977). See also *Lumcorp Ltd v Canadian Imperial Bank of Commerce* [1977] Que SC 993, in which injunctions were refused on the ground that there had been no proof of fraud. See also *NMC Enterprises Inc v Columbia Broadcasting System Inc* 14 UCC Rep 1427 (NYSC 1974).

144 (Conn Sup Ct 1999) LEXIS 2901.

145 [1999] 2 All ER (Comm) 18.

146 UCP 500, Art 14(a) states in part: 'When the Issuing Bank authorises another bank to pay, incur a deferred payment undertaking, accept Draft(s) or negotiate against documents which appear on their face to be in compliance with me terms and conditions of the Credit, the Issuing Bank…(is) bound: (i) to reimburse the Nominated Bank…(ii) to take up the documents.'

The court distinguished between deferred payment letters of credit and acceptance credits. With a deferred payment letter of credit, a discounting bank only obtains an entitlement to the proceeds of the letter of credit by way of an assignment from the beneficiary. As a result the entitlement is subject to equities, including the risk of there being a fraud. With an acceptance credit, a discounting bank becomes a holder for value in due course of the bill of exchange and, accordingly, will not be exposed to that risk.

Unifying the fraud standard

Would it be plausible to suggest the insertion of a fraud provision in the UCP, which reflects the practice and custom of bankers and how they regard and treat fraud situations?

> Fraud is a major factor for any bank that handles letters of credit. Any attempts to reduce the ability to perfect a fraud should be applauded and changes in practice introduced.[147]

Vice President of the ICC Banking Commission, Dan Taylor, has stated that 'Jurisdiction and fraud are two matters which the UCP cannot deal with due to the legal nature of the UCP'.[148] Professor Byrne, similarly, stated that in the matter of the fraud exception 'the law takes the lead'. His view is that it is a matter which should be left to the law as 'government and public policy issues are involved' and that it is for the 'greater good' and in the 'public interest'.[149]

The rules of practice are adopted by parties as terms in a contract. Both Taylor and Byrne explicate that the rules of practice cannot rewrite local law. The terms of the contract may give rights and impose obligations on the parties; however, the parties cannot contract to permit a fraud. The applicable law may be UCC revised Art 5–109 or the Art 19 of the UN Convention.[150]

The UCP 500 does not expressly provide for a fraud exception to the autonomy principle. However, the defence is well established.[151] The ISP98 does make mention of the fraud exception, but only to state that a defence based on fraud is left to the applicable law.[152]

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147 Collyer, G, *et al,* 'How to revise the UCP: DWC experts give their suggestions' (1999) 3(5) Documentary Credit World 18 at 19.

148 Statement at the 2000 Annual Survey of Letter of Credit Law and Practice, New York, 9 March 2000. Dan Taylor is also President of the International Financial Services Association.

149 *Ibid.*

150 See Byrne, JE, 'The official commentary on the International Standby Practices' (1998) Institute of International Banking Law & Practice Inc, MD 20.

151 See notes on *Sztejn* above. See also *Recon Optical Inc v Government of Israel* 816 F 2d 854 (2nd Cir 1987).

152 ISP98, Rule 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 (eg a signed writing); or (c) defenses based on fraud, abuse, or similar matters. These matters are left to applicable law.'

Elizabeth MacDonald states the view that exemption clauses cannot operate to exclude or restrict liability for fraud by the perpetrator of the fraud.[153] This view seems to imply that the point is clear, but the fact that commercial parties have inserted such clauses may go to the factual and practical situation of reliance and, subsequently, to the proof of misrepresentation. In *Walker v Boyle,*[154] a clause stating The properties are believed to be correctly described and any incorrect statement, error or omission in the particulars shall not annul the sale' could 'have no operation where the description was to the knowledge of the vendor incorrect' in that it was 'fraudulent'.[155]

The Canadian case of *Bank of Nova Scotia v Angelica-Whitewear Ltd*[156] and cases from other jurisdictions demonstrate that there is no uniform international approach in applying the fraud exception. Variations occur in relation to the standard of fraud required to enjoin payment. The cases have used descriptors for the level of fraud including proven, gross, material, established, clearly established, outright, obvious, egregious, clear, of such a character, strong and *prima facie,* sufficient, sufficiently grave, intentional and active.

The observer may ask: why do the rules of practice, say the UCP,[157] fail to address these concerns and assist in setting an international standard? The observer must be told that the UCP is not legislation and that its rules form terms for contracts and obligations when incorporated by commercial parties. Nevertheless, the observer may still ask the question: why could not the drafters of the UCP debate the current international practice and insert appropriate articles to create international uniformity for the commercial parties? The standard response to this question has been that the courts typically would not permit the parties to contract out of fraud.

One solution would be to draft some form of international legislation, which is precisely the solution envisaged by the UN Convention and by Art 5 of the UCC. With the UN Convention, the drafters chose to avoid the term 'fraud'. Instead the Convention sets out categories of conduct and then the standards for obtaining court remedies.[158] Of course, the UN Convention has very limited application.

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153 MacDonald, E, *Exemption Clauses and Unfair Terms,* 1999, London: Butterworths. See *Pearson & Son v Dublin Corporation* [1907] AC 351 at 362, 365, HL. Also *Scheider v Heath* (1813) 3 Camp 506; *Garden Neptune Shipping Ltd v Occidental Worldwide Investment Corporation* [1990] 1 L1 Rep 330; *Skipskredittforeningen v Emporor Navigation* [1997] CLC 1151 at 1165.

154 [1982] 1 All ER 634 at 641.

155 *Thomas Witter v TBP Industries Ltd* [1996] 2 All ER 573; 12 Tr LR 145.

156 (1987) 36 DLR (4th) 161, see above. This case gives an excellent comparison of the differing standards in a number of jurisdictions.

157 The UCP is referred in the subsequent paragraphs by way of example, however the discussion equally applies to other rules of practice such as the ISP98.

158 See Arts 19 and 20. On the UN Convention, see below.

Courts will not assist in facilitating fraud. Nevertheless, could the UCP set out the consequences in certain events related to fraud without using that word? That is, the commercial parties, at the time of contracting, could agree on a standard of behaviour and agree to the subsequent granting of relief, which would typically be an injunction to restrain payment. Sir George Jessell's oft cited quote on the freedom to contract is appropriate:

> (I)f there is one thing more than another which public policy requires, it is that men of full age and competent understanding shall have the utmost liberty of contracting and that their contracts, when entered into freely and voluntarily, shall be held sacred and shall be enforced by courts of justice.[159]

By using Arts 19 and 20 of the UN Convention as a template, the word 'fraud' and the nebulous connotations associated with it can be avoided. It is my belief that the result would be greater stability in international letters of credit. It would not usurp local law. The local law on the fraud standard can still apply to extend the circumstances where relief could be granted. However, courts in such jurisdictions may appreciate the effort of the parties, via the UCP, to standardise the fraud exception. The courts may further appreciate that the parties made a considered contractual determination as to the circumstances in which relief should be granted. In such circumstances, the courts may then be reticent to 'interfere'.

In the context of the UCP 500, a possible amendment could be integrated into Art 14 as follows:[160]

> Renumber (d), (e) and (f) to (h), (i), and (j).
> 14(b)—replace 'Upon' with 'Subject to sub-Art 14(d) upon'.
> Insert new (d), (e), (f) and (g):
> (d) If it is manifest and clear that:
> (i) any document is not genuine or has been falsified;
> (ii) no payment is due on the basis asserted in the demand and the supporting documents; or
> (iii) judging by the type and purpose of the undertaking, the demand has no conceivable basis;
> the Issuing Bank and/or Confirming Bank, if any, or a Nominated Bank acting on their behalf, acting in good faith, has a right as against the beneficiary to withhold payment.
> (e) For the purposes of sub-Art 14(d)(iii), the following are types of situations in which a demand has no conceivable basis:
> (i) the underlying obligation of the applicant has been declared invalid by a court or arbitral tribunal;

159 *Printing and Numerical Registering Co v Sampson* (1875) LR 19 Eq 462 at 465.

160 When the UCP is next revised there may be many other changes. This suggestion is made to fit in within the context of the UCP 500. The reason for not drafting a new Article is that the current sub-Articles within Art 14 already apply to discrepancies which can equally apply to the circumstances of the fraud exception.

(ii) the underlying obligation has undoubtedly been fulfilled to the satisfaction of the beneficiary;

(iii) fulfilment of the underlying obligation has clearly been prevented by wilful misconduct of the beneficiary.

(f) In the circumstances set out in sub-Arts 14(d)(i), (ii) and (iii), the applicant is entitled to provisional court measures in accordance with sub-Art 14(g).

(g) (i) Where, on an application by the applicant, the Issuing Bank and/or Confirming Bank, if any, or a Nominated Bank acting on their behalf, it is shown that there is a high probability that one of the circumstances referred to in sub-Arts 14(d)(i), (ii) and (iii) is present, the court, on the basis of immediately available strong evidence, may:

(a) issue a provisional order to the effect that the beneficiary is not to receive payment, including an order that the applicant, the Issuing Bank and/or Confirming Bank, if any, or a Nominated Bank acting on their behalf hold the amount of the credit; or

(b) issue a provisional order to the effect that the proceeds of the credit paid to the beneficiary are blocked, taking into account whether in the absence of such an order the applicant would be likely to suffer serious harm.

(ii) The court, when issuing a provisional order referred to in sub-Art 14(g)(i), may require the person applying therefore to furnish such form of security as the court deems appropriate,

(iii) The court may not issue a provisional order of the kind referred to in sub-Art 14(g)(i) based on any objection to payment other than those referred to in sub-Arts (14(d)(i), (ii) and (iii), or use of the undertaking for a criminal purpose.

In new 14(h)(i) replace 'documents' where first appearing with 'documents or withhold payment'.

In new 14(h)(ii) add at end, 'or must state all grounds in respect of which the bank is withholding payment, as the case may be'.

The concept of fraud is substituted with specific behaviour and circumstances enunciated by sub-Arts 14(d) and (e). Sub-Articles 14(d), (e), (f) and (g) are the same as UN Articles 19(1), (2), (3) and 20 respectively with 'Issuing Bank and/or Confirming Bank, if any, or a Nominated Bank' replacing 'guarantor/ issuer', 'applicant' replacing 'principal/applicant' and UN sub-Arts 19(2)(a) and (e) not

161 UN, Art 19(2)(e) applies to demand guarantees. UN, Art 19(2)(a) would typically apply to guarantees, however, it could apply to standby letters of credit. The proposed amendment could be altered to include this provision.

used.[161] Sub-Article 14(h) (formerly 14(d)) is altered to deal with the situation where the bank withholds payment for the reasons set out in the new sub-articles.

The role of the bank is not fully understood by lawyers. The goodwill, the trust and the comradery of the banks, and perhaps their ratings and reputation, are more important to the banks than the law. The motivating factor for a bank's actions in letters of credit and other financial matters, is more often the banks' desire to maintain this reputation, and the secondary factor will be the law. Bankers have a different point of view than lawyers. The success of letters of credit is due to the fact that banks recognise their mutual trust in the financial world.

It must be acknowledged that the customary law character of the UCP militates against a fraud provision. A not insignificant amount of the success of the UCP is due to its ability to reflect the best banking practices rather than litigation inspired rules. The key question in this context is whether it would be plausible to suggest that inserting a fraud provision could reflect the practice and custom of bankers and how they regard and treat such fraud situations.

For the purposes of validating the argument in favour of an international customary law treatment of remedies against fraud, is could be argued, that empirical proof is needed to establish the types of fraud involved and the effect that the amendments on reducing fraud should be considered.

The expression 'types of fraud' refers to the level and standard of the fraudulent acts arising in the letter of credit transaction and discussed in the cases above. The task of determining the 'types of fraud' would be left to the drafters of the rules of practice. The drafters of the UCP 500, of the latter versions of the UCP and of the ISP98 have exhibited great skill, determination and patience in crafting these rules. Each draft has taken years and has involved the input of many experts, academics and commercial parties.[162] The 'empirical' evidence would be forthcoming from the input of these parties, and the Banking Commission[163] could formulate the necessary wording to reflect the input. My submission emulates the UN Convention.

The effect that the amendments would have in reducing fraud is not a relevant issue. Whilst the number of fraudulent incidents is important to the commercial parties, the aim of the amendments is to create certainty when particular conduct arises. If the amendments would not increase the incidence of such conduct, then the extent of fraud is not a relevant issue.

Two extremes should be considered. The first is a jurisdiction where a high standard of fraud is required before enjoining payment, and the second is a jurisdiction where a low standard of fraud is required. The UK is an example of the former. In the UK, the fraud standard is intentional deceit by or known to

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162 See the forward to the UCP 500 and the preface to the ISP98.
163 In the case of the UCP.

the beneficiary. Any proposal would serve to permit agreed additional circumstances in which remedies could apply. The application would create greater uniformity and certainty.

In a jurisdiction where the standard is lower, one could argue that the amendments are superfluous, that the local law provides all the remedies explicated in the amendments. However, the remedies would also be available for other lesser breaches. The counter argument is that the courts may recognise that the amendments, for example in the UCP, are the uniform customs and practice of the international commercial parties. Courts would be encouraged to apply and limit action to the stated standard. Again, greater uniformity and certainty is encouraged.

Where the parties do not know which jurisdiction will apply, the parties should have a greater expectation of the type of conduct attracting remedies, and of the nature of those remedies.

Jurisdiction

An alternative to amending the rules of practice is for the commercial parties expressly to select a jurisdiction to apply to their letter of credit. Contracting parties are generally at liberty to include an express choice of law and choice of forum clause into their agreements.[164] In *3Com Corp v Banco Do Brasil SA,*[165] the letter of credit was issued in Brazil and the beneficiary presented the documents in California; nevertheless, New York was the forum as the parties had placed reliance on New York law in their briefs, which was determinative as to the application of the forum's law.

In this manner, the dilemma of the unknown is diminished if not removed. The parties can choose the proper law of the transaction which most suits their needs and which increases certainty.

UN Convention

Few provisions of the UN Convention[166] make substantive changes to the relatively acceptable level of custom, practice and interpretation currently experienced under the applicable international rules of practice for both independent guarantees and letters of credit. Central to the Convention's ideology is treatment given to allegations of fraud or abuse in demands for payment in undertakings. One stated main purpose of the Convention is to

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164 See *Compagnie d'Armement Maritime SA v Compagnie Tunisienne de Navigation SA* [1971] AC 572. Cf *Golden Acres Ltd v Queensland Estates Pty Ltd* [1969] Qd R 378. Eg, *Cantrade Privatbank AG Zurich v Bangkok Bank Public Company Ltd* 681 NYS 2d 21 (1998).

165 171 F 3d 739 (2nd Cir 1999); WL 15261 (2nd Cir NY).

166 United Nations Convention on Independent Guarantees and Standby Letters of Credit.

establish greater uniformity internationally in the manner in which guarantors, issuers and courts respond to allegations of fraud or abuse in demands.[167] Fraud has been a topic that has been 'particularly troublesome and disruptive' in practice. Notwithstanding numerous cases of actual fraud, often allegations of fraud are a fallback strategy for the guarantor or issuer where a dispute has arisen in the underlying contract. The differing approaches and interpretations taken by various jurisdictions complicate the area.[168] The official Explanatory Note to the Convention expresses this concern in the following terms:

> That difficulty and the resulting uncertainty have been compounded further because of the *divergent notions* and ways with which such allegations have been treated both by guarantor/issuers and by courts approached for provisional measures to block payment.[169]

Allegations of fraud and abusive demands threaten the integrity of the undertaking and jeopardise the commercial viability of the undertaking. The Convention aims to ameliorate the problem by the inclusion of circumstances in which courts may order that payment be blocked. Although the word fraud is not used in the Convention, the exceptions to the payment obligation parallel the accepted fraud exception.

Article 19 of the Convention is headed appropriately 'Exception to the payment obligation'. However, the precise exceptions contained in the article are designed to deal with specific instances and acts. Such an approach is to be welcomed, considering the divergent opinions expressed by various jurisdictions.[170] Article 19 encompasses fact patterns covered in different legal systems by notions such as 'fraud' or 'abuse of right'. The Convention deliberately avoids the use of the more nebulous term 'fraud' and avoids the multiplicity of definitions, interpretations and complications inherent in the case law. Article 19(1) encompasses situations in which it is manifest and clear that:

- Any document is not genuine or has been falsified.
- No payment is due on the basis asserted in the demand or that the demand has no conceivable basis.
- Judging by the type and purpose of the undertaking, the demand has no conceivable basis.
- In these circumstances, the guarantor or issuer, acting in good faith, is given the right as against the beneficiary to withhold payment.
- For the purposes of clarity, the Convention provides illustrations of situations in which a demand has no conceivable basis:

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167 See official Explanatory Note to the Convention, para 45.
168 *Ibid.*
169 *Ibid* (emphasis added).
170 See above.

- the contingency or risk against which the undertaking was designed to secure the beneficiary has undoubtedly not materialised;
- the underlying obligation of the principal or applicant has been declared invalid by a court or arbitral tribunal, unless the undertaking indicates that such contingency falls within the risk to be covered by the undertaking;
- the underlying obligation has undoubtedly been fulfilled to the satisfaction of the beneficiary;
- fulfilment of the underlying obligation has clearly been prevented by wilful misconduct of the beneficiary.[171]

By setting the standard and presenting examples, the Convention is able to redress the inadequacies of the rules of practice approach. The evolution of the customs and practice of letters of credit ignored the fraud exception. The UCP, ISP98 and the Uniform Rules for Demand Guarantees (URDG) cannot define predetermined fraud standards whereby the guarantor or issuer is entitled to withhold payment. The UCP makes no attempt to deal with the fraud exception at all, leaving the matter to the courts. The ICC Banking Commission has debated the issue on several occasions and made the conscious choice to leave the matter to the courts.[172] The URDG similarly leaves the question of the fraud exception to the courts. The ISP98 expressly provides that it does not define or otherwise provide for defences based on fraud, abuse, or similar matters and that these matters 'are left to applicable law'.[173]

There are two circumstances in which the fraud exception may be relied upon. In the words of the Scottish Court of Sessions, in *Royal Bank of Scotland v Holmes:*[174]

> The authorities disclose two situations in which [the fraud exception] may be relied upon. It may be deployed in support of an application for interdict to prevent the bank from meeting a demand made by the beneficiary in the letter of credit or guarantee, where the bank's customer is in a position to satisfy the court that there is a *prima facie* case that the beneficiary is acting fraudulently in making the claim, and that the balance of convenience favours *interim* interdict… The fraud exception may also be deployed as a defence to a claim for reimbursement by the bank against its customer in respect of sums paid in response to the demand of the beneficiary in the letter of credit or guarantee.

The latter situation arises where the Confirming or Issuing Bank has decided that the material brought before it, otherwise in support of applying the fraud exception, was insufficient to withhold payment. Where the issuer wishes to

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171 Article 19(2). See also the official Explanatory Note, para 47.
172 del Busto, C (ed), *Documentary Credits—UCP 500 & 400 Compared,* ICC Brochure No 511, 2 and 49.
173 Rule 1.05.
174 [1999] Scot CS 10 at 29; SLT 563.

avoid reimbursement to the bank, the issuer must show that a fraud has indeed been committed by the beneficiary, and contrary to the bank's position, the material was sufficient evidence of fraud to justify the bank refusing payment.

The Convention appropriately refers only to the right of the guarantor/issuer to withhold payment. There is no need for the Convention, or any ancillary rules applicable to letters of credit or demand guarantees, separately to deal with the second situation as enunciated in the *Holmes* case. Although there are no cases to date, due to the recent and limited application of the Convention, where circumstances arise in which the guarantor/issuer declines to exercise the right, as granted by Art 19(1), the principal/applicant correspondingly would question why the guarantor/issuer failed to exercise the right. The contractual relationship between the principal/applicant and guarantor/issuer would impliedly, if not expressly, require the latter to act in good faith and in the best interests of the former. Whilst the guarantor/issuer has an obligation to the beneficiary to make payment on due presentment, this obligation is contemporaneous with the contractual obligation to the principal/applicant to act in the interests of the latter where fraud arises, or more specifically, an Art 19(1) situation arises. Just as the guarantor/issuer should consider the position of the principal/applicant where discrepant documents are presented, the guarantor/issuer can be held contractually liable if the right to withhold payment is not exercised to the detriment of the principal/applicant.

Article 19(1) strikes a balance between the competing interests and considerations of the parties involved. The official Explanatory Note to the Convention explicates that by giving the guarantor/issuer a right and not a duty and by requiring a good faith component, the Convention is 'sensitive to the concern of guarantor/issuers over preserving the commercial reliability of undertakings as promises that are independent from underlying transactions'.[175]

The Convention does not annul any rights that the principal/applicant may have in accordance with its contractual relationship with the guarantor/issuer to avoid reimbursement of payment made in contravention of the terms of that contractual relationship.[176]

Where the right arises under Art 19(1), the Convention affirms that the principal/applicant is entitled to provisional court measures to block payment. The level of fraud typically required for court intervention in similar circumstances under the UCP, ISP98 and URDG is fraught with inconsistent judgments and considerations. Article 20 spells out the circumstances in which the parties agree to the issue of provisional court measures.[177]

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175 Paragraph 48.

176 See official Explanatory Note, para 49.

177 Article 20(1): 'Where, on an application by the principal/applicant or the instructing party, it is shown that there is *a high probability* that, with regard to a demand made, or expected to be made, by the beneficiary, one of the circumstances referred to in sub-paragraphs (a), (b) and (c) of parargraph [cont]

The standard of proof is established in Art 20. Orders may be made where it is shown that there is a 'high probability' of the Art 19(1) fraudulent or abusive circumstances 'on the basis of immediately available strong evidence'. Additionally, the court must consider whether the principal/ applicant would be 'likely to suffer serious harm' in the absence of the provisional measures. In this regard the court may require the applicant for the order to furnish security.

Article 20(3) adds that the provisional court orders blocking payment or freezing proceeds may also be made in the case of use of an undertaking for a criminal purpose.

Balancing competing principles

The fraud exception has been fashioned, even from the *Sztejn* decision, not to violate the autonomy principle. The courts have kept a balance between maintaining the integrity, certainty and stability of the letter of credit as an international *tour de force,* with ensuring that rogues do not profit from their actions and that the letter of credit is not used as a vehicle to facilitate fraud.[178]

In *Dynamics Corporation of America v Citizens & Southern National Bank,*[179] the court, without coming to a conclusion, wrestled with the competing views of considering the plaintiff's 'chance of winning this suit'. 'There is as much public interest in discouraging fraud as in encouraging the use of letters of credit.'[180] Too few courts have recognised the need to balance to competing interests, in particular, appreciating the importance of maintaining the integrity and credibility of the letter of credit.

Bernard Wheble sardonically states: '…(t)he way to avoid fraud is to avoid

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(1) of article 19 is present, the court, *on the basis of immediately available strong evidence,* may: (a) Issue a provisional order to the effect that the beneficiary does not receive payment, including an order that the guarantor/issuer hold the amount of the undertaking; or (b) Issue a provisional order to the effect that the proceeds of the undertaking paid to the beneficiary are *blocked,* taking into account whether in the absence of such an order the principal/applicant would be likely to suffer serious harm. (Emphasis added.)

178 Hence the well respected statement, 'It is only in exceptional cases that the courts will interfere with the machinery of irrevocable obligations assumed by banks': Kerr J in *RD Harbottle (Mercantile) Ltd v National Westminster Bank Ltd* [1977] 3 WLR 752 at 761; 2 All ER 862 at 870. Fellinger, GA, concludes that 'the utility of letters of credit in international transactions no longer presents a compelling rationale for upholding a strict autonomy rule': 'Letters of credit: the autonomy principle and the fraud exception' (1990) 2 Journal of Banking and Finance Law 4 at 7. See also I Thodos, N, 'Mareva injunction, attachment and the independence principle: balancing the interests' (1995) 6 Journal of Banking and Finance Law and Practice 101.

179 356 F Supp 991 (ND Ga 1973).

180 *Ibid* at 1000.

181 Wheble, B, 'Revisions compared and explained (documentary credits)' UCP 1974/1983, ICC Pub No 411; (1984) 15.

dealing with a rogue.'[181] Wheble is referring to circumstances where fraud cannot be avoided. Leaving the matter purely to actions at law based on the underlying contracts will prove inadequate. Only attacking the disease at the root will accord a sense of justice. This has been recognised since at least *Derry v Peek* and adopted and used by courts dealing with letter of credit issues.

Canadian Provincial Legislative Powers and Aboriginal Rights Since *Delgamuukw*: Can a Province Infringe Aboriginal Rights or Title?

Margaret Stephenson[1]

In 1888, the Judicial Committee of the Privy Council in the case of *St Catherine's Milling* signalled to the provinces that Aboriginal title lands would not be available as 'a source of revenue' to the provinces until that title had been extinguished.[2] One hundred years later, the Privy Council's statement continues to be a valid warning to provinces in their dealings with Aboriginal title lands. In the 1997 decision of *Delgamuukw v British Columbia,*[3] the Supreme Court left the question of provincial jurisdiction to infringe or regulate Aboriginal title unclear and unresolved.

The *Delgamuukw* court clarified that federal government's legislative and executive jurisdiction over 'Lands reserved for the Indians' under s 91(24) of the Constitution Act 1867 includes within its meaning Aboriginal title lands.[4] Given that federal jurisdiction over Aboriginal title is exclusive under s 91 (24) of the Constitution Act 1867, could a province have the constitutional power to infringe or regulate Aboriginal title? In this paper I will examine the consequences of exclusive federal jurisdiction over Aboriginal title lands. I will consider the impact of this on the provinces' jurisdiction and the extent to which provincial laws can apply to Aboriginal title lands. I will further discuss the constitutional question of whether a province can infringe or affect Aboriginal title or Aboriginal rights. If the provinces are found to have no

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2 *St Catherine's Milling Co v R* [1889] 14 AC 46 at 59. 'The fact that the power of legislating for Indians and [their lands] has been entrusted to…the Parliament of the Dominion is not in the least degree inconsistent with the right of the Provinces to a beneficial interest in these lands, available to them as a source of revenue whenever the estate of the Crown is disencumbered of the Indian title.' See Foster, H, 'Aboriginal title and the provincial obligation to respect it: is *Delgamuukw v British Columbia* "invented law"?' (1998) 56 The Advocate 221.

3 [1997] 3 SCR 1010; 153 DLR (4th) 193 (hereinafter *Delgamuukw*). Although the Supreme Court at 1107 and 1109, found that the provinces had neither the power nor the jurisdiction to extinguish Aboriginal title, it was suggested that provinces have the power to infringe or regulate Aboriginal title. However, this latter issue was not examined in depth. The court in *Delgamuukw* focused on defining the content of Aboriginal title to land, the requirements as to proof of Aboriginal title, and the use of oral histories as evidence.

4 Constitution Act 1867 (UK), s 91(24), Chapter 3 (hereinafter Constitution Act 1867). See *Delgamuukw* [1997] 3 SCR 1010 at 1116–18, *per* Lamer CJC.

power to infringe Aboriginal title, serious consequences will result for provincial land and resource development laws which affect Aboriginal title.

Resolution of the above issues first requires an examination of the distribution of powers between federal and provincial legislatures under the Constitution Act 1867 in relation to Indian matters.[5] It is essential to ascertain the applicable principles for determining which enacted laws apply to Aboriginal lands and to Aboriginal rights. Secondly, an examination of jurisdiction is required to determine whether any applicable laws are capable of extinguishing, infringing or regulating Aboriginal rights or title to land.

Jurisdiction and the division of powers

Provincial legislative powers are set out primarily in s 92 of the Constitution Act 1867. Provincial jurisdiction under s 92 includes general jurisdiction over property and civil rights.[6] Section 91(24) of the Constitution Act 1867 vests in the federal parliament exclusive power to legislate in relation to Indians, and Lands reserved for the Indians'. Thus federal parliament, on the authority of s 91(24), is given power to legislate in relation to matters usually within provincial jurisdiction, such as property and civil rights, where Indians and reserved lands are concerned.

In accordance with general constitutional principles, if a subject matter is exclusively within the provincial sphere it would be outside federal legislative competence, and so federal legislation involving such subject matters would be invalid.[7] However, pursuant to s 91(24), federal legislation that applies to Indians will be valid provided that it can be categorised to be 'in pith and substance' as dealing with Indian matters. The federal parliament has validly legislated on matters such as education, wills and estates in relation to Indian concerns, although these are areas within the provincial legislative domain. As

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5 Section 91(24) states that 'Indians, and Lands reserved for the Indians' are under the exclusive legislative authority of the Parliament of Canada. See generally for a discussion of s 91(24) Hogg, P, *Constitutional Law of Canada,* loose-leaf, 4th edn, 1997, Toronto: Carswell, Chapter 27; McNeil, K, 'Aboriginal title and the division of powers: rethinking federal and provincial jurisdiction' (1998) 61 Saskatchewan L Rev 431; McNeil, K, *Defining Aboriginal Title in the 90s: Has the Supreme Court Finally Got It Right?,* 1998, Toronto: Robarts Centre for Canadian Studies, York University; Slattery, B, 'The constitutional guarantee of Aboriginal and treaty rights' (1983) 8 Queens LJ 233; Slattery, B, 'First nations and the constitution: a question of trust' (1992) 71 Canadian Bar Rev 261; Slattery, B, 'Understanding Aboriginal rights' (1987) 66 Canadian Bar Rev 727; Hughes, P, 'Indians and lands reserved for the Indians: off limits to the provinces?' (1983) 21 Osgoode Hall LJ 82; Sanders, D, "The application of provincial laws', in Morse, BW (ed), *Aboriginal Peoples and the Law,* 1989, Ottawa: Carleton UP.

6 Section 92, however, contains no jurisdiction for the provinces to make laws in relation to Indians or Indian lands. See generally Reiter, RA, *The Law of First Nations,* 1996, Canada: Juris Analytica Publishing Inc, 192.

7 The second part of s 91(24) is an exception to the provinces' general jurisdiction over property. However, Parliament under the pogg (peace, order and good government) residual power in s 91 can legislate in provincial areas of jurisdiction in national emergencies and for matters of pressing national importance. See Hogg, *op cit,* fn 5, Chapter 17.

'Indians, and Lands reserved for the Indians' are within the federal sphere, a province has no power to legislate in relation to such matters. However, provincial laws that address matters falling within provincial jurisdiction can apply to areas within the federal sphere.[8] This overlapping of provincial and federal jurisdiction is referred to as the 'double aspect' doctrine[9] and allows certain provincial laws of general application to apply to Aboriginal people. This will be dealt with below.

Federal jurisdiction

The exclusive federal legislative power in s 91(24) over 'Indians, and Lands reserved for the Indians' comprises two heads of power: one that applies only to 'Indians', whether they reside on reserve lands or not; and another that extends to both Indians and non-Indians where laws relate to 'Lands reserved for the Indians'.[10] However, exactly what these heads of power comprise is not always clear.[11] Pursuant to s 91(24) of the Constitution Act 1867 the federal parliament enacted the Indian Act.[12]

The meaning of 'Lands reserved for the Indians'

Exactly which lands will come within the meaning of 'Lands reserved for the Indians'?[13] The phrase, 'Lands reserved for the Indians', has always been recognised as including land specifically set aside as Indian reserves.[14] Generally, reserved land comprises land held by Indians by virtue of a Crown grant, by legislation, land set aside by the Crown as a reserve, or land excepted from a surrender by Indians of land to the Crown.[15] In *St Catherine's Milling,* the Privy Council held that all lands reserved in any way (including lands

8 In relation to jurisdiction regarding Indians, see *Delgamuukw* [1997] 3 SCR 1010; 153 DLR (4th) 193 at 1115–21; see also *Cardinal v Attorney General of Alberta* [1974] SCR 695 at 703. See generally Slattery (1987), *op cit,* fn 5, 776 and see Hogg, *op cit,* fn 5, Chapter 27.

9 See Hogg, P, *Constitutional Law of Canada,* Student Edition 2002, Toronto: Carswell, 363–64, 401–18.

10 See Hogg, *op cit,* Ch 27–2. See also Lysyk, KM, The unique constitutional position of the Canadian Indian' (1967) 45 Canadian Bar Review 513 at 514. See *Four B Manufacturing Ltd v United Garment Workers* [1980] 1 SCR 1031; [1979] 4 CNLR 21 at 26, Beetz J stated that:
'The power of Parliament to make laws in relation to Indians is the same whether Indians are on a reserve or off a reserve. It is not reinforced because it is exercised over Indians on a reserve any more than it is weakened because it is exercised over Indians off a reserve.'

11 See Woodward, J, *Native Title,* loose-leaf, Scarborough, Ontario: Carswell, 88.

12 RSC 1985, c I–5. This legislation generally, although not exclusively, applies to Indians as defined by the Indian Act.

13 See generally Slattery (1987), *op cit,* fn 5 'Understanding Aboriginal rights' at 772–74. Lands in which Aboriginal people have an interest generally comprise Aboriginal title lands (recognised by the common law) and reserve lands. In some cases reserve land may be traced to common law Aboriginal title.

14 See Hogg, *op cit,* fn 5, Ch 27–5. 'Reserve' is defined in part in s 2 of the Indian Act to mean a tract of land, the legal title to which is vested in Her Majesty, that has been set apart by Her Majesty for the use and benefit of a band.

15 See Slattery (1987), *op cit,* fn 5, 771.

reserved by the Royal Proclamation of 1763) are 'Lands reserved for the Indians'.[16] Lamer CJC relied on this in *Delgamuukw* to include Aboriginal title lands within the meaning of 'Lands reserved for the Indians' and thus within federal jurisdiction.[17] Prior to *Delgamuukw* it was unclear whether Aboriginal title at common law was under federal or provincial jurisdiction.[18] The Supreme Court in *Delgamuukw* recognised that the federal head of constitutional power over 'Indians, and Lands reserved for the Indians' encompasses not only jurisdiction over reserve lands but also jurisdiction to legislate in relation to all land held under Aboriginal title.[19] In *St Catherine's Milling,* the Privy Council observed that 'it appears to be the plain policy of the Act that, in order to ensure uniformity of administration, all such lands, and Indian affairs generally, shall be under the legislative control of one central authority'.[20]

The Delgamuukw court recognised that not only did exclusive federal jurisdiction extend to Aboriginal title, but it also included jurisdiction over Aboriginal rights.[21] Lamer CJC considered that the federal jurisdiction over 'Indians' in s 91(24) included a 'core of Indianness' which encompassed the whole range of Aboriginal rights,[22] including practices, customs and traditions which are not tied to the land.[23] Those rights within the 'core of Indianness' were recognised by Lamer CJC as being beyond the range of legislative competence.[24] Thus, the federal government's exclusive legislative power in

16 The Privy Council in *St Catherine's Milling* (1889) 14 AC 46 at 59, *per* Lord Watson, found that reserved land includes all lands reserved, upon any terms or conditions, for Indian occupancy. The Privy Council considered that s 91(24) covers not only those tracts of land set aside after the Royal Proclamation of 1763 but also land occupied by virtue of the Royal Proclamation.

17 *Delgamuukw* [1997] 3 SCR 1010 at 1116–17.

18 See *Roberts v Canada* [1989] 1 SCR 322.

19 Lamer CJC in *Delgamuukw* [1997] 3 SCR 1010 at 1117, as did Macfarlane in the Court of Appeal in *Delgamuukw v British Columbia* (1993) 104 DLR 470, (hereinafter *Delgamuukw* (CA)) found that the Privy Council in the *St Catherine's Milling* case, (1889) 14 AC 46 at 59, had settled the issue that those words include lands held by Aboriginal title.

20 *St Catherine's Milling, ibid* at 59. As Lamer CJC said in *Delgamuukw, ibid* at 1117, the effect of this decision was to separate the ownership of lands held pursuant to Aboriginal title from jurisdiction over those lands. See, Slattery (1987), *op cit,* fn 5, 774.

21 *Delgamuukw, ibid* at 1118.

22 *Delgamuukw, ibid* at 1119. In *Delgamuukw, ibid* at 1117–8, Lamer CJC further stated that 'separating federal jurisdiction over Indians from jurisdiction over their lands would have a most unfortunate result—the government vested with primary constitutional responsibility for securing the welfare of Canada's Aboriginal peoples would find itself unable to safeguard one of the most central of Aboriginal rights and interests—their lands'.

23 *Delgamuukw, ibid* at 1119.

24 *Delgamuukw, ibid* at 1119. Lamer CJC noted that the Court has held that s 91(24) protects a 'core' of Indianness from provincial intrusion, through the doctrine of interjurisdictional immunity. His Honour further stated that 'Provincial governments are prevented from legislating in relation to both types of Aboriginal rights' ie, rights in relation to land and other rights. Lamer CJC did not define the complete extent of the 'core of Indianness'. It had been indicated that exclusive federal jurisdiction would extend to the status and capacity of Indians. See *Natural Parents v Superintendent of Child Welfare and The Petitioners For Adoption* [1976] 2 SCR 751 at 760–63 (hereinafter *Natural Parents v Superintendent of Child Welfare*).

relation to specific Aboriginal rights such as fishing and hunting was acknowledged.

Implications of exclusive federal jurisdiction

What implications follow from the exclusive federal jurisdiction over Aboriginal title and rights? Both reserve lands[25] and Aboriginal title lands involve a right to the 'exclusive use and occupation' of the land;[26] therefore it would be expected that jurisdictional powers over both types of land would be similar. As the federal government has exclusive jurisdiction in relation to Aboriginal lands, this would mean that, prior to the constitutional entrenchment of Aboriginal rights in 1982,[27] the federal parliament would have had the exclusive power to extinguish Aboriginal title.[28]

Another implication of the federal government's exclusive jurisdiction in relation to Aboriginal title is that grants of title issued by the provinces, where Aboriginal title was unextinguished, could potentially be invalid. (In British Columbia this would involve grants from 1871, when British Columbia joined the Confederation.) The provincial underlying title would remain subject to the Aboriginal title. Any action here by the Aboriginal title holders might, however, be subject to the statutes of limitation. Statutes of limitation, being provincial statutes and not federal statutes, will be subject to the same rules of application to which provincial laws are subject in relation to Aboriginal lands.[29]

Doctrine of interjurisdictional immunity

Section 91(24) of the Constitution Act 1867 protects a 'core' of federal jurisdiction from provincial laws of general application through the doctrine of

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25 Refer to the definition of 'reserve' in s 2 of the Indian Act.

26 In *Delgamuukw* [1997] 3 SCR 1010 at 1083, Lamer CJC recognised Aboriginal title as a right to the exclusive use and occupation of the land. See also Dickson J in *Guerin v Canada* [1984] 2 SCR 335 at 379, recognising that the interest in Aboriginal title and reserve lands is the same. This was affirmed by Lamer CJC in *Delgamuukw* at 1085.

27 Constitution Act 1982, s 35.

28 This was recognised in *Delgamuukw* [1997] 3 SCR 1010 at 1119. Extinguishment is discussed in detail below. It was also recognised by Lamer CJC in *R v Van der Peet* [1996] 2 SCR 507 at 538 that the enactment of s 35(1) of the Constitution Act 1982, prevents even Parliament from extinguishing Aboriginal rights.

29 Provincial legislation, including statutes of limitation, may not apply to Aboriginal title, unless referentially incorporated by federal legislation under s 88 of the Indian Act. Refer to the discussion below. In the British Columbia Supreme Court decision in *Stoney Creek Indian Band v British Columbia* [1998] BC 2468 (currently on appeal to the BCCA) Lysyk J found that the provincial Limitations Act was not applicable to extinguish a cause of action for damages for an unauthorised road on Indian land and for possessory title. The British Columbia Court of Appeal (Quicklaw [1999] BCJ No 2196 6 October 1999) overruled (on a technicality) the decision of Lysyk J. It was considered that this issue was not suitable for resolution in a summary way without consideration of all the evidence and in addition because of an important constitutional implication of the case the appeal court thought it unjust to reach such a conclusion. See also *Chippewas of Sarnia Band v Canada* [1999] OJ 1406, (Quicklaw) (AG) decision of the Ontario (Gen Div) 1999 (on appeal to the Ontario Court of Appeal) where it was found that provincial limitation statutes were not constitutionally applicable in a claim for recovery of Aboriginal title land.

interjurisdictional immunity. This doctrine prevents the provinces from enacting legislation which affects a vital part of the subject matter within the exclusive federal jurisdiction.[30] Otherwise valid provincial laws will be read down if the doctrine of interjurisdictional immunity is infringed. The 'core' of subject matter of federal jurisdiction has been described as laws that affect 'Indians *qua Indians*' or 'Indianness',[31] the 'core of Indianness',[32] the 'status or capacity' of Indians,[33] or the 'use and possession of land'.[34] It is for this reason that provincial laws which affect 'Indianness' are unable, of their own force, to affect Aboriginal rights or title.[35] However, it may be possible for laws of general application that affect Indians to be referentially incorporated into federal law by s 88 Indian Act to apply to Indians.[36] But it is doubtful whether referential incorporation would allow such laws to apply, through s 88 of the Indian Act, to reserve lands, as the weight of the case law and legal principle is against such an interpretation.[37] The above mentioned principles, together with the doctrine of interjurisdictional immunity, would be applicable to Aboriginal lands.[38]

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30 See Beetz J in *Four B Manufacturing v United Garment Workers* [1980] 1 SCR 1031 at 1047. See also *Bell Canada v Quebec* [1988] 1 SCR 749.

31 *Four B Manufacturing* [1979] 4 CNLR 21 at 25. See also *R v Sutherland* [1980] 2 SCR 451 at 455; *Re Stony Plain Indian Reserve No 134* [1982] 1 WWR 302 at 321–22 (Alta CA). The phrase 'Indianness' is used by Beetz J in *Dick v The Queen* [1985] 2 SCR 309 at 326 (hereinafter *Dick's* case). See also *Four B* at 25.

32 See *Dick's* case, *ibid* at 326, 315. See *R v Francis* [1988] 1 SCR 1025.

33 See *Kruger and Manuel v R* [1978] 1 SCR 104 at 110 where Dickson J stated that:

> 'The fact that a law may have graver consequences to one person than to another does not, on that account alone, make the law other than one of general application…. The line is crossed, however, when an enactment, though in relation to another matter, by its effect impairs the status or capacity of a particular group.'

Beetz J in *Dick's* case [1985] 2 SCR 309 at 323–24 explained that laws which crossed the line of general application were those which either overtly or colourably, single out Indians for special treatment or impair their status as Indians. See also *Natural Parents v Superintendent of Child Welfare* [1976] 2 SCR 751 at 761.

34 See *Derrickson v Derrickson* [1986] 1 SCR 285 (hereinafter *Derrickson*); *Corporation of Surrey v Peace Arch* (1970) 74 WWR 380 (BCCA); *Paul v Paul* [1985] 2 CNLR 93. Contrast and compare *Oka (Municipality) v Simon* [1998] 2 CNLR 205 where the Quebec Court of Appeal found that the only use of land that came within the 'core of Indianness' was an Indian use.

35 Similarly provincial laws are not able to affect treaty rights. (See s 88 of the Indian Act.)

36 Refer to the discussion of s 88 Indian Act below. This is supported by *Dick's* case [1985] 2 SCR 309 that s 88 of the Indian Act applied to referentially incorporate provincial laws that affected Indianness by impairing the status or capacity of Indians; in this case in relation to Indian hunting. The legislation in question was a law of general application and thus applicable to the Indian person by referential incorporation. See Hogg, *op cit,* fn 5, Ch 27. See Slattery (1987), *op cit,* fn 5, 774–82.

37 See McNeil, K, 'Aboriginal title and section 88 of the Indian Act' (2000) 34(1) UBC Law Review 159; Bankes, N, '*Delgamuukw,* division of powers and provincial land and resource laws: some implications for the provincial resource rights' (1998) 32(2) UBC Law Review 317 and see Peeling, A, 'Provincial jurisdiction after *Delgamuukw*', presented at the British Columbia Continuing Legal Education Society Conference, Vancouver, March 1998.

38 In *Delgamuukw* [1987] 3 SCR 1010, it was accepted that this doctrine did apply to Aboriginal land. See Lamer CJC at 1121.

'Core' of exclusive federal jurisdiction

Exactly what does the 'core of Indianness' comprise? 'Indianness' would comprise the essential characteristics of the Indian people as a people.[39] It has been described broadly as including the 'political, social and economic life of the Indian community'.[40] 'Indianness' will vary from group to group depending on the essential culture of the Indian group. Certainly the right to the 'use and possession' of land would be a part of the 'core of Indianness', and therefore the Indian right to use and possess the land could not be affected by provincial law.[41] However, in *Oka (Municipality) v Simon,*[42] the Quebec Court of Appeal found that while the exclusive core of federal jurisdiction includes the possession of land and the Indian use of the land, it does not necessarily include general use of the land. On this view, provincial laws of general application could apply of their own force if they do not affect the Indian use of the land. Hunting and fishing by many Aboriginal people on reserve land is not only an important part of their lives, but also involves the use of land and would be a part of the 'core of Indianness',[43] In *Van der Peet,*[44] Lamer CJC described Aboriginal rights as activities which were integral to the distinctive Aboriginal culture of the group claiming the right. Any such activities, whether on reserve land or not, which meet this

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39 See Reiter, *op cit,* fn 6, 122. In the case of *Natural Parents v Superintendent of Child Welfare* [1976] 2 SCR 751 at 760–61, Laskin CJ considered that a provincial adoption statute (to the extent that it had the effect that the Indian status of a child would be removed) would touch 'Indianness'.

40 Sanders, *op cit,* fn 5, 242. In *Lovelace v Ontario* [2000] 1 SLR 950, the court found that the exclusion of non-status Indians from a provincial program involving the distribution of profits from a casino on an Indian reserve did not impair the status or capacity of non-status Indians and therefore it did not affect 'Indianness'. In *Kitkatla Band v Minister of Small Business, Tourism & Culture* [2002] SLR 31, the Supreme Court found that provincial laws authorising the cutting of culturally modified trees did not affect the 'core of Indianness'. However, the court acknowledged that it may be that in different circumstances heritage sites could be a key part of the collective identity of people and that some component of cultural heritage could go to the core of a community's identity.

41 *Derrickson* [1986] 1 SCR 285. Consideration of Aboriginal title or Aboriginal rights which involve the 'use and possession' of land will also be relevant in the discussion of whether s 88 of the Indian Act applies to 'Lands reserved for the Indians'. Refer to the discussion below.

42 [1998] 2 CNLR 205. The Quebec Court of Appeal in *Oka (Municipality) v Simon,* considered that the question of Indianness was relevant where 'Lands reserved for the Indians' was concerned. In this respect the court differed from, and disagreed with, the interpretation in *Corporation of Surrey v Peace Arch* (1970) 74 WWR 380 where the type of use was not considered relevant. Should 'Indian use' include any use by an Indian, in addition to anything that affects an 'Indian as an Indian'?

43 See *R v Isaac* (1975) 13 NSR (2d) 460. In *Kruger and Manuel* [1978] 1 SCR 104, it was found that Indian hunting off reserve was subject to provincial law. However, in *Dick's* case [1985] 2 SCR 309 at 320–321, Beetz J assumed without deciding that a provincial hunting law did not apply proprio vigore to an Indian band as this activity was 'at the centre of what they do and what they are'. Beetz J agreed with the view argued in the lower courts that hunting was part of the 'Indianness' of the band. However, the provincial law in question was found to be a law of general application and the fact that it regulated an Indian as an Indian did not detract from this. However, the court's conclusion in the *Dick* case was not a general conclusion in relation to Aboriginal groups. It will always depend on the culture of the particular group. See also *R v Sutherland* [1980] 2 SCR 451 and *Moosehunter v R* [1981] 1 SCR 282.

44 Supra note 28 at 537. See for commentary Borrows, J, 'The trickster: integral to the distinctive culture' (1997) 8 Constitutional Forum 27.

test would come within the 'core of Indianness'[45] and thus would be immune from provincial law.

Activities on reserve land that come within the 'core of Indianness', or activities which amount 'in pith and substance' to a use of the land (which would bring those activities within the exclusive federal jurisdiction under s 91(24) of the Constitution Act 1867), will not be governed by provincial laws.[46] In *Derrickson v Derrickson* it was argued that 'the pith and substance' of the provincial Family Relations Act was the division of matrimonial property, and not 'the use of Indian lands', and that this legislation did not 'encroach on the exclusive federal jurisdiction as to the use of Indian lands'.[47] In rejecting this argument, Chouinard J agreed with the Attorney General of Canada that this legislation regulated not only who may own or possess the land, but also regulated the right to the beneficial use of the property and its revenues. Chouinard J therefore found these provisions could not apply of their own force to reserve lands, as the 'right to possession of lands on an Indian reserve is manifestly of the very essence of the federal exclusive legislative power under s 91(24) of the Constitution Act 1867'.[48] The decision in *Derrickson* has arguably been extended in its application by the *Delgamuukw* decision that Aboriginal title is a right of exclusive use and occupation and that Aboriginal title lands are 'Lands reserved for the Indians' for the purpose of s 91(24).[49] Thus if provincial legislation regulates the ownership and possession of property,[50] such legislation cannot apply of its own force to Aboriginal title lands.[51]

In *Corporation of Surrey v Peace Arch,*[52] the British Columbia Court of Appeal found those provincial laws which relate to the *use* of lands do not apply on Indian reserves, because the use of reserve land is within the federal government's exclusive jurisdiction. The court found that zoning by-laws and building codes made by a municipality under provincial legislation, and regulations made under the provincial health laws, involved the use of the land, and accordingly were not

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45 See Lamer CJC in *Delgamuukw* [1997] 3 SCR 1010 at 1121. However, Lamer CJC in his comments in relation to infringement by provinces failed to follow through to the conclusion that this would produce immunity from provincial law.

46 This is so even if these laws are not in relation to Indians i.e. are laws of general application.

47 *Derrickson* [1986] 1 SCR 285 at 294.

48 *Ibid* at 296.

49 *Delgamuukw* [1997] 3 SCR 1010.

50 In accordance with the view of the Quebec Court of Appeal in *Oka v Simon* [1998] 2 CNLR 205, legislation which regulates the right to beneficial use of property could apply of its own force to Aboriginal title lands as the non-Indian use of land reserved for Indians is not at the core of federal jurisdiction in s 91(24) of the Constitution Act 1867. It is the Indian use of land rather than the general use of land that is reserved for the Indians which lies at the core of federal jurisdiction. Leave to appeal to the Supreme Court has been refused in this case. *Oka v Simon* [1999] CSCR 76 (Quicklaw).

51 See McNeil, 'Aboriginal title and the division of powers', *op cit,* fn 5,458.

52 (1970) 74 WWR 380 (BCCA). Justice Martland in *Cardinal's* case [1974] SCR 695 at 705, in commenting on *Surrey v Peace Arch* stated that 'Once it was determined that the lands remained lands reserved for the Indians, provincial legislation relating to their use was not applicable'.

applicable to reserves as the federal parliament has exclusive jurisdiction over 'Lands reserved for the Indians'. In *R v Isaac,*[53] the court also considered that provincial laws of general application relating to use of the land cannot apply to Indian reserve lands that are under exclusive federal jurisdiction. Therefore, laws that affect the ways in which property owners use land have to be read down so that such laws do not apply to Aboriginal title lands.[54]

Activities on reserve land that do not come within the 'core of Indianness', or which do not amount 'in pith and substance' to a use of the land, will be governed by provincial laws.[55] In *Four B Manufacturing Ltd v United Garment Workers of America,*[56] a shoe manufacturing business on an Indian reserve was found to be subject to the Ontario labour relations laws. Here the activity conducted on the land, shoe manufacturing, was not within the 'core of Indianness'. In addition, the laws governing employer/employee relations did not involve use of the land. Also, in *R v Francis,*[57] provincial motor vehicle laws were found to apply on Indian reserves. Such laws 'in pith and substance' relate to the use of motor vehicles and not the use of the land.

The real question here is how are the laws to be characterised? Provided provincial laws are not characterised as relating directly to Indian land use or to the occupation of land, and do not affect Indians *qua* Indians, then such laws

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53 (1975) 13 NSR (2d) 460 at 474 (NSSC AD). MacKeigan CJ at 467 noted that provincial legislation cannot validly regulate the reserves as land, cannot regulate the use of that land, and cannot control the resources on that land. If a provincial game law is clearly a land use law, it cannot apply on a reserve. He further noted at 469 that the hunting by an Indian is traditionally so much a part of his use of his land and its resources as to be for him, peculiarly and specially, integral to that land.

54 See McNeil, 'Aboriginal title and the division of powers', *op cit,* fn 5, 458. In *Western Industrial Contractors Ltd v Sarcee Developments Ltd* (1980) 98 DLR (3d) 424 a builder's lien filed pursuant to provincial legislation was found to apply to a company which held a lease acquired pursuant to a conditional surrender by an Indian band of reserve land to the Crown. The fact that the Indian band retained a beneficial interest in the lands did not prevent the provincial legislation from applying. Note that here the lien was only against the company's leasehold interest and therefore did not impact on the beneficial or residual interest of the Indian band. Had the lien been sought against the Indian interest in the land this would have been seen as an infringement of federal jurisdiction under s 91(24), at 432, *per* Morrow JA. In *Re Stony Plain Indian Reserve No 135* [1982] 1 CNLR 133 at 149–50 the Alberta Court of Appeal in considering the application of provincial laws in the case of Indian reservation land being surrendered for the purpose of leasing, found that provincial laws of general operation which impair the full enjoyment of land or an interest therein would be inapplicable. Surrendered lands, even if such lands no longer remain part of a reserve under the Indian Act, continue to be 'Lands reserved for the Indians' within the meaning of s 91(24), and thus are under federal legislative jurisdiction. The court agreed with the *Peace Arch* decision in so far as the decision recognised that provincial legislation relating to use could be inapplicable as inconsistent with the reversionary interest. In *Paul v Paul* [1986] 1 SCR 306, the Supreme Court found that a certificate of occupancy issued under the Indian Act includes a right of occupation and accordingly an order for occupancy under the provincial Family Relations Act interferes with that Indian right of occupation. In the British Columbia Court of Appeal in *Paul v Paul* [1985] 2 CNLR 93 Seaton JA considered that, as the Indian Act regulates who may possess and use reserve land, provincial legislation which purports to do the same has no application to Indian reserve lands. In the Supreme Court, Chouinard J considered this case to be indistinguishable from *Derrickson's* case [1986] 1 SCR 285.

55 Provided also that such laws are not in relation to Indians, ie the laws are laws of general application.

56 [1980] 1 SCR 1031; [1979] 4 CNLR 21.

57 [1988] 1 SCR 1025.

will apply to activities on reserve land. If provincial laws relate to the Indian use or occupation of the land, such laws will not apply of their own force on reserve lands.[58]

Provincial jurisdiction and legislative powers

In what circumstances can provincial laws apply to Indians or Indian lands?[59] As discussed above, the *Delgamuukw* court considered that the interest in reserve land and the interest in Aboriginal land is the same.[60] Therefore (subject to certain statutory exceptions),[61] the body of case law regarding the application of provincial laws on Indian reserve land should apply to Aboriginal title lands.[62]

Despite s 91(24) having the effect of vesting the exclusive jurisdiction over 'Indians, and Lands reserved for the Indians' in the federal parliament, some provincial laws 'of general application' do apply *proprio vigore* to 'Indians, and Lands reserved for the Indians'.[63] Also, despite the federal Indian Act occupying the field—at least to some extent—in relation to 'Indians', provincial laws of

58 See McNeil, 'Aboriginal title and the division of powers', *op cit,* fn 5,461–62.

59 See generally McNeil, *op cit,* fn 37; Bankes, *op cit,* fn 37; Little Bear, L, 'Section 88 of the Indian Act and the application of provincial Laws to Indians' in Long JA and Boldt M (eds), *Governments in Conflict,* Toronto: University of Toronto Press; Sanders, D, 'The Constitution, the provinces and Aboriginal peoples', in Long and Bolt (eds), *Governments in Conflict,* Toronto: University of Toronto Press; Sanders, *op cit,* fn 5; Sanders, D, 'Indian hunting and fishing rights' (1974) 38 Saskatchewan Law Review 43; Hogg, *op cit,* fn 5, Ch 27–8; Hughes, *op cit,* fn 5; Reiter, *op cit,* fn 6, 191–224; Woodward, *op cit,* fn 11, Chapters 3 and 4; Pugh RD, 'Are Northern lands reserved for the Indians?' (1982) 60 Canadian Bar Review, 36; Wilkins, K, 'Of provinces and section 35 Rights' (1999) 22 Dalhousie Law Journal 185.

60 *Delgamuukw* [1997] 3 SCR 1010 at 1085, *per* Lamer CJC, citing *Guerin v Canada* [1984] 2 SCR 335 at 379.

61 Provincial laws that are dependent for their application on the Indian Act provisions would not apply to Aboriginal title lands, as the Indian Act, in its application to lands, is generally limited to reserve lands. See, for example, s 35 of the Indian Act which allows provincial compulsory acquisition laws to apply to reserve lands in certain circumstances. In addition any regulations made pursuant to the Indian Act would also be inapplicable. Sections 57 and 73(1) authorise the Governor in Council to make regulations involving, *inter alia,* reserve land and its use. For example, the Indian Mining Regulations (CRC 1978 c 965, SOR/90–468) which apply to surrendered mines and minerals under reserve lands referentially incorporate some provincial laws. A separate Act deals with oil and gas, the Indian Oil and Gas Act (RSC 1985, c 1–7, originally enacted SC 1974–75–76, c15). The Governor in Council pursuant to this legislation has made regulations, the Indian Oil and Gas Regulations, 1955 (SOR 94–753), containing rules relating to the oil and gas on 'Indian lands'. These regulations also referentially incorporate some provincial laws. Section 4 requires persons involved in oil and gas activities on Indian reserves to comply with 'all provincial laws applicable to non-Indian lands that relate to the environment or to the exploration for, or development, treatment, conservation or equitable production of, oil and gas and that are not in conflict with the Act and these Regulations'. Thus neither the Indian Act nor the regulations made pursuant to the Act would apply to Aboriginal title lands situated outside reserves. See McNeil, *op cit,* fn 37.

62 Except to the extent that the application of provincial laws are excluded by the provisions of federal legislation such as the Indian Act See *Derrickson* [1986] 1 SCR 285.

63 *Delgamuukw* [1997] 3 SCR 1010 at 1119. However, this is subject to the qualification that laws of general application which affect 'Indianness' cannot apply of their own force. See the discussion below. See *Dick's* case [1985] 2 SCR 309 and *Four B Manufacturing v United Garment Workers* [1980] 1 SCR 1031.

general application will not be prevented from applying to Indians.[64] In addition, provincial legislation may incidentally affect a matter assigned exclusively to the federal parliament, including 'Indians, and Lands reserved for the Indians', provided that the provincial law does not touch the central core of federal legislative power in s 91(24) of the Constitution Act 1867.[65] Also, the theory that Indian reserves are federal 'enclaves' in which no provincial laws apply has been rejected by the courts.[66] The Canadian Supreme Court has recognised that provincial laws may (in certain circumstances within the provinces' spheres of legislative competence) apply to Indians.[67]

Provincial 'laws of general application'

As discussed above, provincial legislation may apply on reserves in a limited range of circumstances. Laws of general application may apply to Indians or to Indian land. What is meant by a 'law of general application'? In *Kruger and Manuel v R,*[68] Justice Dickson stated:

> There are two indicia by which to discern whether or not a provincial enactment is a law of general application. It is necessary to look first to the territorial reach of the Act. If the Act does not extend uniformly throughout the territory, the inquiry is at an end, and the question is answered in the negative. If the law does extend

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64 The Indian Act applies pursuant to s 91(24) of the Constitution Act 1867. However, the federal legislation cannot be said to fully occupy the field completely, as all s 91(24) 'Indians' are not 'Indians' within the meaning of the Indian Act. For example, Inuit are expressly excluded by s 4 of the Indian Act but the Inuit are included under s 91(24) of the Constitution Act 1867. See *Reference re Term 'Indians'* [1939] SCR 1.

65 See Peeling, *op cit,* fn 37. An example given by Peeling is of an Indian going to hunt but infringing traffic laws on the way to hunting.

66 See *Cardinal v Attorney General of Alberta* [1974] SCR 695. The *Four B Manufacturing* case [1980] 1 SCR 1031; [1979] 4 CNLR 21, and the case of *R v Francis* [1988] 1 SCR 1025 also rejected this theory. Professor Hogg states in relation to the enclave theory that:
'The theory was always implausible, because it involved a distinction between the first and second branches of s 91(24) for which there is no textual warrant, and it placed the second branch ('lands reserved for the Indians') in a privileged position enjoyed by no other federal subject matter…there is no constitutional distinction between 'Indians' and 'Lands reserved for the Indians' and provincial laws may apply to both subject matters.' (Emphasis added.) Hogg, *op cit,* fn 5, Chapter 27–11. 'May' is the qualifier here. The enclave theory was based on the 'Lands reserved for the Indians' element of s 91 (24) and never existed in relation to the 'Indians' part of s 91 (24).

67 This is discussed generally below. Provincial laws of general application can apply to Indians of their own force. If such laws (that is laws of general application) affect 'Indianness' or affect 'Indians as Indians' then such laws will not be applicable of their own force, but may be applicable through referential incorporation pursuant to s 88 of the Indian Act. See *Dick's* case [1985] 2 SCR 309. However, provincial laws that are in conflict with the Indian Act or other federal legislation will not apply to Indians or Indian land due to the doctrine of paramountcy; provincial laws that single out Indians or Indian reserve land will not be laws of general application and will also not be applicable; and provincial laws which involve the use (or at the very least Indian use) of Indian reserve land, even if they are laws of general application, won't apply on reserves due to s 91(24) and will not be referentially incorporated by s 88 of the Indian Act. See Sanders, 'The Constitution, the provinces and Aboriginal peoples', *op cit,* fn 59.

68 [1978] 1 SCR 104 at 110. In *Kruger and Manuel's* case, the British Columbia Wildlife Act was found to be a law of general application as it had a uniform operation and in its object and purpose it was not directed at Indians.

> uniformly throughout the jurisdiction, the intentions and the effects of the enactment need to be considered. The law must not be 'in relation to' one class of citizens in object and purpose. But the fact that the law may have graver consequences to one person than to another does not, on that account alone, make the law other than one of general application. There are few laws which have a uniform impact. The line is crossed, however, when an enactment, though in relation to another matter, by its effect impairs the status or capacity of a particular group.

Therefore, a provincial law of general application must be one that applies throughout the province[69] and must be a law that is intended to and does, in effect, apply generally to everyone.[70] Such laws would include traffic laws, health and safety requirements, and social and economic regulations.[71] However, if a provincial law of general application affects an Indian as an Indian, then, to that extent, such law could not apply to Indians of its own force.[72] In addition, for any provincial law to be valid it must come within a provincial head of power; otherwise, such law would be *ultra vires* and therefore invalid.[73]

Provincial laws which do not apply to Indians

Provincial laws, other than those of general application, will not usually be applicable to Indians or on Indian reserve land.[74] Inapplicable provincial laws include the following types of legislation. First, provincial laws which are directed at Indians or Indian land, that is, that single out Indians or Indian land for special treatment, are *ultra vires* because they infringe federal jurisdiction.

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69 See *Oka (Municipality) v Simon* [1998] 2 CNLR 205 where the Quebec Court of Appeal found that a municipal law that applied uniformly throughout the territory of the municipality was a law of general application although such law did not apply throughout the territory of the province. The law in issue was not one that was directed at a particular group of citizens.

70 See Beetz J in *Dick's* case [1985] 2 SCR 309 at 323–24, where he stated that in considering whether a law is one of general application '[E]ffect and intent are both relevant. Effect can evidence intent. But in order to determine whether a law is not one of general application, the intent, purpose or policy of the legislation can certainly not be ignored: they form an essential ingredient of a law which discriminates between various classes of persons, as opposed to a law of general application'. See also *Kruger and Manuel v R* [1978] 1 SCR 104.

71 Hogg, *op cit,* fn 5, Chapter 27–9. Professor Hogg states that the 'situation of Indians and Indian reserves is thus no different from that of aliens, banks, federally-incorporated companies and interprovincial undertakings. These, too, are subjects of federal legislative power, but they still have to pay provincial taxes, and obey provincial traffic laws, health and safety requirements…and the myriad of other provincial laws which apply to them in common with other similarly-situated residents of the province'.

72 However, such laws may be referentially incorporated by s 88 of the Indian Act subject to the provisions in that section. See *Dick's case* [1985] 2 SCR 309.

73 Hogg, *op cit,* fn 5, Chapter 27–8.

74 See generally in relation to the exclusionary rules pertaining to provincial legislation: Hogg, *op cit,* fn 5, Chapter 27; Sanders, *op cit,* fn 5, 242; Hughes, *op cit,* fn 5; Woodward, *op cit,* fn 11; and Reiter, *op cit,* fn 6.

Such laws are invalid.[75] Secondly, the doctrine of federal paramountcy will render provincial laws that are inconsistent with federal laws (and that includes the Indian Act) inoperative.[76] Thus, if the federal government enacts positive federal legislation it may, through the doctrine of paramountcy, prevent provincial laws from applying to Indians or 'Lands reserved for the Indians'.[77] Thirdly, s 35 of the Constitution Act 1982 gives constitutional status to 'existing' Aboriginal and treaty rights, and protects those rights from both federal and provincial laws purporting to affect those rights. This is discussed in further detail below.[78] Fourthly, in the three prairie provinces, the Indian rights to fish, trap and hunt for food are protected by 'The Natural Resources Transfer Agreements',[79] and provincial laws are inapplicable to the extent to which such laws are inconsistent with those rights.[80] Fifthly, and most significantly for our purposes, s 91(24) protects a 'core' of federal jurisdiction from provincial laws of general application through the doctrine of interjurisdictional immunity (see discussion above).

Section 88 of the Indian Act

Section 88 of the *Indian Act* creates an exception to the rule that provincial laws do not apply to Indians or to Indian land if such laws touch the 'Indianness' at the core of s 91(24) of the Constitution Act 1867.[81] Section 88 allows provincial 'laws of general application'[82] which would not otherwise

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75 See Hogg, *op cit,* fn 5, Chapter 27–10. *R v Sutherland* [1980] 2 SCR 451 (where the provincial law was invalid); *Dick's* case [1985] 2 SCR 309 at 322–23 *(obiter); Natural Parents v Superintendent of Child Welfare* [1976] 2 SCR 751; *Hopton v Pamajewon* [1994] 2 CNLR 61–70. See also Lysyk, *op cit,* fn 10, 535–6.

76 See Hogg, *op cit,* fn 5, Chapter 27–11; Woodward, *op cit,* fn 11,126. The rule of paramountcy allows both federal and provincial laws to co-exist provided that there is no actual conflict between the laws. In the case of conflict the federal law prevails, and the conflicting provincial law will be read down to avoid the conflict.

77 See Little Bear, *op cit,* fn 59. See Slattery (1992), *op cit,* fn 5, 283, who argues that this doctrine of paramountcy would also apply where an Aboriginal government, within its sphere of authority, enacts divergent legislation which would prevent provincial statutes from applying.

78 Indian Act, s 88 also protects Indian treaty rights from provincial laws. See *R v Cotè* [1996] 3 SCR 139.

79 These Agreements were given constitutional force by the Constitution Act 1930,20–21 George V c 26 (UK). Reproduced in RSC 1985, Appendix No 26.

80 However, *R v Badger* [1996] 1 SCR 77; [1996] 2 CNLR 77, appears to allow provincial infringement of these rights if the justification test in *R v Sparrow* [1990] 1 SCR 1075 can be met. *Badger's* case was referred to with approval by the Supreme Court in *R v Marshall* [1999] SCR 456.

81 *Dick's* case [1985] 2 SCR 309 at 326–28; *Bruce v Yukon Territory (Commissioner)* [1994] 3 CNLR 25. See generally Imai, S, *The 1998 Annotated Indian Act* (1998, Carswell, Thomson, Canada); McNeil, *op cit,* fn 37; Wilkins, K 'Still crazy after all these years: section 88 of the Indian Act at fifty' (2000) 38(2) Alta Law Review 458; Wilkins, *op cit,* fn 59; Bankes, *op cit,* fn 37.

82 In *R v Sutherland* [1980] 2 SCR 451, the Supreme Court found that laws of general application refer only to provincial laws. Federal laws apply of their own force pursuant to s 91(24) of the Constitution Act 1867. The Supreme Court in *R v George* [1966] SCR 267 had taken a similar view and found an Indian guilty of an offence under the Migratory Birds Convention Act (RSC 1952, c 179), on the

apply to Indians to be referentially incorporated into federal law, and thus made applicable to 'Indians'.[83] Section 88 provides:

> Subject to the terms of any treaty and any other Act of Parliament, all laws of general application from time to time in force in any province are applicable to and in respect of Indians in the province, except to the extent that those laws are inconsistent with this Act or any order, rule, regulation or law made thereunder, and except to the extent that those laws make provision for any matter for which provision is made by or under this Act.[84]

Section 88 does not 'invigorate' provincial laws which are invalid because the laws single out Indians for special treatment or because the laws discriminate against Indians, nor does s 88 apply where the laws relate to Indian lands.[85] It is clear that s 88 will not assist a provincial law to apply if a direct conflict exists between the provincial law and either the Indian Act or other federal legislation. Due to the express terms of s 88, the section will not assist a provincial law in applying where treaty rights exist.[86]

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ground that s 88 did not prevent the application of that legislation to Indians who were exercising treaty rights to hunt. Here the court followed *Sikyea v The Queen* [1964] SCR 642.

83 *Dick's* case [1985] 2 SCR 309 at 322, held that s 88 involved referential incorporation by parliament of provincial laws of general application. See also *R v Francis* [1988] 1 SCR 1025 at 1030–31 and *Derrickson* [1986] 1 SCR 285. Referential incorporation is the process by which provincial legislation is incorporated into federal legislation thus making the provincial law the same as if it were a valid federal law. The doctrine of referential incorporation allows parliament or a legislature in enacting a statute which is within its constitutional power to adopt the laws of the other institution. Therefore, for the purposes of its statute, the Indian Act, the federal parliament adopts provincial laws as its own. Pursuant to s 88 of the Indian Act, provincial laws of general application are transformed into federal laws and these provincial laws apply with full force. If s 88 had not referentially incorporated such laws they could not constitutionally apply to Indians and such laws would be 'read down' to achieve that result. See Hogg, *op cit,* fn 5. See also Carter, R 'The application of provincial laws to status Indians under section 88 Indian Act', in Native Law Seminars, Native Law Centre, University of Saskatoon, Saskatchewan, 1987.

84 The limitations in s 88 which prevent provincial 'laws of general application' from applying to 'Indians' are as follows:

- The terms of a treaty prevail against 'laws of general application' in the case of conflict.
- A conflict with any other Act of the Parliament of Canada, ie, federal statutes.
- If the 'law of general application' is inconsistent with any provision in the Indian Act.
- If the 'law of general application' conflicts with any order, rule, regulation or by-law made under the Indian Act, or if any order, rule, regulation or by-law made under the Indian Act 'occupies the field', then the 'law of general application will not apply'. See Hogg, *op cit,* fn 5.

85 See Lamer CJC in *Delgamuukw* [1997] 3 SCR 1010 at 1122 quoting Professor Hogg. Section 88 of the Indian Act refers only to 'Indians' and not to 'Lands reserved for Indians'. Regarding Indian lands refer to the discussion below. Until the 1973 decision in *Cardinal's* case it was unclear whether s 91 (24) of the Constitution Act 1867 prevented all provincial laws from applying to Indians on reserve land. The Supreme Court of Canada in that case rejected the 'enclave theory' in the sense that it could no longer be said that provincial laws could never apply. In *Cardinal's* case Martland J left open the broad question of the application of provincial law on reserves as the application of the provincial game law in question in that case was dependent on the Natural Resources Transfer Agreement. *Cardinal's* case [1974] SCR 695 at 703. The application of some provincial laws to Indians on reserve land was confirmed in *Four B Manufacturing* [1980] 1 SCR 1031; [1979] 4 CNLR 21.

86 *R v White and Bob* (1965) 52 DLR (2d) 481; *Simon v The Queen* [1985] 2 SCR 387; *Quebec v Sioui* [1990] 1 SCR 1025; *R v Cotè* [1996] 3 SCR 139.

Object and purpose of s 88

Section 88 (originally s 87)[87] was enacted as part of the 1951 amendments to the Indian Act. What was Parliament's intention when s 88 of the Indian Act was enacted?[88] From the debate relating to the 1951 amendments in the House of Commons, it appears that s 88 was designed to ensure that Indian treaty rights in relation to hunting and fishing were preserved from interference by provincial laws.[89] If this was Parliament's intention, then s 88 would be a restatement of the then current law.[90] When s 88 was introduced, legal authority indicated that Indians could hunt freely on reserves without provincial interference, and could hunt off reserves in accordance with treaty rights, with provincial legislation,[91] or with the Natural Resources Transfer Agreements.[92] It

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87 Statutes of Canada, 1951 c 29, s 87. See generally Leslie J and Maguire R (eds), *The Historical Development of the Indian Act,* 2nd edn, 1978, Ottawa: Treaties and Historical Research Centre, Research Branch, Corporate Policy, Indian and Northern Affairs Canada.

88 The House of Commons debates on the 1951 amendments to the Indian Act (Bill 79) indicate very little discussion directly concerning s 87 (as it was then enacted). In the process leading to the amendment of the Indian Act the House of Commons appointed a Special Joint Committee of the Senate and House of Representatives (1946–48) (hereinafter referred to as SJC) to examine and consider the Indian Act. This Committee issued reports in 1946, 1947 and 1948 and prepared draft legislation to amend the Act. Debates, 2d Sess, 21 st Parl, at 3936.

89 The Minister of Indian Affairs, Mr Harris, in the second reading speech on the Bill to amend the Indian Act noted that the Minutes of Evidence and Reports of the Special Joint Committee of the Senate and the House of Commons indicated that most Indian witnesses considered that because of provincial laws, particularly game and fishing laws, Indian treaty rights had been restricted. The Minister further noted that 'court decisions have upheld the right of the Indian to hunt and fish, in some cases, in what appears to be a contradiction of provincial game laws'. In view of this the Minister considered that a policy of co-operation with provincial governments should be continued to obtain the maximum conservation of game and fish together with continued Indian rights (House of Commons Debates, 16 March 1951, 1354).
The Minutes of Evidence of SJC reveal concerns by Indians in relation to their treaty rights. A submission to the Committee in 1947 by a band from Watson Lake, Yukon, stated that they wish the Indian Act changed to override the British Columbia provincial game laws (SJC: 1947, 2038). A submission in 1946 to the Committee by the North American Indian Brotherhood states that the Brotherhood considers that 'by virtue of their treaty rights, Indians are not liable to any provincial laws within their territories respecting fishing, hunting and trapping and, therefore, are not liable to take out licences from the provincial governments to fish, hunt and trap within their territories'. (SJC: 1946, 428–29). In *R v George* [1966] SCR 267, the Supreme Court considered that the object and intent of s 88 of the Indian Act, (at that date s 87) was to make Indians, who were under the exclusive legislative jurisdiction of Parliament by virtue of s 91 (24), subject to provincial laws of general application. The court noted that s 88 was not intended to be a declaration of the paramountcy of treaties over federal legislation. The reference to treaties was incorporated in that section, the purpose of which was to make provincial laws applicable to Indians, so as to preclude those laws from interfering with rights under treaties.

90 Indian representatives, on requesting clarification of s 88, were said to be informed that provincial laws would not apply if they contravened any treaty, and/or any Act of parliament, for example the Indian Act. See Summary of the Proceeding of a Conference with Representative Indians held in Ottawa, 1951, House of Commons, in Debates, 4th Sess 21st Parl, 16 March 1951 at 1364–67.

91 Prior to the 1951 amendment provincial laws did not apply to Indians on reserve, but such laws were generally regarded as applying (subject to certain exceptions which include treaty rights) to Indians off reserve. See *R v Jim* (1915) 22 BCR 106 where provincial game laws were found not to apply to Indian reservations and see *R v Rogers* (1923) 2 WWR 353 (Man CA) where Indians were found to be subject to off reserve laws. Prior to the 1951 amendments the courts appeared to have allowed broad

should also be remembered that in 1951, when s 88 was enacted (as s 87), it was unclear whether Aboriginal rights existed at common law. Formal recognition of such Aboriginal rights occurred in the 1973 Supreme Court decision in *Colder v Attorney General of British Columbia.*[93] The parliamentary debates reveal no apparent suggestion that this section was designed to widen the scope of provincial laws applicable to Indians,[94] nor do the debates reveal any consideration of the question of the application of provincial laws to 'Lands reserved for the Indians'.

Application of provincial laws

As noted above, s 88 can make provincial laws apply to Indians where such laws have a severe affect on 'Indianness' by impairing the status or capacity of Indians, or where such laws touch on the 'core of Indianness'.[95] The decision in *Dick v The Queen* (*Dick's* case)[96] confirmed that s 88 is not simply a statement of the

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provincial powers to apply to Indians off reserve. See also *R v Martin* (1917) 39 DLR 635; *R v Discon and Baker* (1968) 67 DLR (2nd) 619; *R v Dennis* (1975) 2 WWR 630. Section 88 may have been intended to be declaratory of the law prior to the 1951 amendment; however, as discussed above, *Dick's* case recognises that s 88 incorporates by reference provincial laws of general application which touch on 'Indianness' (*Dick's* case [1985] 2 SCR 309 at 326–28). However, as Leroy Little Bear comments, 'if the section was simply declaratory [of the application to Indians] of existing game laws, its utilization for the application of run-of-the-mill provincial legislation to Indians is one that should never have occurred'. Little Bear, *op cit,* fn 59,184. See generally Pratt, A, 'Federalism in an era of Aboriginal self government', in Hawkes, DC (ed), *Aboriginal Peoples and Government Responsibility* (1989, Ottawa: Carleton University Press) and also Bartlett, R, *The Indian Act of Canada* (University of Saskatchewan, Native Law Centre, 1980, 5–8 and 24–29.

92 These agreements were given constitutional force by s 1 of the Constitution Act 1930, 20 & 21 Geo V c 26 (UK).

93 [1973] SCR 313. This could explain why treaty rights were specified as protected in s 88 from provincial laws while Aboriginal rights were not so protected. See McNeil, *op cit,* fn 37.

94 However, in the SJC's Report 1948 it was recommended that consideration be given to arrangements to bring Indians within the scope of provincial legislation in relation to certain matters which were dealt with under provincial legislative powers. The matters listed for consideration by the Provinces included provincial fish and game laws; fur conservation and development and Indian traplines; education; provincial liquor legislation; health and social security. (SJC 1948,187–190.) See generally *The Historical Development of the Indian Act,* 1975, Policy, Planning and Research Branch, Department of Indian and Northern Affairs.

95 See generally Hogg, *op cit,* fn 5, Chapter Ch 27–13; Little Bear, *op cit,* fn 59 and see Lamer CJC in *Delgamuukw* [1997] 3 SCR 1010 at 1122. Lambert JA, in *R v Dick* (1983) 22 CNLR 134, found that the provincial law which infringed hunting rights was not referentially incorporated by s 88 because a law which infringes an Aboriginal right cannot be a law of general application. However, in *Dick's* case [1985] 2 SCR 309, Beetz J criticised Lambert JA in the Court of Appeal for using the same test to assess whether an Act was a law of general application and for determining whether such law could be referentially incorporated under s 88. In *Dick's* case the Wildlife Act was found to be a law of general application because the 'intent', 'purpose' and 'policy' of the Act was not to single out Indians for particular treatment. The court considered the legislative intent of the British Columbia legislature to determine whether the law was one of general application.

96 *Ibid.*

general constitutional position, nor is it merely declaratory of existing law.[97] Section 88 does expand the body of provincial law applicable to Indians.[98] *Dick's* case has subsequently been reaffirmed in later cases.[99] Section 88 will referentially incorporate provincial game laws where such laws touch the 'core of Indianness'. For example, although hunting is central to the culture of the group in question, and thus provincial game laws can not apply *proprio vigore,* s 88 could referentially incorporate such laws to apply to Indians.[100] In *R v Alphonse,*[101] the British Columbia Court of Appeal found that s 88 would referentially incorporate provincial laws regarding hunting. Therefore it seems that, subject to s 35 of the Constitution Act 1982, provincial laws impacting on Aboriginal rights, such as hunting and fishing, could be referentially incorporated by s 88 and so apply to Indians undertaking such activities off reserve.[102] It is unclear whether s 88 will referentially incorporate such laws to apply on reserve.[103]

Can s 88 apply to 'Lands reserved for the Indians'?

Can provincial laws that involve 'possession and use of the land' apply to Indian land through s 88? In other words, does s 88 referentially incorporate provincial laws which can't apply of their own force and make them apply to s 91(24) 'Lands reserved for the Indians'? A literal reading of s 88 would indicate

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97 Provincial law has applied to Indians as persons since at least the decision in *R v Hill* (1907) 15 OLR 406 (Ont CA) where provincial laws licensing physicians were applied to Indians. Until *Dick's* case [1985] 2 SCR 309, s 88 had appeared to be merely declaratory of what the law was prior to the enactment of s 88 of the Indian Act. However, the result of this decision was that s 88 incorporates by reference provincial laws of general application which touch on 'Indianness'.

98 See Hogg, *op cit,* fn 5, 27–13. Thus provincial laws that do affect 'Indianness', etc. will be referentially incorporated unless one of the provisos in s 88 prevents that from happening. See also Little Bear, *op* cit, fn 59, 183.

99 See *Derrickson's* case [1986] 1 SCR 285 and *R v Francis* [1988] 1 SCR 1025.

100 In *Dick's* case [1985] 2 SCR 309, the provincial *Wildlife Act* was referentially incorporated through s 88 to apply to an Indian hunting off reserve land. Also in *Kruger and Manuel v R* [1978] 1 SCR 104, provincial game laws were found to be applicable to Indians hunting off reserve.

101 [1993] 4 CNLR 19 (hereinafter *Alphonse's* case). In *Alphonse's* case, the referential incorporation under s 88 was conditional on any infringement created by that law being justified under the *Sparrow test.* This the Crown has failed to do in that case.

102 Refer to the discussion of s 35 and critique of *Alphonse's* case below.

103 In *R v Isaac* (1975) 13 NSR (2d) 46, provincial game laws were found not to apply on Indian reserves as hunting was a use of the land. In *R v Jim* (1915) 26 CCC 236 (BCSC) and in *R v Rogers* (1923) 2 WWR 353 provincial game laws were found not to apply on reserve land. While the Supreme Court in *Cardinal's* case [1974] SCR 695, found that provincial game laws applied to Indians on reserve land, these laws were applicable by virtue of s 12 of the Natural Resources Transfer Agreements which section specifically provided for their application. Provincial game laws have been found to apply to non-Indians hunting on reserve *R v Morley* [1932] 2 WWR 193 (BCCA) and *R v McLeod* [1930] 2 WWR 37 (BC Co Ct). However, the validity of these decisions may be questionable after the decision in *Surrey v Peace Arch* (1970) 74 WWR 380. See McNeil, K, *Indian Hunting Trapping and Fishing Rights in the Prairie Provinces of Canada,* (1983, University of Saskatchewan Native Law Centre, 1983 13–17 and see also McNeil, *op cit,* fn 37, notes 53–58 and accompanying text. Refer also to the discussion below in relation to whether s 88 can apply to 'Lands reserved for the Indians'.

that s 88 would not extend to reserve land.[104] The wording in s 88 specifies 'Indians', with no mention of 'Lands reserved for the Indians'; therefore, the section should apply provincial laws to Indians and not to Indian lands.[105] Section 91(24) of the Constitution Act 1867 has been interpreted by the courts as containing two heads of power: 'Indians' *and* 'Lands reserved for the Indians'.[106]

The Supreme Court of Canada has yet to definitively answer the question whether a provincial law can be referentially incorporated to apply to Indian reserves by s 88 of the Indian Act.[107] The case law so far indicates that provincial laws of general application apply by referential incorporation only to Indians, and not to lands reserved for Indians.[108] This is the position where the provincial laws relate to land use.[109] Support for this view can be found in *Cardinal v Attorney General of Alberta General*).[110] Laskin J (dissenting on other grounds) considered that s 88 deals only with Indians, and not with reserves.[111] However, provincial laws can incidentally affect 'Lands reserved for

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104 Section 88 of the Indian Act relates only to Indians; it does not refer to 'Lands reserved for the Indians'. The Supreme Court in *Derrickson* [1986] 1 SCR 285 referred to the Attorney General of Ontario's argument that provincial laws of general application, including laws relating to land, apply to Indians on reserves as elsewhere. Chouinard J at 299 quoted this argument:
'…Parliament has enacted, in section 88 of the Indian Act, law concerning the exposure of Indians to 'all laws of general application from time to time in force in any province'. It makes no difference whether those laws are in relation to lands or some other class of subjects. In either event, they are applicable to Indians subject to the limits prescribed in the section. There is no reason to import into the construction of the words in section 88 the fact that Parliament has pursuant to section 91 (24), not one but two subjects within its legislative authority.'
However, the court neither accepted nor dismissed this argument. If this argument were accepted then s 88 could make provincial laws apply to 'Indian use of Aboriginal title lands'.

105 See McNeil, *op cit,* fn 37,180 who notes that 'one would expect Parliament to express itself clearly if it intended to authorise the intrusion of provincial laws into both heads of s 91(24) power'.

106 *Four B Manufacturing* [1980] 1 SCR 1031 at 1049–50.

107 See generally Hughes, *op cit,* fn 5, 97–103; Bankes, ND, *The Constitutional Framework for the Development and Regulation of Energy Projects on Indian and Metis Lands in Alberta,* 1986, Edmonton: Environmental Law Centre at 16–18; 'Provincial jurisdiction and resource development on Indian reserve lands', in Saunders, O (ed), *Managing Natural Resources in a Federal State,* 1986, Toronto: Carswell; Saunders, D, *Indians and the Law: The Application of Provincial Laws to Indians and Indian Lands,* 1983 BC Continuing Legal Education; Ladner, HG, *The Application of Provincial Legislation—The Residential Tenancy Act,* 1983, BC Continuing Legal Education.

108 Laws that relate directly to 'Lands reserved for the Indians' will be invalid and cannot be referentially incorporated by s 88 of the Indian Act. See *Hopton v Pamajewon* [1994] 2 CNLR 61–70 70, and see *Delgamuukw* [1997] 3 SCR 1010 at 1122. See also Lambert JA in *Paul v BC (Forest Appeals Commission)* [2001] BCJ 1227 (BCCA).

109 At least three provincial Court of Appeal decisions (*Corporation of Surrey v Peace Arch Enterprises* (1970) 74 WWR 380; *Re Stoney Plain Indian Reserve No 135* [1982] 1 CNLR 133 and *R v Isaac* (1975) 13 NSR (2d) 460 have held that s 88 does not have the effect of applying provincial laws to reserve land. Until the Supreme Court decides otherwise that is the law, at least in those provinces. The Saskatchewan Court of Appeal in *R v John* (1962) 133 CCC 43 at 47, also considered that s 88 relates to Indians and not to reserves. Compare *Oka v Simon* [1998] 2 CNLR 205.

110 [1974] SCR 695 at 727.

111 The majority in *Cardinal's* case, *ibid,* refused to accept that Indian reserves were enclaves which were withdrawn from the application of provincial legislation. In *Cardinal's* case both Laskin J (dissenting) at 715 and Martland J at 708 indicated that provincial game laws may not apply on Indian

the Indians' where such laws relate primarily to another head of provincial power.[112]

In the 1970 decision of *Corporation of Surrey v Peace Arch Enterprises,*[113] the construction of buildings on reserve land that was surrendered and leased to non-Indians under the Indian Act was found to be exempt from provincial zoning laws, as such laws sought to control the use of the Indian land.[114] The use was a non-Indian one—an amusement park which had no Indian character whatsoever. It has been noted by Professor Hogg that the construction of buildings on reserve land seems tenuously related to 'Indianness', but it is directly related to 'Lands reserved for the Indians'.[115] Section 88 itself was not referred to by the court in the *Surrey* case.[116] In the 1975 decision of the Nova Scotia Supreme Court, Appeal Division, in *R v Isaac,*[117] it was found that s 88 would not make applicable to Indian reserve land a provincial game law which would have the effect of regulating the use of that land by Indians.[118] Both the *Surrey v Peace Arch* and *R v Isaac* cases pre-dated the 1985 Dick's case interpretation of s 88, where it was found that s 88 applies to referentially incorporate into federal law, provincial laws which impact on 'Indianness'.[119] However, *Dick's case* concerned the application of provincial laws to Indians,

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reserve land of their own force. Laskin J went on to say that s 88 would not make the provincial game laws apply on reserves. He stated at 727–28 that:
The section deals only with Indians, not with Reserves, and is, in any event, a referential incorporation of provincial legislation which takes effect under the section as federal legislation… If the *Wildlife Act* of Alberta is such an enactment as is envisaged by s 88, an Indian who violated its terms would be guilty of an offence under federal law and not of an offence under provincial law.'
Martland J found it unnecessary to consider the effect of s 88 of the Indian Act. *Cardinal's* case at 705.

112 *R v Francis* [1988] 1 SCR 1025; *Rempel Brothers Concrete v Chilliwack (District)* (1994) 88 BCLR (2d) 209 (BCCA); *Delgamuukw* [1997] 3 SCR 1010 at 1120.

113 (1970) 74 WWR 380 (BCCA).

114 *Ibid.* In *Brantford (Township) v Doctor* [1996] 1 CNLR 49, regulations requiring building permits for swimming pools were applied to Indian lands. These regulations were regarded as only incidentally relating to land. While the decision in *Surrey v Peace Arch* was distinguished in *Brantford's* case it was not overruled by the Supreme Court in *Derrickson's* case.

115 Hogg, *op cit,* fn 5, 27–11.

116 MacLean JA stated in *Surrey's* case, *ibid* at 383, that, if:
'These lands are "Lands reserved for the Indians" within the meaning of that expression as found in s 91(24) of the *BNA Act* 1867 (now the Constitution Act 1867) that provincial or municipal legislation purporting to regulate the use of these "Lands reserved for the Indians" is an unwarranted invasion of the exclusive legislative jurisdiction of Parliament to legislate with respect to "Lands reserved for the Indians".'

117 (1975)13 NSR(2d) 460.

118 *R v Isaac, ibid* at 474, MacKeigen CJNS stated that:
'Section 88 merely declares that valid provincial laws of general application to residents of a province apply also to Indians in the province. It does not make applicable to Indian reserve land a provincial game law which would have the effect of regulating use of that land by Indians. It does not enlarge the constitutional scope of the provincial law which is limited by the federal exclusivity of power respecting such land.'

119 As a result of the *Dick* case [1985] 2 SCR 309, provincial laws of general application which affect 'Indianness' apply by referential incorporation under s 88, apart from the exceptions discussed previously. Indians are therefore subject to extensive provincial legislation. See Little Bear, *op cit,* fn 59, 183.

and not to Indian land. The case did not address the question of whether s 88 can apply in relation to 'Lands reserved for the Indians'. Courts appear to have distinguished between legislation which relates to land itself and legislation which applies to the user of the land and the activities of that user.[120] It seems that provincial laws of general application which affect users as persons, as opposed to the use of reserve land itself, will be applicable on Indian land.[121] In *R v Duncan Supermarket Ltd,*[122] the court found that provincial legislation which required retail businesses to close on certain holidays did apply to a business conducted on reserve land. McKenzie J found that the question was whether the relevant sections of the Act applied to the use of the land, as contrasted to being directed to the activities of the user of the land. The British Columbia Court of Appeal, in *Rempel Brothers Concrete v Chilliwack (District),*[123] found that a municipal by-law which imposed a soil removal and deposit fee applied on reserve lands, as the by-law had only an incidental effect, if any, on the reserve land and did not regulate the use of the land. The British Columbia Supreme Court, in *Froste v Bob,*[124] indicated that the provincial Occupiers Liability Act applied to rodeo grounds on reserve lands, as the court found that the occupier was in breach of duty under that Act. In *Mission (District) v Dewdney/Aloutte Assessor Area No 13,*[125] the British Columbia Court of Appeal considered that while reserve lands which were occupied by non-Indians were liable to assessment under provincial legislation, the same Act did not apply to an Indian lessee of reserve lands. In *R v Fiddler,*[126] the court found that provincial legislation prohibiting the lighting of fires without adequate precautions to control the fire was a safety law of general application, and was not a regulation of the use of the land.[127]

A builder's lien was not permitted to be registered over reserve land which had been leased in the case of *Palm Dairies v The Queen*.[128] However, in the 1979 decision of *Western Industrial Contractors Ltd v Sarcee Developments*

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120 Note that in the *Oka v Simon* [1998] 2 CNLR 205, the court considered that the use must be an Indian use. See also Clark, R, *The Application of Provincial laws to Status Indians Under Section 88 of the Indian Act,* 1987, College of Law, University of Saskatchewan, Saskatoon, Native Law Seminars 10. Woodward, *op cit,* fn 11, 124–26.

121 See Sanders, *op cit,* fn 5, 461. In only one case that I am aware of, *R v Superior Concrete* ((1986) unreported, Vancouver County Court, May), did the court explicitly acknowledge this to be a factor. See *R v Duncan Supermarket Ltd* (1982) 135 DLR (3rd) 700, where this distinction also appears to be made.

122 *Ibid,* at 709 (BCSC). Section 88 was not referred to by the court in this case. *Surrey's* case (1970) 74 WWR 380 (BCCA), was distinguished as the court considered that the legislation was not directed to the use of the land.

123 (1994) 88 BCLR (2d) 209 (BCCA) at 214.

124 (1993) unreported, Doc No Kamloops 15187, January.

125 [1993] 1 CNLR 66.

126 [1994] 4 CNLR 99 at 127–28 (Sask QB). In *R v Sinclair* [1978] 6 WWR 37 it was found that provincial law which regulated the setting of fires was not applicable to Indian land.

127 Noble J in *Fiddler's* case, *ibid.*

128 (1978) 91 DLR (3rd) 665.

Ltd,[129] the Alberta Supreme Court, Appellate Division, allowed a building contractor to file a lien against an Indian-owned corporation which held a lease on reserve land.[130] The court applied provincial legislation in relation to a builder's lien to attach to a leasehold interest on reserve land. The Indian band's reversionary interest in the reserve lands was considered to remain part of the exclusive federal jurisdiction, and accordingly the provincial legislation was inapplicable to that reversionary interest.[131] The Alberta Court of Appeal, in 1982, in *Re Stoney Plain Indian Reserve No 135,*[132] stated that 'we accept the general proposition that provincial legislation relating to the use of reserve lands is inapplicable to lands that are found to be reserved for Indians'. In *Re Stoney* Plain,[133] the court considered that s 88 did not apply in relation to surrenders of Indian land. In *CP Ltd v Paul,*[134] the court considered that, as a constitutional matter, provincial legislation which enabled title to land to be acquired by prescription would not apply to Indian land.

In relation to provincial residential tenancies law applying on reserves, the cases are divided. In 1978, in *Millbrook Indian Band v Northern Counties Residential Tenancies Board,*[135] the court held that the Nova Scotia Residential Tenancies Act[136] did not apply on reserve land as the relationship between landlord and tenant was a proprietary one, and the legislation therefore related to the use of the land. A different position was taken in the 1978 decision in *Re Mobile Homes Sales Ltd and Le Greey,*[137] where the court found that a provision in the British Columbia Landlord and Tenant Act,[138] which prevented the landlord increasing the rent of residential premises, did apply to the lease of a mobile home on an Indian reserve, as this did not affect the use of the land. In 1982, in the case of *Toussowasket Ent Ltd v Mathews,*[139] it was found

129 (1980) 98 DLR (3d) 424.

130 The corporation was not considered by the court to be 'Indian' within the meaning of the Indian Act and the leasehold interest was not considered to be Indian land within the scope of s 91(24). *Surrey and Peace Arch* (1970) 74 WWR 380 (BCCA), was distinguished by the court in *Sarcee* as the lien was against the company's leasehold interest and did not impact on the interest of the Indian band in the land. However, *Peace Arch* also involved a leasehold interest in reserve lands held by non-Indian corporations and it is arguable that the decisions are in conflict with one another.

131 This decision has been criticised. See McNeil, 'Aboriginal title and the division of powers', *op cit,* fn 5, 459. McNeil considers that this decision is limited in two ways: first, it applies only where a non-Indian holds an interest in reserve land as this interest is outside s 91(24), and secondly, *Surrey v Peace Arch, ibid,* was distinguished because it involved land use. Therefore, *Sarcee* would seem not to be applicable if the provincial legislation relates to the use of Indian land, even by a non-Indian. See also the criticism of this decision by Sanders, 'The Constitution, the provinces, and Aboriginal peoples', *op cit,* fn 59, 157.

132 [1982] 1 CNLR 133.

133 *Ibid.*

134 [1989] 1 CNLR 47 at 57 (SCC).

135 (1978) 84 DLR (3rd) 174 at 181–83.

136 SNS 1970c 13.

137 (1978) 85 DLR (3d) 618 at 619.

138 1974 (BC)c 45.

139 [1982] BCD Civ 1863–01.

that the same Residential Tenancy Act applied to a non-Indian on reserve land. However, in 1992, in *Matsqui Indian Band v Bird,*[140] the same Residential Tenancy Act was held not to apply on Indian reserve lands. Despite this finding, the court was prepared to allow the common law of landlord and tenant to govern the interpretation of lease contracts on reserve land.

The question of whether s 88 applied to Indian lands was avoided by the Supreme Court in *Derrickson's* case.[141] In that case, a request was made for an order for half of family assets, where the family real property was reserve land held pursuant to certificates of possession. The court found that the right to possession of lands on reserves was a matter of exclusive federal legislative power, and that provincial laws which affected the right to possession and use of Indian land[142] could not apply of their own force.[143] The court did recognise that provincial legislation could be incorporated through s 88 of the Indian Act. It was argued that s 88, properly interpreted, made provincial laws applicable to reserve lands. The court did not dismiss this argument, as it did not have to decide the issue of referential incorporation.[144] It was found that, even if the provincial legislation relating to lands was generally incorporated, the provincial legislative provisions involving matrimonial property were inconsistent with the provisions of the Indian Act,[145] and thus the doctrine of paramountcy applied.[146]

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140 [1993] 3 CNLR 80. In *Anderson v Triple Creek Estates* (BCSC) (1990) unreported, Doc No Westminster A 90 1403, 18 July it was held that occupation is part of possession. Here the court refused to review an eviction notice under provincial legislation which was issued to a tenant in a mobile home park on Indian reserve lands.

141 *Derrickson* [1986] 1 SCR 285 at 297–99.

142 Compare the decision by the Quebec Court of Appeal in *Oka* [1998] 2 CNLR 205, where the use had to be an Indian use of land to come within the exclusive federal legislative power.

143 Chouinard J in *Derrickson* [1986] 1 SCR 285 at 296 stated:
'The right to possession of lands on an Indian reserve is manifestly of the very essence of the federal exclusive legislative power under s 91(24) of the *Constitution Act* 1867. It follows that provincial legislation cannot apply to the right of possession of Indian reserve lands.'
The decision in Derrickson was followed in *Paul v Paul* [1986] 1 SCR 306, where the Supreme Court found that provincial legislation relating to the occupation of a matrimonial home could not apply on reserve land. In the British Columbia Court of Appeal it was stated that such an order for 'occupancy' deals with the use of the land and these matters come within federal jurisdiction. See also, *Paul v Paul* [1985] 2 CNLR 93 at 97. In *George v George* [1993] 2 CNLR 112 the British Columbia Supreme Court again found that real property on a reserve could not be sold or divided pursuant to provincial family law legislation. In these cases the provincial legislation was also in conflict with the provisions of the Indian Act and was inapplicable through paramountcy rules.

144 Chouinard J in *Derrickson, ibid* at 298 stated that:
'The submission that s 88 does not apply to lands reserved for Indians is quite simple. It is to the effect that not one but two subject matters are the object of s 91(24) of the Constitution Act 1867, namely: 'Indians' and 'Lands reserved for the Indians'. Since only Indians are mentioned in s 88, that section would not apply to lands reserved for the Indians'.

145 *Derrickson, ibid* at 302. Inconsistency of provincial laws with provisions of the Indian Act is one of the qualifications in s 88.

146 *Derrickson's* case was followed in *Simpson v Ziprick* (1995) 126 DLR (4th) 754 (BCSC), where provincial legislation, which allowed joint tenants to apply for partition under the Partition of Property Act, RSBC 1979 C 311, was not applied to reserve land through s 88. Here the provincial legislation was found to be inconsistent with the Indian Act and could not apply to lands reserved for

Generally, the cases support the conclusion that where provincial laws purport to regulate land use, such laws will be read down and have no application to reserve lands.[147] Technically, it is open to the Supreme Court to interpret s 88 so as to allow provincial laws that relate to land to apply to 'Lands reserved for the Indians'. However, good reasons exist to support the view that provincial legislation should not be applied to reserve land. Where ambiguity exists in the interpretation of a statute which affects Indians, the established rule of interpretation of such legislation is that ambiguities should be construed in favour of Aboriginal peoples.[148] Such interpretation would limit referential incorporation to provincial laws of general application that affect Indians, but would not include laws that affect Indian lands.[149] Another reason for limiting provincial laws of general application to laws that affect Indians is that the honour of the Crown could not be upheld where provincial laws infringed Aboriginal title.[150] It would be a dishonourable abdication of the responsibility that was placed on the federal government if that were permitted to occur.[151]

The *Delgamuukw* court, in reaching its decision, failed to address the issues of s 88 and referential incorporation directly, other than in the context of extinguishment of Aboriginal title.[152] Only if s 88 referentially incorporates laws in relation to Aboriginal title could provincial laws of general application, which affect possession and use of lands, apply to Aboriginal interests in land.[153] On the authority of *Alphonse's* case and *Dick's* case, provincial laws that infringe Aboriginal hunting rights can be referentially incorporated if the justification test is met.[154] In that way, provincial laws in relation to Aboriginal title could be

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Indians. In *Derrickson's* case Chouinard J questioned the right of the province to make laws dealing with the severance of a joint tenancy of Indian land. In *Re Bell and Bell* (1977) 78 DLR (3rd) 227, the Supreme Court of Ontario, however, found that partition legislation applied to reserve land.

147 However, see *Oka* [1998] 2 CNLR 205, and the accompanying text.

148 See *Nowegijick v The Queen* [1983] 1 SCR 29 at 36; *R v Sparrow* [1990] 1 SCR 1075 at 1107–08; *Simon v The Queen* [1985] 2 SCR 387 at 402.

149 See McNeil, 'Aboriginal title and the division of powers', *op cit,* fn 5, 440. Compare Wilkins, *op cit,* fn 81, 489.

150 The honour of the Crown has been referred to in *Sparrow* [1990] 1 SCR 1075 at 1107–09; *R v Badger* [1996] 1 SCR 77 at 794 *per* Cory J; *R v Van der Peet* [1996] 2 SCR 507 at 537 *per* Lamer CJC and in *Delgamuukw* [1997] 3 SCR 1010, in the Court of Appeal, *per* Macfarlane JA; and in *R v Marshall* [1999] SCR 456.

151 See also McNeil, 'Aboriginal title and the division of powers', *op cit,* fn 5,440–41.

152 See McNeil, 'Aboriginal title and the division of powers', op *cit,* fn 5,447.

153 However, provincial laws might still have some incidental effect on those interests. See Peeling, *op cit,* fn 37.

154 *Alphonse's* case [1993] 4 CNLR 19 and *Dick's* case [1985] 2 SCR 309.

effective. Lamer CJC, in *Delgamuukw,*[155] suggested that provincial laws can be made applicable to Aboriginal title lands by s 88 of the Indian Act. Such an interpretation of s 88 could result in a substantial invasion by the provinces into Aboriginal land title rights.

Is s 88 unconstitutional?

Section 35 of the Constitution Act 1982 reduces the capacity of federal parliament to erode Aboriginal rights.[156] Section 88 of the Indian Act, of itself, offers no protection to Indians in relation to laws that are inconsistent with s 35 of the Constitution Act 1982. It is only after those laws are incorporated into federal law that the *Sparrow* justification test (see below) would apply. However, the constitutional division of powers clearly places responsibility for 'Indians' with the federal government under s 91(24), and arguably the provinces have no power to infringe Aboriginal rights on their own.[157]

In *Dick's* case,[158] the British Columbia Court of Appeal expressed the opinion that s 88 is not inconsistent with s 35(1) of the Constitution Act 1982, despite the section incorporating laws affecting 'Indianness' which could therefore be inconsistent with s 35(1). In 1993, in *Alphonse's* case,[159] the

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155 Lamer CJC in *Delgamuukw* [1997] 3 SCR 1010 at 1122, considered that provincial land and resource laws affecting Aboriginal title may be given force as federal laws through the operation of s 88. (However, Lamer CJC's discussion of s 88 of the Indian Act is generally in the context of extinguishment and not infringement.) Macfarlane JA in the Court of Appeal in *Delgamuukw* (1997) 153 DLR (4th) 193 at 539, also considered that s 88 'may authorise provincial interference with Aboriginal rights; provincial laws may affect, regulate, diminish, impair or suspend the exercise of an Aboriginal right,' and that 'provincial land and resource laws affecting Aboriginal rights may be given force as federal laws through the operation of s 88 of the Indian Act'. Such laws would still be subject to s 35 of the Constitution Act 1982. This approach to s 88 has been criticised. See commentary by McNeil in 'Aboriginal title and the division of powers', *op cit,* fn 5, and additional commentary by McNeil, *op cit,* fn 37. These views are re-iterated by Bankes, *op cit,* fn 37 and Wilkins, *op cit,* fn 59. For recent judicial rejection of the view that s 88 referentially incorporates provincial laws in relation to 'Lands reserved for the Indians' see Lysyk J in *Stoney Creek Indian Band v British Columbia* [1998] BC 2468. (This decision was overturned on appeal; however, the British Columbia Court of Appeal did not address the substantive issue.)

156 See *Sparrow* [1990] 1 SCR 1075 at 1109–1110 and 1113–1119. In *Sparrow,* the court considered that legislation that affects the exercise of Aboriginal rights will nonetheless be valid, if it meets the test for justifying an interference with a right recognised and affirmed under s 35(1). This test is referred to below.

157 This is because *Badger* [1996] 1 SCR 77, and *Cotè* [1996] 3 SCR 139, held and *Delgamuukw* [1997] 3 SCR 1010, repeated that this was not possible.

158 [1993] 4 CNLR 63 as *per* Macfarlane JA at 69. 'The fact that s 88 referentially incorporates laws that affect Indians qua Indians does not necessarily mean that s 88 is inconsistent with s 35(1). The purpose of s 88 is to give effect to provincial laws of general application. An unconstitutional regulation will not be incorporated as federal law. The question whether incorporated legislation may be challenged as violating s 35 (1) is distinct from the issue whether s 88 is *intra vires* the powers of parliament. Section 88 is an enabling provision. By itself it does not interfere with the exercise of Aboriginal rights. In my opinion it is not inconsistent with s 35(1)'.

159 Supra note 101. See also *R v Sundown* [1997] 4 CNLR 241 (Sask CA), *per* Vancise, affirmed by the Supreme Court of Canada [1999] 2 CNLR 289.

question of whether s 88 of the Indian Act is inconsistent with s 35(1) of the Constitution Act 1982 was again considered by that court. Macfarlane JA (Taggart, Hutcheon and Wallace JAA concurring) upheld the constitutional validity of s 88. Macfarlane JA accepted the province's argument that the section does not, in and of itself, interfere with Aboriginal rights, and therefore s 88 does not need to be justified under the *Sparrow* test. Macfarlane JA further considered the situation where the terms of incorporated provincial legislation interfered with specific Aboriginal rights. This he considered would not support the proposition that s 88 itself is unconstitutional. Macfarlane JA based this view on the *Sparrow* finding that Aboriginal rights are not absolute, and that interference with such rights can be justified. Section 88, he considered, would be unconstitutional only if Aboriginal rights were absolute.

Contrary to the views in the *Alphonse* and *Dick* cases, academic endorsement has been given to the view that s 88 itself requires justification under the *Sparrow* test.[160] It is arguable that infringement of Aboriginal rights through s 88 can be made only 'by the federal government, pursuant to federal objectives, as the provinces are barred by the division of powers from doing so'.[161] Reliance is placed on the words of Lamer CJC in *R v Adams,*[162] that in light of the Crown's fiduciary obligations to Aboriginal peoples it is impossible for parliament to put into place 'an unstructured discretionary administrative regime which risks infringing Aboriginal rights' without explicit guidelines.[163] Section 88 is seen as having many similarities with such an administrative scheme.[164] McNeil[165] and Wilkins[166] further support the interpretation that s 88 would fail to satisfy the *Sparrow* standards of 'sensitivity to and respect for the rights of Aboriginal peoples' and of 'as little infringement as possible in order to effect the desired goals', and therefore this section should be read down so that it is incapable of incorporating provincial laws that infringe Aboriginal rights.[167]

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160 See Wilkins, *op cit,* fn 59, 228, and also McNeil, *op cit,* fn 37. *Sparrow* [1990] 1 SCR 1075.
161 McNeil, *op cit,* fn 37, 167. See also Wilkins, *op cit,* fn 59.
162 [1996] 3 SCR 101, at 132.
163 See Wilkins, *op cit,* fn 81, 495 and McNeil, *op cit,* fn 37 167–68.
164 Wilkins, *op cit,* fn 59.
165 McNeil, *op cit,* fn 37.
166 Wilkins, *op cit,* fn 59, 228.
167 Wilkins, *op cit,* fn 59, quoting *Sparrow* [1990] 1 SCR 1075 at 1119. See McNeil, *op cit,* fn 37, 169. McNeil considers that the constitutional validity of s 88 depends on whether it incorporates any provincial laws that do not infringe Aboriginal rights. If s 88 incorporates some laws that do not infringe Aboriginal rights then s 88 should be read down to limit its application to those laws. He states that 'if the only laws incorporated by it [s 88] are laws that infringe Aboriginal rights…it should be struck down because it violates s 35 (1)'.

Professor Slattery[168] has also argued (prior to the Supreme Court *Delgamuukw* decision) that the federal government cannot subvert the overall constitutional scheme by enacting legislation for Indians that referentially incorporates a wider range of provincial statutes than could otherwise apply to Aboriginals under the division of powers.[169]

Even if the Supreme Court rules that s 88 is valid, but the incorporated law produced a result that was inconsistent with s 35, then the incorporated law must be read down to eliminate the unconstitutional effect.[170]

Extinguishment and infringement of Aboriginal title and s 35 of the Constitution Act 1982

The existing Aboriginal and treaty rights of the Aboriginal peoples of Canada' are constitutionally protected by s 35(1) of the Constitution Act 1982. Aboriginal rights which are recognised and affirmed by s 35 of the Constitution Act 1982 are not absolute.[171] Such rights can, in a very limited range of circumstances, be extinguished and infringed by legislation.[172] Aboriginal title is not just a property right, but a property right that is constitutionally protected by s 35(1) of the Constitution Act 1982.[173] The actual content of Aboriginal title (which is protected by s 35) was described in *Delgamuukw* as a right to the exclusive use and occupation of the land. An inherent limit on this title prohibits the use of the land 'in a manner that is irreconcilable with the nature of the

168 See Slattery (1992), *op cit,* fn 5, 285–86.

169 Slattery (1992), *op cit,* fn 5, 285 states that 'the provinces do not possess the power to legislate in relation to Aboriginal and treaty rights' and at 286 that:
'it follows that the Federal Parliament cannot subvert the overall constitutional scheme by enacting legislation for Aboriginal peoples that referentially incorporates a wide range of Provincial statutes that could not otherwise apply to First Nations under the division of powers. Such Federal legislation, it is submitted, would seriously affect the Aboriginal right of self-government under section 35 of the *Constitution Act, 1982* and cannot meet the *Sparrow* standard of justification. So, section 88 of the current *Indian Act,* which referentially makes applicable to Indians 'all laws of general application from time to time in force in any province is of doubtful constitutional validity'.

170 McNeil, *op cit,* fn 37,165 considers that it would be impossible for a province to meet the *Sparrow* test and to show a compelling and substantial objective, respect for the Crown's fiduciary obligations and consultation without revealing an unconstitutional objective. McNeil further considers that if it is the federal government that has to establish the compelling and substantive objective, etc. how could this be done when Parliament was not involved in the enactment of the particular provincial law.

171 *Delgamuukw* [1997] 3 SCR 1010 at 1107. In *Sparrow* it was also recognised that, while s 35 restrained sovereign power, the rights recognised under s 35 were not absolute. Dickson CJ stated that 'Federal legislative powers continue including the right to legislate with respect to Indians…' And that 'federal power must, however, be reconciled with the federal duty towards the aboriginals and the best way to achieve that reconciliation is to demand the justification of any government regulation that infringes upon or denies aboriginal rights.' *Sparrow* [1990] 1 SCR 1075 at 1109.

172 Refer to the discussion below in relation to the limited range of circumstances in which extinguishment of Aboriginal rights can occur. After the passage of the Constitution Act 1982, parliament cannot extinguish constitutionally protected rights.

173 McNeil, 'Aboriginal title and the division of powers', *op cit,* fn 5, 456. See also McNeil, 'Defining Aboriginal title in the 90s: has the Supreme Court finally got it right?', *op cit,* fn 5.

attachment to the land which forms the basis of the group's claim to Aboriginal title'.[174] This limit may restrict the scope of Aboriginal title but it cannot alter the exclusivity of Aboriginal title,[175] and can in no way change the fact that the Aboriginal right which is constitutionally protected is the right to the 'exclusive use and occupation of the land'. As discussed above, Aboriginal title also clearly comes within the subject matter of s 91(24) of the Constitution Act 1867.

Extinguishment of Aboriginal title and rights

Extinguishment of Aboriginal title can occur in a limited range of circumstances. These include voluntary surrender to the Crown,[176] constitutional amendment,[177] or legislation enacted by the federal parliament prior to 1982.[178] Parliament's power to extinguish legislatively existed only prior to the enactment of the Constitution Act 1982, as after that date it is not possible for Parliament to extinguish constitutionally protected rights.[179] In *Sparrow,*[180] a standard for the pre-1982 extinguishment of Aboriginal rights (including Aboriginal title) was established. That standard requires that a 'clear and plain intent' to extinguish be shown. While the standard of 'clear and plain intent' does not require language which refers expressly to extinguishment of Aboriginal rights, the standard required to establish the requisite intent is high.[181]

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174 *Delgamuukw* [1997] 3 SCR 1010 at 1088.

175 See McNeil, 'Aboriginal title and the division of powers', *op cit,* fn 5,456.

176 *Ontario (Attorney General) v Bear Island Foundation* [1985] 1 CNLR 1 affirmed by the Supreme Court on this point. See *Bear Island Foundation v Ontario (Attorney General)* [1991] 3 CNLR 79. See for commentary McNeil, K, The high cost of accepting benefits from the Crown: a comment on the Temagami Indian land case' [1992] 1 CNLR 40.

177 *R v Horseman* [1990] 1 SCR 901. While this case dealt with treaty rights, it illustrates the possibility of modifying those rights by constitutional amendment. A treaty right to hunt commercially was taken away by the Natural Resources Transfer Agreements, which were given constitutional force by the Constitution Act 1867.

178 *Sikyea v The Queen* [1964] SCR 642; *Sparrow* [1990] 1 SCR 1075. Post-s 35 of the Constitution Act 1982 this power has now been removed.

179 This was recognised by Lamer CJC in *Van der Peet* [1996] 2 SCR 507. A fortiori, the executive cannot extinguish Aboriginal rights, as the executive cannot interfere with vested rights without legislative authority. See McNeil, K, 'Racial discrimination and the unilateral extinguishment of native title' (1996) 1 AILR 181.

180 *Sparrow* [1990] 1 SCR 1073 at 1099.

181 See *R v Gladstone* [1996] 2 SCR 723. In this case the regulatory schemes affecting the fishing were found not to express a clear and plain intention to eliminate the Aboriginal right. Lamer CJ (para 38) considered that the failure to recognize an Aboriginal fishing right, and the failure to grant special protection to it, did not constitute the clear and plain intention necessary to extinguish the right. The regulations never prohibited aboriginal people from obtaining licences to fish. See also *Van der Peet, per* L'Heureux-Dube J (dissenting on other grounds) (para 138) [1996] 2 SCR 507.

Extinguishment by federal laws

As Parliament has exclusive jurisdiction in relation to 'Indians' and 'Lands reserved for the Indians', it also had exclusive jurisdiction to extinguish Aboriginal title prior to 1982.[182] The provinces have no power in the Constitution over Aboriginal title or Aboriginal rights,[183] and accordingly the provinces lack power to extinguish these rights. Because Aboriginal rights are 'part of the "core of Indianness" at the heart of s 91 (24)' under federal jurisdiction, provincial power to extinguish Aboriginal title rights has, in fact, been lacking since Confederation.[184] Thus, even prior to Aboriginal rights being protected by the Constitution Act 1982, those rights could not be extinguished by provincial laws.[185]

Extinguishment by provincial laws

Although provincial laws of general application can apply to Indians, such laws cannot extinguish Aboriginal rights. The federal government's exclusive jurisdiction in relation to extinguishment of Aboriginal rights would appear incompatible not only with any power of extinguishment, but also with any power of infringement by provincial legislatures.[186] If, however, the provincial legislatures can infringe Aboriginal rights, where does this power of infringement come from?

Underlying title to Aboriginal lands

Could provincial power to infringe Aboriginal rights be found in the fact that the underlying title to Aboriginal land is vested in the provinces? The separation of the right to the underlying title to Aboriginal land from the jurisdiction over Aboriginal land was recognised in the *St Catherine's Milling* case.[187] Section 109 of the Constitution Act 1867 vests the underlying title to Aboriginal land in the Crown in right of the provinces,[188] and not the Crown in right of the federal government. The underlying title of the provincial Crown is subject to Aboriginal title.[189] Thus, despite the federal government's exclusive legislative

182 This was recognised by the *Delgamuukw* Court [1997] 3 SCR 1010 at 1122–23. The *Delgamuukw* court found that the province can neither extinguish nor accept a surrender of Aboriginal title.

183 This is apart from the specific provisions like paragraph 12 of the Natural Resources Transfer Agreements.

184 Lamer CJC in *Delgamuukw* [1997] 3 SCR 1010 at 1119, found that laws which touch the 'core of Indianness' and purport to extinguish those rights are 'beyond the legislative competence of the provinces to enact'.

185 *Delgamuukw, ibid* at 1121.

186 Refer to the discussion below regarding infringement of Aboriginal title and rights.

187 [1889] 14 AC 46.

188 The Privy Council in *St Catherine's Milling* case, supra note 2, found that 'Lands reserved for the Indians' were not transferred to the federal government under the Constitution Act 1867. (In the three prairie provinces, it is not s 109 of the Constitution Act 1867, but Natural Resources Transfer Agreements, 1930 which are relevant.)

189 Section 109 provides that 'all lands, mines, minerals and royalties belonging to the several provinces of Canada…at the union…shall belong to the several provinces…subject to any trusts existing in respect thereof, and to any interest other than that of the Province in the same'.

power in relation to 'Lands reserved for the Indians', which includes unextinguished Aboriginal title lands, the federal government has no interest in the underlying (or 'radical') title to those lands. However, after a surrender to the Crown of Aboriginal title by the Indians, the province obtains a full and beneficial title to that land.[190]

The *St Catherine's Milling Case*[191] recognised that provincial ownership of the underlying title to reserve land did not operate to limit federal jurisdiction in any way. The *Delgamuukw* court rejected arguments that, as the province held the underlying title to Aboriginal land, this right carried with it the right to grant fees simple, which by implication extinguish Aboriginal title, and so, by implication, exclude the Aboriginal title from s 91(24).[192] Lamer CJC, in *Delgamuukw,* found that this argument had failed to take account of the wording of s 109, which provides that the lands belonging to the provinces are held subject to other interests in the land, which include Aboriginal title.[193] Therefore, the vesting of the underlying title in the province affords the province no jurisdiction over Aboriginal rights.

Standard to establish extinguishment

Lamer CJC, in *Delgamuukw,* found that because a law of general application cannot by definition meet the standard for extinguishment, as set out in *Sparrow*[194] (one of 'clear and plain intent'), without being *ultra vires* the province, it could never extinguish Aboriginal title.[195] Therefore, a provincial law of general application could never extinguish Aboriginal rights *proprio vigore.* An intention to extinguish Aboriginal rights would take the law outside the provincial jurisdiction. A further reason why Aboriginal rights could not be extinguished by provincial laws of general application is that Aboriginal rights form part of the 'core of Indianness' at the heart of s 91(24).[196] This would prevent any extinguishment of Aboriginal rights by the provinces even prior to the enactment of s 35(1) of the Constitution Act, 1982.

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190 *St Catherine's Milling case* [1889] 14 AC 46; *Attorney General Can v Attorney General Ont (Indian Annuities)* [1897] AC 199; *Smith v The Queen* [1983] 1 SCR 554.

191 *St Catherine's Milling, ibid.*

192 *Delgamuukw* [1997] 3 SCR 1010 at 1116–18. Lamer CJC at 1111, referred to the grant of fees simple for agriculture although His Honour did not state that the provinces could make such grants.

193 *Delgamuukw, ibid* at 1117. See also *St Catherine's Milling* [1889] 141 AC 46. Campbell J confirmed this in *Chippewas of Sarnia Band v Canada* [1999] OJ 1406, Ontario Superior Court of Justice. Campbell J, at para 377, noted that the underlying or radical title to Indian land is the Crown's, subject to the overlaying burden of unsurrendered Indian land title. He stated that 'it does not follow from the nature of the underlying title, that the unextinguished burden of *sui generis* Indian title is in the gift of the Crown to dispose without surrender'. Thus the Crown cannot grant land to a third party in a way that extinguishes Aboriginal title.

194 *Sparrow* [1990] 1 SCR 1075 at 1099.

195 *Delgamuukw* [1997] 3 SCR 1010 at 1120.

196 *Delgamuukw, ibid* at 1122 and at 1119, per Lamer CJC. La Forest (L'Heureux-Dube J concurring) also found that a province could not extinguish Aboriginal title.

Referential incorporation by s 88

Referential incorporation by s 88 of the Indian Act will not save a provincial law that involves extinguishment of Aboriginal title. Any law that meets the 'clear and plain intention' test of extinguishment would not be a law of general application.[197] Lamer CJC, in *Delgamuukw,* noted that there is nothing in the language of s 88 which suggests any intention to extinguish Aboriginal rights, and the explicit reference to treaty rights suggests that s 88 was clearly not intended to undermine Aboriginal rights. In addition, s 88 itself reveals no clear and plain intention to authorise extinguishment of Aboriginal title or Aboriginal rights.[198] Thus the court in *Delgamuukw* was clear that provinces have no power to extinguish Aboriginal title or rights.

Infringement of Aboriginal title and rights

The Supreme Court of Canada, in *R v Sparrow,*[199] recognised that all legislative infringements of s 35 constitutionally protected rights will be invalid unless the legislation meets the required standard of justification. In *Delgamuukw,* the court considered that both federal[200] and provincial[201] legislatures could infringe Aboriginal title and Aboriginal rights.[202] Although Lamer CJC found that provincial governments are able to infringe Aboriginal title and Aboriginal rights,[203] it is not clear where this power comes from.[204] It is this division of powers issue, and the question whether the provinces have the constitutional authority to infringe Aboriginal rights, which require resolution.[205] Lamer CJC

197 This is clear from the Supreme Court's decision in *Delagmuukw* [1997] 3 SCR 1010. See also McNeil, 'Aboriginal title and the division of powers', *op cit,* fn 5, 437.

198 See McNeil, 'Aboriginal title and the division of powers', *op cit,* fn 5,448.

199 *Sparrow* [1990] 1 SCR 1075 at 1109, the court stated:
'The words "recognition and affirmation" in s 35 incorporate the fiduciary relationship between the aboriginal peoples and the government and so import some restraint on the exercise of sovereign power. Rights that are recognised and affirmed are not, however, absolute. Federal legislative powers continue, including the right to legislate with respect to Indians pursuant to s 91(24) of the *Constitution Act, 1867.* This federal power must, however, be reconciled with the federal duty towards the aboriginals and the best way to achieve that reconciliation is to demand the justification of any government regulation that infringes upon or denies Aboriginal rights.'

200 See Lamer CJC in *Delgamuukw* [1997] 3 SCR 1010 at 1107 and at 1111.

201 *R v Cotè* [1996] 3 SCR 139.

202 See Lamer CJC in *Delgamuukw* [1997] 3 SCR 1010 at 1107 and at 1111.

203 *Ibid* at 1107.

204 See McNeil, 'Aboriginal title and the division of powers', *op cit,* fn 5, 448–53. As McNeil notes if Aboriginal rights are within the 'core of Indianness' and thus within exclusive federal jurisdiction then where is provincial power to infringe? Lamer CJC relied on *R v Cotè* [1996] 3 SCR 139, however, this case did not deal directly with the question of exclusive federal jurisdiction and the provinces' ability to infringe Aboriginal rights. Nor could reliance be placed on *R v Badger* [1996] 1 SCR 77, as providing authority for the fact that provinces have power to infringe Aboriginal rights as in this case legislative power was conferred on the province under the Natural Resources Transfer Agreements. (This agreement was given constitutional force under s 1 of the Constitution Act 1930, 20 & 21 Geo V c 26 (UK).)

considered that provincial laws of general application, although touching on 'Indianness' at the core of federal jurisdiction, could, through s 88 of the Indian Act, be referentially incorporated to apply to Indians.[206] He stated that:

> Section 88 extends the effect of provincial laws of general application which cannot apply to Indians and Indians lands because they touch on the Indianness at the core of s 91(24). For example, provincial laws which regulated hunting may very well touch on this core. Although such a law would not apply to Aboriginal people *proprio vigore,* it would still apply through s 88 of the Indian Act, being a law of general application.

By saying this, did Lamer intend to extend s 88 to apply to Indian lands as well as to Indians? Lysyk J in *Stoney Creek Indian Band v British Columbia,*[207] in commenting on Lamer CJC's words in *Delgamuukw,* stated that, given the care taken to leave this point open in both *Derrickson's* case[208] and in *Paul v Paul,*[209] and given the current of authority to the opposite effect in other decisions, it is doubtful whether this passing reference was intended to be a considered conclusion that s 88 extends otherwise inapplicable provincial laws not only to Indians but also to Indian lands.[210]

Sparrow *justification test*

All infringements of Aboriginal rights must be justified under the *Sparrow* test.[211] In accordance with s 35(1) of the Constitution Act 1982, any laws (either federal or provincial)[212] which were found to apply to Aboriginal land would still have to meet the justification test in *Sparrow* if they infringe Aboriginal title or other Aboriginal or treaty rights.[213] The *Sparrow* test of justification has two parts. It requires that the government show first that the infringement is 'in furtherance of a legislative objective that is compelling and

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205 See McNeil, 'Aboriginal title and the division of powers', *op cit,* fn 5; Peeling, *op cit,* fn 37; and Wilkins, *op cit,* fn 59. See also Isaac T, 'Provincial Jurisdiction Adjucative Authority and Aboriginal Rights'. A comment on *Paul v B.C. (Forest Appeals Commission)* Vol 60, Part 1, 2002 The Advocate 77.

206 *Delgamuukw* [1997] 3 SCR 1010.

207 [1998] BC 2468, paras 35 and 36],

208 [1986] 1 SCR 285.

209 [1986] 1 SCR 306.

210 Lysyk's views in *Stoney Creek* are shared by McNeil, *op cit,* fn 37 at 160–64. Lysyk J further commented that the point has yet to be clearly resolved by the Supreme Court of Canada.

211 *Sparrow* [1990] 1 SCR 1075, generally at 1109–19.

212 Provincial laws could be found to apply either by referential incorporation under s 88 of the Indian Act or where provincial laws 'of general application' applied proprio vigore. Refer to the discussion above. *Delgamuukw* [1997] 3 SCR 1010 at 1120.

213 Although the *Sparrow* court [1990] 1 SCR 1015 at 1109–19, would generally indicate that the public interest is too large a test for justification, the *Delgamuukw* court has indicated that such a broad justification is possible. See Lamer CJC in *Delgamuukw, ibid* at 1111, who considered that the economic development of the province is a valid legislative objective.

substantial', and, secondly, that the infringement is 'consistent with the special fiduciary relationship between the Crown and the Aboriginal peoples'.[214]

After the decision in *R v Gladstone,*[215] the range of legislative objectives that can justify the infringement of Aboriginal title is fairly broad.[216] Lamer CJC, in *Delgamuukw,* expanded on the application of the justification test and stated:

> The range of legislative objectives that can justify the infringements of Aboriginal title is fairly broad. Most of the objectives can be traced to the reconciliation of the prior occupation of North America by Aboriginal peoples with the assertion of Crown sovereignty which entails the recognition that 'distinctive Aboriginal societies exist within, and are part of, a broader social, political and economic community'… (T)he development of agriculture, forestry, mining and hydroelectric power, the general economic development of the interior of British Columbia, protection of the environment or endangered species, the building of infrastructure and the settlement of foreign populations to support those aims, are the kind of objectives that are consistent with this purpose and, in principle, can justify the infringement of Aboriginal title. Whether a particular measure or government act can be explained by reference to one of those objectives, however, is ultimately a question of fact that will have to be examined on a case by case basis'.[217]

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214 *Sparrow, ibid,* at 1109–19. Justification under *Sparrow* involves determining the effect of the order of priorities in relation to fisheries: first, conservation, secondly, Indian fishing (particularly for food requirements and social and ceremonial purposes), thirdly, non-Indian commercial fishing and fourthly, non-Indian sports fishing. The burden of conservation measures should not fall primarily upon the Indian fishery. Additional questions, within the analysis of justification, require consideration as to whether there has been as little infringement as possible in order to effect the desired result; whether, in a situation of appropriation, fair compensation is available; and whether the Aboriginal group in question has been consulted with respect to the conservation measures being implemented. Aboriginal people would be expected to be informed regarding the determination of an appropriate scheme for the regulation of their rights. *Sparrow* has been confirmed, although slightly modified, in later decisions. In *R v Gladstone* [1996] 2 SCR 723, the Supreme Court found that the *Sparrow* justification test remains good law; however, considerations in relation to priorities can differ. Where an internal limitation exists (eg, where fishing is for food, social and ceremonial purposes) the *Sparrow* test applies, but if no internal limit exists (eg, where the right is to fish commercially) then, on the priority approach taken in *Sparrow,* the Aboriginal right would be exclusive and so the priority rules are modified accordingly. In the absence of an internal limit, allocation of the resource must include an account of Aboriginal rights and must reflect the priority that Aboriginal rights have over other users. Justification requires that government demonstrate that both the process of allocation and the actual allocation reflect the prior interest of Aboriginal rights holders. Conservation continues to have priority. After conservation goals are met, objectives that can satisfy justification include the pursuit of economic and regional fairness, and the recognition of historical reliance upon and participation in the fishery by non-Aboriginal groups. See comment McNeil, K, 'How can infringements of the constitutional rights of Aboriginal peoples be justified?' (1997) 8(2) Constitutional Forum 33.
Infringements of treaty rights are also subject to the same justification requirements. See *R v Badger* [1996] 1 SCR 77 at 811–16; *R v Sundown* [1999] 1 SCR 393 at 413; and *R v Marshall* [1999] SCR 456.

215 *Gladstone, ibid.*

216 This was recognised by Lamer CJC in *Delgamuukw* [1997] 3 SCR 1010 at 1111.

217 *Ibid* at 1111.

Most of the activities mentioned by Lamer CJC (for example, agriculture, forestry and mining) are within provincial jurisdiction under s 92 of the Constitution Act 1867 in the division of powers.[218]

The justification test will not be available to justify infringements by provincial laws where such laws encroach on federal jurisdiction.[219] Despite the fact that the province has no power to make laws in relation to Indians or treaty rights under s 92 of the Constitution Act 1867, where provincial laws of general application impact on Aboriginal or treaty rights, these laws should also be subject to the justification test.[220]

Federal laws which are validly enacted pursuant to s 91(24) may be justified under the *Sparrow* test and may prevail. If provincial laws of general application impact on 'Indianness', and are accordingly referentially incorporated by s 88 of the Indian Act so as to be applicable as part of federal law, then arguably justification would be available in relation to infringement, as the provincial law is incorporated as federal legislation.[221] However, this would be subject to s 88 being found not to be unconstitutional pursuant to s 35 of the Constitution Act 1982.[222]

Sparrow and provincial legislation

The *Sparrow* court stated that one of the effects of s 35 was that it 'affords Aboriginal peoples constitutional protection against provincial legislative power'.[223] The *Sparrow* test was formulated in the context of a federal (not provincial) regulation, which infringed an Aboriginal right. An infringement of Aboriginal rights by provincial legislation would be expected to be a violation of s 35. However, despite this constitutional protection, Lamer CJC, in *Delgamuukw,* considered that the exclusive rights of Aboriginal title can be infringed by a provincial legislature where the infringement can be justified under the *Sparrow* test.[224] The examples of infringement offered by the court in *Delgamuukw*–the granting of fees simple for agriculture and of leases for forestry and mining–indicate that provincial governments can infringe Aboriginal title holders' rights to the exclusive use and occupation of land.

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218 See Hogg, *op cit,* fn 5.

219 See McNeil, 'Aboriginal title and the division of powers', *op cit,* fn 5, 450–51.

220 See *R v Badger* [1996] 1 SCR 77 at 813–16 and 820 where provincial laws in question were game laws of general application which, because they infringed treaty rights to hunt, as modified by the Natural Resources Transfer Agreement (Constitution Act 1930, 20–21 George V c 26 (UK)), were required to meet the same test of justification under *Sparrow,* This view was endorsed by the Supreme Court in *R v Marshall* [1997] SCR 456, paras 55 and 64. See also *R v Cotè* [1996] 3 SCR 139. See Slattery (1992), *op cit,* fn 5, 285.

221 See Lamer CJC in *Delgamuukw* [1997] 3 SCR 1010 at 1122.

222 Refer to the above discussion. See also McNeil, *op cit,* fn 37; McNeil, 'Aboriginal title and the division of powers', *op cit,* fn 5; and Peeling, *op cit,* fn 37.

223 *Sparrow* [1990] 1 SCR 1075 at 1105 and at 1111–20.

224 *Delgamuukw* [1997] 3 SCR 1010 at 1111.

Suggestions have been made by the Supreme Court of Canada, in *R v Cotè,*[225] that a *Sparrow* type justificatory test might be applied to provincial legislation which infringed Aboriginal rights, where that legislation was referentially incorporated by s 88 of the Indian Act.[226] Although this has never previously been done,[227] it is arguable that if s 88 of the Indian Act referentially incorporates provincial law into federal law, which applies to Indians, any infringement under the referentially incorporated law is technically justifiable, as such law has become a federal law. However, Kent McNeil assesses the position correctly in relation to provincial infringements when he states 'this makes the constitutionalisation of Aboriginal title by s 35(1) virtually meaningless'.[228]

Regulation versus extinguishment

Regulation of a right is not a partial extinguishment of that right.[229] The *Sparrow* court found that regulation by a series of legislative controls and a system of discretionary licensing systems which restricted the Aboriginal right to fish did not amount to extinguishment of that right, as there was no clear and plain intention to extinguish the right. However, regulation of Aboriginal rights, including Aboriginal title, must also be justified.[230]

Is there a difference between *infringement* and *regulation* in relation to the application of provincial laws to Aboriginal rights? Macfarlane JA, in the *Delgamuukw* Court of Appeal decision, considered that infringement means to 'affect, regulate, diminish, impair or suspend the exercise of an Aboriginal right' and not to partially extinguish.[231] Infringement appears broader than regulation, as regulation is only one of the listed ways to infringe Aboriginal title. Regulation of a right involves the exercising of jurisdiction over the right. Could an 'infringement' of Aboriginal title also be a partial extinguishment? To establish a *prima facie* infringement, it is necessary to establish one of the

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225 Supra note 79. Lamer CJC in *R v Cotè* [1996] 3 SCR 139 at 185, considered that:
'It is quite clear that the *Sparrow* test applies where a provincial law is alleged to have infringed an Aboriginal or treaty right… The text and purpose of s 35(1) do not distinguish between federal and provincial laws which restrict Aboriginal or treaty rights, and they should both be subject to the same standard of constitutional scrutiny.'
The British Columbia Court of Appeal in *Alphonse's* case [1993] 4 CNLR 19, also suggested that the *Sparrow* justification test would apply to provincial legislative infringement of Aboriginal rights.

226 Lamer CJC in *Cotè, ibid,* relied on the decision in *R v Badger* [1996] 1 SCR 77, but in that case constitutional authority authorised provincial infringements of Aboriginal treaty rights. Here a provincial statute violated a treaty right which was modified by the Natural Resources Transfer Agreement. The constitutional authority allowing infringement in this case was para 12 of the Alberta Natural Resources Transfer Agreement.

227 See *Simon's* case [1985] 2 SCR 387, where conservation was in issue.

228 McNeil, 'Aboriginal title and the division of powers', *op cit,* fn 5, 457.

229 *Sparrow* [1990] 1 SCR 1075.

230 *Sparrow, ibid; Delgamuukw* [1997] 3 SCR 1010 at 1111.

231 *Delgamuukw* (CA) (1993) 104 DLR 470 at 539.

following: that the limitation is unreasonable, or that it imposes undue hardship, or that the interference denies the preferred means of exercising the right.[232] What if the interference denies not only the preferred means to exercise the right, but also denies a substantial exercise of the right? Examples of infringement offered by the Supreme Court in *Delgamuukw* include the granting of fees simple for agriculture, and the granting of leases for forestry and mining.[233] The granting of such interests will not only have a profound impact on Aboriginal rights, but may result in the permanent destruction of certain aspects of Aboriginal title. Such grants in effect amount to *defacto expropriations* which partially extinguish aspects of Aboriginal title over that land. Expropriation of a right involves taking away the property interest. For example, if all valuable minerals are extracted, the Aboriginal interest in those minerals will be forever lost.[234] Where a grant of a fee simple is made, will the Aboriginal interest be extinguished, or will it be regarded as infringed, as was suggested in *Delgamuukw*?[235] If a fee simple is regarded as an infringement, then will Aboriginal title revive if the fee simple comes to an end? Should laws that result in the partial destruction of Aboriginal rights be classed as laws that prevent the effective enjoyment or utilisation of the 'exclusive use and occupation' of the Aboriginal title lands, and be regarded as partial extinguishments of Aboriginal title rather than as mere infringements or regulations?[236] Before an 'infringement' could amount to a partial extinguishment of Aboriginal rights, the 'clear and plain intention' test of extinguishment would have to be met. However, as noted previously, extinguishment of Aboriginal title or rights is no longer possible since the Constitution Act 1982.[237] Therefore, although provincial Acts or legislation post-1982 may meet the test for extinguishment, such Acts will not be able to effect

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232 *Sparrow* [1990] 1 SCR 1075. See also *R v Gladstone* [1996] 2 SCR 723, where the court recognised some problems with this approach.

233 *Delgamuukw* [1997] 3 SCR 1010 at 1111.

234 In *Delgamuukw, ibid* at 1068, it was found that Aboriginal title included the minerals in and on the land. Thus a provincial law authorising a mineral lease on Aboriginal title lands should be read down to restrict its application. Such a law would in effect extinguish Aboriginal rights to minerals and should be contrary to s 35 of the Constitution Act 1982.

235 In *R v Badger* [1996] 1 SCR 77, the court acknowledged that the grant of a fee simple does not have the effect of extinguishing treaty rights in relation to hunting. See also *Alphonse's* case [1993] 4 CNLR 19. Badger's case involved a hunting right and there was no question of interference with the possession of land by Indians. Will Canadian courts ultimately follow the Australian High Court decision in *Fejo v Northern Territory* (1998) 195 CLR 96, and find that a grant of a fee simple totally and permanently extinguishes Aboriginal title to land? As the Supreme Court in *Delgamuukw, ibid* at 1083, defined Aboriginal title as a right to the exclusive use and occupation of land, logically it would seem impossible for Aboriginal title and a fee simple to co-exist. Whether a fee simple can extinguish Aboriginal title or rights in Canada is subject to the constitutional division of powers question and the protection of s 35 of the Constitution Act 1982, the combined effect of which restricts any possible extinguishment to actions and legislation by the federal parliament which occurred prior to 1982 and which meet the requisite standards.

236 See *R v Gladstone* [1996] 2 SCR 723. In this case the Aboriginal right to sell herring spawn on kelp was found not to be extinguished by the prohibition of this right at certain times and also by the extensive regulatory regime in relation to this type of fishing.

237 See *Van der Peet* [1996] 2 SCR 507.

an extinguishment of Aboriginal title or rights. Whether a clear and plain provincial intention to extinguish Aboriginal rights can be established in relation to Acts or legislation prior to 1982, will only become an issue if it is found that the provinces have a constitutional right to regulate activities that relate to the 'exclusive use and occupation' of Aboriginal lands. As noted above, since 1982 generally Aboriginal title can be extinguished only by negotiated agreement or constitutional amendment.

Aboriginal lands claims agreements

As Aboriginal title is within the exclusive jurisdiction of the federal government, federal presence is constitutionally required for any current treaty negotiations. This means that, constitutionally, the provinces need no longer be involved in treaty negotiations, although politically a province's presence would be essential.[238] In the provinces where land surrender treaties were not signed, so called provincial 'Crown' land[239] could be subject to Aboriginal title.

Conclusion

Prior to *Delgamuukw,* it had been unclear whether Aboriginal title at common law was under federal or provincial jurisdiction. Lamer CJC, in *Delgamuukw,* clarified that Aboriginal title lands came within exclusive federal legislative power under s 91(24) as 'Lands reserved for the Indians'. One of the most significant questions this finding raised was: can provincial laws ever apply in relation to Aboriginal title lands?

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238 Another reason that provinces have to be included in any negotiations is that the geographical extent of Aboriginal title lands is unknown, and the Federal government cannot compromise provincial interests by agreement

239 The term 'Crown' land should not be used to refer to land held under Aboriginal title. It is generally recognised that the underlying or radical title to Aboriginal title lands is held by the Crown in right of the province, subject to the overlaying burden of unsurrendered Aboriginal title. The beneficial or absolute title to this land does not vest in the Crown until after the surrender of Aboriginal title. See s 109 of the Constitution Act 1867; *St Catherine's Milling* [1889] 14 AC 46; see also Campbell J in *Chippewas of Sarnia Band v Canada* [1999] OJ 1406, Ontario Superior Court of Justice, at para 377. The term 'Crown land' is usually defined in provincial legislation. For example, 'Crown land' is defined in the British Columbia Land Act (RSBC, 1996 c 245) to mean 'land, whether or not it is covered by water, or an interest in land vested in the government'. If land is subject to Aboriginal title then, although the underlying title remains with the Crown, can such land be said to be 'vested in the government' in the same way that a legal right to land is vested in government? To continue using the term 'Crown' land in legislation to include Aboriginal title lands is misleading, particularly where the terms of provincial legislation permit the Crown to undertake activities, such as issuing grants, in relation to 'Crown land'. In the absence of a more accurate expression, the term 'Crown' land has been used in this paper to refer to 'Crown' land which is held subject to Aboriginal title. To alleviate this identification dilemma it is suggested that, once Aboriginal lands have been identified, a public register of Aboriginal title lands be maintained by government and that a distinction be maintained in legislation in reference to Aboriginal title lands and 'Crown' land.

Can provincial laws apply to those lands of their own force? The Canadian Supreme Court had previously recognised that some provincial laws may (in certain limited circumstances within the provinces' spheres of legislative competence) apply to Indians, despite s 91(24) vesting exclusive jurisdiction over 'Indians, and Lands reserved for the Indians' in the federal parliament. Significantly, however, s 91(24) protects a 'core' of federal jurisdiction (which includes 'Indianness', Aboriginal rights, including Aboriginal title, and treaty rights) from provincial laws of general application through the doctrine of interjurisdictional immunity, requiring otherwise valid provincial laws to be read down where that doctrine is infringed. In the instance where provincial laws apply to Aboriginal title lands of their own force, and these laws infringe Aboriginal title or rights, then these laws must be justified on the standards set in *Sparrow*.

If provincial laws apply to Aboriginal title lands of their own force (for example, in relation to mining, forestry or agriculture), then can these laws apply to infringe Aboriginal title? In other words, do provinces have the constitutional legislative authority to infringe it? There is no clear authorisation in the division of powers that provides the constitutional authority for the province to infringe Aboriginal title. Such laws would seem to encroach on federal jurisdiction where Aboriginal title lands are concerned. (It is clear that provinces have no jurisdiction to extinguish Aboriginal title.)

Despite the federal 'core', certain provincial laws of general application that affect Indians can be referentially incorporated into federal law by s 88 of the Indian Act. One of the issues in determining provincial legislative powers is the question whether s 88 of the Indian Act referentially incorporates provincial laws to apply to reserve lands or to Aboriginal title lands. The weight of the case law has suggested that this section is not capable of making provincial laws apply to 'Lands reserved for the Indians'. The object and purpose of this section does not indicate that Parliament's intention in passing this amendment to the Indian Act in 1951 was otherwise. In addition, to the extent that s 88 permits infringement of Aboriginal rights, doubts exist as to its constitutional validity. Does s 88 have to meet the standards of justification required by the Supreme Court in *Sparrow*? If so, to the extent that it cannot be justified it must be read down so as not to conflict with s 35(1) of the Constitution Act 1982. Even if s 88 of the Indian Act was valid, and referentially incorporated provincial laws to reserve lands, it is not at all clear that this section could referentially incorporate provincial laws to apply to Aboriginal title lands. If it is not possible to utilise s 88 to apply provincial law to Aboriginal title lands, then on what basis could provincial laws apply to such lands?

From the above discussion, provincial power to infringe Aboriginal title rights appears to be absent.[240] Thus it follows that provincial resource development laws, such as laws in relation to mining and forestry, or laws in relation to tourism initiatives, are inapplicable to Aboriginal title lands, to the extent to which such laws impact on those lands. The consequences of this for provinces will be enormous, particularly in those provinces where few historical treaties involving Aboriginal title have been signed, namely British Columbia, the Atlantic provinces and Quebec.

240 In British Columbia, at least some provincial 'Crown' land would remain subject to Aboriginal title. (For example, Treaty 8 area in the north-east of British Columbia may continue to be subject to Aboriginal title, altought this is debatable. It is also unclear whether Aboriginal title extends to all non-treaty areas in British Columbia.) The *Delgamuukw* court could have avoided these issues by finding not that the Aboriginal interest in land was different from that held as 'Lands reserved for the Indians', but by finding that Aboriginal title lands were not 'Lands reserved for the Indians', and therefore bringing such lands under provincial jurisdiction.

Avoidance and the Notion of Fundamental Breach Under the CISG: An English Perspective

Darren Peacock[1]

Introduction

In an era of globalisation, harmonisation of international sales law represents both an uncertainty and an opportunity for states. Domestic jurists are often wary of unfamiliar concepts in international documents. They may rightly fear that the originality of the concepts will lead to divergent interpretations in domestic courts. They may have difficulty in identifying the exact content of the law due to its newness and lack of interpretation. Nonetheless, harmonised and internationalised rules for resolving conflict can also expedite the flow of trade across state borders, thereby strengthening the economic power of the states which take part.

The debate surrounding the UK's failure to ratify the United Nations Convention on Contracts for the International Sale of Goods (CISG or the Convention)[2] is reflective of this dilemma. This paper does not propose to interpret the Convention through the lens of English sales law. Nor will it distort the Convention into 'either a mere image of the known or a menacing shadow of change'. Rather, it will examine one aspect of the two bodies of law side by side, noting the departures and similarities, with a view to demystifying the Convention to the extent possible in such a brief review. In so doing, this paper will focus on one of the more contentious areas of the Convention, and sales law in general: the circumstances under which an injured party should be entitled to terminate, or 'avoid', the contract for breach of a contractual obligation.

It will begin by considering some of the issues associated with the UK's failure to ratify the Convention. It will then discuss the notion of 'fundamental breach', which is the Convention's threshold test for avoidance. Although this test may at first seem unfamiliar to English lawyers, an examination of the trends in England's own law on avoidance indicates that the fundamental breach test is, in fact, not so far-removed. The paper will conclude with a comparative review of the operation of the avoidance mechanisms under the

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1 The University of Cambridge, BCom and LLB, University of Queensland.

2 *United Nations Treaty Series,* vol 1489, p 58.

CISG and English Sale of Goods Act 1979 (SGA) as applied to both buyer and seller.

The UK stand-off

> What distinguishes the English judges from their colleagues in other countries is that they even go so far as to justify their egocentric attitude by the alleged superiority, at least in the area of international trade law, of their own law and the way it is administered.[3]

As this quote indicates, England's failure to ratify the CISG came as a blow to advocates of harmonisation. Nevertheless, it was not entirely unexpected. The UK had played a leading role in negotiations leading up to the adoption of CISG and had previously been quick to adopt the two Hague Conventions on the Uniform Laws on International Sales of 1964 (ULIS).[4] However, the English had rendered the latter instrument's ratification virtually meaningless through the reservation that the ULIS would only apply where parties chose it as die law of the contract. As for English traders, there is no evidence of recourse to the ULIS in British commerce.[5]

Within the English legal fraternity, a number of objections to ratification have been raised. According to the Law Society of England and Wales (the Law Society), the Convention would result in a reduced role for English law in international trade.[6] Moreover, the Law Society was concerned that sophisticated commercial traders would easily circumvent the Convention, and that Art 6, which allows parties to exclude it,[7] may lead the Convention to apply by default[8] more often than by choice. The Law Society and the UK Department of Trade and Industry (DTI),[9] consequently or but feared that the Convention would not achieve uniformity because of differing interpretations in national courts. Yet other commentators have criticised the CISG for an alleged lack of certainty.[10]

Nonetheless, support for ratification within the UK is growing. In a position paper released in February 1999, the DTI modified its position against ratification by stating that the Convention 'should' be brought into national law 'when there is time available in the legislative programme'.[11]

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3 Bonell (1993), p116.
4 The Uniform Laws on International Sales Act 1967 introduced the Convention Relating to a Uniform Law on the International Sale of Goods (ULIS) and the Convention Relating to a Uniform Law on the Formation of Contracts for the International Sale of Goods (ULF) into English law.
5 Ziegel (2000), pp 336–37; Bridge (1999), p 41; Nicholas (1989), p 202.
6 Law Reform Committee of the Council (1981), noted in Lee (1993), p 132.
7 Article 6 provides that the parties may exclude the application of the Convention.
8 Pursuant to Art 1(1).
9 DTI Consultation Document (1997), pp 3 and 27.
10 Hobhouse (1990); Wheatley (1990), p 37; and note the reply: Goode, (1990), p 31.
11 DTI Position Paper (1999).

Indeed, there are at least four compelling reasons why the UK should hesitate no longer.

First, as Goode points out, 'for every international sales contract governed by English law there will be another [contract] governed by a foreign law with which the English party may not be familiar and which may be in a language he does not understand'.[12] In these cases, it is beneficial to have recourse to a set of principles common to all nations and available in several languages.

Secondly, England's failure to ratify does not necessarily immunise English merchants against the CISG. The Convention applies to commercial[13] contracts for the sale of goods between parties whose places of business are in different contracting states, or when the rules of private international law lead to the application of the law of a contracting state.[14] Thus, English parties may find themselves subject to the CISG when the proper law of the contract invokes the CISG. Additionally, the CISG may apply as the general law of international sales contracts. Parties to international transactions often exclude the operation of domestic law over their contracts by designating 'general principles of law', or the *lex mercatoria,* as the proper law of the contract. Still others appoint arbitrators to decide the dispute *ex aequo et bono*.[15] Recently, the Iran-US Claims Tribunal found that the CISG applied to a contract governed by either US or Iranian law because that convention represented the 'recognised international law of commercial contracts'.[16] Further, an International Chamber of Commerce (ICC) tribunal, when faced with a contract silent as to the applicable law, based its decision on the CISG, *even though the contract was between parties whose places of business were located in non-contracting states.*[17] Thus, English parties may find themselves subject to the Convention despite the UK failure to ratify.

Thirdly, even if British Parliament were to proceed with ratification, contracting parties may still provide for English law to govern their contracts. Under Art 6,[18] CISG parties may *vary* or *completely exclude* most of the provisions of the Convention.[19] Thus, the Convention will apply only where,

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12 Goode (1995), p 926.
13 Article 2(a).
14 Article 1(1).
15 UK Arbitration Act 1996, s 46(1) provides that the arbitral tribunal shall decide the dispute '(a) in accordance with the law chosen by the parties as applicable to the substance of the dispute, or (b) if the parties so agree, in accordance with *such other considerations* as are agreed by them or determined by the tribunal' (emphasis added).
16 *Watkins-Johnson Co & Watkins- Johnson Ltd v The Islamic Republic of Iran & Bank Saderat Iran* (1990) XV Yearbook of Commercial Arbitration 220 (Iran-US Claims Tribunal, No 370 (429–370–1), 28 July 1989; (1989–11) 22 Iran-US Claims Tribunal Reports 218.
17 ICC Court of Arbitration, No 5713/1989 (1990) XV Yearbook of Commercial Arbitration 70.
18 See Art 6.
19 Article 6 provides: 'The parties may exclude the application of this Convention or, subject to Art 12, derogate from or vary the effect of any of its provisions.'

and to the extent that, the parties have failed to reach agreement on a particular matter in their contract.[20]

Finally, it is argued that the Convention should itself prevent parochial interpretation, since Art 7(1) of the CISG provides that in interpretation of the CISG, regard must be had to that document's 'international character' and 'to the need to promote uniformity in its application'. Moreover, should national courts or international tribunals fail to implement the Convention in accordance with the provisions of the CISG, a large body of international legal scholars will ensure that misapplications do not become precedents.

Avoidance under the CISG: the concept of fundamental breach

One of the most important—and the most controversial—provisions of the CISG is that of fundamental breach under Art 25 of the CISG. Fundamental breach is essential to the contractual system established by the CISG, since it is the primary mechanism for avoidance by either party.[21] However, it has been widely criticised for its generality and the resultant potential for multifarious interpretations. A brief survey of the legislative history of Art 25 of the CISG may reveal the source of the confusion.

Brief history of Art 25

Throughout the unification process, the avoidance mechanism proved to be one of the most problematic issues under debate. It has been the subject of countless proposals, and has undergone substantial overhauls on several occasions. The first draft document to be produced, the 1939 Text of Rome, did not contain the sweeping notions of breach of contract engendered by fundamental breach. Rather, it took a 'fragmented approach',[22] reminiscent of the traditional English approach to avoidance. Contractual obligations were categorised according to their relative import, only breaches of 'essential conditions' of the seller justifying avoidance by the buyer.[23]

In 1951, the ULIS Working Group in The Hague identified two primary flaws with this formulation. First, the rights of the buyer were given precedence over the rights of the seller. Secondly, it was perceived that the ULIS provision did not further the higher aim of saving the contract, since it

20 For an earlier analysis of party autonomy and termination rights, see Carter (1993).
21 See Arts 49(1)(a), 51(2), 64(1)(a), 72(1), 73(1), and 73(2).
22 Will in Bianca and Bonell (1987), p 206.
23 Article 55 of the Text of Rome stated, 'An obligation of the seller is an essential condition of the contract where it appears from the circumstances that the buyer would not have concluded the contract without such an undertaking'.

entitled a party to avoid the contract for breaches of an essential condition, even in circumstances where the breach caused relatively minimal harm. In response to these criticisms, the Danish representative proposed that the notion of breach of contract be extended to *any* violation by *any* party to the contract of *any* obligation under the contract, and that the notion of 'breach of a fundamental obligation' be replaced by 'fundamental breach of an obligation'.[24] This proposal carried the day and was incorporated into Art 15 of the 1956 draft Uniform Law on Sale.[25]

However, Art 15 was also extensively criticised, in particular for its subjectivity.[26] Mr Davies, of the UK, expressed fears that 'if the Court attempted to discover the intention of the parties, Art 15 would result in different interpretations in different countries'.[27] Amid these criticisms, the UK proposed a substitute for draft Art 15 which resembled the defunct English concept of fundamental breach:

> A breach of contract shall be deemed to be fundamental wherever the performance of the contract is by reason of the breach rendered radically different from that for which the parties contracted.[28]

This proposal was not supported. After considerable drafting and redrafting, the revised Art 10 of the ULIS appeared as follows:

> For the purposes of the present Law, a breach of contract shall be regarded as fundamental wherever the party in breach knew, or ought to have known, at the time of the conclusion of the contract, that a reasonable person in the same situation as the other party would not have entered into the contract if he had foreseen the breach and its effects.

Later, at the Vienna Conference, further proposals were made for review of the 'agonisingly hypothetical'[29] ULIS test for fundamental breach, in the interests of greater precision and objectivity.[30] In fact, it was proposed by some that a definition of fundamental breach should be omitted altogether.[31] According to

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24 Will in Bianca and Bonell (1987), p 206.

25 Article 15 of the draft Uniform Law on Sale (1956) stated, 'A breach of the contract shall be deemed to be fundamental wherever the party knew or ought to have known, at the time the contract was made, that the other party would not have contracted had he foreseen that such breach would occur'.

26 See Records of the 3rd meeting Committee on Sale, reproduced in Ministry of Justice of the Netherlands (1966), Vol I, pp 35 and 36.

27 Ministry of Justice for the Netherlands (1966).

28 Ministry of Justice for the Netherlands (1966), Vol II, p 274, Doc./V/Prep/16.

29 Ziegel (1984), pp 9–15.

30 There was no reappearance of England's 1964 proposal in The Hague to substitute the English concept of fundamental breach 'and rightly so': Will in Bianca and Bonell (1987), p 209. However, a Pakistani proposal suggesting a return to the 1939 Text of Rome formulation which focussed on the categorization of the conditions of the contract rather than the gravity of the breach, did not receive support: Eörsi (1983), p 340.

31 There were repeated proposals throughout the negotiation process that a definition of the threshold for avoidance should be omitted. 'The fault is not in the definition but in striving for a definition': Eörsi (1983), pp 336–37. See also Schlechtriem (1998), p 176.

Gyula Eörsi, the notion of fundamental breach would only develop through years of interpretation and application.[32] In practice, a judge will form an opinion instinctively as to whether the gravity of the breach of contract justifies avoidance. However, Eörsi reluctantly acknowledges that failure to adopt a definition, imperfect as it may be, would have resulted in criticism of the delegations by generations of practising lawyers and judges for failing to provide practical guidance on such a vital concept. Further, 'a definition is necessary to give legal expression for one's already formed conclusion', despite the fact that 'in order to come to a conclusion, one does not need a definition'.[33] Furthermore, failure to incorporate a definition, no matter how general and imprecise, could only lead to even greater divergence of interpretation influence by national laws.[34]

So it was that, after considerable drafting gymnastics,[35] the current version of Art 25 of the CISG was born. Article 25 of the CISG provides:

> A breach of contract committed by one of the parties is fundamental if it results in such detriment to the other party as substantially to deprive him of what he is entitled to expect under the contract, unless the party in breach did not foresee and a reasonable person of the same kind in the same circumstances would not have foreseen such a result.

Analysis of Art 25

'Fundamental breach', as it finally emerged in Art 25 of the CISG, is comprised by three elements: (1) 'breach' (2) 'detriment' and (3) 'foreseeability'. This paper will address each in turn as well as the general principle of *favour contractas* that underlies them all.

Breach

It is axiomatic that before there can be a fundamental breach of contract, there must first be a *breach*. Although the word 'breach' is not defined in the CISG, Art 79 indicates that breach extends beyond the English formulation of a failure to perform not amounting to frustration.

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32 'A general concept can only be defined exactly if the cases of application can be listed one by one': Eörsi (1983), p 337. Generalities are by definition unable to be exhaustively defined and any attempt to do so is futile: '…any abstract definition must expect criticism, if it (wrongly) regards the question not as a matter to be assessed according to the circumstances, but by applying a formula under which the facts can be neatly subsumed': Schlechtriem (1998), p 176.

33 Eörsi (1983), p 336.

34 See drafting history above, and in particular the Danish proposal that the notion of 'breach of a fundamental obligation' be replaced by 'fundamental breach of an obligation' which turned the title away from the fragmented approach of the Text of Rome resembling the English condition/warranty approach.

35 Eörsi (1983), pp 340–41.

Under English law, a frustration dissolves the parties' rights under the contract, and thus any claim to breach and damages.[36] By contrast, Art 79 of the CISG, which deals with impediments to performance beyond the parties' control, neither strips the innocent party of his rights to a remedy, nor automatically results in avoidance. Nothing in Art 79 of the CISG 'prevents either party from exercising any right other than to claim damages under this Convention'.[37] Thus, the injured party may still exercise any of the rights set out in Arts 45(1)(a) or 61(l)(a) of the CISG, such as the right to substitute goods under Art 46 of the CISG.[38] Further, if the impediment results in a fundamental breach of contract, the contract will only come to an end at the election of the innocent party, and not automatically as under English law.[39] The innocent party must first declare his avoidance, or set an additional period *(Nachfrisf)*[40] after the expiry of which he may avoid if performance remains outstanding. Thus, while the English law conception of breach is an 'unexcused failure in performance',[41] the CISG conception of breach seems to encompass those failures to perform which are in fact excused by an impediment beyond the parties' control.[42]

Detriment

The second element of fundamental breach is also not defined in the CISG. Thus its meaning must be deduced indirectly from the legislative history of Art 25 of the CISG as well as from its apparent role in fundamental breach. The concept of substantial detriment was first incorporated into the definition of fundamental breach at the United nations Commissions on International Trade Law Conference. This initial formulation read:

> A breach committed by one of the parties is fundamental if it results in substantial detriment to the other party unless the party in breach did not foresee and had no reason to foresee such a result.[43]

In response to complaints that this test was too subjective, the definition was overhauled at the Vienna Conference in 1980, to emerge in its present form. Now, pursuant to Art 25 of the CISG, a breach is fundamental where it results in 'such detriment to the other party as substantially to deprive him of what he is entitled to expect under the contract'. However, Art 25 of the CISG has been

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36 Goode (1995), p 937.
37 Article 79(5).
38 Orders for specific performance are issued in accordance with domestic law pursuant to Art 28, and it is most unlikely that an English court would order specific performance where the impediment rendered performance impossible.
39 Treitel (1994), p 278.
40 *Nachfrist* is discussed below.
41 Treitel (1994), p 932. See the definition of 'frustration' in Garner (1999), p 679.
42 See further, Goode (1995), pp 936–37; Treitel (1994), pp 535–37.
43 1977 Draft Convention, Art 23.

criticised for setting a higher threshold test for fundamental breach than was originally intended. It is argued that failure to deliver, for example, 10% of the goods would constitute a 'substantial detriment' to the buyer under Art 25 of the CISG, even though, in all probability, the buyer would not be 'substantially deprived' of his legitimate contractual expectations.[44] Furthermore, Art 25 of the CISG is said to present an *idem per idem* definition of fundamental breach, on the basis that 'fundamental' and 'substantial' are tautological descriptors.[45] However, this latter point is of little merit, as 'fundamental' denotes the very essence of a thing, whilst 'substantial' is of lesser import, meaning 'of considerable amount or intensity'.[46]

In any case, it is clear that detriment cannot merely be determined by identifying the quantum of damage, especially of monetary damage, in relation to the entire contractual expectation.[47] Indeed, if damages would serve as an adequate remedy there is arguably no detriment within the meaning of the Art 25.[48] According to Michael Will, detriment is a much broader concept which must be interpreted from a teleological perspective:[49]

> Detriment, without qualifying language, fills the modest function of filtering out certain cases, as for example where breach of a fundamental obligation has occurred but not caused injury; the seller disregarded his duty to package or insure the goods, but they arrived safely nevertheless; if, however, the buyer would lose a resale possibility or a customer, there would be detriment.[50]

This interpretation of detriment also emerges from the change in wording from 'substantial detriment' to 'detriment' which 'substantialy deprives' the innocent party of his contractual expectation. Arguably, this amendment shifted the emphasis in fundamental breach from the amount of the damage suffered, to the importance of the damage to the injured party's contractual expectations.[51] Practically, this means that while extent of damage is certainly relevant to the determination of the injured party's contractual expectations, it is not always necessary that such damage be calculated and proved.[52] The present test of detriment emphasises the qualitative importance of the injured

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44 Ziegel (1984), pp 9–15 to 9–16. Given the seemingly inherent quantitative aspect of the present test for detriment, it could be argued that the buyer must be deprived of at least fifty per cent of what he was entitled to receive, although this result is not etymologically justified. See also Will in Bianca and Bonell (1987), p 214.

45 Eörsi (1983), pp 336–37; Enderlein and Maskow (1992), p 113; Will in Bianca and Bonell (1987), p 212.

46 *The Oxford Popular Dictionary & Thesaurus,* 2000 Oxford: OUR

47 *Ibid.*

48 Enderlein and Maskow (1992), p 113. A UK proposal (A/CONF.97/C1/L104, OR, p 99) that a sentence to that effect be incorporated into the definition of fundamental breach was withdrawn (First Committee Deliberations, OR, p 304).

49 Will in Bianca and Bonell (1987), pp 211–12.

50 Will in Bianca and Bonell (1987), pp 211–12.

51 Schlechtriem (1998), pp 175 and 177.

52 Schlechtriem (1998), pp 175 and 177.

party's lost or compromised interest as determined under the contract, not the quantum of the loss. Moreover, as detriment is not a static element, the plaintiff may be required to establish the point at which a continuing breach satisfies the requisite degree of substantiality to justify avoidance.[53]

Given the importance of the parties' expectations to a determination of detriment, it is essential that those expectations be discernible from the terms of contract.[54] To this end, it is 'principally for the parties themselves to make clear what importance is to be attached to each obligation and to the corresponding interest of the promisee'.[55] Notably, however, a party may not simply stipulate that all obligations contained in his contract are of fundamental importance, so that any breach, no matter how trivial, founds an avoidance. In determining detriment, the overall impact of the breach will always be decisive rather than the technical non-fulfillment of a contractual term.[56] Further, Art 7 of the CISG provides that in interpreting the Convention, due regard must be afforded to the underlying principle of good faith.[57] Clearly, any attempt by a party to insert such a clause would violate this overarching principle.

Finally, English lawyers should resist the temptation to find parallels to the concept of detriment under the CISG to English law. As a technical term,[58] detriment does not equate to the English concepts of 'damage', 'loss' or 'injury'. Indeed, the detriment test has been compared with s 325/326 of the German Civil Code Burgerliches Gesetzbuch (BGB), which asks whether the injured party has lost interest in performing the contract.[59] Of greater interest to English lawyers is the comment by Will:[60] that the formula for fundamental breach in Art 25 of the CISG was inspired by Lord Diplock's common law innominate term test set out in *Hongkong Fir Shipping Co Ltd v Kawasaki Kisen Kaisha Ltd* (Hongkong Fir),[61] and subsequently applied to contracts for the sale of goods in *Cehave NV v Bremer Handelsgesellschaft mbH* (The Hansa Nord):[62]

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53 Enderlein and Maskow (1992), p 113.

54 Enderlein and Maskow (1992), p 113. The expectations of the injured party are not to be discerned from that party's 'inner feelings', but should be tied to the terms of and circumscribed by the contract, although the ever changing circumstances surrounding the contractual relationship must also be taken into account: Will in Bianca and Bonell (1987), p 215.

55 Schlechtriem (1998), p 177.

56 Enderlein and Maskow (1992), pp 113–14: 'not every ambitious expectation is protected'.

57 Babiak (1992), p 142.

58 Will in Bianca and Bonell (1987), p 210. For an American perspective, see Kritzer (1989), pp 205–07.

59 Schlechtriem (1998), p 176; Nicholas (1989), p 218. 'Detriment basically means that the *purpose* the aggrieved party pursued with the contract *was foiled* and, therefore, led to his losing interest in the performance of the contract': Enderlein and Maskow (1992), p 113.

60 Will in Bianca and Bonell (1987), p 213.

61 [1962] 2 QB 26.

62 [1976] QB 44.

> …does the occurrence of the event deprive the party…of substantially the whole benefit which it was the intention of the parties as expressed in the contract that he should obtain…?[63]

Foreseeability component

The final conceptual component of fundamental breach under Art 25 of the CISG, that of foreseeability, is also unique to the CISG. It prevents a finding of fundamental breach where the breaching party can establish that the negative outcome of the breach *was not* foreseen by him, and that a reasonable person in his position *would not have* foreseen such an outcome.[64] The notion of foreseeability was born from the widely held belief that, in abnormal circumstances, there should be an equitable balancing of both parties' interests.[65] Nonetheless, it has been widely criticised as providing an 'easy way out' for parties who claim ignorance. In practical terms, the presence of the foreseeability component is additional reason for parties contracting under the CISG to draw attention to the importance of their contractual expectations in the contract itself.

The foreseeability component of fundamental breach was also subject to several modifications. Article 10 of the ULIS originally provided that a fundamental breach would only arise where the breaching party:

> …knew, or ought to have known, at the time of the conclusion of the contract, that a reasonable person in the same situation as the other party would not have entered into the contract if he had foreseen the breach and its effects.

The first shift in meaning was brought about by the inclusion of the word 'unless'. Arguably, this amendment shifted the onus of proof from the party setting up fundamental breach to the party in breach of contract. According to Will, the proposal was intended to '[relieve] the aggrieved party from the unfair burden of a most difficult proof'.[66] Indeed, an Egyptian proposal to include the words 'unless *the party in breach proves that he did not foresee*' was thought superfluous since 'unless' is a term of art which 'clearly shifts the burden of proof to the party in breach, when that party invokes unforeseeability'.[67]

The second amendment to the ULIS foreseeability component was the inclusion of an objective test to assess the breaching party's knowledge of the detriment arising from the breach. If the breaching party is to avoid a verdict of fundamental breach, he must prove that the detriment *was not* foresee by

63 [1962] 2 QB 26, 66.
64 Article 25; Will in Bianca and Bonell (1987), p 215; Kritzer (1989), pp 207–08.
65 Will in Bianca and Bonell (1987), p 215.
66 Will in Bianca and Bonell (1987), p 216.
67 Will in Bianca and Bonell (1987).

him and the detriment *could not have been* foreseen by a 'reasonable person of the same kind in the same circumstances'.[68] '[O]f the same kind' implies that the benchmark will be that of a hypothetical merchant 'engaged in the same line of trade, exercising the same function'.[69] However, 'in the same circumstances' authorises adjudicators to consider the background and present context of the transaction, as well as 'the conditions on world and regional markets…legislation, politics and climate…prior contacts and dealings and to other factors'.[70] Will concludes that it 'simply serves to eliminate unreasonable persons, that is, those who are to be considered intellectually, professionally or morally sub-standard in international trade', from consideration.[71] Thus, according to Michael Bridge, the practical effect of this element is doubtful, for 'it would be a strangely unimaginative contract breaker who failed to foresee effects of such magnitude'.[72]

Thirdly, due to the inability to reach agreement in Vienna, a provision as to the relevant time of foreseeability was omitted from the Convention test. While ULIS opted unequivocally for 'the time of the conclusion of the contract',[73] a UK proposal in Vienna to maintain this as the relevant time in the Convention was withdrawn for lack of support.[74] Accordingly, the weight of opinion seems to be that the time of conclusion of the contract is relevant, but that, in exceptional circumstances, facts emerging after conclusion of the contract but before the time of breach may be taken into account.[75] The ultimate decision is left to the discretion of the courts on a case by case basis.[76]

Finally, it should be noted that the foreseeability component represents a major departure from English law which does not require the breaching party to foresee substantial deprivation of the other party's interests under the contract. However, should the parties express particular obligations to be 'conditions', that is, of essential importance to the promisee under the contract, a breaching party cannot prevent avoidance by arguing the detriment was not foreseeable.[77]

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68 CISG, Art 25.
69 Will in Bianca and Bonell (1987), p 219: It is even suggested that 'not only must business practices be taken into account, but the whole socio-economic background as well, including religion, language, average professional standard'.
70 Will in Bianca and Bonell (1987), p 219.
71 *Ibid.*
72 Bridge (1999), p 86.
73 ULIS, Art 10.
74 Pre-Conference Proposals (A/CONF.97.9, OR, p 76); Nicholas (1989), p 219; Ziegel (1984), pp 9–19.
75 Enderlein and Maskow (1992), p 116; Will in Bianca and Bonell (1987), p221; Feltham (1981), p 353; compare Schlechtriem (1998), p 180.
76 Will in Bianca and Bonell (1987), p 220; Ziegel (1984), pp 9–19.
77 Schlechtriem (1998), p 178.

Principles underlying fundamental breach

The precise scope of fundamental breach under Art 25 of the CISG will only emerge through the application of the CISG over time. However, in interpreting this term, adjudicators are required under Art 7 of the CISG to have regard to the Convention's underlying principle of *favor contractas,* or preservation of the original agreement, in spite of breach wherever possible.[78]

The presence of *favor contractas* within the CISG is evidenced by the relative availability to the parties of damages,[79] specific performance,[80] and price reduction where a breach is not fundamental.[81] Its presence is also demonstrated by the very high threshold test for the avoidance under Art 25 of the CISG itself. Indeed, the mere fact that the breach must be 'fundamental' highlights the reticence of drafters to allow avoidance in anything but the most drastic circumstances.

Moreover, *favor contractas* is an essential to contractual certainty, since the particular circumstances of international trade make avoidance both attractive and costly. The potential for enormous swings in world commodity and financial markets will often create incentives for the disadvantaged party to search for an escape route to the contract.[82] Likewise, the financial burden of avoidance is particularly great in international sales contracts, due to storage and reshipment expense. Were the standard for avoidance set too low, a party may find it more cost-effective to terminate the contract rather than to fulfill their obligations. Thus, when interpreting any of the concepts in fundamental breach it should be borne in mind that, in striking a balance between the interests of buyer and seller, the CISG avoidance mechanism seeks to preclude avoidance on trivial grounds.

Avoidance under English law: fundamental breach in disguise?

Ultimately, both the CISG and English laws on avoidance are concerned with the question of whether the breach is of sufficient seriousness to justify avoidance. Nonetheless, 'there can be a great practical difference between the criteria in the two systems for determining whether the buyer can avoid the contract…particularly as a result of the fixed categorisation by the Sale of Goods Act of certain terms as conditions and the treatment by the courts of even a small breach of such conditions as ground for treating the contract as repudiated'.[83] The following examination of the English approach to avoidance

78 Also an embodiment of the principle of *pacta sunt servanda.*
79 Articles 74–77.
80 Articles 46 and 62.
81 Article 50.
82 Michida (1979), p 279.
83 Nicholas (1989), p 228.

of the contract will outline some points of departure as well as similarities to the provisions of the CISG.[84]

Parallels to fundamental breach in English law

At the outset, it should be noted that the concept of fundamental breach under the CISG is in no way related to the defunct English concept of the same name.[85] The English doctrine of fundamental breach was developed gradually during the 30 years from around 1950, primarily to deal with unreasonably extensive exemption clauses.[86] The courts began to recognise that a contractual term was even more important than a condition—the so-called 'fundamental term' which went to the core or root of the contract, breach of which amounted to nothing less than a complete non-performance of the contract.[87] A rule[88] emerged which held that a fundamental breach could not be excluded by any exemption clause, no matter how widely drafted.[89] After a chequered career,[90] the doctrine of fundamental breach was finally 'forcibly evicted by the front [door]'[91] by the House of Lords in *Photo Production Ltd v Securicor Transport Ltd.*[92]

In fact, the primary source of the law in England on the international sale of goods, the Sale of Goods Act 1979 (SGA or the Act),[93] contains no direct counterpart to fundamental breach at all. Its regime for avoidance hinges on the so-called condition/warranty dichotomy,[94] according to which all

84 For a very detailed analysis of the history and application of the CISG concept of fundamental breach, see Koch (1999).

85 Will in Bianca and Bonell (1987), p 209; Ziegel (1984), pp 9–15; Schlechtriem (1998), p 174, n 5.

86 For discussions of the English doctrine of fundamental breach, see Melville (1980); Beatson (1998), pp 170ff; Atiyah (2001), pp 75ff; and Reynolds in Guest (1997), paras 13–039ff.

87 The classic example given by Lord Abinger was that if a buyer contracted to buy peas and the seller supplied beans, the seller had effectively not performed the contract: *Chanter v Hopkins* (1838) 4 M & W 399 at 404.

88 See Reynolds in Guest (1997), para 13–042.

89 See *Smeaton Hanscomb & Co Ltd v Sassoon I Setty, Son & Co* [1953] 1 WLR 1468 1470.

90 In *Suisse Atlantique Société d'Armement Maritime SA v NV Rotterdamsche Kolen Centrale* [1967] 1 AC 361 it was confirmed that the doctrine of fundamental breach had been demoted from its status as a 'rule of law' to a mere matter of construction or interpretation by the House of Lords.

91 *George Mitchell(Chesterhall) Ltd vFinney Lock Seeds Ltd* [1983] 2 AC 803 at 813, *per* Lord Bridge, affirming the decision in the *Photo Production* case.

92 [1980] AC 827.

93 The SGA consolidates the original Sale of Goods Act of 1893 with amendments made up to 1979. The SGA has since been further amended by the Sale and Supply of Goods Act 1994 and the Sale of Goods (Amendment) Act 1995. From its inception, the SGA was intended to codify the law relating to sale of goods. However, the SGA specifies that it may be interpreted in the light of, and supplemented by, general principles of contract law: s 62(2). Note that discussion of the effects of fraud, misrepresentation, mistake, duress and coercion on the contract is beyond the scope of this paper.

94 The condition/warranty dichotomy was originally a common law principle first elucidated by Bowen LJ in *Bentsen v Taylor, Sons & Co* [1893] 2 QB 274 at 281. See also Lord Denning MR in *The Hansa Nord* [1976] QB 44 at 59; Sellers LJ in *Hongkong Fir* [1962] 2 QB 26 at 60; Reynolds in Guest (1997), para 10–027. The predecessor legislation to the SGA enacted in 1893 'endeavoured to reproduce

contractual terms are classifiable as conditions or warranties.[95] Under s 61(1) of the SGA, warranties are terms 'collateral to the main purpose' of the contract, whilst, by necessary inference, conditions are those terms 'integral to the main purpose' of the contract.[96] In recent times, this two-tier division has been supplemented by the 'innominate' or 'intermediate' term.

Prima facie, breach of a condition will *always* give rise to an entitlement to avoid the contract, whereas breach of a warranty would *never* give rise to such an entitlement.[97] Before the enunciation of the intermediate term, the strict application of the condition/warranty dichotomy meant that 'any terms whose breach *could possibly* take a serious form naturally tended to be treated as… condition[s]' even though 'their breach caused only minor inconvenience or loss, or even none at all'.[98] Accordingly, the consequences flowing from the breach and their impact on the injured party were historically irrelevant to determination of the right to avoid the contract.

Although this strict, and rather simplistic, classification was intended to foster certainty in the law,[99] it has proved too inflexible to deal adequately with modern commercial transactions. As a result, the dichotomy has undergone substantial renovation, beginning with the landmark decision of the Court of Appeal in 1962, in *Hongkong* Fir.[100] In that case, the Court promulgated a third type of contractual term which has come to be known as the 'innominate' or 'intermediate' term. According to Lord Diplock:

> …all that can be predicated [of intermediate terms] is that some breaches will and others will not give rise to an event which will deprive the party not in default of substantially the whole benefit which it was intended that he should obtain from the contract; and the legal consequences of a breach of such an undertaking, unless provided for expressly in the contract, depend upon the nature of the event to which the breach gives rise and do not follow automatically from a prior classification of the undertaking as a 'condition' or a 'warranty'.[101]

The foundation of *Hongkong Fir* was the conception that avoidance rights should not necessarily depend upon the status or characterisation of the term breached, but rather upon the impact of events flowing from the breach on the

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as exactly as possible the existing law' Mark (1975), p viii, 'Introduction to the first edition (1894)'. Thus avoidance under the SGA must be predicated on the characterization of the terms of the contract as 'conditions' or 'warranties'.

95 Treitel (1999), pp 702–65; Beatson (1998), pp 535–51.

96 Bridge (1997), pp 151 and 152.

97 Lord Diplock in *Photo Production Ltd v Securicor Transport Ltd* [1980] AC 827 at 829; Reynolds in Guest (1997), paras 10–027–10–028.

98 Atiyah (2001), p 79.

99 Bridge (1997), p 151.

100 [1962] 2 QB 26.

101 *Ibid* at p 70.

injured party's contractual expectations. This approach can be traced to the court's equitable conviction that a party should not be allowed to escape his contractual obligations by asserting a mere technical claim, even at the expense of certainty and predictability. Indeed, there is a long standing common law principle that 'unless the non-performance alleged in breach of the contract goes to the whole root and consideration of it, the covenant broken is not to be considered as a condition precedent, but as a distinct covenant, for the breach of which the party injured may be compensated in damages'.[102]

The concept of the intermediate term was first applied to sale of goods by Lord Denning MR in *The Hansa Nord.*[103] In that case, the buyer sought to avoid the contract for delivery of goods which were only slightly damaged. His Lordship opined that Parliament, in enacting the SGA in 1893, could not have intended to exclude the application of the intermediate term,[104] since s 62(2) of the SGA preserves the rules of common law, except insofar as they are inconsistent with the Act.[105] However, in finding for the seller, the Court was forced to hold that the implied condition of merchantability[106] under s 14(2) of the SGA was not breached,[107] and likewise, that the express term under the contract that goods be shipped 'in good condition' was not a condition, but an intermediate term.[108]

As a result of *The Hansa Nord,* it seemed that an implied term of merchantability under the SGA was to be treated differently to an express term in the contract. According to Atiyah, 'if it is express, it may or may not be a condition in the strict sense, but if it is implied under the Act, then it must be (because the Act says it is) a condition—and it was assumed that this means a condition in the strict sense'.[109] Effectively, the court held express contractual conditions to be subject to the general law, whereas the particular rules set out in the SGA would continue to regulate implied conditions. This produced the contradictory result that the goods were 'merchantable' under the Act, but not 'in good condition' under the contract.

Following *The Hansa Nord,* courts increasingly expressed a desire to move away from the strict condition/warranty dichotomy, but have been unable to do so without contradicting the express words of the SGA.[110] Courts have

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102 Lord Ellenborough CJ in *Davidson v Gwyrtne* 12 East 380 at 389, cited by Upjohn LJ in *ibid* at 63. See also *Boone v Eyre* 1 HB1 273 of 1773; *Mersey Steel and Iron Co Ltd v Naylor, Benzon & Co* (1884) 9 AC 434 and Lord Denning MR in *The Hansa Nord* [1976] QB 44 at 59–60.

103 [1976] QB 44.

104 *Ibid* at p 60.

105 *Ibid.*

106 Now the implied condition of satisfactory quality.

107 Lord Denning MR, p 63; Roskill LJ, pp 77–78; Ormrod LJ, p 79.

108 Lord Denning MR, p 61; Roskill LJ, p 73; Ormrod LJ, p 84.

109 (2001), p 81, commenting on the case.

110 See also *Reardon Smith Line Ltd v Yngvar Hansen-Tangen* [1976] 1 WLR 989; *Bunge Corp v Tradax Export SA* [1981] 1 WLR 711.

afforded greater priority to the principle of *favor contractas,* and have expressed a preference for the more flexible rules of the common law in circumstances where the strict rules of the SGA would lead to inequity. In *The Hansa Nord,* Roskill J stated that:

> …[I]n principle contracts are made to be performed and not to be avoided according to the whims of market fluctuation and where there is a free choice between two possible constructions I think the court should tend to prefer that construction which will ensure performance and not encourage avoidance of contractual obligations.[111]

Moreover, Lord Wilberforce, in *Reardon Smith Line Ltd v Yngvar Hansen-Tangen,* expressed his predilection for this 'modern doctrine' as follows:

> The general law of contract has developed along much more rational lines in attending to the nature and gravity of a breach or departure rather than in accepting rigid categories which do or do not automatically give a right to rescind…[112]

From this new judicial ethos emerged three possible formulations for the law of avoidance.[113] The first formulation recognises three categories of contractual term in accordance with *Hongkong Fir:* if the term is neither a condition nor warranty, then it is simply deemed intermediate. Under the second formulation, all terms which are not conditions are 'other terms', for which the remedy will be determined by the nature and consequence of the breach.[114] The final formulation for avoidance is proposed by Treitel, who suggests that remedies should be determined by the seriousness of the breach except where the term breached is a condition.[115]

Although commentators have hailed the second formulation[116] as simpler and more flexible,[117] it appears that the first, now more traditional, formulation will continue to dominate.[118] Moreover, the prospects for the last formulation seem limited so long as the courts are constrained by the iron (albeit malleable) shackles of the SGA.

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111 *The Hansa Nord* [1976] QB 44 at 71.
112 [1976] 1 WLR 989 at 998.
113 Reynolds in Guest (1997), para 10–033; Treitel (1999), p 739.
114 This latter approach was endorsed in *The Hansa Nord* [1976] QB 44 by Lord Denning at 60 and Ormrod U at 82–84, in the *Photo Production* case by Lord Diplock [1980] AC 827 at 849 and in *Lombard North Central plc v Butterworth* [1987] QB 527 at 535 by Mustill LJ.
115 Treitel (1999), pp 734 and 742–43.
116 Reynolds in Guest (1997), paras 10–033–10–035; Treitel (1999), pp 734 and 739.
117 Reynolds in Guest (1997), para 10–033.
118 Reynolds in Guest (1997), para 10–033; Treitel (1999), p 739.

Legislative developments

The apparent desire of the English courts to move away from the traditional understanding of the condition/warranty dichotomy has been perceived by legislators. Recently, the traditional condition/warranty distinction under the SGA has been modified by the introduction of s 15A into the SGA. Section 15A(1) provides:

> (1) Where in the case of a contract of sale-
>
> (a) the buyer would, apart from this sub-section, have the right to reject goods by reason of a breach on the part of the seller of a term implied by ss 13, 14 or 15 above, but
>
> (b) the breach is so slight that it would be unreasonable for him to reject them,
>
> then, if the buyer does not deal as consumer, the breach is not to be treated as a breach of condition but may be treated as a breach of warranty.

Section 15 A of the SGA does not recognise the intermediate terms so much as modify the concept of the condition to accommodate modern commercial transactions. As such, s 15A represents an attempt to replace the condition/warranty dichotomy with a more flexible approach to avoidance. However, as Treitel has remarked, the section may have 'sacrificed certainty without attaining justice'.[119]

According to commentators such as Treitel, s 15 A of the SGA merely adds to the complexity of the existing system of classification.[120] First, this section only applies to breaches of contract by the seller, leaving breaches of contract by the buyer unaffected. Secondly, s 15A is limited to conditions implied by ss 13, 14 and 15 of the SGA. The buyer's right to avoid the contract for a breach of any other condition, whether express, implied at common law, or implied elsewhere under the Act, is likewise unchanged. Thirdly, the difficulties in the SGA which led to the development of the intermediate term are not resolved by s 15A of the SGA. It does not prevent the buyer from avoiding in circumstances where the seller's breach is too serious to be considered 'slight', and yet not serious enough to deprive the buyer of 'substantially the whole benefit the parties intended by the contract that he should obtain'.[121] Section 15A of the SGA thereby allows a disproportionate loss by the seller under the same contract.

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119 Treitel (1999), p 745.
120 Treitel (1999), pp 743–44.
121 Lord Diplock's intermediate term test.

Future trends

English law makers have not ignored the problems associated with the condition/warranty dichotomy under the SGA. Rather, they have interpreted the SGA so as to allow avoidance in circumstances where there is sufficient detriment to the injured party. The result is a test for avoidance under English law which parallels the fundamental breach provisions of the CISG. In some respects, it could even be said that the condition/warranty dichotomy is a test of seriousness of breach, albeit with a different name.

The restrictions of statute and precedent have, however, forced English jurists to adopt highly technical justifications for utilising substantial detriment tests under the SGA. This led the New Zealand High Court, in *Crump v Wala,*[122] to suggest that the much simpler CISG provisions should serve as a model for reform.[123] Moreover, there is a notable international trend towards the CISG's detriment-oriented test and away from the classification of terms native to English law.[124]

Whether England adopts a universal test for avoidance similar to that under Art 25 of the CISG is as yet unclear. On the one hand, recent cases, law reforms and international trends look to the detriment to the injured party's interests rather than the class of term violated. On the other hand, English law makers are still constrained by the SGA, centuries of precedent and a legal culture which favours certainty over flexibility. However, the current system for avoidance is so complex that it only undermines the certainty which classification of terms was intended to achieve. Accordingly, English law makers would be well advised to acknowledge that avoidance is determined by detriment and not by the classification of terms.

The CISG avoidance mechanism: a comparative perspective

Having examined the respective tests for avoidance under the CISG and under English law, this paper will consider the application of the CISG provisions using English law to highlight points of departure. The focus will be on

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122 [1994] 2 NZLR 331 at 338. This was a decision of the New Zealand High Court on the New Zealand version of the SGA.

123 The American Uniform Commercial Code (UCC), Sections 2–608, 2–612 and 2–504 and ULIS were also suggested. See Michida (1979), pp 280–81; Flechtner (1988), p 63.

124 See the Scandinavian states' Sale of Goods Acts. Lando and Beale (2000), p 367; the Netherlands *Burgerlik Wetboek,* Art 6:82–83 and 6:265: Schlechtriem (1998), p 174; UNIDROIT Principles of International Commercial Contracts (UNIDROIT Principles), Art 7.3.1. See Bonell (1997); the Principles of European Contract Law (PECL), Art 8:103. See Lando and Beale (2000), p 364; Bonell (1996). The EC Directive on Certain Aspects of the Sale of Consumer Goods and Associated Guarantees Directive (99/44/EC) (OJ 1999 L 171, 7 July 1999) also derives its remedial scheme from the CISG: Atiyah (2001), pp 214–20.

circumstances in which a party attains, and subsequently loses, the right to avoid.[125]

Avoidance of the contract by the buyer

In contrast to the SGA, one of the Convention's great virtues is that it attempts to maintain symmetry between the rights of buyer and the rights of the seller. To demonstrate this symmetry, the rights of the buyer and seller to avoid will be examined separately.

When is the buyer entitled to avoid?

The position under the CISG

Chapter II of the CISG governs the obligations of the seller. Within Chapter II, Section III deals with remedies for breach of contract by the seller. Specifically, Art 45 of the CISG provides the buyer with remedial rights upon the seller's failure to perform a contractual obligation. The buyer acquires the right to claim damages under Arts 74–77 of the CISG, to require specific performance under Art 46 of the CISG, to claim a price reduction under Art 50 CISG, or to avoid the contract under Art 49 of the CISG. According to Art 49 of the CISG:

> (1) The buyer may declare the contract avoided:
>
> (a) if the failure by the seller to perform any of his obligations under the contract or this Convention amounts to a fundamental breach of contract; or
>
> (b) in case of non-delivery, if the seller does not deliver the goods within the additional period of time fixed by the buyer in accordance with paragraph (1) of Art 47 or declares that he will not deliver within the period so fixed.

Even though it only features in sub-para (a), the central element of Art 49(1) of the CISG is fundamental breach.[126] Sub-paragraph (b) effectively provides an exception to the requirement of a fundamental breach, however, only in one very specific and limited circumstance.

(1) Article 49(1)(a)—fundamental breach by the seller

Article 49(1)(a) of the CISG represents the buyer's central avoidance mechanism under the Convention. It consists of two elements. First, the buyer must establish that the seller has failed to perform an obligation. Secondly, he

125 There is a distinction under both English law and the CISG between rejection of the goods and avoidance of the contract: Atiyah (2001), p 501. This paper will focus primarily on the provisions dealing with the latter.

126 Will in Bianca and Bonell (1987), p 362. For a comparitive analysis of Art 49 from an American perspective, see Kritzer (1989), pp 366–72.

must establish that the failure to perform amounts to a fundamental breach of contract within the meaning of Art 25 of the CISG.

In relation to the first element of Art 49(1)(a) of the CISG, the failure to perform may be of any obligation of the seller contained in either the contract or the Convention. These are set out in Sections I and II of Chapter II of the Convention. Thus the seller will *prima facie* fail to perform an obligation if he:

- fails to transfer property in the goods in accordance with Art 30 CISG;
- does not deliver the goods in accordance with Arts 30 and 31 CISG, or does not deliver within the period determinable under Art 33 CISG;
- does not enter appropriate contracts of carriage or provide consignment or insurance information to the buyer as required by Art 32;
- does not hand over documents relating to the goods as required by Arts 30 and 34;
- delivers non-conforming goods within the meaning of Art 35;
- delivers goods which are subject to any industrial or intellectual property right of a third party, or subject to any other right or claim of a third party in violation of Arts 42 or 41 of the CISG respectively.

Failure to perform must be interpreted very broadly[127] and will, therefore, also include failure to preserve goods when the buyer delays in taking delivery pursuant to Art 85 of the CISG, and failure to take reasonable measures to sell perishable goods pursuant to Art 88(2) of the CISG.[128] Additionally, the principle of party autonomy[129] under the CISG means that failure by the seller to comply with contractual stipulations relating to any of the above matters will also constitute a failure to perform under Art 45 of the CISG.[130]

The second element of Art 49(1)(a) of the CISG requires the buyer, before exercising the right to avoid, to be satisfied that the seller's failure to perform amounts to a fundamental breach of the contract. Whether the breach is fundamental is a question of fact and degree, determined in the light of all the circumstances in each case.[131]

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127 Huber in Schlechtriem (1998), p 357.
128 Huber in Schlechtriem (1998), p 357.
129 This is in part evidenced by Art 6 of the CISG which enables the parties to contract out of, or vary, the provisions of the Convention.
130 Huber in Schlechtriem (1998), p 357. This may include failure to comply with contractual obligations to refrain from an act (for example, where the seller acts inconsistently with a contractual confidentiality or exclusivity clause), or to 'protect, warn or inform' the buyer.
131 Contrast the situation of ordinary chickens delivered one week late with Christmas turkeys delivered one week late: Michida (1979), pp 282–83; Huber in Schlechtriem (1998), p 417. For more information please see above.

(2) Article 49(1)(b)—seller's failure to comply with a Nachfrist ultimatum

Article 49(1)(b) of the CISG allows the buyer to avoid the contract for a non-fundamental failure to deliver the goods. Under Art 49(1)(b) of the CISG, the buyer may fix an additional period for performance, or *Nachfrist,* the requirements for which are set out in Art 47(1) of the CISG.[132] During this period, the buyer may not resort to any remedy for breach of contract unless the seller notifies the buyer that he will not perform within the additional period.[133] If the seller does not perform within this period, the buyer has the right to avoid the contract no matter how trivial the original breach.[134]

Articles 47 and 49(1)(b) of the CISG off-set the particular importance of timely delivery to the buyer against the actual severity of the seller's breach. On the one hand, where the seller is in breach of any obligation other than non-delivery of the goods, the buyer may only avoid where that breach is fundamental. On the other hand, under Art 49(1)(b) of the CISG the buyer may avoid for a non-fundamental breach of the delivery obligations, providing the buyer complies with the *Nachfrist* requirements under Art 47 of the CISG. Article 49(1)(b) of the CISG therefore confers increased powers of avoidance on the buyer where the seller has failed to deliver the goods, although only in circumstances where the seller has failed to comply with the *Nachfrist* provisions of Art 47 of the CISG. The seller is given a second opportunity to deliver the goods,[135] thereby balancing the potentially serious consequences of non-delivery for the buyer against the seller's right to perform the contract where his breach is minor.

If the seller's initial failure to deliver the goods *does* constitute a fundamental breach under Art 25 CISG, the buyer may avoid immediately under Art 49(1)(a) of the CISG without resort to the *Nachfrist* procedure. Thus, Art 49(1)(b) of the CISG does not preclude non-deliveries from giving rise to a fundamental breach and founding an immediate right to avoidance. Nonetheless, even where the seller's breach of the delivery obligation is fundamental, the buyer is often well advised to avoid through the *Nachfrist* procedure of Art 49(1)(b) of the CISG. The broad terms of Art 25 of the

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132 CISG, 47(1), states: 'The buyer may fix an additional period of time of reasonable length for performance by the seller of his obligations.'

133 *Ibid,* Art 47(2).

134 It is irrelevant whether the failure to deliver constitutes a fundamental breach of contract. This results from the perception that delivery is 'such a fundamental obligation that its breach, even though not fundamental, opens the Nachfrist-avoidance-mechamsm': Huber in Schlechtriem (1998), p 394; Will in Bianca and Bonell (1987), p 363. Reading 49(1)(a) and (b) together, it would seem that 49(1)(b) permits the buyer to avoid for any failure by the seller's to deliver the goods so long as the additional period set under 47(1) of CISG has expired. Additionally, Will has argued that delivery is 'such a fundamental obligation that its breach, even though not fundamental, opens the Nachfrist-avoidance-mechanism': Huber in Schlechtriem (1998), p 394. Article 326 of the German Civil Code; Honnold (1999), p 316.

135 Honnold (1999), p 343; Secretariat Commentary, OR, p 39; Kritzer (1989), pp 354–55.

CISG may create conjecture as to whether delay in delivery has amounted to a fundamental breach, and the point at which the breach became fundamental.

Thus where the goods have not yet been delivered, the *Nachfrist* ultimatum serves a vital role in the scheme of the buyer's remedies. By fixing an additional period of time for delivery, the buyer circumvents the potentially onerous task of establishing whether the seller's failure to deliver constitutes a fundamental breach.[136]

(3) Partial avoidance, instalment contracts and anticipatory breach

Article 51(1) of the CISG allows the buyer to avoid the contract where a partial delivery or partial non-conformance of the goods amounts to a fundamental breach of the delivery or performance obligations respectively.[137] However, where the contract is for delivery of goods by instalment, the special provisions of Art 73 of the CISG will apply. Under Art 73(1) of the CISG, failure by the seller to perform his obligations in regard to any instalment, will allow avoidance for that instalment only.[138] Under Art 73(2) of the CISG, the buyer may only declare the contract avoided for the future if the seller's breach in regardsto an instalment gives the buyer 'good grounds' to conclude that a fundamental breach will occur with respect to future instalments.[139] Finally, under Art 73 of the CISG, the buyer may only declare the contract avoided in respect of past *or* future deliveries 'if, by reason of their interdependence, those deliveries could not be used for the purpose contemplated by the parties at the time of the conclusion of the contract'.[140]

Article 71 of the CISG governs anticipatory breach. It confers the right to suspend performance by one party if 'it becomes apparent that the other party will not perform a substantial part of his obligations'. Pursuant to Art 72(1) of the CISG, the buyer may declare a contract avoided if, prior to the date for performance, it is clear that the seller will commit a fundamental breach of contract. Unless the seller has declared that he will not perform his obligations,[141] Art 72(2) of the CISG provides that the buyer must give

136 This is subject to the limitation in An 47 that the additional period of time so fixed must be of 'reasonable' length. What is reasonable must be determined in the light of all circumstances surrounding the transaction: Huber in Schlechtriem (1998), pp 396–97. The elements to be taken into account include 'the nature, extent and consequences of the delay, the seller's possibilities of and time needed for delivery, and the buyer's special interest in speedy performance': Will in Bianca and Bonell (1987), p 345.

137 Article 51(2). See further Huber in Schlechtriem (1998), pp 445–48.

138 Article 73(1) states: 'In the case of a contract for delivery of goods by installments, if the failure of one party to perform any of his obligations in respect of any instalment constitutes a fundamental breach of contract with respect to that instalment, the other party may declare the contract avoided with respect to that instalment.'

139 The right to avoid under Art 73(2) is also subject to the requirement that the buyer declare avoidance within a reasonable time.

140 Article 73(3). See further Leser in Schlechtriem (1998), pp 542–51.

141 Article 72(3).

reasonable notice of avoidance in order to permit the seller to provide adequate assurance of his performance.[142]

The position under English law

A comparative analysis of avoidance under English law reveals the sheer complexity and the entangled interaction of the SGA and the common law. Unlike the CISG, the buyer's right to avoid the contract under English law depends upon the seller either breaching a condition, or seriously breaching an intermediate term. The CISG's *Nachfrist* avoidance mechanism has no direct equivalent in English sales law, but was, in fact, borrowed from German law.[143]

Three sources of contractual condition may be identified at English law. First, the SGA implies into contracts a number of conditions, any breach of which confers on the buyer a *prima facie* right of avoidance pursuant to s 11(3) of the SGA.[144] However, if 'the breach is so slight that it would be unreasonable' for the buyer to reject the goods pursuant to s 15A of the SGA, these conditions are to be treated as warranties. Secondly, international sales contracts contain a number of conditions implied at common law.[145] None of these conditions are covered by s 15A of the SGA, and their breach, no matter how trifling, will render the contract voidable at the option of the buyer. Finally, the parties may express certain terms of their contract to be conditions. The courts are not bound to construe them as such, but should they, such conditions also fall outside the scope of s 15A of the SGA.

Once conditions have been identified, the process of classification becomes much more difficult. All remaining terms of the contract will either be intermediate terms, a serious breach of which will entitle the buyer to avoid the contract, or warranties, breach of which will never found avoidance. However, the SGA makes no attempt to clarify which terms will be warranties, and further, since the intermediate term is a judicial creation, there is no statutory guidance as to its definition. The need for classification is circumvented by the CISG, which looks to the gravity of the breach to determine the right to avoidance regardless of the nature of the obligation.

Historically, English law has also differed from the CISG in its treatment of avoidance of the contract in part, or avoidance of instalment contracts. In

142 See further Leser in Schlechtriem (1998), pp 532–41.

143 Article 326 of the German Civil Code; Honnold (1999), p 316.

144 Section 13(1): where there is a contract for the sale of goods by description, the goods must correspond with the description (deemed a condition by virtue of s 13(1 A)); s 14(2) and 14(6) the goods must be of satisfactory quality; s 14(3) and 14(6) the goods must be fit for any particular purpose made known to the seller; s 15(2) and 15(3) in the case of a contract for sale by sample, the goods must correspond with the sample in quality, and must be free from any defect which would not be apparent on reasonable examination of the sample.

145 These include conditions as to time: *Bunge Corp v Tradax Export SA* [1981] 1 WLR 711; the port of loading in an FOB contract, the name and type of vessel if agreed between the parties, or if not agreed, a vessel which is commonly used in the trade to carry the goods in question: D'Arcy (2000), p 86.

many ways, English law has lacked the clarity of the CISG. The introduction of s 35A of the SGA has, however, brought the SGA more into line with the CISG in these areas. It now seems from ss 35A and 35(7) of the SGA that the buyer has a right of partial rejection unless the defective goods form part of one commercial unit with goods that have already been accepted.[146] Furthermore, although s 31(2) of the SGA only seems to allow the buyer to avoid the entire contract for a defective instalment, or claim damages for such an instalment, it is likely that, by implication, a buyer may reject the defective instalment without repudiating the contract as a whole.[147] However, in contrast to the CISG, it is still unclear whether a right of rejection applies to prior or future instalments.[148] Also, courts are given negligible guidance as to the basis for repudiation under s 31(2) of the SGA.

The law on anticipatory breach is not codified in the SGA, but is governed by the common law. With two notable exceptions, the common law's approach to anticipatory breach is similar to that of the CISG. First, English law does not formally recognise the buyer's right to suspend performance, although in practice the buyer may withhold payment while the seller fails to deliver under s 28 of the SGA.[149] Secondly, there is no requirement to seek adequate assurance,[150] although in practice the impact of this departure would seem to be minimal.[151]

Despite some legislative reforms, the English law on avoidance remains convoluted and uncertain when compared to that of the CISG. Under English law, the line is blurred vis à vis the application of the common law and the SGA, and between the historical emphasis on certainty and predicability and more recent attempts to modernise the law by introducing greater flexibility.

When does the buyer lose the right to avoid?

The position under the CISG

Under the CISG, there are five broad circumstances in which the buyer will lose the right to avoid the contract. The first, and most controversial, arises from the seller's right to cure. Under Art 48 of the CISG, the seller may cure any defect in goods after the date for delivery.[152] Article 48(1) of the CISG provides that:

146 Atiyah (2001), pp 527–28.
147 This right is, however, subject to the rules governing partial acceptance contained in s 35A(2): Atiyah (2001), p 506.
148 Atiyah (2001), p 507; Bridge (1999), p 89.
149 Goode (1995), p 424.
150 A requirement also contained in UCC, s 2–609.
151 Bridge (1999), p 91.
152 Article 37 permits the seller to cure defects in goods delivered early, up to the date for delivery.

> Subject to Art 49, the seller may, even after the date for delivery, remedy at his own expense any failure to perform his obligations, if he can do so without unreasonable delay and without causing the buyer unreasonable inconvenience or uncertainty of reimbursement by the seller of expenses advanced by the buyer.

At issue is the question of whether the buyer's right to avoid the contract is subject to any right of the seller to cure the breach. The fact that Art 48(1) of the CISG is expressed to be 'subject to Art 49' has led some commentators to conclude that this right is always subordinate to the buyer's right to avoid the contract. These commentators argue that the fundamentality of breach should be determined objectively without regard to whether the defect is capable of being remedied.[153] On this view, the right to cure after the date for delivery is restricted to minor defects, rendering Art 48(1) of the CISG practically insignificant.[154]

However, others would argue that fundamentality of breach within the meaning of Art 49(1)(a) CISG must be decided in the light of *all* the circumstances, *including the seller's offer to cure.*[155] This view appreciates that the very ability of the seller to rectify a defect speedily, without causing unreasonable inconvenience to the buyer, itself ameliorates the otherwise fundamental character of the breach.[156]

Thus, where cure is feasible, the buyer should be wary about hastily avoiding the contract without first determining whether the seller will cure the defect. If it is clear, according to the buyer's actual knowledge,[157] that the seller will cure, the buyer's right to avoid will be suspended until any delay or inconvenience associated with the cure itself amounts to a fundamental breach. Conversely, where the defects are incurable, or any attempt to cure will clearly result in unreasonable delay, inconvenience or uncertainty and the failure to perform would constitute a fundamental breach. In such circumstances, the buyer may declare the contract avoided immediately. Crucially, 'the right to avoid the contract is not excluded by the seller's right to cure after the date for delivery'. Rather, 'there is an indirect exclusion of that right only inasmuch as a fundamental breach of contract (Arts 25, 49(1)(a) CISG) will

153 See Huber in Schlechtriem (1998), p 409; Ziegel (1984), pp 9–22.

154 Honnold (1999), p 210.

155 Hannold (1999), pp 320–21; Enderlein and Maskow (1992), p 185; Kritzer (1989), p 363. This view was supported by suggestions at UNCTTRAL's 1977 review of the draft Convention on Sales that Art 25 should be amended to subject determination of a fundamental breach to consideration of 'all the circumstances, including reasonable offer to cure'. Such an amendment was considered 'unnecessary' and 'superfluous': UNCITRAL, *VIII Yearbook* (New York 1977), A/32/17, Annex I, p 31, in Honnold (1999), p 210.

156 Huber in Schlechtriem (1998), pp 408–10; Honnold (1999), p 210.

157 This may include 'good experience with the seller, an *ad hoc* commitment, the underlying conditions of sale' or a prompt and reasonable offer to cure which satisfies the requirements of Art 48(1): Will in Bianca and Bonell (1987), p 351.

generally not exist so long as the seller fulfils the requirements of Art 48(1)'.[158]

The second situation in which the buyer will lose the right to avoid arises under Art 48(2) of the CISG, where 'the seller requests the buyer to make known whether he will accept performance and the buyer does not comply within a reasonable time'. Thus, even when the circumstances for the exercise of a *right* to cure under Art 48(1) of the CISG are not met, the buyer who, having received the offer to cure,[159] does not respond to the offer within a reasonable time may be bound to accept the cure. The seller may perform within the period indicated in his offer to cure, and during that time the buyer's right to avoid, or to take any other remedial action inconsistent with performance, is suspended.

Thirdly, pursuant to Art 39 of the CISG, the buyer loses the right to rely on a lack of conformity of the goods, and consequently the right to avoid the contract, if 'he does not give notice to the seller specifying the nature of the lack of conformity within a reasonable time after he has discovered it or ought to have discovered it'. Similarly, under Art 43 of the CISG, the buyer loses the right to avoid the contract if he fails to give notice to the seller specifying the nature of a third party right or claim.

Fourthly, the buyer may lose the right to avoid under Art 49(2) of the CISG if he does not do so within a reasonable time after delivery, or in the case of a breach other than late delivery, within a reasonable time after he knew or ought to have known of the breach, or after the expiration of any *Nachfnst* period which may have been granted, or after the period of time for cure indicated by the seller pursuant to Art 48(2) of the CISG. The time limits set in Arts 39 and 43 of the CISG prevail over that set out in Art 49(2) of the CISG. Therefore, if the fundamental breach involves a non-conformity or third party claim and the buyer has not notified the seller in accordance with Arts 39 or 43 of the CISG, the right to avoid is already lost.[160] In this respect, Art 43 of the CISG is more generous to the buyer than Art 39 of the CISG, in that the latter provision stipulates an outside limit of two years for notification.[161] Otherwise, what is reasonable must be determined on a case by case basis. According to Fritz Enderlein and Dietrich Maskow, 'a *reasonable time* in this case more or less means *immediately*'[162] in order to avoid the possibility of increased expense and risk associated with care and redisposition of unwanted goods.[163]

158 Huber in Schlechtriem (1998), p 410.
159 Article 48(4).
160 Will in Bianca and Bonell (1987), pp 365–66.
161 Will in Bianca and Bonell (1987), pp 365–66. While two years may seem excessive to English lawyers, it was the result of compromise at the instigation of developing countries: Eörsi (1983), p 350.
162 Enderlein and Maskow (1992), p 193.
163 Honnold (1999), p 330.

Finally, Art 82(1) of the CISG excludes the buyer's right to declare the contract avoided 'if it is impossible for him to make restitution of the goods substantially in the condition in which he received them'. Pursuant to the exceptions in Art 82(2) of the CISG, the buyer retains the right to avoid where the impossibility of restitution is not due to the buyer's act or omission, where the goods have perished as a result of examination required by Art 38 of the CISG, or where the goods have been sold or consumed in the normal course of business. In the latter case, it is a condition of avoidance that the buyer account to the seller for any benefits received under Art 84(2) of the CISG.

The position under English law

The circumstances in which avoidance will be precluded differ vastly under the CISG and under English law. The seller's right to cure under the SGA is not expressly provided for, as it is under the CISG, but hangs on nuance and implication. Moreover, the SGA allows the seller to preclude avoidance in circumstances not countenanced in the CISG.

It would seem that the seller's right to cure is, at the very least, limited under the SGA. First, the ability of the seller under Art 48(2) of the CISG to suspend the buyer's right of avoidance in circumstances in which the buyer fails to respond to the seller's offer to cure has no counterpart in English law.[164] The Law Commission has observed that 'there is great uncertainty…as to the existence or extent of the seller's right to repair or replace defective goods', although they declined to introduce cure provisions into commercial sales contracts due to the complexity of such contracts and the consequent impracticability of cure.[165] Roy Goode expresses regret that 'opportunity has not been taken to modernise the Sale of Goods Act by including express provisions as to the right of cure, a right which mitigates the impact of an improperly motivated rejection by the buyer while at the same time tending to avoid economic waste'.[166]

Secondly, avoidance under the SGA is even less certain where the seller's offer to cure comes after the date for delivery. While Art 48(1) of the CISG subordinates the buyer's right to avoid to the seller's right to cure, under the SGA a term's status as a condition, warranty or intermediate term is apparently unaffected by the ability of the seller to cure a breach.[167] English law does not recognise a superior, or indeed any, right in the seller to cure defects after the

164 See s 35(6)(a).

165 Bridge (1997), p 197, citing Consultative Document No 58, para 2.38.

166 Goode (1995), p 364.

167 Although it is conceivable that the ability of the seller to cure may influence a court to exercise its discretion with respect to the effect of breach of an intermediate term in favour of the seller. It will also be interesting to see whether s 15A may be used by courts to introduce a right to cure—for instance, if a breach of condition is objectively serious, but the seller could remedy the defect the next day at no cost to the buyer, could a court invoke s 15A to assert that 'the breach is so slight that it would be unreasonable for [the buyer] to reject [the goods]'?

delivery date.[168] In practice, the seller will rarely be entitled to redeliver after the date for performance, as time of delivery is *prima facie* of the essence in commercial contracts.[169] Finally, although there is some common law recognition for the proposition that, in certain circumstances in commercial contracts, the seller may be entitled to cure a defective tender prior to the contractual delivery date,[170] it generally seems that a defective delivery in itself will amount to a breach of contract justifying avoidance by the buyer.[171]

However, despite the absence of any clear right to cure in English law, cure is 'common enough in countless unlitigated examples of contracting parties settling their differences'.[172] Moreover, it is clear that the CISG approach reflects modern commercial practice, as the UCC,[173] the UNIDROIT Principles[174] and the Principles of European Contract Law (PECL)[175] all contain overriding right-to-cure provisions. Hence, it is also arguable on this basis that the seller's right to cure would represent a meaningful addition to English sales law.

Unlike the CISG, the SGA contains provisions which preclude the buyer from avoiding the contract if he is deemed to have accepted the goods. The general principle under the SGA is that, despite the seller's breach of condition or serious breach of an intermediate term, if the buyer is deemed to have accepted the goods, he loses his right to reject them,[176] although he may claim damages for the overpaid amount.[177] According to s 35 of the SGA, the buyer is deemed to have accepted the goods when he:

- intimates to the seller that he has accepted them;[178]
- performs an act inconsistent with the seller's ownership of the goods;[179] and
- retains the goods for a 'reasonable time' without intimating to the seller that he has rejected them.[180]

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168 Reynolds in Guest (1997), para 10–028.
169 *Bunge Corp v Tradax Export SA* [1981] 2 All ER 513.
170 Reynolds in Guest (1997), para 12–031; Goode (1995), pp 363–66; Bridge (1999), pp 91–92. For example, *Motor Oil Hellas (Corinth) Refineries SA v Shipping Corp of India Ltd (The Kanchenjunga)* [1990] 1 Lloyd's Reports 391 at 399; *Kwei Tek Chao v British Traders & Shippers Ltd* [1954] 2 QB 459; *Borrowman, Phillips & Co v Free and Hollis* (1878) 4 QBD 500.
171 Atiyah (2001), p 508.
172 Bridge (1997), p 201.
173 Section 2–508.
174 Article 7.1.4.
175 Article 8:104.
176 Section 11(4).
177 The seller retains the right to damages up until six years from the date of the breach of contract: Limitation Act 1980.
178 Section 35(1)(a).
179 Section 35(1)(b).
180 Section 35(4).

The first head of acceptance has no counterpart in the CISG. While the buyer will lose his right to avoid under the CISG for failure to give to the seller timely notice of non-conformity, of third party claims or of avoidance itself, there is no corresponding loss of the right to avoid if the buyer indicates to the seller that the goods are perfectly acceptable. In any case, this head has now fallen into relative disuse.[181] Similarly, the second head is not found in the CISG. The only possible parallel is found in Art 82(2)(c) of the CISG, which holds that if the buyer transforms, uses or resells the goods he may inhibit his restitution of the goods substantially in the condition in which he received them.[182] Only the third head is familiar in the context of Arts 39, 43 and 49(2) of the CISG, the question of what constitutes a 'reasonable time' also being a question of fact.[183]

Under any of these three heads, the buyer cannot be deemed to have accepted the goods, thereby losing his right to avoid, before he has had a reasonable opportunity of examining them.[184] Thus, a person who signs an acknowledgment of receipt of goods before examining the goods will not be taken to have accepted the goods within the meaning of s 35(1)(a) of the SGA.[185] Likewise, under Art 38 of the CISG, the buyer has a non-legal obligation to examine the goods 'within as short a period as is practicable in the circumstances'.[186] The period for giving notice of non-conformity under Art 39 of the CISG (and consequently the period for declaring avoidance under Art 49(2)(b) of the CISG) begins when the buyer discovers, or ought to have discovered, the defect. This point will be influenced by the nature of the defect, but will ordinarily be the expiry of the period for examining the goods.[187]

Avoidance of the contract by the seller

When is the seller entitled to avoid?

The position under the CISG

Chapter III of the CISG deals with the obligations of the buyer to pay the price[188] and take delivery of the goods,[189] whilst Section III sets out remedies for

181 Bridge (1997), p 171.
182 Bridge (1997), p 172. Article 82(2)(c) provides that the buyer does not lose his right to avoid despite being unable to make restitution in accordance with Art 82(1) where the buyer has resold, consumed or transformed the goods in the normal course of business before he discovered or ought to have discovered the lack of conformity. Section 35(6)(b) performs a similar role in relation to sub-sales.
183 Section 59.
184 Sub-sections 32(2) and (5).
185 Atiyah (2001), pp 513–14; Bridge (1997), pp 170–71.
186 This is not a legal obligation. Thus failure to examine does not render the buyer liable in damages, but may eventually result in loss of the buyer's right to avoid: Schwenzer in Schlechtriem (1998), p 302.
187 Schwenzer in Schlechtriem (1998), pp 315–16.
188 Articles 54–59.
189 Article 60.

breach of contract by the buyer. Many of the provisions contained in these two sections confer parallel rights on the seller in the case of the buyer's breach, as conferred on the buyer in case of the seller's breach. So, Art 61 of the CISG mimics Art 45 of the CISG in allowing the seller to claim damages,[190] require performance by the buyer[191] or avoid the contract. Likewise, Art 64(1) of the CISG is virtually the mirror image of Art 49(1) of the CISG in conferring on the seller a right to avoid the contract. The central element of Art 64(1)(a) of the CISG is the notion of fundamental breach, whereas 64(1)(b) of the CISG also provides that the injured seller may avoid in limited circumstances under the *Nachfrist* mechanism.[192] These parallels, as well as some remaining differences, between the remedies for the buyer's and the seller's breach will be further discussed below.

(1) Article 64(1)(a)—fundamental breach by the buyer

According to Art 64(1)(a) of the CISG, the seller is entitled to avoid the contract for a fundamental breach of any obligation by the buyer. Again, the determinative factor in fundamental breach is not the quantum of loss suffered in monetary terms, but the significance attributed to die particular obligation by the parties. Indeed, the Secretariat Commentary questions how frequently, in practice, the buyer's failure to make good his primary obligation to pay the price and take delivery will constitute a fundamental breach. It states that 'in most cases the buyer's failure would amount to a fundamental breach…*only after the passage of some period of time*'.[193] This uncertainty highlights the advantages of the *Nachfrist* procedure, which allows the seller to avoid immediately on expiration of the additional period without waiting until he is certain that the breach has become 'fundamental'.

(2) Article 64(1)(b)—buyer's failure to comply with a Nachfrist ultimatum

The seller's right to issue a *Nachfrist* ultimatum under Art 63 of the CISG parallels the buyer's same right under Art 49(1)(b) of the CISG. Article 63(1) of the CISG provides that 'the seller may fix an additional period of time of reasonable length for performance by the buyer of his obligations'.[194] Under Art 63(2) of the CISG, the seller is prohibited during that period from resorting to any remedy for breach of contract unless the buyer notifies the seller that he will not perform within the additional period. Article 64(1)(b) of the CISG allows the seller to declare the contract avoided if the buyer does not, or declares he will not, perform his obligation to pay the price or to take delivery of the goods within the additional period granted under Art 63(1) of the CISG. Thus, while the seller may issue a *Nachfrist* ultimatum under Art

190 Articles 74–77.
191 Article 62.
192 For an analysis of Art 64 from an American perspective, see Kritzer (1989), pp 427–31.
193 Secretariat Commentary, OR, p 50 (emphasis added); Kritzer (1989), p 429; Honnold (1989), p 440. Compare Enderlein and Maskow (1992), p 244.
194 Article 63(1).

63(1) of the CISG for failure by the buyer to perform *any* of his obligations, only the buyer's failure to pay the price or take delivery of the goods will enable the seller's avoidance under Art 64(1)(b) of the CISG. In these limited circumstances, there is no requirement that the failure to pay or take delivery amounts to a fundamental breach. In all other instances, the seller's right to avoid for the buyer's failure to perform an obligation[195] depends solely upon whether the breach in question constitutes a fundamental breach. Thus, the *Nachfrist* avoidance mechanism provides a degree of certainty to the seller by allowing the seller to avoid the contract without first establishing a fundamental breach of contract by the buyer.

The position under English law

Like the CISG, the SGA imposes two primary obligations on the buyer: the duty to pay the price under s 27 SGA, and the duty to take delivery of the goods under s 28 of the SGA. However, the CISG provides much more satisfactory protection to an injured seller than the SGA. While the SGA contains general provisions dealing with the right of the buyer to avoid the contract for repudiation by the seller, there are no general provisions dealing with the equivalent right of the seller.[196] In this respect, the SGA lacks the symmetry offered by the CISG.

The effect of s 10(1) of the SGA is to create a *prima facie* presumption that the buyer's duty to pay the price is not a condition, even in a commercial contract of sale.[197] The result is that the seller is not entitled to declare the contract avoided for the buyer's late payment, although he is entitled to claim interest,[198] and may sue the buyer for any damage suffered. This rule has been criticised as an extension of compulsory credit to the buyer.[199] However, it may be off-set by a tendency of the courts to treat stipulations as to time in commercial contracts as conditions which may extend to time of payment in certain circumstances.[200]

Nevertheless, the 'unpaid seller'[201] has certain statutorily enshrined real remedies which he may exercise over the goods and which may allow avoidance. Under s 39 of the SGA, whether or not the property in the goods has passed to the buyer, the unpaid seller is granted a lien on goods while he is in possession of them. He is also granted the right of stoppage in transit where the buyer is insolvent, and a right of resale. The right of resale is of greatest interest

195 For example, the obligation to 'sell goods only to specified resellers or at specified prices': Hager in Schlechtriem (1998), p 491.
196 The repeated reference in ss 11 and 53(1) to the right to 'reject the goods' indicates that it was only intended to cover the buyer's remedies.
197 Goode (1995), p 423.
198 Harris in Guest (1997), paras 16–006–16–010.
199 Atiyah (2001), p 303.
200 *Bunge Corp v Tradax Export SA* [1980] 1 WLR 711; Atiyah (2001), p 83.
201 'Unpaid seller' is defined in s 38 of the SGA.

in the context of avoidance, since it involves the seller accepting repudiation by the buyer and treating the contract as void. Thus, under s 48(1) of the SGA, 'a contract of sale is not rescinded by the mere exercise by an unpaid seller of his right of lien or retention or stoppage in transit'.

Section 48(4) of the SGA allows the seller to resell the goods where the seller has expressly reserved the right of resale on default by the buyer. Moreover, 'where the goods are of a perishable nature, or where the unpaid seller gives notice to the buyer of his intention to resell and the buyer does not within a reasonable time pay or tender the price', the unpaid seller may, under s 48(3) of the SGA, resell the goods and sue for damages. This latter provision, strikingly similar to the CISG's *Nachfrist* mechanism, reflects the common law rule that time can be made of the essence by service of notice.[202] Although this was originally an equitable principle for contracts for the sale of land,[203] *RV Ward Ltd v Bignall* confirmed that it also operates in contracts for the sale of goods and s 48(3) of the SGA.[204]

Where the buyer has not signalled their repudiation under s 48 of the SGA, the seller must resort to the general law of contract to determine when the buyer has acted so as to repudiate the contract. If the buyer evinces 'an intention to be no longer bound by the contract',[205] the seller is entitled to accept this repudiation, treat the contract as avoided, and deal with the goods as owner.[206]

The seller's rights in relation to instalment contracts have not been clarified by s 31 (2) of the SGA, which allows the buyer to avoid in relation to the individual parts of an instalment contract. It appears from *Warinco AG v Samor SPA*[207] that the seller is entitled to avoid the contract for future instalments where it is clear that the buyer will not perform. Notably, an unqualified refusal to pay may constitute repudiation by the buyer, although payment for prior instalments is not usually a condition precedent to delivery of subsequent instalments by the seller.[208] The seller's right of stoppage in transit under s 39(1)(b) of the SGA roughly equates to the right to suspend performance under Art 71 of the CISG, albeit narrower in scope.

When does the seller lose the right to avoid?

The position under the CISG

The circumstances in which the seller loses the right to avoid under the CISG are set out in Art 64(2) of the CISG. These relate to the point at which

202 Goode (1995), p 445.
203 *Stickney v Keeble* [1915] AC 386.
204 [1967] 1 QB 534 at 550; Ziegel (1984), pp 9–17, n 49.
205 *Mersey Steel and Iron Co Ltd v Naylor, Benzon & Co* (1884) 9 AC 434 at 444.
206 *Compagnie de Renflouement v W Seymour Plant Sales & Hire Ltd* [1981] 2 Lloyd's Reports 466 at 482.
207 [1977] 2 Lloyd's Reports 582 at 588; [1979] 1 Lloyd's Reports 450.
208 Guest (1997), para 8–081.

knowledge of the breach or knowledge of performance occurs, either constructively or in fact. Notably, the seller will never lose the right to declare the contract avoided unless the buyer has actually paid the price. Moreover, the total price must have been paid, so that, in the case of payment by instalments, all instalments must have been paid.[209]

In determining when the seller loses the right to avoid, the Convention distinguishes between 'late performance by the buyer' in Art 64(2)(a) of the CISG and 'any breach other than late performance by the buyer' in Art 64(2)(b) of the CISG. Logically, 'late performance' in Art 64(2)(a) of the CISG covers circumstances in which performance has occurred, albeit after the due date.[210] Presumably then, Art 64(2)(b) of the CISG covers all breaches in which the buyer's performance remains outstanding. The implication is that, in either case, the seller is initially entitled to avoid the contract, either for fundamental breach by the buyer or the buyer's failure to comply with a *Nachfrist* ultimatum.

In the case of a late performance, namely late payment of the price or delay in taking delivery, the seller loses the right to declare the contract avoided immediately upon becoming aware that performance has been rendered.[211] However, each separate breach which entitles the seller to avoid is a separate ground for avoidance, and the loss of the right to avoid in respect of one breach does not preclude the right to avoid in respect of another.[212] With respect to breaches other than late performance, the seller loses the right to avoid where: (1) the price has been paid in full; (2) he does not avoid within a reasonable time after he knew or ought to have known of the breach; or (3) he does not avoid within a reasonable time after the expiration of an additional period fixed by a *Nachfrist* ultimatum; or (4) after the buyer has declared he will not perform within that period.[213]

The position under English law

The SGA provides negligible guidance as to the situations where the seller's right to avoid the contract is lost. However, it is generally accepted that this occurs where the buyer has both the possession of, and the property in, the goods.[214] At this time, the seller has no remedy against the goods themselves, but must be content with a personal claim against the buyer for the price or damages under the contract. One possible justification for this approach is that

209 Secretariat Commentary, OR, pp 50–51; Kritzer (1989), p 430; Honnold (1989), pp 440–41; Hager in Schlechtriem (1998), p 492; Knapp in Bianca and Bonell (1987), p 470.
210 Hager in Schlechtriem (1998), p 492.
211 Article 64(2)(a).
212 Knapp in Bianca and Bonell (1987), p 473.
213 Article 64(2)(b).
214 Goode (1995), p 441. The seller may retain the *power* to transfer good title to the goods to a second buyer in circumstances in which he does not have, as against the original buyer, the *right* to resell the goods: Harris in Guest (1997), para 15–102; Atiyah (2001), pp 464–65.

the seller should be afforded no more favourable treatment than the buyer under the SGA. As s 11(4) of the SGA deprives a buyer who has accepted the goods of his right to avoid for a seller's breach of condition, a seller who has transferred possession of and property in the goods should likewise lose the right to avoid for the buyer's breach.[215] This approach differs markedly from that taken in CISG, which seems to allow the seller to avoid the contract even after the buyer has been in possession of the goods for a considerable period of time.[216] At English law, it is also possible for the seller to waive his right to avoid at common law, as occurred in *Panoutsos v Raymond Hadley Corporation of New York.*[217]

Conclusion

Twenty-one years after inception of the CISG, the UK is one of the few major trading nations to have abstained from ratification. Originally, the UK justified its position by reference to the alleged certainty of English law in comparison to the general provisions of the CISG. However, as has been shown, the CISG establishes a very structured and comprehensive regime for avoidance of the contract which compares favourably with the complexity of English sales law. For the most important breaches, the *Nachfrist* mechanism counterbalances any uncertainty created by the broad definition of fundamental breach. Moreover, English sales law, in its current state, presents no greater degree of certainty to litigants than the CISG, which favours performance of the contract and reflects international trends in sales laws. Further, the provisions of the CISG regulating avoidance effect an equitable balancing of both parties' interests by creating near-perfect symmetry between the rights of the buyer and the seller. In contrast, the SGA gives precedence to the rights of the buyer. Practically, this may lead English buyers to exclude of the CISG from their contracts in favour of English law, whilst English sellers will be more likely to adopt the opposite approach.

Finally, it is unlikely that the UK will be able to shelter its trader from the scope of the CISG in the future, given the apparent popularity of the Convention. In the 13 years since the CISG came into force, it has been ratified by countries accounting for over two thirds of all world trade,[218] and over 670 cases on the CISG have been decided worldwide.[219] In the same period, the value of the UK's international trade has more than doubled.[220]

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215 See Harris in Guest (1997), para 15–118.
216 Ziegel (1984), pp 9–33.
217 [1917] 2 KB 473. See also Beatson (1998), pp 496–500.
218 Pace University CISG database at www.cisg.law.pace.edu/cisg/cisgintro.html.
219 Will (2000), p 6.
220 In 1988, the UK exported goods to the value of £81,654.9 million and imported £106,571.2 million worth of goods. In the year 2000, the UK exported £187,382.3 million and imported £222,266.9 million worth of goods: HM Customs & Excise Statistics (2000), Table 1.

Against this backdrop, there is no doubt that UK merchants will increasingly encounter the Convention in their business dealings. However, if the UK maintains its isolation, English courts will only contribute to the development of a CISG jurisprudence occasionally, where the proper law of the contract incorporates the Convention.[221] Thus, the UK can best protect its traders by embracing the CISG and contributing to the evolution of global commercial norms.

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221 For example, *Egmatra v Marco Trading Corp* [1999] 1 Lloyd's Reports 862.

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The Availability of Court-Ordered Interim and Conservatory Measures in Aid of International Arbitration in the United States of America and France—A Comparative Essay

Kate Brown[1]

Introduction

In international commercial arbitration, pre-award protective measures are essential to ensure the effectiveness of arbitral awards.[2] Such measures may be necessary to preserve the subject matter of the arbitration, to maintain the status quo during the arbitral proceedings, or to secure the eventual payment of an award.[3] Van den Berg explains that if no pre-award protective measures are available, 'an award in favour of a creditor may turn out to be a Pyrrhic victory. At that time the debtor may well have "sheltered" his assets in another jurisdiction'.[4] Indeed, requests for such protective measures are becoming increasingly common.[5]

Court assistance in international arbitrations

There are significant justifications for seeking protective measures from a court rather than from the arbitral tribunal itself. In an international arbitration, the arbitral tribunal's power to provide interim relief is not always assured. Indeed, an arbitrator's jurisdiction to award conservatory remedies must have its origin in the provisions of the arbitration agreement, or in the institutional rules

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2 Burrows and Newman (1982); Newman and Nelson (1986), p 99.

3 Hoellering (1984).

4 Van den Berg (1989), p 16.

5 Parodi (1991), p 486.

6 Buchman (1994), p 257. This issue is not, however, within the scope of this paper.

governing the agreement.[6] Additionally, at the preliminary stages of a dispute when provisional remedies are most often needed, the arbitrators will not have yet been appointed.[7] Moreover, even where an arbitral tribunal does have the power to grant provisional relief, this power is subject to the limitation that an order granted by an arbitrator cannot be enforced without judicial confirmation.[8] A party obtaining an order for relief directly from a court avoids the need for supplementary court proceedings for enforcement.[9] Finally, the power of an arbitrator, being contractual in nature, is not effective to enforce an interim order against third parties.[10] Therefore, where the assets in dispute are in the possession of a third party, an arbitral tribunal is ill-equipped to provide urgent relief.[11] For these reasons, where emergency interim measures are required, it can be more efficient to seek assistance from a court, subject to the precondition that the court has jurisdiction to grant such measures.

Although there is a strong tendency towards unification of the law governing international arbitration proceedings, the availability of court-ordered pre-award protective measures in international arbitration remains governed by the law of the place from which a measure is sought.[12] The United Nations Commission on International Trade Law Model Law on International Commercial Arbitration (hereafter the UNCITRAL Model Law), which is designed to unify domestic rules regarding international commercial arbitration, has found acceptance in a large number of states.[13] However, when choosing a forum for the arbitration of future disputes, knowledge of which national court systems are prepared to grant pre-award protective measures is essential to ensure an effective and enforceable arbitral award. Thus, there is much to be gained from comparing the development of court powers in relation to arbitration in common law countries and the approach taken in civil law jurisdiction where courts derive their powers from enacted legal rules and not from case precedent.[14]

This paper compares the court-ordered pre-award protective measures available in the United States of America and France, each of which is a party to the United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards, New York 1958 (hereafter the New York Convention). Of particular interest is the extent to which the common law and civil law structures of these two legal systems have affected the development of their respective arbitration doctrines.

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7 Meier (1987), p 34.
8 Buchman (1994), p 257.
9 Shenton (1987), p 34,
10 Buchman (1994), p 257.
11 Buchman (1994), p 257.
12 Kreindler (1998), p 209. See also Parodi (1991), p 486.
13 See Borris (1995), pp 102–03.
14 In the continental legal tradition courts derive their powers from enacted legal rules. Hence it seems that the issue of how courts should deal with arbitration must be approached separately for any given legal system.' Schlosser (1992), p 189.

Arbitration in the United States

The United States is generally perceived as adopting a progressive approach to international arbitration.[15] Interestingly, however, there is no provision in the United States Federal Arbitration Act 1925 (hereafter the Federal Arbitration Act) allowing provisional remedies to be granted by the courts when the parties have agreed to arbitration.[16] The absence of a federal statutory determination on the availability of court-ordered provisional remedies in aid of arbitration has led to an *ad hoc,* state-by-state development of this area of the law. Indeed, there is a general reluctance among the United States judiciary to interfere with an arbitration once it has been initiated.[17] Newman and Nelson comment that, '[t]o the extent that court remedies are available in support of arbitration, they are most often available before the arbitrators have been appointed, or after the making of the award'.[18] Courts will ordinarily not grant interim relief unless the arbitrators are unable to provide it.[19] Support for this approach is found in the extensive powers vested in arbitrators in the United States.[20] Consequently, the judicial treatment of arbitrable disputes in the United States can be categorised as non-interventionist.

The non-interventionist approach adopted by the United States courts has been criticised by some scholars. Schlosser argues that:

> [t]o approach the issue in terms of 'court interference' is entirely inadequate …[on] the contrary, the courts may be very helpful to arbitrators and arbitrating parties by 'interfering' where such interference is animated by the desire to provide a reliable foundation for commencing arbitration and to arbitration procedures risking the loss of their reliable foundation or even deadlock. The courts should be encouraged to intervene in a timely fashion rather than be blamed for being too distrustful of arbitration.[21]

The availability of pre-award conservative measures from United States courts in aid of international arbitration

The New York Convention, to which the United States is a party,[22] is intended to ensure that a party may not breach its agreement to arbitrate a dispute by

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15 Lew (1991), p 179.
16 An exception exists in the case of maritime arbitration. See Section 8 of the Federal Arbitration Act. See also Kreindler (1998), p 211.
17 *Moses H Cone Memorial Hospital v Mercury Construction Corp* 460 US 1 (1983). Court interference in this process is disfavoured. See *McCreary Tire & Rubber Co v CEAT SpA* 501 F 2d 1032 (3d Cir 1974).
18 Newman and Nelson (1986), p 99.
19 See NY Civ Prac Law, Art 62 (McKinney 1980).
20 Newman and Nelson (1986), p 99.
21 Schlosser (1992), p 191.
22 The United States acceded to the New York Convention in 1958 and implemented the New York Convention in its municipal law in 1970 by adding a new Chapter 2 to the Federal Arbitration Act. 2. See Becker (1986), p 207.

commencing parallel legal proceedings in the court system.[23] Article 11(3) of the New York Convention provides that a court, when 'seized' of an action involving a written arbitration agreement, 'shall, at the request of one of the parties, refer the parties to arbitration'.[24] In 1974, the Federal Appeals Court in Philadelphia ruled in *McCreary Tire & Rubber Co v CEAT SpA* (hereafter *McCreary*)[25] that the New York Convention's requirement that a court 'refer' the parties to arbitration implied an absolute prohibition against judicial involvement, even for the limited purpose of granting preliminary relief.[26]

McCreary concerned a dispute between a United States corporation and an Italian company over the breach of a distribution agreement. The parties had agreed to arbitrate disputes in Brussels according to the Arbitration Rules of the International Chamber of Commerce. The Federal Court of Appeals in Philadelphia ruled that the agreement fell under the New York Convention, and that the court was consequently stripped of all jurisdiction other than the power to refer the parties to arbitration. The court described McCreary's resort to litigation as:

> …[a] violation of McCreary's agreement to submit the underlying disputes to arbitration… This complaint does not seek to enforce an arbitration award by foreign attachment. It seeks to bypass the agreed upon method of settling disputes. Such a bypass is prohibited by the Convention…the Convention forbids the court from entering a suit that violates the agreement to arbitrate.[27]

According to the reasoning of the court, attachments cannot be granted in cases falling under the New York Convention, which requires courts to 'refer' the parties to arbitration. However, attachments are available in domestic arbitrations falling under the Federal Arbitration Act, which merely requires the courts to 'stay' proceedings pending arbitration. This decision has been criticised as taking the principles of the New York Convention so far as to become a hindrance rather than an aid to international arbitration. Redfern states:

> It is undoubtedly too severe in its demarcation of the line between courts and arbitrators in its apparent concept that an international arbitration agreement acts as a warning notice to the courts: 'this is private property—keep out'.[28]

Van den Berg is similarly critical of the court's reasoning:

> It is submitted that the *McCreary* decision is based on the wrong presumption that Article II(3) of the Convention completely divests the courts of the Contracting States of their jurisdiction. The effect of Article 11(3) is merely that the courts have no jurisdiction to hear the *merits* of a dispute […] No contrary

23 Kaplan (1998), p 187.
24 UN Convention, Art II(3), reprinted following 9 USCA 5201.
25 501 F 2d 1032 (3rd Cir 1974).
26 See Becker (1986), p 208.
27 *McCreary Tire and Rubber Co v Ceat SpA* 501 F 2d 1032 (3d Cir 1974) at 1038.
28 Redfern (1995).

> inference can be drawn from the use of the word 'refer' in Article II(3) of the New York Convention rather than 'stay the court action'. The word 'refer' is used for historical reasons and its technical procedural sense must be deemed as a court directive staying the court proceedings on the merits.[29]

This academic criticism was echoed by the California Federal District Court in *Carolina Power & Light Co v Uranex* (hereafter *Uranex*).[30] The *Uranex* case involved a contract between a North Carolina public utility and a French group that marketed uranium internationally. Following the dramatic rise in the price of uranium fuel in world markets, Uranex defaulted on its supply obligation. The utility commenced legal action in the San Francisco Federal District Court and obtained an *ex parte* attachment of a debt owed to Uranex by a San Francisco customer under a supply agreement. The parties had agreed that disputes would be settled by arbitration in New York. The utility invited the court to stay the action and maintain the attachment in order to protect any award it might receive in the New York arbitration, as Uranex had no other assets in the United States. Uranex moved to dismiss the complaint and quash the attachment, relying upon *McCreary*.

In *Uranex,* the court rejected the reasoning in *McCreary* as unpersuasive, suggesting that:

> The use of the general term 'refer' [in article 11 (3)] might reflect little more than the fact that the Convention must be applied in many very different legal systems, and possibly in circumstances when the use of the technical term 'stay' would not be a meaningful directive.

However, as the interpretation of the New York Convention is a question of supreme federal law,[31] the holding by the Federal Court of Appeals in *McCreary* was important authority that was followed by the New York Court of Appeals in *Cooper v Ateliers de la Motobecane* (hereafter *Cooper*)[32]

In *Cooper,* the dispute concerned the valuation of shares in a New York corporation owned by the parties. It had been agreed that disputes over valuation would be resolved by arbitration in Switzerland. The plaintiff obtained an *ex parte* order of attachment of a debt owed by the New York Corporation to the defendant. In a four-to-three majority decision, the New York Court of Appeals vacated the order, ruling that pre-arbitration attachment is incompatible with the New York Convention.

The decision of the *Cooper* court has been widely condemned. Van den Berg particularly criticises the court's argument that attachment is not necessary in the arbitration context, since voluntary compliance is the usual consequence of a proceeding:

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29 Van den Berg (1989), pp 15–17. See also Kaplan (1998), pp 203–04. See Also Turck (1991), p 141.
30 451 F Supp (ND CaT 1977).
31 Becker (1986), p 207.
32 57 NY 2d 408 (1982).

> This opinion is, with due respect, contrary to practice. Practice shows that by the time the award is rendered, the assets of the debtor may well have disappeared to some jurisdiction where the award cannot be enforced under the Convention or have been transferred to a third party.[33]

The *Cooper* court also maintained that the remedy of attachment and associated judicial proceedings inject uncertainty and foreign legal principles into the arbitration process, thereby defeating the purpose of the New York Convention. Furthermore, the court was persuaded that permitting pre-arbitration attachment of foreign property in New York would expose United States corporations to reciprocal abuse in foreign countries. Becker, however, observes that while the New York Convention undeniably accelerates the enforcement of awards in member countries, many states with commercial interests, such as Algeria, Argentina, Brazil, Canada, China, Saudi Arabia, Turkey and Venezuela, are not parties to the Convention. Consequently, Becker argues that foreign attachment in aid of arbitration remains essential to the effectiveness of any final arbitral award.[34] Moreover, although it is true that pre-arbitration attachment does involve the courts and foreign law in arbitration, this involvement is similarly necessary when a party seeks to obtain a stay of arbitration, an order to compel arbitration, or the confirmation of an award, according to the various judicial procedures and substantive laws of the member states. Thus, the inherent uncertainty that exists whenever foreign law is introduced into arbitration proceedings is not seriously compounded by the additional availability of attachment procedures.[35] The fact that the arbitration rules of UNCITRAL (Art 26(3)) and those of the International Chamber of Commerce (ICC) (Art 8(5)) expressly permit the parties to apply to the courts for interim or conservatory measures is compelling evidence that such measures are not deemed incompatible with international arbitration.

Despite the criticism of the *McCreary* and *Cooper* doctrine,[36] the availability of court-ordered pre-award protective measures, and particularly attachment, in the United States remains uncertain.[37] This uncertainty is due largely to the disparate approaches adopted by federal and state courts, and to the presence of significant differences between the decisions of different federal circuit courts.

The availability of specific interim measures in the United States

In the United States, international arbitrations are governed by federal law.[38] The Federal Arbitration Act does not expressly authorise provisional remedies in aid

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33 Van den Berg (1989), p 15.
34 Becker (1985), p 40.
35 Becker (1985), p 40.
36 Van den Berg (1989), pp 15–17.
37 Kreindler (1998), p 211.
38 See the United States Federal Arbitration Act 1925 (hereafter the Federal Arbitration Act). See also Meier (1987), p 41.

of non-maritime arbitrations.[39] However, in certain circumstances, United States courts are prepared to provide interim remedies in support of international arbitral proceedings. These remedies fall into two basic categories: (a) injunctions and similar equitable remedies which are intended to maintain the status quo until the dispute can be finally resolved; and (b) attachment and other remedies provided by state law involving the seizure of property to ensure that assets are available to satisfy any ultimate judgment.[40]

Injunctions

Federal courts

All federal district courts may order preliminary injunctions.[41] However, the requirements for a preliminary injunction to be ordered vary according to the federal circuit.[42] The majority of the federal court circuits have adopted the approach that a preliminary injunction may be granted in an international arbitration where the plaintiff satisfies the circuit's normal preliminary injunction test.[43] This standard has been applied in the First,[44] Second,[45]

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39 Federal Arbitration Act, s 8 provides that if the basis of jurisdiction is a claim, 'otherwise justiciable in admiralty,' the claimant may begin his proceeding…by libel and seizure of the vessel or other property …and the court shall then have jurisdiction to direct the parties to direct the parties to proceed with the arbitration…'.

40 Anderson (1994), p 743; Newman and Nelson (1986), p 101.

41 Fed R Civ, p 65.

42 See, eg, *Friends for All Children, Inc, v Lockheed Aircraft Corp* 746 F 2d 70 at 72 (2d Cir 1979) (the plaintiff must show that, on balance, the consideration of four factors—plaintiff's potential irreparable injury, plaintiff's likelihood of success on the merits, the balance of hardship between the plaintiff and the defendant, and the public interest—favours granting an injunction); *Long Island RR Co v International Assn Of Machinists* 874 F 2d 901 at 910 (2d Cir 1989), cert denied, US; 107 LEd 831; 110 S Ct 836 (1990) (the plaintiff must show (a) irreparable harm and (b) either (1) likelihood of success on the merits or (2) sufficiently serious questions going to the merits to make them a fair ground for litigation and a balance of the hardships tipping decidedly in towards the party requesting the preliminary relief). In making the determination of irreparable harm, both harm to the parties and to the public may be considered; *United States v Jefferson County* 720 F 2d 1511 at 1519 (11th Cir 1983) (the plaintiff must demonstrate (1) a substantial likelihood of success on the merits (2) that he will suffer irreparable harm unless the injunction issues (3) that the threatened injury outweighs whatever damage the injunction will cause the other party and (4) that the injunction will not be contrary to the public interest). See Anderson (1994), p 749.

43 In general, a preliminary injunction may be obtained from a Federal Court where: (1) plaintiff will stiffer immediate and irreparable harm; (2) plaintiff is likely to prevail at trial; (3) the balance of hardships is in plaintiff's favour; and (4) the public interest will be served by the grant of the requested injunction. See, eg, *Washington Metro Area Transit Comm'n v Holiday Tours, Inc* 559 F 2d 841 (DC Cir 1977); *Friends for All Children, Inc v Lockheed Aircraft Corp* 746 F 2d 70 at 72 (2d Cir 1979); *Long Island RR Co v International Assn of Machinists* 874 F 2d 901 at 910 (2d Cir 1989), cert denied, US; 107 LEd 831; 110 S Ct 836(1990); *United States v Jefferson County* 720 F 2d 1511 at 1519 (11th Cir 1983); *Sauer-Getribe KG v White Hydraulics, Inc* 715 F 2d 348 at 351–52 (7th Cir 1983).

44 *Teradyne, Inc v Mostek Corp* 797 F 2d 43 at 51 (1st Cir 1986).

45 *Roso-U.no Beverage Distrib, Inc v Coca-Cola Bottling Co of New York* 749 F 2d 124 at 125 (2d Cir 1984).

Third,[46] Seventh,[47] Eighth[48] and Ninth[49] Circuit Courts of Appeals. The most restrictive basis for a grant of provisional remedies pending an arbitration is that the parties must have expressly contracted to maintain the status quo during arbitration. This has been applied in the Fifth[50] and the Tenth[51] Circuits. By contrast, the Fourth Circuit has held that provisional remedies are appropriate if they are necessary to preserve the status quo,[52] whether or not the parties have expressly provided for such a remedy. This is to ensure that the arbitration is not a hollow formality.[53] While there are no cases holding that injunctions are not available in cases falling under the New York Convention, there has been some academic discussion regarding whether the reasoning in *McCreary Tire & Rubber Co v CEAT SpA* and *Cooper v Ateliers de la Motobécane,* SA, that judicial proceedings are inimical to the purposes of the Convention, could apply to all provisional remedies.[54]

State courts

State courts follow state law in determining whether to grant preliminary injunctions, even in cases falling under the New York Convention, in which federal law otherwise applies.[55] For example, the New York state courts have ruled that the fact that a dispute is subject to an arbitration agreement does not deprive the court of authority to grant preliminary injunctions in aid of arbitration. One New York court has ruled that the power of a court to enforce the arbitration agreement 'includes the power to see that the arbitration is not rendered a nullity.'[56] Similarly, while recognising that pre-award attachments may not be available under the New York Convention, the New York District Court in *Rogers, Burgun, Shahine & Deschler, Inc v Dongson Construction Co* ordered a preliminary injunction despite the fact that the case fell within the scope of the New York Convention.[57] Consequently, whether a pre-award injunction is available from a United States state court in support of international arbitration proceedings will always turn upon the current status of the law of arbitration in that particular jurisdiction.

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46 *Ortho Pharmaceutical Corp v Amgen, Inc* 882 F 2d 806 at 811–13 (3d Cir 1989).
47 *Sauer-Getribe KG v White Hydraulics, Inc* 715 F 2d 348 at 351–52 (7th Cir 1983).
48 *Ferry-Morse Seed Co v Food Corn, Inc* 729 F 2d 589 at 592 (8th Cir 1984).
49 *PMS Distributing Co v Huber & Suhner, AG* 854 F 2d 355 at 356–58 (9th Cir 1988).
50 *RGI, Inc v Tucker & Assoc, Inc* 858 F 2d 227 at 230 (5th Cir 1988).
51 *Merrill Lynch, Pierce, Fenner & Smith, Inc v Dutton* 844 F 2d 726 at 728 (10th Cir 1988).
52 *Merrill Lynch, Pierce, Fenner & Smith, Inc v Bradley* 756 F 2d 1048 at 1053–54 (4th Cir 1985).
53 *Merrill Lynch, Pierce, Fenner & Smith, Inc v Bradley* 756 F 2d 1048 at 1053–54 (4th Cir 1985).
54 Newman and Nelson (1986), p 102.
55 Newman and Nelson (1986), p 103.
56 *J Brooks Securities, Inc v Vanderbilt Securities, Inc,* 484 NYS 2d 472 at 474 (Sup Ct NY Co 1985). See also *Shay v 746 Broadway Corp* 409 NYS 2d 69 (Sup Ct NY Co 1978).
57 598 F Supp 754 (SDNY 1984). See Meier (1987), p 46.

Attachment

Federal courts

Under United States law, a federal court may only make an order for attachment where that remedy is provided for in the law of the state in which the court sits.[58] Although the principles upon which relief will be granted are broadly similar, the precise requirements for an order for attachment vary significantly from state to state, and remedy to remedy.[59]

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58 Fed R Civ, p 64. states: 'At the commencement of and during the course of an action, all remedies providing for seizures of person or property for the purposes of securing satisfaction of the judgement ultimately to be entered in the action are available in the circumstances and in the manner provided by the law of the state in which the district court is held, existing at the time the remedy is sought, subject to the following qualifications: (1) any existing statute of the United States governs the extent to which it is applicable; (2) the action in which any of the foregoing remedies is used shall be commenced and prosecuted or, if removed from a state court, shall be prosecuted after removal, pursuant to these rules. The remedies thus available include arrest, attachment, garnishment, replevin, sequestration and other corresponding or equivalent remedies, however designated and regardless of whether by state procedure the remedy is ancillary to the action or must be obtained by an independent action.'

59 New York's Civ Prac L & R, s 6201 allows an order of attachment where: (1) the defendant is a non-domiciliary residing ouside the state, or is a foreign corporation not qualified to do business in the state (this includes corporations registered in other states of the United States); or (2) the defendant resides or is domiciled in the state and cannot be personally served despite diligent efforts to do so; or (3) the defendant, with intent to defraud his creditors or frustrate the enforcement of a judgement that might be rendered in the plaintiff's favour, has assigned, disposed of, encumbered or secreted property, or removed it from the state or is about to do any of these acts: or (4) the cause of action is based on a judgment, decree or order of a court of the United States or of any other court which is entitled to full faith and credit in this state, or on a judgment which qualifies for recognition under the provisions of article 53. The attachment or injunction will be awarded to ensure that the arbitration award will not be rendered ineffectual by sinister manoeuvres on the part of the respondent. See NY Civ Prac Law 57205, 1985 Supplementary Practice Commentary (McKinney 1986 Supp). The plaintiff must also usually show that they have a likelihood of success on the merits of the claim. (NY Civ Prac Law 56201 (McKinney 1980).) See Meier (1987), p 46.

In Georgia, attachments may issue when the debtor: (1) Resides outside of the state; (2) Moves or is about to move his domicile outside the limits of the county; (3) Absconds; (4) Conceals himself; (5) Resists legal arrest: or (6) Is causing his property to be removed beyond the limits of the state (Ga Code section 18–3–1).

Illinois law provides several additional grounds for attachment. Section 4–101 provides: 'In any court having competent jurisdiction, a creditor having a money claim, whether liquidated or unliquidated, and whether sounding in contract or in tort, may have an attachment against the property of his or her debtor, or that of one or more of several debtors, either at the time of commencement of the action or thereafter, when the claim exceeds $20, in any one of the following cases: (1) Where the debtor is not a resident of this State; (2) When the debtor conceals himself or herself or stands in defiance of an officer, so that process cannot be served upon him or her; (3) Where the debtor has departed from this State with the intention of having his or her effects removed from this State; (4) Where the debtor is about to depart from this State with the intention of having his or her effects removed from this State; (5) Where the debtor is about to remove his or her property from this State to the injury of such creditor; (6) Where the debtor has, within two years preceding the filing of the affidavit, fraudulently conveyed or assigned his or her effects, or a part thereof, so as to hinder or delay his or her creditors; (7) Where the debtor has, within two years prior to the filing of such affidavit, fraudulently concealed or disposed of his or her property so as to hinder or delay his or her creditors; (8) Where the debtor is about to conceal, assign, or otherwise dispose of his or her property or effects so as to hinder or delay his or her creditors; (9) Where the debt sued for was fraudulently contracted on the part of the debtor. The statements of the debtor, his or her agent or attorney, which constitute the fraud, shall have been reduced to writing, and his or her signature attached thereto, by himself or herself, agent or attorney.'

The weight of federal authority now appears to support the granting of provisional remedies in aid of an arbitrable dispute. However, it must be noted that the following authorities relate to domestic arbitrations, and do not fall within the scope of the New York Convention. The First,[60] Second,[61] Third,[62] Fourth,[63] Fifth,[64] Seventh,[65] Ninth[66] and Tenth[67] Circuit Courts of Appeal have permitted the granting of provisional remedies notwithstanding the fact that an arbitration agreement existed between the parties. The Eighth Circuit issued conflicting opinions in 1984; one panel upheld a provisional remedy,[68] while another reversed an injunction[69] because it found it to be inconsistent with the purposes of the Federal Arbitration Act. The Eighth Circuit is yet to reconcile these conflicting judgments.

State courts

United States state courts are also divided on the issue of the availability of court-ordered interim measures in support of arbitration. Two states have adopted provisions that expressly address the question of the use of courtordered provisional remedies in support of international commercial arbitration.[70] However, the weight of state authority is against providing interim relief where a dispute is subject to an arbitration agreement.[71] This continuing uncertainty is one of the reasons offered by the American Bar Association Committee on State International Arbitration Statutes in support of

60 *Teradyne, Inc v Mostek Corp* 797 F 2d 43 at 51 (1st Cir 1986).
61 *Guinness-Harp Corp v Jos Schiltz Brewing* Co 613 F 2d 468 at 472–73 (2d Cir 1980); *Roso-Lino Beverage Distrib, Inc v Coca-Cola Bottling Co of New York* 749 F 2d 124 at 125 (2d Cir 1984).
62 *Ortho Pharmaceutical Corp v Amgen, Inc* 882 F 2d 806 at 811–13 (3d Cir 1989).
63 *Merrill Lynch, Pierce, Fenner & Smith, Inc v Bradley* 756 F 2d 1048 at 1053–54 (4th Cir 1985).
64 *RGI, Inc v Tucker & Assoc, Inc* 858 F 2d 227 at 230 (5th Cir 1988).
65 *Sauer-Getribe KG v White Hydraulics, Inc* 715 F 2d 348 at 351–52 (7th Cir 1983).
66 *PMS Distributing Co v Huber & Suhner, AG* 854 F 2d 355 at 356–58 (9th Cir 1988).
67 *Merrill Lynch, Pierce, Fenner & Smith, Inc v Dutton* 844 F 2d 726 at 728 (10th Cir 1988).
68 *Ferry-Morse Seed Co v Food Corn, Inc* 729 F 2d 589, at 592 (8th Cir 1984).
69 *Merrill Lynch, Pierce, Fenner & Smith, Inc v Hovey* 726 F 2d 1286 at 1292 (8th Cir 1984).
70 See Cal Code Civ Proc, ss 1297.91–95; Florida International Arbitration Act 1986, ss 684.16, 684.23.
71 *Drexel Burnham Lambert Inc. v Ruesbsamen,* 139 AD 2d 323, at 531 NYS 2d 547 at 550–52 (1 st Dept. 1988) (provisional remedies are inconsistent with the New York Convention); *Cooper v Ateliers de la Motobecane SA* 57 NY 2d 408, at 415–16, 456 NYS 2d 728, at 731–32, 442 NE2d 1239 (1982); *Merrill Lynch, Pierce, Fenner & Smith, Inc v McCollum* 666 SW 2d 604 at 608–09 (Tex. App, 14th Dist, 1984) (Federal Arbitration Act requires the Court to refer parties to arbitration and prohibits provisional remedies by the Court), cert denied 467 US 1127 (1985); *Job Industries, Inc v Silex SpA* 601 F Supp 971 (SDNY 1985) (the court cited *Cooper* as authority for the proposition that '[g]enerally, with the exception of maritime cases, provisional remedies such as attachments or compulsory bonds are not available in arbitration.'). Contrast *Hull Municipal Lighting Plant v Massachusetts Municipal Wholesales Elec Co* 399 Mass. 640, 560 NE 2d 140 (1987) (an injunction does not interfere with arbitration); *Loeb and Loeb v Beverly Glen Music, Inc* 166 Cal App 3d 1110 at 1117–18; 212 Ca Rptr 830 at 834–35 (2d Dist 1985) (an attachment ordered by court does not interfere with arbitration); *Lease Plan Fleet Corp v Johnson Transp, Inc* 76 Misc 2d 822; 324 NY S. d 928 (1971) (an arbitration clause does not preclude replevin); *Schwartz v Leibel* 249 Cal App 2d 761; 57 Cal Rptr 831 at 833 (2d Dist 1967) (seeking provisional remedy from court is not inconsistent with an arbitration agreement).

the adoption of the UNCITRAL Model Law.[72] It has also stirred two United States Supreme Court judges to argue strongly that the Supreme Court should grant *certiorari* to a representative case to facilitate the resolution of this issue.[73] To date, however, neither the United States federal legislature, nor the United States Supreme Court, have taken the necessary steps to settle the question of the availability of court-granted interim measures in aid of international arbitration.

Conclusions: pre-award interim and conservatory measures in the United States

The controversy over the availability of pre-award protective measures in aid of international arbitrations in the United States remains unresolved. The disparate decisions of the United States federal and state courts, and the different approaches adopted by different circuits of the federal courts, have compounded the ambiguity in this area of the law. While there have been calls for a Supreme Court decision that will put an end to the present uncertainty,[74] such intervention is dependant upon the existence of a suitable case. As a more expedient solution, Meier proposes that the Federal Arbitration Act be amended to reverse the rule in *McCreary* and *Cooper,* and to ensure the availability of interim and conservatory measures from United States courts in aid of arbitration in both domestic cases and in cases falling under the New York Convention.[75]

Arbitration in France

Historically, France has been intricately involved in the promotion of dispute resolution through arbitration.[76] The home of a large number of arbitration institutions,[77] France is described as a hospitable jurisdiction for arbitration.[78]

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72 ABA Committee on State International Arbitration Statutes Report, March 30, 1990.

73 *Merrill Lynch, Pierce, Fenner & Smith, Inc v McCollum* 469 US 1127 (1985). The majority of justices disagreed and the issue remains unsolved.

74 Van den Berg (1989), pp 15–17.

75 'Such an amendment would remove that perceived compulsion by providing that "nothing in the Convention…shall affect the power of a district court of the United States or of a State court to grant the provisional remedies of attachment, preliminary injunction, or other provisional remedies, however designated, under the circumstances and in the manner provided by law'": Meier: (1987), p 43.

76 See Buchman (1994), p 254.

77 The International Court of Arbitration of the International Chamber of Commerce; The Chambre Arbitrale de Paris, sponsored by the Paris Chamber of Commerce—deals predominantly with commodities arbitration; The Association Française d'Arbitrage, sponsored by the Paris Bar; The Chambre Arbitrale des Cafés et Poivres du Havre and thé Chambre Arbitrale de l'Association Française du Commerce des Cacaos, respectively sponsored by the French Coffee and Cocoa Trade Associations; The Chambre Arbitrale Maritime de Paris (Chamber of Maritime Arbitration of Paris)—dealing with maritime arbitration; The Association Cinétographique Professionelle de Conciliation et d'Arbitrage (ACPCA)—dealing with motion picture arbitration; The Comité d'Arbitrage des Travaux Publics—dealing with construction arbitration; The Chambre Arbitrale Interprofessionelle, sponsored by the employers union (CNPF); The Association pour le Règlement des Conflits par l'Arbitrage et la Mediation (ARCAM); The Centre d'Arbitrage pour les Enterprises.

78 Buchman (1994), p 254.

Arbitral awards in France immediately acquire the force of *res judicata*.[79] With respect to interim or conservatory measures, France adopts a three-tiered strategy. The New Civil Procedure Code (hereafter NCPC) provides for court assistance in ensuring the viability of an arbitral tribunal in the initial stages of the proceeding.[80] State courts are also empowered to grant interim measures in order to guarantee that the final arbitral award can be enforced.[81] Furthermore, a party can apply to the court for the validation of interim orders given by the arbitral tribunal.[82] This combination of mechanisms has been described as an example of a proper connection between arbitration proceedings and state jurisdiction.[83] Although France has not adopted the UNCITRAL Model Law,[84] its legislative framework provides strong support for arbitration as a means of international dispute resolution.

The availability of pre-award conservative measures from French courts in aid of international arbitration

In France, parties to disputes covered by an arbitration agreement may have recourse to state courts for provisional measures in aid of arbitration on the condition that such remedies do not prejudice the outcome of the arbitration on the merits.[85] The key provisions are contained in the NCPC.

> Article 1458 of the NCPC states:
>
> When a dispute, pending before an arbitration tribunal further to an arbitration agreement, is brought before a public court, the latter must declare itself without jurisdiction.
>
> If the matter has not yet been brought before the arbitration tribunal, the court must also declare itself without jurisdiction unless the arbitration agreement is plainly void.

Article 1458 of the NCPC has been interpreted as prohibiting a court from ruling on the merits of a dispute that is *prima facie* governed by an arbitration agreement.[86] Consequently, Art 1458 of the NCPC operates without prejudice to Arts 808, 809, 872 and 873 of the NCPC, which provide for pre-award court-ordered conservatory measures in aid of arbitration.[87]

Under the NCPC, obtaining interim or conservatory measures in an arbitrable dispute involves a two-step procedure. Initially, pursuant to Arts 808

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79 New Civil Procedure Code (NCPC), Art 1476.
80 Robert and Carbonneau (1983), para 2.05. See in particular Articles 1444, 1454, 1456, 1457 and 1463 of the NCPC, which provide, for example, for court intervention to assist in the appointment or replacement of arbitrators, or the imposition or extension of a deadline for the rendering of an award.
81 Parodi (1991), p 489.
82 NCPC, Art 489.
83 Parodi (1991), p 489.
84 Buchman (1994), pp 255–56.
85 See Buchman (1994), p 258.
86 The *Eurodif* decision of the Cour de Cassation (20 March 1989). See Kreindler (1998), p 211.
87 See Buchman (1994), p 258. See also Buhart in Shenton and Kuhn (1987), p 164.

and 872 NCPC, the party seeking an interim measure must demonstrate that an emergency situation exists, and that the relief sought is not seriously objectionable.[88] The respondent bears the onus of showing that a serious objection to the claim exists.[89] If the presence of a serious objection is established, the claimant must then satisfy the two-fold test contained in Arts 809 and 873 of the NCPC. First, the claimant must establish that the damage is imminent, or that a manifestly unlawful behaviour or activity is taking place. Secondly, the relief must be necessary to prevent the occurrence of the imminent damage or to stop the manifestly unlawful behaviour or activity.[90]

If these requirements are satisfied, the claimant may obtain provisional remedies from a state court.[91] The competent judicial authority is usually the President of the Tribunal de Grande Instance, or the President of the Commercial Court if the dispute is of a commercial nature. In an international arbitration involving foreign parties, the competent court is usually the court in the jurisdiction where the interim measure is to be ordered.[92] Only one member of the court hears the action and he or she rules in a special capacity (as *juge des référés*) reserved for the consideration of urgent matters.[93]

The scope of the jurisdiction of the President sitting en référé

The powers of the President sitting *en référé* are limited only when, after the arbitral tribunal has been constituted, the relief sought may impinge upon the merits of the case.[94] It has been ruled that, once the arbitral tribunal has been formally constituted, the *juge des référés* loses his/her jurisdiction to grant an injunction to pay even the undisputed part of any monies claimed.[95] However, the French courts have broadly defined the phase of the arbitral tribunal's constitution.[96] Accordingly, an arbitration tribunal has not been constituted

88 Buchman (1994), p 262.
89 Cour de Cassation, 1st Civil Chambers, of 4 November 1987' Bulletin Civil I at 204. Buchman (1994), p 263.
90 Buchman (1994), p 263.
91 Cassation, 21 June 1904, Dalloz 1906 at 395; July 3, 1951 Dalloz 1951 at 701. Where a case of urgency is duly established, existence of an arbitration clause may not prevent a judge *en référé* from exercising his powers of jurisdiction,' (Cassation, 7 June 1979 [1980] Rev Arb 78); Cassation, 3rd Civil Chambers, 7 June 1979 and 9 July 1979 [1980] Rev Art 78 and 1st Civil Chambers, 20 March 1989, Bulletin Civil I at 84.
92 Cassation, 9 December 1976, Dalloz, IR at 139. See Buhart in Shenton and Kuhn, (1987), p 163.
93 The right of a party to an arbitration to have recourse to the *juge des référés* for an action within his jurisdiction has never been challenged. See Cassation (Com) Judgment of March 24, 1954 [1955] Rev Arb 95; Cassation (Com) Judgment of 14 November 1959, 1 GAZ PAL 191 (1960); Cassation (Civ), Judgment of 9 June 1979, [1980] Rev Arb 78 (Courteault, *Note*). See also Robert and Carbonneau (1983), para 2.05. See also Parodi (1991), p 489.
94 Buchman gives as an example the situation where the claimant seeks an order of partial payment of the monies principally claimed in the dispute. See Buchman, (1994), p 262.
95 Cassation, 2nd Civil Chambers of 18 June 1986 [1986] Rev Arb 565.
96 Schlosser (1992), p 198.

until the last arbitrator has formally accepted his appointment.[97] The mere fact that an arbitrator has informally agreed to participate in the first oral hearing does not satisfy this criterion.[98]

Once the tests of emergency situation and no serious objection are satisfied, and the necessity of the relief to prevent the imminent damage is established, the court's broad jurisdiction to order provisional measures in regular court cases is extended to international arbitration proceedings.[99] If the assets forming the subject matter of the dispute are located in France, the *juge des référés* has jurisdiction over the proceeding when a French national, or a person domiciled in France pursuant to the Brussels Convention of 1968, is either the plaintiff or the defendant. French courts do not generally have jurisdiction over a dispute involving only non-nationals. However, if the assets are located in France a *juge des référés* has jurisdiction to order interim remedies even where both parties are non-nationals, the law governing the contract is not French law and the seat of arbitration is outside of France.[100] This principle was enunciated by the Cour de Cassation as early as 1868:

> While French courts are incompetent with respect to the subject matter of disputes arising between foreigners, on account of the fact that the latter assert or deny the existence of claims, French courts are competent to authorize and maintain, in the interest of foreigners and all other parties, such measures as may be considered purely conservatory and which do not affect or prejudice the merits and by reserving the merits, aim to prevent goods and monies from being misappropriated to the detriment of rightful claimants properly recognized as such by the laws and constitutions which govern them…that such measures taken within this limit and in the general interest of public peace and justice are part of people's rights and are applicable regardless of nationality.[101]

The *juge des référés* is also competent when the two parties are not French nationals, but the interim remedies involve real estate located in France[102] or a plane that has landed in French territory.[103] In 1983, Evergreen (a US company) successfully seized, under Art R 123–9 of the Civil Aviation Code, an Air Algeria plane at Orly airport for overdue payment by the latter of a sum of US$329,644.[104] It must be noted, however, that French courts are never competent to order interim measures concerning real estate located abroad.[105]

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97 Cour d'Appel de Paris, 14th Chambers B, 1 July 1988 [1989] Rev Arb 113. See Buchman (1994), p 259.
98 Cour de Premier Instance de Paris [1987] Rev Arb 373 375. See also Schlosser (1992), p 198.
99 Buhart (1987), p 163.
100 Parodi (1991), p 489.
101 Cour d'Appel de Paris, 8 October 1964, Journal du Droit International 1965 at 901.
102 Cassation, 22 March 1965.
103 Tribunal Instance d'Ivry sur Seine, 28 March 1983 and April 1983.
104 Tribunal Instance d'Ivry sur Seine, 28 March 1983 and April 1983.
105 Cassation, 28 March 1962, Bulletin Civil 1962, IV at 247, Revue critique de droit international privé, 1963, p 844. This is the case even where a French national is involved.

Similarly, requests for attachments or interim measures to be ordered abroad fall outside the jurisdiction of French courts.[106]

The types of interim measures available in France

Under French law, the available interim measures include: (a) attachments *(saisies-conservatoires);* (b) interlocutory payments; (c) judicially-granted guarantees *(sûretés judiciaires)* such as provisional judicial mortgages *(hypothèques judiciaires provisoires)* or judicial pledges *(nantissements judiciaires);* and (d) injunctions and temporary restraining orders *(ordonnances de référé).*[107] These provisional remedies are cumulative, and are available to both French and non-French petitioners.[108]

Attachment

The conservatory attachment is an *ex parte* proceeding (an '*ordonnance sur requête'*) that may be founded on a monetary claim against a debtor. An attachment results in the assets which are subject to the attachment order, whether they consist of chattels in the actual possession of the debtor, intangible property of the debtor detained by third parties, or cash in the bank, becoming untransferable by the debtor, subject to the effect of any intervening bankruptcy of the debtor. If these assets are held by a third party and not by the debtor, the third party becomes personally liable to the creditor if any attached monies or chattels are removed or are remitted to the debtor.[109] An attachment may be applied for in respect of foreign arbitral proceedings whether the proceedings have been concluded by the rendering of an award or are still pending.[110]

An attachment order may be defeated in two ways. First, the debtor may request the *juge des référés* to withdraw the ordinance. Such a withdrawal may be ordered where the requirement of urgency is not satisfied. Secondly, the debtor can file an appeal within a period of 15 days.[111] The debtor may also ask the juge sitting *en référé* for the withdrawal *(mainlevée),* or for the reduction *(cautionnement)* of the attachment by offering to deposit sufficient funds to guarantee the cause of the attachment with an escrow agent.[112]

106 Cassation, 12 May 1931, Journal du Droit International, 1932 at 387; 27 May 1970, Bulletin Civil I, No 176.
107 Buchman (1994), p 256.
108 See Buchman (1994), p 256.
109 Buchman (1994), p 261.
110 Buchman (1994), p 260.
111 NCPC, Art 50, para 1.
112 Buhart in Shenton and Kuhn (1987), p 174.

Interlocutory payment

Pursuant to Art 67 of the Law of July 9, 1991, the interlocutory payment of a debt will be granted where the President sitting *en référé* is satisfied that the petitioner has a *prima facie* serious claim against the debtor, and that some circumstances are threatening the recovery of the claim.[113] It has been argued that a ruling on the seriousness of the claim requires an examination of the merits of the dispute, and is therefore beyond the jurisdiction of the *juge des référés*.[114] However, the Cour de Cassation has ruled that the existence of an arbitration agreement does not affect the competence of the judge sitting *en référé* to grant an interim payment to a claimant where the defendant's obligation is not seriously in dispute.[115] Consequently, although the President sitting *en référé* will be reluctant to make an order which results in the satisfaction of the principal amount of the claim, the judge has a discretion to order that the amount which is not seriously objectionable be paid forthright.[116] It should be noted that a request for interlocutory payment is not admissible once the arbitration proceeding is in progress.[117]

A claimant seeking an order for interlocutory payment must first establish the existence of a debt within the meaning of Art 67 of the Law of July 9, 1991. This provision is still largely untested. However, the language 'any creditor justifying that his claim seems in its principle to be well grounded' which was used in Art 48 of the Code of Civil Procedure (hereafter CCP), the predecessor to Art 67 of the Law of July 9, 1991,[118] is again present in the new article. Buchman therefore suggests that the prior case law, which adopts a relatively liberal test when deciding to grant an interlocutory payment, is relevant to the interpretation of the new provision.[119] Under Art 48 of the CCP, the definition of a debt was very wide and could consist of a contractual debt or simply damages in tort. It was not necessary that the debt be liquidated, nor that the amount be due. Finally, the debt could be conditional or even eventual. 120

The second requirement for an order for interlocutory payment is that there are circumstances threatening the recovery of the debt; that there is some urgency. Although the condition of urgency is not always necessary in domestic arbitrations, commentators generally agree that such a condition is required in

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113 Buchman (1994), p 261.
114 3 July 1979, JCP 1980 11 19389.
115 Cassation, 9 July 1979 [1980] Rev Arb 78.
116 Cassation. Commercial Chambers, of 20 January 1981, Bulletin Civil IV at 30; and in Gazette du Palais 1981. 1. 332.
117 Cassation, in its judgment of 14 March 1984 [1985] Rev Arb 69.
118 Article 48 of the Code of Civil Procedure (no longer in force since it was cancelled by the Law of July 9, 1991).
119 Buchman (1994), p 261.
120 Cour d'Appel de Dijon, 21 December 1959, JCP 1960 11 11670. In case of a *'saisie-arrêt'* the debt must be certain. But for a *'saisie conservatoire'* the only requirement is that the debt is *prima facie* founded in law. See Buhart in Shenton and Kuhn (1987), p 173.

the field of international arbitration.[121] Under the predecessor to Art 67 of the Law of July 9, 1991,[122] the existence of threatening circumstances was a matter for the discretion of the judge.[123] However, the test was satisfied where the debtor was likely to become bankrupt,[124] or where the prospects of future recovery of the claim were diminished by the amount of the claim and the debtor's financial position.[125] Again, Buchman suggests that this approach is likely to be applied under the more recent provision.[126]

Finally, pursuant to Art 489 NCPC, the President sitting *en référé* has a discretion to make the enforcement of his order for interlocutory payment subject to the posting by the claimant of a security.[127]

Judicially-granted guarantees

This measure is available in any claim against the debtor that could form the basis of an attachment.[128] The result of the relief, if granted, is that even though the assets which are the subject of the order remain transferable by the debtor, the underlying assets of the judicially-granted guarantee, whether they consist of shares owned by the debtor or the debtor's current business, may be levied by the claimant against any transferee. Again, this remedy is subject to any intervening bankruptcy of the debtor, which would transform the claimant into a privileged creditor if the guarantee has been properly registered. Such judicially-granted guaranties effectively prevent any transfer of the mortgaged or pledged asset without the amount of the registered mortgage or pledge being carved out of the proceeds of the transfer and placed in escrow.[129]

A provisional judicial mortgage or a judicial pledge may be sought in respect of pending or concluded international arbitral proceedings. Although it is not necessary for the petitioner to prove the existence of an emergency situation, a real and substantial threat over future collection of the debt must be established.[130]

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121 La coopération du président du Tribunal de Grande Instance à l'arbitrage [1985] Rev Arb 5.
122 Article 48 of the Code of Civil Procedure (no longer in force since it was cancelled by the Law of July 9,1991).
123 Cassation, 30 April 1982, Bulletin Civil IV at 132.
124 Cassation, 22 May 1979, Bulletin Civil IV at 171.
125 Cassation, 2nd Civil Chambers, 13 February 1980, in Bulletin Civil 11 at 24.
126 Buchman (1994), p 261.
127 Buchman (1994), p 266.
128 Buchman (1994), p 261.
129 Buchman (1994), p 262.
130 Buchman (1994), p 262.

Injunctions and temporary restraining orders

Any civil or commercial claim may form the basis of an application for an injunction or temporary restraining order.[131] These interim remedies operate predominantly as safeguards, designed to preserve the status quo until the arbitral award on the merits is rendered. Under this head, the President sitting *en référé* may order that sums of money or shares of companies be put in escrow, or that a surveyor, accountant or other expert be appointed to gather evidence which will be used in an action on the merits.[132] The Cour de Cassation has ruled that 'the existence of an arbitration clause will not prevent a judge sitting *en référé* from ordering, prior to the competent jurisdiction being seized of the matter, the legally permissible measures of instruction, if there exists a legitimate motive for preservation or for the establishment of evidence on which the outcome of the dispute might depend'.[133] Such measures can include expert reports or orders for the inspection of property.[134]

Injunctions and temporary restraining orders may be granted in international arbitrations, whether the proceedings have not yet started, are still pending, or have been concluded by the rendering of an award. Importantly, the mere fact of seeking an injunction or a temporary restraining order from a French court of summary jurisdiction before an arbitration is started is not considered a waiver by the claimant of its right to proceed with the arbitration. Nor does it deprive the arbitrators of their powers to render an award on the merits.[135]

Conclusions: pre-award interim and conservatory measures in France

In France, under the provisions of the NCPC, the President sitting *en référé* has jurisdiction to order a wide range of interim and conservatory measures in aid of international arbitrations. These powers, although extensive, are limited in two respects. The *juge des référés* may not issue interim measures once the arbitral tribunal has been officially convened. This restriction has little practical effect since it is during the period prior to the constitution of the tribunal that the parties are most likely to seek emergency measures.[136] Additionally, the *juge des référés* must not grant any measure, or make any ruling that may prejudice the merits of the dispute being arbitrated. These limitations aside, France's

131 Buchman (1994), p 262.
132 Buchman (1994), p 263.
133 Cassation, 20 December 1982, Bulletin Civil III at 195 No 260.
134 Buhart in Shenton and Kuhn (1987), p 170.
135 Cassation, Commercial Chambers, 3 July 1951, Dalloz, 1951 at 701: and Commercial Chambers, 4 November 1959, in Gazette du Palais 1930. 1. 191.
136 Kreindler (1998), p 211.

reputation as a jurisdiction conducive to effective international arbitration has been reinforced by the continued legislative support of judicial intervention in aid of international arbitration.

Conclusion

Hulbert acknowledges that a measure of parochialism remains in the development of the law on the availability of interim conservatory measures from national courts in aid of international arbitration.[137] This is particularly apparent in the United States, where there is some residual doubt as to the compatibility of court-ordered interim remedies with Art II of the New York Convention. The absence of any US federal statute authorising provisional remedies in aid of non-maritime international arbitration has perpetuated a line of judicial authority which is inconsistent with the practice of most signatories to the New York Convention that have had occasion to address the issue.[138] Van den Berg notes that the uncertainty surrounding the availability of pre-award preventative measures, and the different standards required in different courts, undermines the general 'pro-enforcement bias' of the courts in the United States. He argues that this uncertainty may deter parties from agreeing to international arbitration.[139] In contrast, the expedited procedure available through the French *juge des référés* has been described as 'the most innovative approach to the judicial support of arbitration'.[140] Under appropriate circumstances, this judicial intervention serves to encourage arbitration, particularly at the international level, by allowing the parties to take immediate measures necessary to ensure that the award will be enforceable once rendered.[141] These arguments suggest that strong legislative leadership is necessary to ensure a uniform and consistent approach to the availability of interim conservatory measures in international arbitration.[142] The codified civil law system, exemplified by the French *référé-provision,* is therefore better able to ensure that arbitration is an efficient and effective means of international dispute resolution.

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137 Hulbert (1993), p 103.
138 'The advisability and availability of provisional remedies in the arbitration process' (1984) 39 The Record 625 at 633.
139 Van den Berg (1989), pp 15–17.
140 Schlosser (1992), p 190.
141 Buhart in Shenton and Kuhn (1987), p 175.
142 In fact, the UNCITRAL Model Law was drafted specifically with a view to promoting uniformity in domestic law on international commercial arbitration.

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Cross-Border Transactions in Vietnam and the Vietnam-US Bilateral Trade Agreement

Quan Hien Nguyen[1]

Introduction

After decades as a closed, command economy, Vietnam has committed itself to market reform. On its way to full integration with the global market, Vietnam has signed a bilateral trade agreement with the United States of America. Under this agreement, Vietnam agrees to open its domestic markets for trade with, and investment from, the United States and other countries which have a Most Favoured Nation[2] relationship with Vietnam.

Although Vietnam is accelerating the process of liberalisation, it does not yet have in place the legal principles necessary to support a market economy. Some areas of commercial law in Vietnam still operate according to doctrines and principles native to the command economy. Moreover, many commercial rights, which are well established in traditional market economies, are alien to, or only partially recognised under, Vietnamese law. Nonetheless, after the implementation of the Vietnam-US Bilateral Trade Agreement (hereafter the Vietnam-US Trade Agreement or the Agreement), the volume of cross-border transactions involving Vietnam is expected to increase exponentially. Thus, there is even greater potential for conflict over the recognition of commercial rights in the Vietnamese legal system.

Opening the market

The process of liberalisation

On 3 October 2001, US Congress ratified the Vietnam-US Trade Agreement with an overwhelming majority and a 'surprising lack of controversy'.[3] After

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2 Most Favored Nation status is incorporated into bilateral investment agreements between Vietnam and Algeria, Argentina, Armenia, Australia, Austria, Belarus, Belgium, Bulgaria, China, Cuba, the Czech Republic, Denmark, Egypt, Finland, France, Germany, Hungary, India, Indonesia, Italy, Laos, Latvia, Lithuania, Luxembourg, Malaysia, Netherlands, Philippines, Poland, Romania, Russia, Singapore, South Korea, Sweden, Switzerland, Taiwan, Tajikistan, Thailand, Ukraine and Uzbekistan.

3 The US Senate approved the House Joint Resolution with a vote of 88 to 12.

four years of negotiation, this agreement not only completed 'the process of normalisation, reconciliation and healing between [the] two nations'[4] but also created optimism that the volume of bilateral trade between the two countries would sharply increase. The historic significance of this agreement does not diminish its economic significance: the Agreement will open the Vietnamese domestic market, the fourth largest market in the Asia-pacific region, to American products, as well as the US domestic market—the largest market in the world—to Vietnamese exports.

Historically, cross-border transactions were a rare occurrence in Vietnam. Before the 1992 Constitution was put in place, the state monopolised foreign trade and could therefore limit international transactions to barter arrangements with other socialist countries.[5] Even after the National Assembly promulgated the first law on foreign direct investment in Vietnam in 1987,[6] cross-border trading was still limited to a number of state-owned import-export companies,[7] which collected commissions from local enterprises in return for representation in international contracts. As a consequence of many years of economic isolationism, Vietnamese legislators paid little or no attention to the law of cross-border transactions in Vietnam.

The implementation of the 'Doi-Moi' (Reformation) policy as part of the 1992 Constitution provided the legal foundation for comprehensive economic reform in Vietnam.[8] Stimulated by Vietnam's commitment to an ASEAN Free Trade Area (AFTA),[9] 'Doi Moi' also began the process of legal reformation in Vietnam. It generated the Civil Code,[10] which provides the framework for private international law in Vietnam,[11] as well as the Commercial Law[12] and Decree 57/1998/ND-CP, which entitle all business organisations, including foreign invested enterprises, to import and export goods subject only to registration requirements.

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4 Remarks by President Bill Clinton on the announcement of the Vietnam-US Trade Agreement on 13 July 2000 at the Rose Garden.

5 The Constitution 1980, Art 21, provides that 'The State monopolizes foreign trade and all other economic relations with foreign states'.

6 Law on Foreign Investment in Vietnam.

7 The state controlled direct international transactions by licensing import-export activities. Most licensed importers and exporters were state-owned enterprises: Decree 114-HDBT dated 7 April 1992.

8 The phrase 'The State monopolies foreign trade and all other economic relationships with foreign countries' in Art 21 of the Constitution 1980 was replaced by 'The State administers and extends foreign trade activities, develops various ways of economic relationships with all nations and international organisations' in Art 24 of the Constitution 1992. However private commercial rights in foreign trade were not fully elaborated upon until the Commercial Law promulgated by the National Assembly on 10 May 1996, effective on 1 January 1997, and Decree No 57/1998/ND-CP promulgated by the Government on 1 January 1998 to give instruction on implementation of the Commercial Law.

9 Decree No 09/2000/ND-CP of government dated 21 March 2000.

10 Civil Code promulgated by the National Assembly on 28 November 1995, effective 1 July 1996 is the first civil code of Vietnam. See Ministry of Justice of the Socialist Republic of Vietnam, *Commentaries on Some Fundamental Issues of the Civil Code* (1997).

11 Ministry of Justice, *ibid,* 364–65.

12 Commercial Law promulgated by the National Assembly on 10 May 1997, effective 1 January 1998.

One of the most significant changes to result from the 'Doi Moi' was the revocation of the import-export licences, which had been a primary mechanism for protectionism in the Vietnamese economy.[13] After the promulgation of the Commercial Law in 1997, the Vietnamese state abandoned licensing of import-export activities, choosing instead to control trade volume by tariffs and quotas for certain categories of goods.[14] Since 1998, the Government has finalised regulations to cancel import-export licensing requirements for virtually all Vietnamese and foreign firms.[15] Most recently, the General Department of Customs issued Circular 07,[16] which further simplifies the registration of import/export activities. This document implements the recent policy that allows all merchants who have acquired a Customs Duty Code to conduct regular import/export activities. The provincial customs agency where the merchant's headquarters are located is authorised to issue a permanent Customs Duty Code to the merchant after receiving from him:

- a certified copy of the Certificate of Registration of Tax Code issued by the tax agencies of the Ministry of Finance;
- a certified copy of the Certificate of Registration of Business (if local merchants) or Investment License (if foreign-invested enterprises) issued by the Ministry of Planning and Investment; and
- a Declaration for the Customs Duty Code.

The Customs Duty Code then allows merchants to conduct import/export activities at any port throughout Vietnam.

Despite the significant changes wrought on the Vietnamese legal system in response to 'Doi Moi', even more radical adaptations will be required under the US-Vietnamese Trade Agreement. To this end, the Vietnamese government has begun a large-scale investigation into current laws and regulations promulgated by the central authorities. The six categories established by the investigation correspond with the six chapters of the Trade Agreement: (1) trade in goods; (2) intellectual property rights; (3) trade in services; (4) investment; (5) transparency; (6) dispute settlement.[17] The investigation has revealed that, amongst the 135 legal documents reviewed, 24 required revision, 29 replacement and six revocation. In addition, the investigation recommended that Vietnam ratify six international conventions.

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13 The Ministry still retains licences for certain categories of goods, although the general licencing requirement was repealed by Decree 89/CP dated 15 December 1995.

14 Under the Vietnam-US Trade Agreement, quotas for imports from the US will be eliminated over a period of three to seven years.

15 'With an eye on WTO, Vietnam to relax trade' (2001) Australian Financial Review, 14 February.

16 Circular No 07/2001/TT-TCHQ promulgated by the Department of Customs on 18 October 2001.

17 Memo from the Office of the Vietnamese Prime Minister, 'Re: preparatory tasks after the US and Vietnam Agreement', 21 November 2000.

In keeping with the previous changes, it would seem that further refinement of the rules of private international law in Vietnam will fall to the executive and not to the courts. The Ordinance on Promulgation of Legal Documents[18] provides both that precedent is not a source of law in Vietnam, and that Vietnamese courts are prohibited from engaging in interpretation of laws.[19] Accordingly, the Vietnamese courts depend almost entirely on administrative by-laws and statements of government policy to guide their decisions. For example, government decrees provide regulations on implementation of laws or ordinances,[20] whilst circulars issued by individual ministries, or jointly by ministries, guide courts as to how a particular ministry will administer laws, ordinances, or decrees.[21] Guidelines of the Prime Minister, although not legal instruments, are nonetheless policy outlines indicating that state agencies and provincial people's committees should be set up to deal with issues.[22] Without interpretive powers, courts are heavily reliant on these bylaws, especially in regards to areas where there is little or no jurisprudence, such as private international law.

Commercial rights

Although Vietnam no longer prohibits domestic Vietnamese entities from participating in import/export activities, the commercial rights of these entities are not well defined.[23] Despite numerous reforms, a legal framework synchronous with the development of a market economy has not yet been established.[24] Two recent cases illustrate how the overlap of old and new laws, as well as doctrines and habits of state management, stymie the recognition of private commercial rights in Vietnam's transitional legal system.[25]

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18 Ordinance on Promulgation of Legal Documents, promulgated by the National Assembly on 12 November 1996.

19 Ordinance on Promulgation of Legal Documents, Art 52 provides that the Standing Committee of the National Assembly will interpret unclear provisions in laws or ordinances. Entities that can request interpretation by the Standing Committee on unclear provisions include the President, the Standing Committee, sub-committees of the National Assembly, the Government, the Supreme Court, the Supreme Bureau of Prosecution, the Vietnam Fatherland Front and its sub-agencies and members of the National Assembly.

20 Ordinance on Promulgation of Legal Document, Art 15.

21 *Ibid,* Art 18.

22 *Ibid,* Art 15.

23 Le Dang Doanh, 'Economic reformation in Vietnam: legal and social aspects and impacts' (1996) 6 Australian Journal of Corporate Law 14 at 30.

24 *Ibid* at 16.

25 John Gillespie, Private commercial rights in Vietnam: a comparative analysis' (1994) 30 Stanford Journal of International Law 325 at 346.

Sadaco v Bao Minh Insurance Co[26]

The facts of the *Sadaco v Bao Minh Insurance Co* reflect the gradual process of liberalisation in Vietnam. In 1997, Bao Minh Insurance Co issued to Sadaco, a local company trading in agricultural products, a policy covering a $4 million CIF shipment of flour from Bombay, India to Ho Chi Minh city, Vietnam.[27] The policy included a choice of law clause which was in favour of English law. The ship sank during its journey. After fruitless negotiations, Sadaco sued. Bao Minh Insurance applied to set aside the proceedings, arguing that under English law the limitation period for litigation had expired. At first instance the Economic Court of Ho Chi Minh City, and later the Supreme Court on appeal, held that the choice of law clause was void. Although the legal reasons for this finding were not clearly discussed in the judgment, it would seem that the choice of law clause should have been ratified by the Ministry of Finance, of which Bao Minh Insurance was a subsidiary. The choice of law clause being void, Vietnamese law applied by default.

Sadaco v Bao Minh Insurance Company raises two difficult, but important, questions for Vietnam's transitional economy. First, it problematises the issue of party autonomy in cross-border transactions under Vietnamese civil law. Secondly, it questions the status of state-owned companies as legal individuals under Vietnamese law.

It is a common principle in international trade law that contractual parties to cross-border transactions may nominate the law to govern their contract. In Vietnam, this principle has gained increasing recognition during the reform period. The Civil Code[28] now provides that parties to a civil contract with 'foreign elements' may elect to be governed by foreign law if the foreign law is not inconsistent with Vietnamese law,[29] whilst the Commercial Law also recognises choice of foreign law in international sale of goods contracts. Nonetheless, party autonomy is a new and rather uncertain doctrine in Vietnamese law.[30] Lawmakers

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26 *'Nua phu ky hop dong, 5 nam doi tien bao hiem'* (half a minute to sign a contract, five-year litigation for insurance compensation), Thanh Nien Newspaper, 14 July 2001. Visited at http://vnexpress.net/Vietnam/Phap-luat.

27 Since 1993, the Vietnamese government has been experimenting with foreign investment in the domestic insurance market. Traditionally this market was a monopoly of the state-owned Bao Viet Insurance Company. However under Decree 100, foreign insurance companies may establish joint-ventures with Vietnamese insurance companies or wholly foreign-owned insurance companies in Vietnam: Decision No 16/2001/QD-TTg of the Prime Minister promulgated on 2 May 2001. As a result of this decree, the market has been growing at around 40% since 1994 and out of the 20 insurance companies operating in Vietnam, two-thirds are joint-ventures with foreign insurance companies or are wholly foreign-owned. The Vietnam-US Trade Agreement promises further liberalisations in favour of insurance companies from the US or other 'most-favored-nations'. Indeed, Annex G of the Trade Agreement provides that Vietnam will not limit cross-border supply of insurance services to enterprises with foreign invested capital, foreigners working in Vietnam; reinsurance services; insurance services in international transportation; insurance brokering and reinsurance brokering services; advisory, claim settlement and risk assessment services.

28 Civil Code, promulgated by the National Assembly on 28 October 1995, effective 1 July 1996.

29 *Ibid.* Art 827.

have conferred on the courts unpredictable discretion to revoke any application of foreign law, with the result that parties may never be completely assured that their choice of law will apply. Indeed, the most important discretionary ground, that of 'public policy', is subject to extremely broad interpretation by Vietnamese courts, due to Vietnam's many years as a central command economy.

The second issue raised by *Sadaco v Bao Minh Insurance Co* is the status of state-owned companies under Vietnamese law in respect of economic rights.[31] The long-standing debate surrounding this issue has its origins in the 1992 Constitution. Under Art 42 of the 1992 Constitution, 'all individuals are equal in law'. If companies are to be accorded the rights of individuals, as a matter of logic Art 42 would force the Vietnamese government to provide a level playing field for state-owned and private companies alike. Whilst this outcome would vindicate the drafters of the Enterprise Law, who wished to establish one enterprise law for all and thus increase competitiveness in the state sector,[32] it would also defeat the more conservative elements of the Vietnamese government[33] who have defended the operation of state-owned companies under the separate Law on State-owned Enterprises.[34]

Kexim Vietnam Co Ltd v Chi Dat Co Ltd[35]

Kexim Vietnam Co Ltd v Chi Dat Co Ltd also illustrates the tenuous embrace of commercial rights in transitional Vietnam. In 1997, Chi Dat Co and Phu Tho Tourism Co entered into a joint-venture agreement to operate a bowling centre. Chi Dat's share in this joint-venture was a $2 million bowling system leased from Kexim Vietnam Co, a wholly foreign-owned company in Ho Chi Minh City. The leasing contract between Chi Dat Co and Kexim Vietnam Co was signed in 1998 for a period of 36 months. The joint-venture was not a success. After several months, Chi Dat stopped paying the rent and Kexim Vietnam sued. At the first instance, the Economic Court in Ho Chi Minh City found that the Business Registration Certificate of Chi Dat Co, issued by the

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30 John Gillespie, *op cit,* fn 25, 346.

31 Nguyen Quan, *'Cai Nhin Moi Ve Phap Nhan Va Su Binh Dang Trong Kinh Doanh'* (a new point of view on enterprise and equality in business), *Thoi Bao Kinh Te Saigon (Saigon Economic Times)* (Ho Chi Minh City, Vietnam) 25 June 1998, 11.

32 Corporate laws in Vietnam distinguishes in matters of taxation, commercial rights and administration among three kinds of corporations. State-owned enterprises operate under the Law on state-owned Enterprises, promulgated by National Assembly on 20 April 1995; private enterprises operate under the Law on Enterprises, promulgated by 12 June 1999, effective 1 January 2000; and foreign invested enterprises operate under the Law on Foreign Investment, promulgated by the National Assembly on 12 November 1996.

33 Mr Le Dang Doanh, Director of the Institute of Economic Management Research, one of the chief drafters of the Law on Enterprises, explained that delay in achieving a single corporations law was due to economic and social conditions of Vietnam's transition. See Nguyen Quan, *op cit,* fn 31, 11.

34 Nguyen Quan, *op cit,* fn 31.

35 *Lao Dong Newspaper, 'Quyet dinh khang nghi gay xon xao gioi thue mua tai chinh'* (Supreme Court's revocation worries financial leasing companies), *Lao Dong Newspaper,* 26 October 2001, http://vnexpress.net/Vietnain/Phap-luat/2001/10/3B9B5BA9.

Ministry of Planning and Investment, did not include bowling as one of its registered business activities. However, the court found that the bowling centre set up by the joint-venture between Chi Dat and Phu Tho Tourism was operating under Phu Tho Tourism's Business Registration Certificate, which did include bowling business activities. The court ruled that as Chi Dat did not have the capacity to enter into a bowling business, the leasing contract between Chi Dat and Kexim Vietnam was void under the Ordinance on Economic Contracts.[36]

Kexim Vietnam appealed. Were that decision sustained, Kexim Vietnam would be forced to take back the bowling system with account for rent, although the bowling system had been in operation for several months.[37] The Court of Appeals reversed the finding of the judge at first instance. It ruled that the Ministry of Planning and Investment's approval of the joint-venture between Chi Dat and Phu Tho Tourism automatically extended Chi Dat's business registration to the bowling business. Accordingly, the leasing contract between Chi Dat and Kexim Vietnam was enforceable. However, in July 2001, the Supreme Court overturned the decision of the Court of Appeals on the ground that the Court of Appeals erred in application of laws.[38] The case is now pending in the Supreme Court awaiting the final decision of the judges' panel. Meanwhile, dissatisfaction and protests increase within the business community. It hoped that, in line with recent trends, these protests will influence the judges' panel in interpreting the old-fashioned laws in accordance with market principles. Yet, even if the judges' panel were to rule in favour of Kexim Vietnam, such a decision may prove a shallow victory. It will not override the Ordinance on Economic Contracts, which provides that economic contracts must be within the registered business activities of contractual parties to be enforceable.

Chi Dat Co v Kexim Vietnam Co thus represents the clash between the 'old' and 'new' thinking as to commercial capacity in reformation Vietnam. Under the principles of the command economy, which previously dominated Vietnam, commercial capacity was a privilege, not a right.[39] Accordingly, companies were only permitted to do what was not prohibited by the state. By contrast, the principles of the open market which are now gaining force in Vietnam, hold that

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36 Ordinance on Economic Contract, promulgated by the Standing Committee of the National Assembly on 25 September 1989.

37 Kexim Vietnam Company may start civil proceedings against Chi Dat Company to claim for damages for 'Liabilities out of contracts' in Chapter V of the Civil Code, which parallels tort in the common law system, albeit less fully developed.

38 Ordinance on Economic Procedure, promulgated by the Standing Committee of the National Assembly on 29 March 1994, effective 1 July 1994, Art 75(3).

39 In the past Vietnamese lawmakers and bureaucrats insisted that any activity, particularly any commercial activity, is unlawful unless expressly authorized by law. See John Gillespie, *op cit,* fn 25.

companies may engage in whatever is legitimate and profitable.[40] Indeed these new principles find support in the 1992 Constitution.[41]

Nonetheless, it seems unlikely that this debate will be resolved by reference to the 1992 Constitution through cases such as *Chi Dat Co v Kexim Vietnam Co.* The Vietnamese Supreme Court lacks the mandate to decide on constitutional rights of individuals. Moreover, the National Assembly,[42] the only authority with this power, has been hampered in its constitutional functions by its heavy schedule of law making.[43]

Chi Dat v Kexim Vietnam also raises two important issues regarding the capacity of Vietnamese companies to enter into cross-border transactions. First, *Chi Dat v Kexim Vietnam* indicates that cross-border transactions between a local company and a foreign partner may be unenforceable under the Ordinance on Economic Contracts, if the business activity is interpreted as being outside the registered business activity of the Vietnamese company.[44] This contrasts to the situation in most market economies where companies may enter into any transaction not prohibited by law.[45] Secondly, *Chi Dat v Kexim Vietnam* creates uncertainty as to whether Vietnamese courts will recognise foreign judicial decisions by enforcing cross-border contracts between local companies and foreign partners if the local company does not have contractual capacity under Vietnamese law.

The law of cross-border transactions

Many of the problems associated with cross-border transactions in Vietnam may be circumvented if the parties successfully nominate foreign law as the law of their agreement. This next section deals with the indigenous Vietnamese law on contract as well as the Vietnamese conflict of laws rules which may cause foreign law to be applied to a cross-border contract.

Classification of contracts

Any discussion of the Vietnamese contract law must start with Vietnam's system of contract classification. Under Vietnamese law, contracts will fall into

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40 See Le Dang Doanh, *op cit,* fn 23; John Gillespie, *op cit,* fn 25.

41 Article 21 of the 1992 Constitution provides that:
'In the private individual and private capitalist sectors people can adopt their own ways of production and trading; they can set up enterprises of unrestricted scope in fields of activities which are beneficial to the country and the people'.

42 The Constitution 1992, Art 84(2).

43 Recent reforms to the National Assembly's functions stress supervision of individual rights by members of the National Assembly. See John Gillespie, *op cit,* fn 25.

44 Ordinance on Economic Contract, Art 8(1)(b).

45 John Gillespie, *op cit,* fn 25.

one of three distinct categories of contract, each of which corresponds with a substantive contractual law. The system of classification results in different substantive provisions on formal validity, essential validity and the capacity to contract.

The first category of contract, the Civil Contract, is governed by the Vietnamese Civil Code. Civil Contracts are intended to satisfy living or consumption requirements of the contractual parties.[46] Parties to a Civil Contract may be:

- individuals with legal capacity to engage in civil acts;[47]
- legal entities established or permitted to be established as private companies by competent authorities which are legally permitted to own and be responsible for properties on which companies are established and able to file civil actions or be sued;
- households and co-operatives;[48] or
- foreign organisations and individuals.[49]

Generally, a Civil Contract will be formally valid where the contract is in writing, concluded verbally, or evidenced by performance of specific activities.[50] However, Vietnamese law requires that some types of civil contracts must be in writing, certified by Public Notary, and even registered.[51]

The second category of contract, the Economic Contract, is governed by the Ordinance on Economic Contract.[52] An Economic Contract is made for commercial purposes to execute production, for the exchange of goods and services, for research, for application of scientific and technical knowledge and for other commercial activities.[53] Economic Contracts must conform to higher standards of formal validity than Civil Contracts. They must be in writing or formed by exchange of documents,[54] and must be made between juridical persons or between a juridical person and an individual with a business registration certificate.[55] By contrast, Civil Contracts are made between individuals, either in writing or verbally, for non-commercial purpose.

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46 This is inferred from the different jurisdictions of the Economic Contract and those Commercial Contracts which are engaged for commercial purposes. Ordinance on Economic Contract, Art 1; Commercial Law, Arts 1–6.
47 Civil Code, Arts 16–22.
48 *Ibid,* Arts 116 and 120.
49 *Ibid,* Art 826.
50 *Ibid,* Art 400(1).
51 *Ibid,* Art 400(2).
52 Ordinance on Economic Contract, promulgated by the state Council on 25 September 1989.
53 *Ibid,* Art 1.
54 *Ibid,* Art 11: exchange of documents can be inferred from official letters, telegrams, offers, purchase orders, etc.
55 *Ibid,* Art 2.

The third and final category of contract is the Commercial Contract. Commercial Contracts are governed by the Commercial Law. They are identified in the Commercial Law as including contracts for the purchase of goods, process agent contracts, brokerage contracts, sales agent contracts, goods-processing contracts, contracts on freight and forwarding of goods, contracts on advertising of goods and contracts for the exhibition of goods. A Commercial Contract is formally valid when signed between merchants.[56]

Grounds for establishing the proper law of the contract for cross-border transactions

Under the rules of private international law contained in the Vietnamese Civil Code, it is possible that a cross-border transaction involving Vietnam will be governed by a foreign law and not by Vietnamese domestic contract law. In keeping with Vietnam's civil law tradition, the Civil Code provides the original source of law on civil and commercial matters. The Seventh Part of the Civil Code, Civil Relations with Foreign Elements, provides definitions and basic legal principles for cross-border transactions.[57] It defines civil transactions with foreign elements as civil relations where any of three following elements are present:[58]

- there is a foreign party (either a natural or a legal person) in that relationship;
- the relation is formed, altered or terminated in a foreign state; or
- the relation involves a property located in a foreign state.

In the absence of specific regulations governing different types of cross-border transactions, the 13 Articles contained in the seventh Part are widely interpreted as governing all international commercial and civil transactions, including the very technical fields of banking, transfer of high technology, copyright and trading of general goods and services.

Article 834(1) of the Civil Code stipulates that the law of the country where the contract is made governs the formalities of cross-border contracts. In other words, the *lex contractus* governs *formal* validity of cross-border contracts. An exception to the *lex contractus* principle arises where a contract which is formally invalid under the *lex contractus* is formally valid under the laws of Vietnam. In such a case, the contract will be valid in Vietnam.[59] The same is not true in reverse, however. Problems may arise when a cross-border contract is formally valid under the *lex contractus,* but formally invalid under Vietnamese law.

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56 Merchants may be individuals, juridical persons, co-operatives, and households with commercial capacity: Commercial Law, Art 5(6).
57 Ministry of Justice, *op cit,* fn 10.
58 Civil Code, Art 826.
59 *Ibid,* Art 834(1).

Foreign law may also apply to a cross-border transaction under Art 834(2) of the Civil Code. Article 834(2) sets out that the law of the place of performance of the contract will govern contractual rights and obligations, that is, the *lex solutionis* governs the *essential* validity of a cross-border contract. There are two qualifications to this principle, however. First, Vietnam has no jurisprudence on the 'place of performance' in relation to cross-border contracts or contracts performed in several countries.[60] Article 834(2) of the Civil Code does provide that contractual parties may nominate the place of performance in their contracts. However, where contractual parties have failed to indicate the place of performance in their contract, Vietnamese law will apply to determine the place of performance.[61] Secondly, Art 834(3) of the Civil Code provides an exception to the *lex solutionis* where a cross-border contract concerns immovable property located in Vietnam.[62] Where foreign individuals and organisations have been granted land use rights to implement investment projects in Vietnam,[63] Vietnamese law will govern formal validity as well as essential validity of the contract.

In the case of arbitration agreements, the parties' choice of law will be excepted as the proper law of a cross-border transaction. The Ordinance on Recognition and Enforcement of Foreign Arbitral Awards in Vietnam[64] provides that parties to an international arbitration agreement can choose a law governing their arbitration agreement.[65] If the parties fail to validly chose a law under Art 16(1)(a), the law of the seat of the arbitration will govern their arbitration agreement.[66]

The most important, and perhaps the most controversial, means by which foreign law will apply to cross-border contracts, arises where parties positively elect a foreign law in a choice of law clause. Article 827(3)(2) of the Civil Code deals with choice of law clauses for cross-border transactions. It states:

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60 The jurisdiction of Vietnamese courts on contracts performed partly in Vietnam and partly abroad was discussed in Inter-sectoral Circular No 04/TTLN, jointly promulgated by the Supreme Court and the Supreme Prosecution Bureau on 7 January 1995 to give instruction on implementation of some provisions of the Ordinance on Economic Contract. In this document, the Supreme Court instructed that if an economic dispute arises from a contract performed partly in Vietnam and partly abroad, Vietnamese courts only have jurisdiction to hear claims on the part of the contract performed in Vietnam. However, this document did not touch the issue of the law governing the contract.

61 Civil Code, Art 834(2).

62 Generally, Vietnamese law does not recognise foreign ownership of immovable property in Vietnam. However, in the area of foreign investment, foreign commercial interests may be granted land use rights in Vietnam to implement their project: Amendment to Land Law (1993), promulgated by National Assembly on 2 December 1998, Art 1.

63 Amendment to Land Law (1993), promulgated by the National Assembly on 2 December 1998, Art 1.

64 Ordinance on Recognition and Enforcement of Foreign Arbitral Awards in Vietnam, promulgated by Standing Committee of National Assembly on 14 September 1995.

65 Ordinance on Recognition and Enforcement of Foreign Arbitral Awards in Vietnam 1995, Art

66 *Ibid,* Art 16(1)(a).

> Foreign law is also applicable if parties to a civil contract so agree in their contracts, and if such agreements are not inconsistent with provisions of this Code and other legal documents of the Socialist Republic of Vietnam.

This Article indicates that Vietnamese law generally recognises that choice of law clauses override the place of performance in determining the applicable law of a cross-border contract. The provision that the choice of law clause 'must not be inconsistent' with Vietnamese laws, whilst a potential restriction, also means that foreign law are not *ipso facto* illegal under Vietnamese law and that application of the foreign law is authorised under Vietnamese law.

Complicating factors in establishing foreign law as the proper law of the contract

A discussion of the developments in Vietnamese private international law in response to 'Doi Moi' would not be complete, however, without an equally thorough analysis of the problems facing foreign litigants who seek to have foreign law applied as the substantive law of their contracts. These difficulties include undue judicial deference to the executive, unintended application of the foreign private international law rule through the doctrine of *renvoi,* and problems of proof and public policy. The following section will address each potential complication in turn.

Judicial deference to the executive

As *Sadaco v Bao Minh Insurance Company*[67] illustrates, it is still far from automatic that a choice of law clause will be found valid in the Vietnamese legal system, even when it meets the statutory requirements under Art 827(3)(2) of the Civil Code. Without a clear answer on the nature of commercial rights, conservative judges will tend to seek authorisation from administrative agencies before upholding foreign choice of law clauses. Indeed the government has gone so far as to officially recognise this conservative direction in the area of Built-Operate-Transfer (BOT) projects. Government Decree 62[68] on BOT contracts for infrastructure projects only allows parties to a BOT contract, as well as parties to any contract that requires a guarantee by authorised state agencies, to choose foreign law to govern their contract. It provides that the foreign law will only apply where the choice of law agreement is not inconsistent with Vietnamese law and the Ministry of Justice gives its approval to the choice of law agreement.

Interestingly, by nominating the place of performance of the contract, parties may circumvent the restrictions on choice of law clauses, as Art 834(2) of the

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67 Thanh Nien Newspaper, *op cit,* fn 26.

68 Decree No 62/1998/ND-CP on BOT contracts, promulgated by the government on 15 August 1998.

Civil Code stipulates that the law of the place of performance governs contractual rights and obligations.[69]

Renvoi

The second complicating factor arises from the application of the theory of *renvoi* in the Vietnamese private international law. In common law, this theory establishes that where the forum's choice of law rules require the forum court to apply a foreign law, the forum court should apply the foreign law as a whole legal system, including the foreign choice of law rules.[70] In Vietnamese law, *renvoi* is provided for under Art 827(3) of the Civil Code, which stipulates:

> In situations where the application of foreign law is stipulated by this Code, other legal documents of the Socialist Republic of Vietnam or international conventions of which Vietnam is a member state, then foreign law is applicable on civil relations with foreign elements; if foreign choice of law rules refer to the law of the Socialist Republic of Vietnam, then the law of the Socialist Republic of Vietnam is applicable.

Thus, unlike the common law systems where the theory of *renvoi* is not applicable in the commercial area, Vietnamese private international law recognises *renvoi* in all circumstances where foreign law is applied. According to Decree 60-CP, *renvoi* is applicable:[71]

- where foreign law is applied by the Civil Code of Vietnam, or by other Vietnamese legal documents;
- where foreign law is applied by international conventions of which Vietnam is a member state; and
- where foreign law is applied in contractual relations by a valid choice of law agreement by contractual parties.

From these provisions, it appears that Vietnamese private international law follows the single theory of *renvoi*.[72] Accordingly, when Vietnamese private international law choice of law rules refer to 'foreign law', the foreign system's rules of private international law are included.[73] This offers considerable scope to contracting parties who may wish the entire body of a foreign law to govern their transaction. However, the application of *renvoi* also poses serious risks for

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69 Civil Code, Art 834(2).

70 *Collier v Rivaz* 2 Curt 855 at 858, *per* Sir Herbert Jenner that, 'Every nation has a right to say how far the general law shall apply to its born subjects, and the subject of another country; and the court sitting here to determine it, must consider itself sitting in Belgium under the particular circumstances of the case. In that sense, the forum court applying foreign law in cases of *renvoi* should also apply choice of law rules of the foreign law as the foreign court would do if the case comes before the foreign court'.

71 Decree 60-CP dated 06/06/1997 by the government to give instructions on the application of the Civil Code in civil relations on foreign matters, at Art 5(3).

72 See JHC Morris, *The Conflict of Laws* (3rd ed, 1984) 469.

73 Ministry of Justice, *op cit,* fn 10, 374.

the reason that if the choice of law rules of the foreign law refer back to the law of Vietnam, Vietnamese law will apply to the entire transaction. In addition, if the choice of law rules of the foreign law refer to the law of a third country, then the third country's laws will govern the contract.

Public policy

Thirdly, in all conflict of laws cases pleaded under Art 827(3) of the Civil Code, that is, all conflict of laws cases involving choice of laws clause or claims of *renvoi,* a broad discretion is conferred on the court under Art 828 of the Civil Code. Article 828 provides:

> In situations provided in Article 827 paragraph 3 of this Code, foreign laws and international practices are applicable only if the consequences of such applications of foreign laws and international practices are not inconsistent with *basic principles of the law* of the Socialist Republic of Vietnam [emphasis added].

Although a major variable in any Art 827(3) case, the exact meaning which will be given to 'basic principles of the law' is extremely difficult to predict. The specific factors which will inform the courts' judgment of public policy have never been formulated into one consistent principle or theory.[74] 'Basic principles of the law' is merely the latest reflection of a concept of public policy which has been present but changing in Vietnamese law since the economic reformation began.[75] Indeed, when Vietnam was a command economy, public policy meant that any commercial transaction inconsistent with any administrative decree was void.[76] As Vietnam changes from a command to a market economy, 'basic principles of Vietnamese laws' is undoubtedly a less onerous formulation of public policy, although the precise meaning of this phrase is still unclear.

Even if it is argued that 'basic principles' of Vietnamese law are found in Arts 2–14 of the Civil Code, it is unclear how these basic principle map onto the three categories of contract into which cross-border contract may fall. In the absence of any clear provision stating how Arts 2–14 of the Civil Code are to be applied to Economic, Civil and Commercial Contracts respectively, it would seem that determination of 'basic principles of Vietnamese law' will fall to the Vietnamese Courts and other authorities.[77]

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74 Ministry of Justice, *op cit,* fn 10, 374.

75 For example, at the beginning of the reform process, the Law on Civil Aviation provided for 'public interest and public order': Law on Civil Aviation, promulgated by the National Assembly on 26 December 1991, effective 1 June 1992.

76 See Civil Code, Art 828. See also Le Dang Doanh, *op cit,* fn 23.

77 Jurisprudence says that basic principles of Vietnamese laws may include political and social principles. See Ministry of Justice, *op cit,* fn 10, 376.

The final difficulty in interpreting 'basic principles of law' arises from the fact that these basic principles of law can extend to political and social values, as well as to legal principles.[78] Examples of 'political and social values' can be found in the Vietnamese Civil Code.[79] However, their content is to a greater or lesser extent unknown. As a consequence, Vietnamese Court have conferred another wide ground of discretion when interpreting the contents of a disputed agreement or when deciding whether to apply foreign law to a cross-border contract.

Burden of proof

Even where foreign law is otherwise applicable to a cross-border transaction, a plaintiff may be unable to establish this as a matter of evidence. Although Art 827(3) of the Civil Code provides that the contractual parties must establish that they agreed that a foreign law should govern their contract,[80] Vietnamese private international law does not indicate how the choice of the foreign law can be proved. Moreover, the absence of a law on evidence in civil and commercial matters,[81] as well as the requirement of an *exequatur* on all foreign legal documents,[82] means that agreement on foreign law may be difficult to prove or to rebut. In relation to this last point, the Ordinance on Consular Service,[83] at Art 26(2), states:

> State agencies of Vietnam only accept for examination foreign papers and documents that have been legalized unless otherwise provided by Vietnamese laws and international conventions of which Vietnam is a contracting state.

As a consequence of this provision, Vietnamese courts are unlikely to accept evidence on foreign law which is not official, in writing and legalised.[84] Thus, expert testimonies may only be used to prove a foreign law if they are made in writing, certified or notarised in the countries of origin and legalised by Vietnamese consular agencies. In practice, the requirement of *exequatur* proves to be difficult for foreign litigants. Vietnamese law on notarisation and

78 Ministry of Justice, *op cit,* fn 10, 375.

79 For instance, the Civil Code provides that a contract will be void if it violates social morals: Civil Code, Art 395(1), or if any contractual party lacks 'good will, co-operation, faith and honest': Civil Code, Art 395(2).

80 Civil Code, Art 827(3).

81 The Vietnamese courts are civil courts with an inquisitorial trial procedure. There are some provisions on evidence in the Ordinance on Civil Procedure (Arts 38–40) and the Ordinance on Economic Procedure (Art 35). The absence of a law on evidence in Vietnam reflects the arbitrary trials in Vietnamese courts at the beginning of economic reformation.

82 Ordinance on Consular Service, promulgated by the Standing Committee of the National Assembly on 24 November 1990, effective 1 January 1991.

83 *Ibid.*

84 Legalisation of foreign documents to be used in Vietnam is conducted at consular sections of the Ministry of Foreign Affairs in Ha Noi and Ho Chi Minh City or at Vietnamese Diplomatic Missions abroad: Ordinance on Consular Service, Art 26.

legalisation requires certification as to the contents of foreign legal documents. However, consular officers and notaries from the United States and some common law countries will only certify the signature of the declarants, and not the contents of the document.

The burden of proof can be relieved somewhat if contractual parties choose harmonised laws to govern their contracts. Where the cross-border transaction involves the sale of goods, the United Nations Convention on the International Sale of Goods 1980 (CISG) is a particularly apt choice. Although Vietnam has not ratified the CISG, the CISG enjoys much popularily amongst Vietnam's legal community. Consistent with Vietnam's 'Doi-Moi' policy of integration with world markets, Vietnam's Commercial Law 1997 resembles the CISG.[85] Moreover, books on the CISG by Vietnamese authors are available in Vietnam and are familiar sources for Vietnamese authorities when dealing with cross-border transactions. In addition choice of harmonised commercial laws can also relieve parties to cross-border transactions in Vietnam from the ubiquitous doctrines of public policy which may override the party autonomy principle.

Proper law of contract under the Vietnamese-US Trade Agreement

Where the parties to a cross-border transaction are a Vietnamese company and a US company or national, or a Vietnamese company and a company or national of a state with a most favoured nation relationship to Vietnam, the Vietnam-US Trade Agreement overcomes many of the problems identified above. According to Art 827(2) of the Vietnamese Civil Code, international agreements to which Vietnam is a party will override the Civil Code's rules of private international law. Thus, Art 7 of Chapter 1 of the Trade Agreement, which provides for arbitration of disputes, will supersede the Civil Code provisions which govern the application of foreign law under a cross-border contract. Art 7 of Chapter 1 reads:

> The parties encourage the adoption of arbitration for the settlement of disputes arising out of commercial transactions concluded between nationals or companies of the United States of America and nationals or companies of the Socialist Republic of Vietnam. Such arbitrations may be provided for by agreements in contracts between such nationals and companies, or in separate written agreements between them.

85 The influence of harmonized commercial laws on Vietnamese domestic laws may be attributed to two main forces: (1) Vietnam's attempts to integrate into the world economy and (2) conditioned aid from international institutions such as the World Bank, the Asian Bank for Development, the International Monetary Fund, etc. See generally Claude Rower, 'Progress and problems in Vietnam's development of commercial law' (1997) 15 Berkeley Journal of International Law 275.

> The parties to the dispute, unless otherwise agreed between them, should specify as the place of arbitration a country other than the United States of America or the Socialist Republic of Vietnam, that is a party to the Convention on the Recognition and Enforcement of Foreign Arbitral Awards, done at New York, June 10, 1958.
>
> Nothing in this article shall be construed to prevent, and [the US and the Social Republic of Vietnam] shall not prohibit, the parties from agreeing upon any other form of arbitration or on the law to be applied in such arbitration, or other form of dispute settlement which they mutually prefer and agree best suits their particular needs.

Thus where a cross-border agreement falls within the scope of the Vietnam-US Trade Agreement, the parties may provide for dispute settlement by any means they see fit, including by arbitration. Moreover, parties to such transactions may agree to arbitration under any internationally recognised set of arbitration rules and may make any modifications to those rules as they apply to their agreement. The only restriction is that the parties designate an Appointing Authority in a country other than the United States or the Socialist Republic of Vietnam. Consequently, it is unlikely that Vietnamese law will apply to the transaction and more likely that the parties' choice of foreign law will be respected. It is only where the successful party wishes to enforce the award in Vietnam that potential problems arise, since is not clear whether provisions of public policy in the Civil Code[86] override the principle of party autonomy under the Vietnam-US Trade Agreement.

Settlement of cross-border trade disputes

A further crucial issue for cross-border litigants is the forum in which disputes will be heard. Since 'Doi Moi', there has been a rapid upsurge in the number of market-oriented institutions in Vietnam which provide for dispute resolution.[87] Further developments in this area are likely, following the Vietnam-US Trade Agreement, which stipulate that nationals and companies of each party are to be accorded national treatment in respect of access to 'all competent courts and administrative bodies in the territory of the other Party, as plaintiffs, defendants or otherwise'.[88] The following section will look first at the grounds upon which a Vietnamese court will have jurisdiction over disputes arising from cross-border transactions. Secondly, it will examine any

86 Civil Code, Arts 827, 828.

87 Civil courts in the Supreme Court and provincial people's courts were established by the Amendment to the Law on Organization of the People's Court (1982), promulgated by National Assembly on 22 December 1988; the Economic Courts in the Supreme Court and in provincial people's courts were established by Amendment to the Law on Organization of the People's Court (1992), promulgated by National Assembly on 28 December 1993, Arts 4 and 12.

88 Vietnam-US Trade Agreement, Chapter 1—Trade in Goods, Art 7(1).

possible grounds for judicial discretion upon which Vietnamese courts could refuse jurisdiction to an applicant.

Jurisdiction of Vietnamese courts

Under Vietnamese law, both the civil and the economic provincial courts of Vietnam have jurisdiction to hear disputes arising from cross-border transactions.[89] In both cases, the courts will only have jurisdiction to hear the dispute when either *general* or *specific* jurisdictional grounds are established. Notably, where an action may be pleaded on either a general or a specific ground, the general ground will prevail. Thus, if a plaintiff may sue in the specific jurisdiction of the court of Danang province or in the general jurisdiction of the court of Ho Chi Minh City, the court in Danang will decline jurisdiction.

Vietnamese courts will have general jurisdiction over a cross-border dispute where:

1 the *domicile* of the defendant is in Vietnam, or if the defendant is a judicial person, then where the *head office* of the defendant is in Vietnam;[90] or
2 immovable property is located in Vietnam if the subject of the dispute is immovable property.[91]

They will have specific jurisdiction where:

1 the cross-border agreement is performed in Vietnam;[92] or
2 the defendant has assets in Vietnam; or
3 the defendant company has a branch in Vietnam and the dispute arises from operations of the branch in Vietnam.[93]

The first general ground of jurisdiction is invoked if the defendant is *domicile* in Vietnam.[94] Article 48 of the Civil Code 1996 clarifies that a person will be domiciled:

(a) in the location where he is registered with the local registrar as a household resident. If he is not registered as a household resident, then he is domicile where he is registered as a *temporary resident;*[95] or
(b) in the location where he works or where he has his assets, if he is not registered as either a household or a temporary resident.[96]

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89 Ordinance on Civil Procedure, Art 11(2)(a); Ordinance on Economic Procedure, Art 13(2).
90 *Ibid,* Art 13(1); Art 14.
91 *Ibid,* Art 13(2); Art 14.
92 *Ibid,* Art 14(5); Art 15(3).
93 *Ibid,* Art 14(2); Art 15(2).
94 *Ibid,* Art 13(1); Art 14.
95 In Vietnam, the District Administrative Police are the Registrar for household or temporary residence within the district.
96 Civil Code 1996, Art 48.

The first arm of this definition presents *prima facie* difficulties when applied to foreigners living in Vietnam. In the first place, it is not possible under Vietnamese law for a foreigner living in Vietnam to be classified as a 'household resident'. In addition, Vietnamese law provides two forms of residency for foreigners living in Vietnam, rather than just the one classification of 'temporary' resident cited in the section.[97] Foreigners working, or carrying out an investment project, in Vietnam may be issued with a temporary residence visa for a period of up to one year and a certificate of temporary residence. However, they may also become permanent residents. As general jurisdiction is even more applicable to permanent residents, it may be presumed that 'domicile' includes all foreigners living in Vietnam, whether temporarily or permanently. On a comparative analysis, the emphasis under Vietnamese law on the 'domicile' of the defendant under Vietnamese law resonates with European concepts.

The Vietnamese courts will also have jurisdiction to hear disputes under the first general ground of jurisdiction where the defendant is a juridical person whose head office is located in Vietnam. Under Vietnamese private international law, the location of the head office is adduced from the company charter or from other legal documents which constitute the company. If those documents indicate that the head office is located in a country other than Vietnam, Vietnamese courts will have no jurisdiction over the dispute, even though the company was originally incorporated in Vietnam.[98] Concepts such as 'the seat of business' or 'central management and control' do not apply under Vietnamese law.

Three qualifications to this ground of general jurisdiction should be noted, however. First, the Vietnam-US Trade Agreement provides that 'company of a Party' to the trade agreement means a company constituted or organised under the law of that contracting state.[99] Secondly, laws on foreign investment in Vietnam provide that fully foreign-owned companies or joint-ventures established in Vietnam are considered Vietnamese entities.[100] Thirdly, Vietnamese courts may assume specific jurisdiction where a defendant has a branch office located in Vietnam,[101] so long as the cause of action arises from the acts or omissions of the branch office which is located in Vietnam.[102]

Where a defendant has assets located in Vietnam, the second ground of specific jurisdiction will be triggered. Under Vietnamese law, 'assets' are defined as 'tangible property, money, papers with money value and property rights'.[103] Assets may also be classified as movable and immovable property.[104]

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97 Ordinance on Entry, Exit and Residence of Foreigners in Vietnam, promulgated by the Standing Committee of National Assembly on 1 August 2000.

98 There is no requirement that foreign invested companies must have their head office in Vietnam.

99 Vietnam-US Trade Agreement, Chapter 4, Art 1(3).

100 Decree No 24/2000/ND-CP of the government dated 31 July 2000 to elaborate on the Law on Foreign Investment in Vietnam 1996.

101 Beatrice Favarel-Veidig, 'France', in Carel JH Baron Van Lynden (ed), *Forum Shopping* (1998), 89.

102 In this sense, Vietnamese law has more in common with German rather than French law: Christian Breitzke, 'Germany', in Van Lynden, *ibid* at 99.

In addition, there are subordinate classifications such as consumables and inconsumables,[105] general and specific,[106] income and revenue,[107] public property and private property.[108] Classification of movable property and immovable property is based on the physical characteristic of the property,[109] although all intangible property rights can be classified as movable property.[110] As 'assets' include 'immovable property', there would seem to be some overlap between this ground of specific jurisdiction and the second ground of general jurisdiction, which provides that the Vietnamese courts will have jurisdiction where 'the subject of the dispute is immovable property' and the 'immovable property' is located in Vietnam.[111]

Under Art 833(3), a conflict of laws will be resolved in favour of the jurisdiction where the property in located, whether that property is movable or immovable *(lex situs)*.[112] However, if the cross-border transaction is considered to be a civil transaction, then the Vietnamese courts will only have jurisdiction to hear the dispute where the defendant is domicile in Vietnam. Similarly, in an economic action the Vietnamese courts will only entertain the matter where the defendant's address is unknown.[113]

Finally it should be noted that, under Vietnamese law, the nationality of the contracting parties is not a jurisdictional ground. This contrasts to the position under French law, where the courts will assume jurisdiction with respect to contracts between a French national and a foreigner.[114]

Forum non conveniens and *lis alibi pendens*

Once the criteria for specific or general jurisdiction have been met, it would seem that Vietnamese courts have no discretionary power to refuse an exercise of that jurisdiction. In contrast to common law systems, where courts may decline jurisdiction of grounds of *forum non conveniens* or *lis alibi pendens,* Vietnamese courts are required to abide strictly by statutory provisions. A violation of procedure will result in the judgment being annulled by the Court

103 Civil Code, Art 172.
104 *Ibid,* Art 181.
105 *Ibid,* Art 1185.
106 *Ibid,* Art 186.
107 *Ibid,* Art 182.
108 See also NN Dien, *A Study on Property in Vietnamese Civil Law* (1999), 26.
109 *Ibid* at 28.
110 *Ibid* at 34.
111 Ordinance on Civil Procedure, Art 13(2); Ordinance on Economic Procedure, Art 14.
112 Civil Code, Art 833(3).
113 Ordinance on Civil Procedure, Art 14(1); Ordinance on Economic Procedure, Art 15(1). There is no jurisprudence on why Vietnamese lawmakers put more restriction on the plaintiff in economic cases. In some situations, a plaintiff in an economic dispute can transform its action into a civil action to enjoy wider international jurisdiction of the Civil Court.
114 New Code of Civil Proceedings, Art 14.

of Directorate Review.[115] In relation to disputes between companies and nationals of Vietnam and the US, this issue has potential to be especially problematic, since American private international law provides for open-ended jurisdiction of American courts.

The doctrines of *forum non conveniens* and *lis alibi pendens* allow the courts to decline jurisdiction at common law. In Australia, *forum non conveniens* allows the forum court to decline jurisdiction where the court finds that it is a clearly inappropriate forum.[116] Similarly, *lis alibi pendens* permits a forum court to stay proceedings if the forum court is a clearly inappropriate forum for the dispute and there are related proceedings between the same parties pending in another jurisdictions.[117] Whilst the doctrine of *forum non conveniens* has no obvious equivalent under Vietnamese law, *lis abili pendens* is reflected under Art 38 of the Ordinance on Economic Procedure. This Article provides that a court may stay proceedings if the same case or a related cause of action is brought before another court and it is more convenient for the other court to decide the case.[118]

In practice, it seems highly unlikely that Vietnamese courts will cede jurisdiction to a foreign court by upholding a claim under Art 38 or by recognising a doctrine of *forum non conveniens*. Indeed, it does not appear that a Vietnamese court has ever denied jurisdiction to a case which falls squarely within its general or specific jurisdiction. Moreover, Vietnamese private international law is strongly influenced by concepts of territoriality,[119] meaning that deference to a foreign court is regarded as a breach of sovereignty. Also, the doctrine of *lis alibi pendens* is inconsistent with the Vietnamese stance towards recognition and enforcement of foreign judgments. Generally, Vietnam only recognises foreign judgments which have been rendered in a state which is party to a bilateral agreement with Vietnam on reciprocal recognition and enforcement of judgments. If a Vietnamese court were to halt proceedings to await the result of a proceeding abroad, it would appear that Vietnamese courts were recognising the foreign court's decision.

An exception to the general position on *lis alibi pendens* may arise in regards to arbitrations covered by the Vietnam-US Trade Agreement. The Agreement provides that Vietnamese courts will recognise the jurisdiction of an international arbitration agreed upon by contractual parties to hear their disputes. It is likely that *lis alibi pendens* will stay proceedings before a

115 Ordinance on Civil Procedure, Art 71; Ordinance on Economic Procedure, Art 75.

116 The doctrine of *forum non conveniens* in Australian law means that the forum court has power to decline jurisdiction where the court finds that it is the clearly inappropriate forum. See PE Nygh, *Conflict of Laws in Australia* (6th edn, 1995), 102.

117 'Clearly inappropriate forum' is the Australian test of *lis alibi pendens.* See Reid Mortensen, *Private International Law* (2000), 69.

118 Ordinance on Economic Procedure.

119 Ministry of Justice, *op cit,* fn 10, 375.

Vietnamese court if the Vietnamese-US contractual dispute is also being heard before an international arbitral tribunal.

Enforcement of American judgments in Vietnam

Despite the generally liberal provisions of the Vietnam-US Trade Agreement in regards to choice of law clauses, arbitration and *lis abili pendens,* it is uncertain whether US judgments will be recognised and enforced in the Vietnamese Courts. The Vietnam-US Trade Agreement does not provide for the mutual recognition and enforcement of foreign judgments.[120] Indeed, US courts generally recognise and enforce foreign judgments on the grounds of reciprocity and jurisdiction. However, Vietnamese law provides only limited circumstance in which foreign judgments will be enforced in Vietnam. The Ordinance on Foreign Judgments[121] provides that foreign judgment on civil matters will be recognised and enforced in Vietnam where:

1 the foreign judgment is of a country which is a member state of an international agreement on foreign judgment of which Vietnam is also a member state;[122] or
2 the foreign judgment is one which Vietnamese law stipulates is to be recognised and enforced in Vietnam.[123]

As Vietnam and the United States are not member states of any multilateral agreement on mutual recognition and enforcement of foreign judgments, it is unlikely that a US judgment will be recognised and enforced on the first ground. Also, following the Inter-Sectoral Circular No 04/TTLN, jointly promulgated in 1993 by the Ministry of Justice, the Supreme Court and the Supreme Bureau of Prosecution, it would seem that the Ordinance on Foreign Judgments[124] will be narrowly construed. The Circular states that Vietnamese courts could only examine, recognise or enforce foreign judgments on civil matters from states which had signed with Vietnam a judicial co-operation agreement on civil, matrimonial and criminal matters and which provides for mutual recognition and enforcement of judgments. This document listed seven countries which had such bilateral agreements with Vietnam;[125] however, the US was not included.

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120 *Hilton v Guyott* (1895) 159 US 113, *per* Gray J; Restatement (Third) of Foreign Relations Law, s 481.
121 Ordinance on Recognition and Enforcement of Foreign Judgments in Vietnam, promulgated by Standing Committee of National Assembly on 17 April 1993.
122 Ordinance on Recognition and Enforcement of Foreign Judgments in Vietnam, Art 2(1)(a).
123 *Ibid*, Art 2(1)(b).
124 Ordinance on Recognition and Enforcement of Foreign Judgments in Vietnam, promulgated by the Standing Committee of the National Assembly on 17 April 1993.
125 The following countries have all signed an agreement on mutual recognition and enforcement of judgments with Vietnam: Belarus, China, Cuba, Bulgaria, France, Germany, Hungary, Laos, Mongolia, Poland, Russia, Sec, Slovakia and Ukraine. Since 1993, the number of states on this list has doubled.

Furthermore, the Vietnamese Ministry of Foreign Affairs has refused to legalise judgments by American courts, or documents of the courts of any country which has not signed a bilateral judicial co-operation agreement with Vietnam. The Ministry of Foreign Affairs and the Ministry of Justice have legalised the use of certain American judicial documents in Vietnam. However, this recognition is only intended to accommodate matrimonial and civil relations between the two countries, given the large Vietnamese-American community living in the US.[126] Thus it would appear that, generally, Vietnam does not automatically recognise the legitimacy of foreign judgments in Vietnam unless there is an agreement between Vietnam and the country concerned.

International arbitration in Vietnam

International arbitration in Vietnam has developed in pace with the influx of foreign investment. As foreign investment has increased, so has the demand for independent dispute settlement institutions to supplement the newly established civil and economic courts and the transitioning legal system.[127] However, it is unlikely that foreign parties trading with Vietnamese individuals or companies will elect to settle their disputes except through international arbitration institutions operating outside the Vietnamese legal system. The awards of such institutions are both more impartial and more enforceable than those rendered in Vietnam itself.

First, the only international arbitration institution presently operating in Vietnam, the Vietnam International Arbitration Centre,[128] will almost inevitably apply Vietnamese law to cross-border transactions. The Centre's jurisdiction extends to all disputes arising from international economic relations[129] where one of the parties is a foreign national or a foreign corporation or all the parties are foreign nationals or foreign corporations.[130] As the Centre's Charter stipulates that arbitration must take place in

126 In 1999, the Committee for Vietnamese Oversea estimated that there were around 1.3 million Vietnamese in the US.

127 The separation of the Civil Court from the People's Court in 1989, followed the recognition in Vietnam of civil transactions under the Ordinance on Civil Contract 1989. The Economic Court was subsequently established in 1994 to replace the arbitrary administrative procedures of the Economic Arbitration Institution.

128 Decision of the Prime Minister of the Government No 204/TTG, 28 April 1993. Although Vietnam does not prohibit foreign arbitral organisations from operating in Vietnam, no international arbitral organisation has its representative office in Vietnam.

129 Economic relations include foreign trade contracts and contracts concerning investment, tourism, international transportation and insurance, transfer of technology, services, international credits and payments.

130 Initially, the Centre's jurisdiction was limited to disputes arising from international economic relations although since 1996, the Centre's jurisdiction has been extended to disputes arising from domestic economic transactions.

Vietnam,[131] it is most likely that Vietnamese law will be applied as the law of the seat of arbitration.

Secondly, it is unclear when an arbitration agreement is validly concluded under Vietnamese law. Formation of an arbitration agreement under Vietnamese law is governed by general principles of Vietnamese contract law, rather than by a specific law on arbitration. Thus, an arbitration agreement will be categorised as a civil, commercial or economic transaction depending on the type of contract of which it is a term. Nonetheless, it is unclear whether an arbitration agreement must conform to the same conditions for formal validity as its 'host' contract. The Vietnam-US Trade Agreement avoids this ambiguity by providing that an arbitration agreement must be in writing.

Thirdly, and similarly, there is no general legal mechanism for the enforcement of arbitral awards rendered by Vietnamese arbitrators in Vietnam. However, it would seem that arbitral awards rendered by Vietnamese arbitrators in Vietnam may be enforceable as contracts if parties to the arbitration agree in advance that they are bound to the decision of the arbitration.

By contrast, arbitral awards rendered by international arbitrators (either in Vietnam itself or overseas) in accordance with the New York Convention will be enforceable in Vietnam under the Ordinance on Recognition and Enforcement of Foreign Arbitral Awards in Vietnam 1995 (the Ordinance of Foreign Arbitral Awards). The Ordinance of Foreign Arbitral Awards establishes a procedure of *exequatur* whereby an application for recognition or enforcement of foreign arbitral awards submitted to the Ministry of Justice may only be examined for formalities of the application before being transferred to provincial court. Generally, in enforcing the award, the courts may not consider the reasons behind the decision, only the conformity of the award with Vietnamese laws and the New York Convention. However, there is some potential for judicial interference, since Vietnamese courts can refuse to recognise or enforce a foreign arbitral awards in Vietnam where:[132]

1 The arbitral agreement is void under the governing law of that agreement or the law of the seat of the arbitration.
2 The arbitral procedure does not provide the defendant appropriate opportunities to defend himself.
3 The arbitration does not have jurisdiction on the cause of action under Vietnamese law or the law governing the arbitration.
4 The arbitral procedure does not conform to the arbitration agreement.

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131 Article 18 of the Arbitration Rules of the Vietnam Arbitration Center at the Chamber of Commerce and Industry of Vietnam. These Rules of Arbitration are formulated in accordance with Art n of the Statutes of the Vietnam International Arbitration Centre issued in conjunction with Decision No 204/ TTg dated 28 April 1993 of the Prime Minister of the Government of the Socialist Republic of Vietnam. This Rules can be accessed at http://www.jurisint.org/pub/03/en/F_7005.htm.

132 Ordinance on Foreign Arbitral Awards, Art 16.

5 The arbitral award is not binding.

6 The arbitral award is not effective under the law governing the award.

7 The recognition and enforcement of the arbitral award is not inconsistent with basic Vietnamese legal principles.

In addition to these seven grounds, a defendant may appeal a decision to recognise or enforce the foreign arbitral award against him.[133] Finally, arbitral awards rendered by the Vietnam International Arbitration Centre may not be enforced under the Ordinance on Recognition and Enforcement of Foreign Arbitral Awards in Vietnam, as there is no provision in Vietnamese law that a Vietnamese arbitration award may be enforced in the same manner as a Vietnamese civil judgment.

The Vietnam-US Trade Agreement offers the greatest potential for international arbitration in cross-border disputes involving Vietnam. The Agreement 'encourages the adoption of arbitration for the settlement of disputes arising out of commercial transactions concluded between nationals or companies of the United States of America and nationals or companies of the Socialist Republic of Vietnam'.[134] It provides that the seat of arbitration may be any country other than the Socialist Republic of Vietnam or the United States of America.[135] In addition, parties to a cross-border transaction governed by the Agreement are free to agree upon any other form of arbitration or on the law to be applied in such arbitration.[136]

Conclusion

The decision of the Vietnamese Government to open Vietnam to foreign trade and investment has required considerable adaptations in many areas of Vietnamese law. After years as a closed command economy, Vietnam did not have in place the legal principles necessary to support cross-border transactions. Since 'Doi Moi', Vietnamese law makers have instituted a swathe of reforms in the areas of private international law. Nonetheless, principles of the command economy still hinder the recognition of individual commercial rights. In particular, principles of party autonomy in choice of law, forum and method of dispute resolution are still to be fully recognised in Vietnam.

Against this background, the implementation of the Vietnam-US Trade Agreement marks a considerable step towards open market principles in Vietnam. Although it will only apply to certain cross-border transactions

133 *Ibid,* Art 18.
134 Vietnam-US Trade Agreement at Chapter 1, Art 7(2).
135 *Ibid,* Art 7(3).
136 *Ibid,* Art 7(4).

between Vietnamese and certain foreign entities, the Agreement requires radical changes in the problematic areas of choice of laws and dispute resolution. Thus there is ample reason to except that Asia's fourth largest nation will continue to move, both legally and commercially, towards a profitable commercial relationship with the rest of the world.

Finding the Equilibrium for Dispute Resolution: How Brunei Darussalam Balances a British Legacy With Its Malay and Islamic Identity

*Ann Black**

Introduction

Although a kingdom on the island of Borneo for over a thousand years, the small southeast Asian nation of Negara Brunei Darussalam[1] was one of the last countries in Asia to lose its colonial ties. It entered the world stage as an independent nation in 1984, almost 100 years after the Sultanate's fate became tied to that of its coloniser, Great Britain. Initially, Brunei became a British Protectorate in 1888, followed by a British Residency in 1906, and finally obtained internal self-rule for the 25 years (1959–84) prior to independence. During this period of colonial dominance, an English common law model—laws, institutions, and jurisprudence—was transplanted and imposed upon the people of Brunei. The acceptance and resultant primacy of the English model, particularly for the resolution of commercial, trade and business disputes, led to a consequential devaluing of local indigenous and Islamic means for dispute resolution during most of the pre-independence era.

Since independence, Brunei has been trying to find an equilibrium between western values and processes and its own traditional Bruneian practices and values. On the one hand, Brunei strives to assert its own identity in the region as an independent Malay Muslim monarchy. To do so, it employs a model of statehood that had its genesis in the 14th century. Brunei's monarch, Sultan Hassanal Bolkiah,[2] claims direct descent from the first Bruneian Sultan[3] who converted to Islam in 1362, and he also claims lineage from the Prophet Mohammad.[4] To endorse and protect the three pillars of the nation's identity, Brunei has employed a nationalistic state ideology, known as *Melayu Islam Beraja* (MIB). The ideology is designed to promote and protect the dominance

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1 Nation of Brunei, the Abode of Peace. Daru' L-Salam is an honorific Arabic title that was adopted by the government at the time of independence in 1984.

2 His Majesty Paduka Seri Baginda Sultan Haji Hassanal Bolkiah Mu'izzaddin Waddaulah, Sultan and Yang Di-Pertuan, Negara Brunei Darussalam.

3 Awang Alak Betatar.

4 The third Sultan, Berkat, was an Arab descendant of the Prophet, who became Sultan of Brunei through marriage with the daughter of the second Sultan.

of Islam and Malay culture whilst ensuring the retention and support for an absolute monarchy. At the same time, Brunei has not only retained and endorsed many of the institutions and practices derived from the British, but continues to embrace western style developments, concepts and practices. Finding an acceptable balance between the traditional and the western secular processes is a recurring theme within Brunei and can be seen in relation to dispute resolution processes.

MIB, as the vehicle for setting the national agenda, has created the priorities, the direction and the impetus for all development within the nation, including dispute resolution. It acts as a filter by which the country can determine which of the offerings from the west are compatible with Bruneian values and processes. The first focus was to reduce the incongruity of the English secular common law system dominating in a quintessentially Islamic and Malay nation. This countermanded the obligation arising from MIB that upholds 'Islamic principles and values based on the *Quran* and *hadith* as the basis of all activities',[5] and required the government to put Islamic laws at their rightful place as the principle legal system in the country and not the colonial system as practiced today'.[6] The result has been a significant restructuring and upgrading of the religious courts so that the newly created *Syariah* courts[7] manifest greater parity with their common law counterparts, the civil courts. This has been accompanied by a spate of legislation strengthening Islamic law in the country.[8]

The quest for achieving the equilibrium between the traditional Bruneian and the more secular western processes extends beyond establishing parity in the formal structures of courts and adjudication. It can be seen also in the developments in other forms of dispute resolution, including arbitration and mediation. Both of these process are well established in most common law countries and have also been identified as according with a general 'cultural preference to resolve disputes privately' noted in a range of Asian societies.[9] In reviewing arbitration and mediation in Brunei Darussalam, this paper commences with an overview of the historical and cultural antecedents of dispute resolution in the Sultanate. It then outlines the role of arbitration and mediation in Brunei, identifying how the country is accommodating its British legacy whilst preserving and promoting its own Islamic Malay identity.

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5 *Titah* (Speech given by the Sultan) to mark the Promulgation of Brunei Darussalam's Independence 1984 extracted in *Borneo Bulletin Yearbook 2000* at 92.

6 *Ibid.*

7 Emergency (Syariah Courts) Order (1998).

8 Islamic Family Law Order (1999); Syariah Courts Evidence Order (2001); Islamic Adoption of Children Order (2001); Syariah Courts Order (1998); Halal Meat Order (1998).

9 APEC International Commercial Disputes at www.arbitration.co.nz/apec/introduction.htm.

Historical and cultural antecedents for dispute resolution in Brunei

Prior to the establishment of courts during the period of the British Residency, Brunei fitted the mould of a society which had a long tradition of resolving disputes informally and consensually. The interventions of headmen, local *ulama* (religious scholars) in the community, and *imam* (prayer leaders at local mosques) had been well established as the means for settling differences and disputes at the local level. More serious disputes would come to either the district chiefs or the Sultan personally, with both fulfilling roles as mediator/arbitrator for those disputes involving valued property, or people of standing. For Brunei the historical antecedents provide strong endorsement for both mediation and arbitration. Being long-standing practices, they were embedded in the culture and continued to influence attitudes and sustain preferred ways of behaving, long after the establishment of the English common law courts.

In terms of culture,[10] researchers have found that people from different cultures adopt different priorities and means for managing conflict and resolving disputes. Moore[11] suggests dividing the world into direct dealing and non-direct dealing cultures. In the former, conflict and confrontation is accepted, and members are comfortable with direct dialogue, face to face interactions, and direct negotiations.[12] Members of non-direct cultures avoid conflict and confrontation, aim to preserve face for themselves and others, and opt for intermediaries in a resolution process.[13] Moore's descriptors are consistent with the findings of social science research undertaken into cultural variation. One cultural variable,[14] identified as correlating with divergence in managing conflict and dispute resolution, is that of individualism-collectivism. This cultural variable has been described and studied by Hofstede[15] and other cross-cultural researchers such as Bond[16] Hui and Triandis,[17] and Kim[18] so that

10 Culture has recently been defined as 'ideals, values and beliefs members of a society share to interpret their experience and generate behaviour and that is reflected by their behaviour', in Haviland, W, *Cultural Anthropology,* 1999, Fort Worth: Harcourt Brace College Publishers, 36. For an outline of the diverse and interdisciplinary perspectives on defining culture see: Johnston, DM and Ferguson, G (eds) *Asia-Pacific Legal Development,* 1998, Vancouver: UBC Press, 519.

11 Moore, CW, *The Mediation Process: Practical Strategies for Re solving Conflict,* 1996, San Francisco: Jossey-Bass Publishers, 33.

12 *Ibid.*

13 *Ibid.*

14 Other variables include high and low context communication, uncertainty avoidance, power distance, affectivity-affective neutrality.

15 Hofstede, G, *Culture's Consequence: International Differences in Work-related Values,* 1980, Beverly Hills: Sage.

16 Bond, MH and Hwang, K 'The social psychology of Chinese people', in Bond, MH (ed), *The Psychology of the Chinese People,* 1986, Hong Kong: Oxford University Press, 226.

it can be considered a concise, integrated and 'empirically testable dimension of cultural variability'.[19] The dimension is bi-polar, with individualism and collectivism at opposite ends of a continuum. Although it is acknowledged that both individualism and collectivism will be found in every culture, the research shows that one may clearly dominate over the other in particular cultures and countries.[20]

Countries that have been categorised as predominantly 'collectivist' share certain similar attitudes and preferred practices for dispute resolution. They give emphasis to the implications of their behaviour on others, share resources, emphasise harmony with shame being the controlling regulator, define themselves by group membership and subordinate personal goals to those of the group. By contrast, people in individualist cultures share mostly with their immediate or nuclear family, are less willing to subordinate their personal goals to that of the group, are prepared to confront others, feel personally responsible for their own successes or failures, and focus on individual initiative, achievements and uniqueness. When conflict arises, people in individualist cultures are more likely to confront the other party directly and employ their rights to justify their solution, on the basis that 'not to claim in the appropriate circumstances that one has a right is to be spiritless or foolish'.[21] Where direct confrontation fails, disputants can elect to articulate their case to a non-partisan third party. In collectivist cultures, conflict is perceived as disrupting the harmony in relationships, thereby necessitating these relationships be restored and maintained. The preferred way to restore relationships is to avoid any direct confrontation[22] and to negotiate a settlement directly, or through a third party, who also shares that group's goals. Only when this fails, and after successive efforts to resolve it intra-group, will external means be used.[23]

Brunei fits the mould of a predominantly collectivist country. Although Hofstede did not specifically study Brunei, his work in Malaysia is relevant. Hofstede has positioned Malaysia as a nation with a predominately collectivist culture. As both Malaysia and Brunei have similar ethnic mix, with Malays, Chinese and indigenous non-Malays comprising over 80% of the population,

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17 Triandis, HC, *Individualism and Collectivism,* 1995, Boulder: Westview Hui, CD and Triandis, HC. 'Individualism—Collectivism: a Study of Cross-cultural Researchers' (1986) 17 Journal of Cross-cultural Psychology, 225–48.

18 Kim, U, *Individualism and Collectivism: A Psychological, Cultural and Ecological Analysis,* 1995, Copenhagen: Nordic Institute of Asian Studies, Report Series No 21.

19 *Ibid* at 3.

20 Gunykunst, WB, *Bridging Differences: Effective Intergroup Communication,* 1991, Newbury Park: Sage, 61.

21 Kim, *op cit,* fn 18, 51.

22 For individualists, confrontation is seen as being direct, assertive, open and 'to the point'. All of which are regarded as positive being signs of personal strength.

23 Ting-Toomey, S, 'Intercultural conflict styles: a face-negotiation theory', in Young Yun Kim and Gudykunst, W (eds), *Theories in Intercultural Communication,* 1988, Newbury Park: Sage, 539.

and share a similar geographic, historical, linguistic and social development, it is logical that Brunei's culture would fall into the collectivist dimension. Additionally, the current promotion under MIB of values in accordance with traditional Malay culture ensures continuance of the collectivist viewpoint. Endorsement and maintenance of traditional cultural practices is occurring at both an official and local level, in order to create a buffer against the materialism and individualism of western culture.[24]

Traditional Malay culture aims to ensure that harmony in human relations prevails. Social harmony is to be maintained through mutual obligations, and through a defined social hierarchy in which respect and loyalty[25] is promoted. Community effort and mutual co-operation *(gotong-royong)* is fostered by kinship and locality ties, and reinforced by Islamic values.[26] Decisions in the *kampongs* are to be reached through consensus.[27] The way to maintain good relations in families and communities is through avoidance of conflict by adhering to proper behaviour or *halus,*[28] respecting rank and status, and deferring to those with higher status.[29] Social harmony is further achieved by observing the established rituals of courtesy. There is a strong commitment to mutual help, based on notions of duty, obligation and generosity,[30] with co-operation and sharing amongst group members known as *memucang-mucang.*[31] These features of Malay culture extend beyond the family and social setting into the commercial and professional area. Business relationships are equally personalised, and governed by 'elaborate forms of curtesy and standardised rituals calibrated according to the rank of the recipient'.[32] In business dealings, there is as much concern for the social relationship[33] as there is for the commercial side of the negotiation, with contractual details and obligations being less important than the trust and understanding between the parties.

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24 Matussin bin Omar and Dato Paduka Haji, 'The making of a national culture: Brunei's experience', in Thumboo, E (ed) *Cultures in ASEAN and the 21st Century,* 1996, Singapore: Singapore University Press, 10.

25 Selverajah, CT, 'The cultural dimensions of Brunei entrepeneurs' (1995, 1996) 4 Journal of Small Business Enterprise Research Australia and New Zealand 64 at 66.

26 Hamzah-Sendut, Tan Sri Datuk and Thong Tin Sin, G, *Managing in a Plural Society,* 1989, Singapore: Longman, Singapore, 139.

27 Process for working through differences to find consensus is known as *musyawarah.*

28 There are similarities between *halus* and other Asian concepts based on respect for others, and their mutually reinforcing nature, such as Korean *'kibun'* (considerate behaviour), Thai *krengchai,* and Chinese *mien-tzu* and *lien* or 'face'. See Hamzah-Sendut *et al, op cit,* 141–42.

29 Rank is derived from origins, age and seniority, socio-economic rank, personal attributes and morality. Morality is important as it revolves around notions of personal honour (*muruah*). See Wazir Jahan Karim, *Women and Culture: Between Malay Adat and Islam,* 1992, Boulder: Westview Press, 5.

30 *Ibid* at 10.

31 Matussin bin Omar, *op cit,* fn 24, 14.

32 Hamzah-Sendut *et al, op cit,* fn 26, 141.

33 The social relationship is also governed by *halus,* and the familiarity and informality that may mark western business dealings, can run counter to correct or polite conduct in the Malay context.

One consequence of Brunei's collectivist character is the desire to avoid direct confrontation when dispute arises, in favour of compromise and settlement through direct, or third party, negotiations. Collectivist cultures generally correlate with preference for consensual rather than adversarial outcomes.[34] As the western process of ADR, particularly those of mediation and arbitration, are seen as being less adversarial and as giving more control to parties in a dispute than litigation, there was an expectation that these ADR processes would be adopted in collectivist societies such as Brunei.

However, the processes labelled as part of ADR in the west[35] were ones that developed in highly individualistic cultures. ADR grew as a response to disillusionment with the litigation model that was being used in common law countries such as America, England and Australia. It was widely perceived in those countries that delays in the courts were impacting negatively on outcomes and the perception of justice.[36] Concern was also expressed that: 'the adjudicative bias of today's legal profession is not only a fantasy: it harms dispute resolution. Litigation as used in many traditional areas of law is too expensive, divisive, inaccessible or ineffective.'[37] It was also critiqued on grounds that it was perceived to be hostile and alienating: 'women and minorities have remained at the periphery of the Anglo-Celtic, male matrix of legal values which are expressed in a court room, together with a distressing style of cross-examination and oppressive discourse.'[38] There was sufficient consensus that deficits existed with the model and that these needed to be addressed. One means was by reform to the existing system by way of case management. The other was for alternative processes, loosely categorised under the catch-all phrase of ADR, to be encouraged and officially supported by governments and their agencies, the courts, professionals legal and non-legal, and by educational or training facilities. A need was perceived and ADR was part of the remedy.

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34 Pirie, AJ, 'Alternative dispute resolution in Thailand and Cambodia', in Johnston, DM and Ferguson, G, *Asia Pacific Legal Development,* 1998, Vancouver: UBC Press, 525.

35 The modern emergence of ADR is generally attributed to the American developments in the 1970s, including the American Bar Association's establishment of the Special Committee on Alternative Means of Dispute Resolution in 1976, and role of the Society of Professionals in Dispute Resolution promoting 'use of neutrals' in resolving disputes. See Folberg, J and Taylor, A, *Mediation: A Comprehensive Guide to Resolving Conflicts Without Litigation,* 1984, San Francisco: Josey-Bass, 5. Developments in America were followed in United Kingdom and Australia, 'not as direct parallels' but cognizant of those developments. In Australia, Community Justice Centres were established in the 1980s for community disputes, the Family Court of Australia created in 1975 promoted conciliation and counselling, and Sir Laurence Street was instrumental in setting up the Australian Commercial Disputes Centre in 1986. See Astor, H and Chinkin, C, *Dispute Resolution in Australia,* 1992, Sydney: Butterworths, 1–12.

36 Folberg, J and Taylor, A, *ibid* at 4.

37 Effron, J, 'Alternatives to litigation: factors in choosing' (1989) 52 Modern Law Review 480.

38 Thorton, M, 'Equivocations of Conciliation: the resolution of discrimination complaints in Australia' (1989) 52 Modern Law Review 735.

In Brunei Darussalam the same need has not been identified. Court congestion is not a pressing problem, there has been little concern expressed about the cost of litigation, and the society has religious and cultural beliefs, traditions and practices that are distinctive and not shared with the west. More importantly, Brunei already had its own operational forms of traditional dispute resolution, including mediation and arbitration. Although these had evolved centuries before the period of British colonisation, they had continued to be utilised right through the period of the British Residency. Whilst the British brought in adversarial concepts that limited outcomes to winners and losers, as well as limiting remedies, for most Bruneians, especially those living outside the towns, little changed over those decades. Most disputes at the local level continued to be resolved, as they had been in the past, through the intervention of the village headmen.[39] There was no need for most disputes to reach the courts. These could still be settled within the villages in accordance with *adat,* as had been done for centuries. This continuity with tradition was not erased by the British, and continued informally to co-exist with the formal processes provided by the common law. Both the traditional and the western common law continue to inform, to varying degrees, arbitration and mediation in the Sultanate.

Arbitration in Brunei Darussalam

Arbitration can be described a process in which a dispute is referred to the adjudication of a third party arbitrator chosen by the disputing parties and whose decision will be binding on them. It is a consensual process which is executed in a judicial manner. Parties, either in a dispute or entering into a contract together, may decide that were a dispute to arise, it should be resolved by arbitration. It can give an award which is legally binding, but avoid what they consider may be the disadvantages of litigation in the courts.[40] The preference disputing parties will have for arbitration as a process is determined by many factors. These come from their perceptions as to the degree of advantage or disadvantage of arbitration vis à vis other processes, knowledge the parties have of these, past experiences, advice given by others, perceptions regarding the specific expertise of the arbitrator or centre providing dispute resolution services, availability, risk assessment, cultural preferences and personal instinct.

In Brunei, there are two forms of arbitration available to disputing parties. There is arbitration in accordance with legislation—Emergency (Arbitration)

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39 Brunei Annual Reports confrim this. For example, the Report for 1910 notes that Dusun and Tutong headmen were upholding *adat* law when dealing with disputes in their villages.

40 Advantages for arbitration suggested in the literature include choice of tribunal; confidentiality; speed; technical rather than legal expertise of a particular arbitrator; cost; wider choice of representation; flexibility of procedure, wider jurisdiction than a court. See Tay Swee Kian, C, *Resolving Disputes by Arbitration,* 1998: Singapore, Singapore University Press, 18–23.

Order (1994)—which is designed to meet the needs arising from commercial transactions, both domestic and international. It reflects both the country's British legacy and the nation's continuing priority to facilitate certainty and confidence in Brunei as a centre for trade, business, investment, finance, construction, and banking in the region. However, Brunei's Islamic identity can be seen in the retention of traditional Islamic arbitration—*takhim*. To date, *takhim* has been mainly limited to family and marital disputes, although in other Islamic nations it is used widely in commercial disputes as well.[41] The availability of these two forms of arbitration is a manifestation of how Brunei balances its British legacy with its Islamic and Malay core values.

Features of arbitration pursuant to the Arbitration Act (1994)

The Emergency (Arbitration) Order (1994) was enacted less than 10 years ago to provide the country with the legislative framework for resolution of civil disputes by means of arbitration. It has subsequently become classified as the Arbitration Act (1994), Cap 173 of the Laws of Brunei Darussalam. As Brunei Darussalam is now a party to The United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards (the New York Convention), the Act gave effect to the provisions of that Convention. The Convention obliges the courts in Brunei, as one of the signatory states,[42] to defer to arbitral jurisdiction whenever a case is brought under a contract containing an arbitration clause,[43] and to enforce an arbitral decision made in another country[44]—although there are some limited exceptions to the latter. The grounds for appealing arbitral awards are set out in Art V, including that the award was set aside by a court in the country where it was originally awarded.[45]

To date, Brunei Darussalam is not a party to the Washington Convention (ICSID),[46] nor has it entered into any bilateral investment agreements with arbitration provisions. Brunei Darussalam has recently become a signatory member of WIPO.[47]

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41 Saudi Arabia is one such country. See Sayen, G, 'Arbitration, conciliation, and the Islamic legal tradition in Saudi Arabia' (1987) 9 University of Pennsylvania Journal of International Business Law 211–55. Generally on Islamic arbitration, see Powell-Smith, V, *Aspects of Arbitration: Common law and Shari'a Compared,* 1995, Selangor, Central Law Book Corporation.

42 New York Convention 1958, Art III.

43 *Ibid,* Art II.

44 No foreign arbitral awards had been enforced at the time of communication with the Chief Justice, September 2000.

45 New York Convention 1958, Art V (e).

46 International Convention on the Settlement of Investment Disputes between States and Nationals of other States was signed in Washington 1965. In 1966, the Centre for settlement of international investment disputes through arbitration and conciliation was established as an autonomous international organisation.

47 World Intellectual Property Organisation is an international body of the United Nations established to promote and protect intellectual property around the world. In 1994 the WIPO Arbitration and Mediation Center was established.

The Act does not adopt the UNCITRAL Model law for arbitrations. This procedural model was adopted by the United Nations General Assembly in 1958, with the aim of establishing a comprehensive set of rules that would give a unified framework for efficient settlement of commercial disputes internationally, and harmonise the various national legal systems. Parties in Brunei Darussalam could apply the rules of UNCITRAL or the rules of an arbitration institution,[48] as the Act does not limit the parties doing so. It gives them autonomy to modify the procedural rules in the Act, and to introduce their own. The reason for Brunei Darussalam not adopting UNICITRAL may lie in the fact the Britain has not done so. The commercial and civil law of Brunei is essentially the same as that of England.[49]

The Act will apply when parties have made an arbitration agreement. Section 2 of the Arbitration Act defines an arbitration agreement as 'an agreement in writing (including an agreement contained in an exchange of letters, facsimiles or telegrams) to submit to arbitration present or future differences capable of settlement by arbitration whether an arbitrator is named therein or not'. This covers *ad hoc* submissions of existing or current disputes, as well as those where the original agreement between the parties had a contractual clause to the effect that any disputes arising out of their agreement would be resolved by arbitration.

It has been estimated[50] that arbitration agreements would be contained in 90% of contracts in the construction industry, which is the second largest industry in Brunei Darussalam,[51] as well as in a large number of commercial contracts, especially where the subject matter of the contract is complex or technical. Such arbitration agreements are typically found in contracts with the Government of Brunei, for the government and its agencies have immunity from suit. Arbitration can provide an avenue for adjudication in the event of a dispute, otherwise the contracting party has to rely on negotiated settlements with the government. Although the majority of commercial and construction contracts contain arbitration agreements, in practice most parties prefer to waive their rights under the arbitration agreement, in many cases being advised to do so by their lawyers. Arbitration agreements can be put into contracts to be used as a delaying tactic to buy time, should a dispute arise and the other party commences legal proceedings to get summary judgment in the court. This is because the Act allows for an application to be made to stay the court proceedings in order for arbitration to take place.[52] The court will stay the proceedings unless it is satisfied that the arbitration agreement is null and void,

48 Rules of arbitration of the Institute of Engineers (Malaysia) or the Singapore Institute of Architects.
49 Ong, CYC, *Cross-Border Litigation within ASEAN,* 1997, The Hague: Kluwer, 135.
50 Based on discussions with lawyers and an arbitrator from the firm of JR Knowles regarding arbitrations in the construction industry.
51 Oil and gas industry being the largest.
52 Arbitration Act (Cap 173), s 7.

inoperative, incapable of being performed or that there is in fact no dispute between the parties. The Act does not specify which types of disputes can be arbitrated. Certainly, criminal matters are excluded[53] and generally have been in the past for reasons of public policy. However, contracts 'relating to land or an interest in land'[54] would also be excluded, because an arbitrator cannot make an order for specific performance where there is such a contract. Otherwise, the arbitrator has the same power as a court regarding specific performance remedies, unless it is expressly excluded by the contract. Generally, it is matters in which damages may be claimed that go to arbitration. The High Court does have power to set aside any award from an arbitration if it is satisfied that the arbitration agreement was null and void, inoperative or incapable of being performed, or that there is not in fact any dispute between the parties with regard to matters agreed upon for arbitration.[55]

The Act makes a distinction between domestic and international arbitration. The significance is that there are different provisions[56] in the Act to be applied in either case. An arbitration is international 'when the agreement expressly or by implication provides for arbitration in a state or territory other than Brunei Darussalam and to which neither:

(a) an individual who is a national of, or habitually resident in any state or territory other than Brunei Darussalam; nor
(b) a body corporate which is incorporated in, or whose centre management and control is exercised in any state or territory other than Brunei Darussalam,

is a party at the time the proceedings are commenced'.[57]

The law to be applied in arbitration is that determined by the parties. In most domestic arbitration agreements it is stipulated to be the law of Brunei Darussalam. Whilst government contracts are generally silent as to the choice of law, the *prima facie* position is that the law of Brunei Darussalam would be held to apply. This accords with the English position that in the absence of an express choice it is the law with which the agreement is most closely associated.[58]

There is no stipulation as to the language to be used in arbitrations, but as English is the language used in legal proceedings in the secular courts, and is widely spoken as the second language in Brunei in commercial and international dealings, English would customarily be used in arbitrations.

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53 Given the long title which states 'An Act to make provision for arbitration in civil matters'.
54 Arbitration Act (Cap 173), s 21.
55 *Ibid,* s 8(1).
56 Applications for stay of proceedings, s 8; exclusion agreements, s 30.
57 Arbitration Act (Cap 173), ss 8(3) and 30(2).
58 *Hamlyn v Talisker Distillery* [1894] AC 202.

There is no provision in the Act on confidentiality, so this would need to be specified in the agreement to arbitrate.

There are no restrictions on who can be appointed arbitrator, apart from the fact that the consent of the Chief Justice is required before judges and magistrates of Brunei Darussalam can be appointed; and the Minister of Law, who is chairman of the Public Service Commission, must give consent for the appointment of any public servant.[59] Government contracts give the authority to the Minister of Development to appoint an arbitrator, and where the Minister does not so nominate, then the Chief Justice can appoint the arbitrator.

Conciliation under the Act

Conciliation is provided for in Part 11 of the Arbitration Act, but is limited to circumstances where the parties to an arbitration agreement have included a written provision in their arbitration agreement that they should first attempt to settle their dispute by conciliation.[60] Conciliation is not defined but has been taken to mean a process whereby parties are assisted by a neutral conciliator/mediator to reach a mutually acceptable solution to the dispute.[61] The term 'mediation' can be used interchangeably with 'conciliation', but in the context of this Act, conciliation is used. If the conciliation process fails to produce such an agreed solution, it automatically terminates at the end of three months. Where an acceptable agreement is reached and is signed by the parties, it will be treated as an arbitration award and is to be enforced in the same way as an arbitral award.[62] Where there is a provision for the conciliator to become an arbitrator if the conciliation were to fail, that alone does not become a ground for objection. The Act is silent as to the confidentiality of conciliation.

Where the arbitration agreement contains a conciliation provision but does not specify who is to act as a conciliator, the court can appoint a conciliator. The High Court of Brunei Darussalam had not made such an appointment up to 2001.[63] Legal practitioners indicated that they were not aware of any conciliation proceedings having occurred under the Act, and there were some expressions of concern or doubt as to who would have the ability or experience to warrant such an appointment. Provisions for conciliation are not standard in either commercial or construction contracts in Brunei Darussalam, and there was a perception that if a dispute had reached a stage where it was proceeding to arbitration, it would be too late and unproductive to spend time on conciliation.

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59 Arbitration Act (Cap 173), s 16.
60 *Ibid,* s 3.
61 Based on the definition of conciliation and mediation used in WIPO: http://arbiter.wipo.int/arbitration/index.html.
62 Arbitration Act (Cap 173), s 3(4).
63 Personal communication with the Chief Justice, Dato Sir Deny s Roberts.

Factors impacting upon the role of arbitration in Brunei Darussalam

There are no official figures available on the number of domestic arbitrations taking place in Brunei Darussalam. Lawyers in commercial practice indicated that the actual numbers of arbitrations were small, and that it was an under-utilised option. The Chief Justice was in agreement[64] that the numbers were small, estimating that possibly four to six disputes a year would be decided by arbitration, though two to three times that number of disputes would threaten to use arbitration as a means to bring about a settlement. Like litigation, arbitration was used as a tactic to facilitate negotiations rather than a dispute resolution process in itself. 'There may be an Act, but people in business don't think of it (arbitration) as a serious option' was one lawyer's summary of the situation.[65]

In Brunei, there seemed to be a perception that there was no real need for arbitration to play a greater role. There could be several explanations for this. On the practical side, local lawyers considered that the courts generally work effectively. It meant there was no reason to look for alternatives when 'it doesn't take long to get a matter before the courts and you can be guaranteed a fair hearing'.[66] It was also indicated that there was no significant difference in terms of time or costs between arbitration and litigation, and if there was, arbitration was considered the more expensive (especially arising from payment of arbitrators' fees) and more protracted. Possibly the effectiveness of the court process has been complemented by the introduction of pre-trial conferences. These are mandatory for all cases set for trial before the High and the Intermediate Court, where parties are legally represented. The judge or the Registrar attempts to facilitate a settlement between the parties prior to trial. The degree of knowledge and familiarity of arbitration as a process could also be a contributory factor. Arbitration was not a service that all firms in Brunei were able to offer, or to provide representation for their clients. This applied to both domestic and international arbitration. There was also questioning of the ability of some of the other firms to actually provide arbitration for their clients. The process of 'selling' arbitration as a service in Brunei Darussalam has been undertaken by a British firm that specialises in the provision of ADR services to the construction industry. The firm reports that whilst there had been good attendance at information seminars, the majority of attendees were employed by the government, with private business and the legal fraternity under-represented and generally resistant to the possibilities. The indications were that in Brunei Darussalam lawyers perceived arbitration as an alternative method of litigation,

64 *Ibid.*
65 Personal communication.
66 Personal communication from a lawyer in private practice in response to a question about using arbitration. It was representative of the opinions given by several of the lawyers interviewed.

rather than as an alternative to it, and the level of confidence in the courts obviated the need to actively consider the alternatives. There have been occasions, however, when the Supreme Court has diverted a matter to arbitration, when the amount of evidence was such that the protracted nature of proceedings would adversely affect the court list.

It was suggested that a number of contracts and transactions in Brunei Darussalam may be tainted with aspects of illegality, minor and major, and that the scrutiny by the courts or by arbitrators would not be wanted. Even without that consideration, both processes were seen as 'going into the minutiae' rather than getting to the crux of the dispute—essentially coming from the western stable of processes, and not according with the inherent collectivist viewpoint. Both appear to threaten, possibly to be destructive of, good social relationships, which are prioritised in Bruneian culture. Whilst in theory arbitration can be less regulated, less formal and more consensual than adjudication in the courts, in reality, many in Brunei Darussalam see it as equally rule bound, inflexible, and adversarial. It means the choice will come down to going to court, always with the strong possibility that a negotiated settlement will be the outcome (3–6 % of cases registered in the Intermediate or Supreme Courts settle before trial), or the dispute will be settled through 'local means and contacts'. This refers to direct negotiations between the parties, and negotiations which are facilitated 'intra communally' when both disputants share the same ethnicity, language and culture.[67] It involves calling on contacts within one's own community to assist in the resolution of the dispute. Often it will involve a significant third party in that community assisting in an informal but persuasive form of mediation. The third party will be connected to one or both of the disputants through family, friendship or business ties. This is possible given the small population of Brunei Darussalam—330, 700 (1999), with 200,000 residents in Bandar Seri Begawan, the capital and commercial centre.

An important question, when any dispute arises in Brunei Darussalam involving a company, is: 'who is behind it?' The indications are that if the person is well connected, especially with links to the Royal family, then the likelihood of proceeding with either litigation or arbitration becomes negligible. Apart from concern over the impact on future business dealings and possible diminution of goodwill, local culture ensures that a Bruneian Malay would find it socially inappropriate to bring an action in the courts, or to invoke arbitration, even when there is a contract with a provision for arbitration. The tenacity of the traditional social hierarchical structure and accompanying rules of appropriate behaviour, even in today's society, mitigate

67 In Brunei Darussalam awareness of ethnicity is evident. It is a factor in employment, education and government services. The Government uses 'ethnicity' as a classifier more explicitly than do multi-cultural countries such as Australia. Identity cards, passports, entry permits and visas will require 'race' to be entered as well as nationality.

against taking action against a person of royal standing or rank. The factor of social place, with its accompanying power dimension, requires deference to be displayed to persons of higher rank, social status or age. This is seen to impede the acceptance and implementation of western ADR processes, including arbitration, and has parallels in other countries such as Thailand and Cambodia.[68]

The role of the state ideology, MIB, in reinforcing this reluctance to arbitrate or litigate against such parties is a consequence of the *Beraja* component, which endorses traditional Bruneian values and practices. It promotes the *adat istana*[69] and the formalities and features of traditional stratified Brunei society which places the Sultan and the royal family at the apex.[70] Even if there is a good legal or arbitral issue, a Malay party may compromise to their own financial disadvantage, or 'lump' the grievance altogether. Though derived from these traditional notions of polity and order in society, these notions were also reinforced during the period of British residency. Civic apathy 'concomitant with an inborn respect for authority' has been found in other colonised countries in the region.[71] The colonial authority, whilst allotting only a small decision making role to the Sultan and the traditional power holders, maintained an outward show of their symbolic authority. The current ideology of MIB has retained these notions of respect for authority by harnessing these concepts as 'Bruneian'. These considerations impact upon dispute resolution in Brunei, and contribute to the generally low litigation rates[72] and the reluctance to go to arbitration. The consequence is that arbitration would be more likely to be employed for dispute resolution where there exists some equality in social and commercial standing, without there being a close social relationship. For this reason, overseas international companies rather than local Bruneian ones have been more willing to arbitrate.

Although arbitration has not been widely adopted in Brunei Darussalam as a process for commercial dispute resolution, domestically or internationally, this seems to be consistent with, rather than against, the trend in many Asian countries.[73] However, as some Asian nations, including Hong Kong and Singapore, have high acceptance of arbitration, it highlights the problem in generalising about the region. A recent APEC Report noted: 'arbitration is

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68 Pirie, AJ, 'Alternative dispute resolution in Thailand and Cambodia: making common sense on (un)common ground'. Johnson and Ferguson, *op cit,* fn 10, 534.

69 Law and customs of the Palace.

70 Traditional Brunei society was stratified into two groups, nobles and non-nobles, with the nobles at the apex of society in terms of social standing, power and influence and wealth.

71 Crane, C, Gillen, M and McDorman, TL, 'Parliamentary supremacy in Canada, Malaysia and Singapore', in Johnston and Ferguson, *op cit,* fn 10, 208–15.

72 Number of disputes registered in the courts of Brunei was 2 per 1,000, compared with 5 per 1,000 in Japan, and 50 per 1,000 in England. Comparative figures from Nottage, L and Wollschlaeger, C, 'What do courts do?' (1996) New Zealand Law Journal 369.

73 Pirie, *op cit,* fn 68, 543.

certainly a dispute resolution technique that is in use in the Asia Pacific region. It would appear, however, mainly from anecdotal evidence, that resort to arbitration to settle disputes has not grown as rapidly as one would have expected given the growth in the number of transactions that make up the present trade flows in the region.'[74] Structural reasons are given, including that rules for conducting arbitration differ between the countries in the region which creates uncertainty and diminishes confidence, and that there are differences in the region in the willingness of courts to enforce arbitral awards in international commercial disputes.[75] Cultural reasons, such as the adversarial nature of arbitration in societies where compromise is prioritised, and its capacity to destroy business relationships were also given. A further cultural factor was that in international transactions where parties may come from diverse geographical and legal backgrounds, there may be insufficient understanding of the other's culture to trust ADR processes as being fair or reasonable.[76]

Features of Islamic arbitration (Takhim)

Long before the advent of Islam, much of the Middle East, including Arabia, practiced arbitration. Disputes were settled either by means of self-help processes, by way of negotiation and personal vengeance, or by tribal arbitration. The latter was the sanctioned form for dispute settlement.[77] The divine revelations to the Prophet Mohammad made him an arbitrator *(hakam)* for disputes amongst his followers. He rejected the pagan elements that existed in pre-Islamic arbitration, but not arbitration as a process.[78] He conducted arbitrations as well as adjudications, the differences being that in arbitration the parties chose their arbitrators, whilst in adjudication the judge was appointed by the ruler or government. The Prophet also recommended

74 APEC International Commercial Disputes: www.arbitration.co.nz/apec/introduction.htm.

75 *Ibid.* On practical difficulties with arbitration see: Ong, *op cit,* fn 49, 27.

76 Ong, *op cit,* fn 49.

77 Arbitration operated as a voluntary private arrangement with the awards not legally binding and their enforcement dependent on the moral authority of the arbitrator. The parties were able to appoint any person as arbitrator, or *hakam.* Schacht reports that that a *hakam* 'was chosen for his personal qualities, for his reputation, because he belonged to a family famous for their competence in deciding disputes, and above all, perhaps, his supernatural powers which the parties often tested beforehand by asking him to divine a secret. Because these supernatural powers were most commonly found among soothsayers *(kahiri),* these last were most frequently chosen as arbitrators'. The divine inspiration claimed by these early arbitrators was significant in inducing submission of disputes for arbitration and in ensuring the parties abided by the awards given. See Schacht, J, *An Introduction to Islamic Law,* 1964, London: Oxford University Press, 7.

78 Evidence of the Prophet Mohammad's endorsement of arbitration for disputes and specifically for marital ones can be seen in this *sura* from the Quran: 'And if you have reason to fear that a breach might occur between a [married] couple, appoint an arbiter from among his people and an arbiter from among her people; if they both want to settle things aright, God may bring about their reconciliation. Behold, God is indeed all knowing, aware.' (Sura al-Nisa 4:35.)

others to be arbitrators.[79] After his death, the Prophet's companions recognised validity in the process and exhorted the role of those who arbitrate and conciliate.[80] The importance is evident in the advice that 'composing of differences between men is better than all fasts and prayers'.[81] Islamic arbitration evolved in the centuries that followed. Although it was derived from the *Syariah,* and was required to be in accordance with it, doctrinal variations between the major schools of law developed. These included whether an agreement to arbitrate in a possible future dispute was valid in Islamic law, or void for uncertainty.[82] There were differences in the process of appointment of the *hakam,*[83] but all were in agreement that a third party, even an Islamic judge *(kadi),* could not appoint a *hakam* who was unacceptable to the disputing parties.[84]

There were aspects of conciliation incorporated into *takhim*. Attempts were made to conciliate *(suhl)* the parties, to persuade rather than to coerce, with the *hakam* endeavouring to create a co-operative atmosphere conducive to amicable settlement. If *suhl* could not be attained, then the *hakam,* guided by the *Syariah,* reached a decision for the parties. The schools differed as to whether a decision of an arbitrator could bind the parties. Imam Shafi'i considered that an arbitral award would only be enforceable if both parties agreed to it.[85] This renders it closer to a form of conciliation or mediation. There were other scholars, in addition to the Malaki and Hanbali, who felt a *hakam's* decision was legally equal to that of a *kadi,* as an Islamic judge. The Hanafi scholars held that a *kadi* could only enforce an arbitral award if he agreed with the veracity of the decision.[86]

In all schools, the qualifications for an Islamic arbitrator are essentially the same as for a *kadi,* and reflect the religious character of the process. The arbitrator must be just and trustworthy, learned in the *Syariah,*[87] and without defects, mental or physical. In the Shafi'i school he must be male,[88] and

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79 Abdul Hamid El-Ahdab, 'The Moslem arbitration law', in Proceedings of the International Bar Association First Arab Regional Conference, Cairo February 1987, Vol 1, 342.

80 Powell-Smith, V, *Aspects of Arbitration: Common law and Shari'a Compared,* 1995, Selangor: Central Law Book Corporation, 4–6.

81 In the Fatamid authority *Da'a'im al'Islam* cited in *ibid.*

82 The uncertainty *(gharar)* is based on the possibility of a dispute arising at some future time over an aspect of the contract that was unknown at the time of agreement.

83 In the Shafi'i, Hanifa and Hanbali schools, the appointment of the *hakam* could be revoked by either of the disputing parties or by the *hakam* himself, up until the announcement of the decision. In the Malaki texts it was irrevocable. See Sayen, *op cit,* fn 41,230.

84 However, where the appointment of a *hakam* was ratified by a *kadi,* it could not be revoked.

85 Abdul Hamid El-Ahbad, *op cit,* fn 79, 341.

86 Sayen, *op cit,* fn 41, 235.

87 The Hanafis do not hold this as an essential requirement, as an arbitrator can avail himself of professional advice. See Hussain, J, *Islamic Law and Society,* 1999, Leichhardt: Federation Press, 175.

88 Also in the Malaki and Hanbali schools. The Hanafi school permits a woman to sit as a *kadi* in financial and commercial matters and hence is able to arbitrate in these matters.

credible *(adil),*[89] so that he is beyond reproach in religious and worldly matters, and a Muslim. There are some exceptions to this, for instance, when the arbitration is taking place in a non-Muslim country, or when one party is a non-Muslim and the dispute is purely commercial, not a involving family or personal matters.[90]

Today, arbitration remains a recognised process for resolution of commercial as well as family disputes in many Islamic countries.[91] Whilst the *Syariah* continues to inform the procedural and substantive aspects, the actual application and implementation does differ widely between schools and therefore countries. The degree of secularisation of the courts, the extent to which statute law has been developed, as well as the 'degree of strictness'[92] in adherence to specific Islamic doctrine, have created significant divergence in application.

Role of Islamic arbitration in Brunei Darussalam

To date, the scope of Islamic law has been limited to family, succession, personal and religious matters, with the common law regulating commercial and financial matters. This was a direct consequence of the prioritisation the British gave to commercial and trade matters to ensure replication, as far as was possible, of English common law in its colonies. This was to negate the development of *takhim* as a method of commercial dispute resolution in Brunei. However, this could change, given the increasing Islamisation of all aspects of Brunei society, including extensions into the commercial and administrative sectors. The first manifestations of Islamisation (apart from the prohibition on the sale and importation of alcohol in 1991 and pork production in 1992) were seen in laws relating to the financial sector, when provisions were made for Islamic banking and finance.[93] The opening of the first Islamic Bank of Brunei in 1993 was followed by subsequent branches;[94]

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89 This is also a requirement for witnesses see Anwarallah, *Islamic Law of Evidence,* 1994, Bandar Seri Begawan: Islamic Da'wah Centre, 11; Powell-Smith, *op cit,* fn 41, 37.

90 Abdul Hamid El-Ahdab, *op cit,* 377.

91 Saudi Arabia, Egypt, Jordan, Sultanate of Oman, Qatar, Bahrain, Yemen Arab Republic, United Arab Emirates.

92 Saleh, S, *Commercial Arbitration in the Arab Middle East,* 1984, London: Graham & Trotman, 12. Also Proceedings of the International Bar Association First Arab Regional Conference, February 1987, Cairo.

93 This provides services to clients free from the giving or taking of 'interest', as this may be classified as *riba,* which is prohibited under the Quran and *Sunnah* in Islamic law. Business activities are to be based on *halal* profit, that is, profit from activities allowed and not forbidden in Islam, and must not involve *gharar,* unreasonable uncertainty or speculation. Financial transactions must accord with Islamic principles or social justice, and banks have obligations to pay *zakat* (tithe) to assist the disadvantaged persons in the local community. For a detailed analysis see Abdullah Saeed, *Islamic Banking and Interest,* 1999, Leiden: EJ Brill; Lewis, MK and Algoud, Latifa M, *Islamic Banking,* 2001, Cheltenham: Edward Elgar.

94 In 1996 the Branch at Seria opened. *Borneo Bulletin* 13/14 July, 1996.

the development of the Islamic Trust Fund *(Tabung Amanah Islam Brunei)*; Islamic Insurance *(takaful)*;[95] and the conversion of the Development Bank of Brunei from conventional banking to a '*riba*-free' full Islamic system.[96]

However, as the British had not been so concerned with interpersonal family matters arising amongst their colonised people, Islamic processes could be applied in matters relating to divorce, marriage, and succession. Part IV of the Religious Council and Kadi Courts Act (1956), and as revised in 1984, did provide for arbitration in disputes relating to marriage and divorce, when both parties were Muslim and their marriage was solemnised in accordance with Islamic law. The Quranic recommendations regarding arbitration for marital disputes were reflected in the specific sections of the Religious Council and Kadis Courts Act (1984), which required the appointment of *hakam* by the *kadi* when there were 'constant quarrels between the parties to a marriage'.[97] Two arbitrators, acting for the husband and wife respectively, were to be appointed. Where possible, the *hakam* should be a close relative of the parties because this would provide them with knowledge of the circumstances of the case,[98] and ensure a strong commitment to do what is in the best interests of the disputants. The *kadi* could give directions to the *hakam* on how to conduct the arbitration, which must be in line with Islamic law. Where the arbitrators were unable to resolve the dispute, or the *kadi* was not satisfied with the arbitral process, other *hakam* could be appointed. If the *hakam* were in agreement that the parties could not be reconciled, a divorce could be granted by the *hakam,* provided the parties had given their authority for this. Otherwise, the *kadi* could confer on *hakam* the authority to decree a divorce and to have it registered.

The second provision for the intervention of a *hakam* under the Act was when there had been a revocable divorce after one or two *talaks,*[99] and the husband has pronounced *rujok* (the term for his intention to resume 'conjugal relations')[100] with the wife consenting to the *rujok,* but not resuming conjugal relations. Where there was no reason in Islamic law not to resume conjugal relations, *hakam* could be appointed to arbitrate a resolution to the dispute.

The use of *hakam* pursuant to the Act had been declining,[101] so that rarely did the *kadi* use his discretion for the appointment of such arbitrators. The

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95 This operates on similar principles to Islamic banking set out at fn 93.
96 'Imams praise Islamic Banking' *Brunei Bulletin,* 5 August 2000.
97 Religious Council and Kadis Courts Act, s 149.
98 *Ibid.*
99 *Talak* or *talaq* is a form of divorce in Islamic law, available only to a husband. The *talaq* is a pronouncement to his wife that a husband is divorcing her. The *talaq* can be revoked by the husband during the period known as idah (the time during which three menstrual periods elapse), and the marriage continues. After three *talaqs* a divorce becomes irrevocable. See Hussain, *op cit,* fn 87,87–89.
100 Religious Council and Kadis Courts Act, s 150(6)(a). Also *ruju* in s 53 of the Emergency (Islamic Family Law) Order (1999).
101 Official figures are not available but personal communication with the Chief Kadi indicated this.

reasons[102] given for this were that divorce had become more accepted as a common life event for both Muslims and non-Muslims in Brunei.[103] This had lessened the social stigma of divorce, and so the earlier priority to reconcile disputing spouses had reduced. Marriage breakdowns had become more complex and bitter, with less willingness to be conciliatory. *Kadis* continued to encourage settlement and conciliatory solutions to marital disputes, but were increasingly using professional counsellors, known as Family Advice Service officers, rather than *hakam*. Unlike *hakam,* these officers received training for their role, being supervised employees of the Religious Affairs Department. The establishment of the Family Advisor Unit in the Department of Religious Affairs corresponded with the declining role for *takhim* in marital conflict and disputes.

Despite this noted decline in *takhim,* the recent Emergency (Islamic Family Law) Order (1999), which came into effect in 2001 with the establishment of the *Syariah* courts, has retained and expanded the role of *hakam* in the reconciliation of *syiqaq* disputes (those marked by marital discord and disharmony).[104] The Order distinguishes the roles for the Family Advice Service Officer and for *hakam*. *Hakam* can intervene when the Family Advice Service Officer has been unable to effect reconciliation between parties where one of them is seeking divorce.[105] *Takhim* is also specified in the Order for cases where the court rejects a wife's complaints to them that her husband has mistreated, assaulted or caused her harm, but she continues to repeat similar complaints, thus demonstrating that there are constant quarrels in the marriage.[106] In these cases, the court may appoint two qualified *hakam,* 'competent in matters relating to arbitration', with 'one acting on behalf of the husband, and the other on behalf of the wife in accordance with *Hukum Syara*'.[107] The qualifications referred to are those required under Islamic law, as discussed above, rather than professional arbitral qualifications. Also in accordance with traditional practice, the Order states that 'where possible' preference should be given to appointment of family members as '*qarabah qarib*[108] of the parties having knowledge of the circumstances of the case'.[109] *Hakam* are given authority to investigate the reasons for the quarrels, *syiqaq,*

102 Based on discussion with the Chief Kadi, practitioners in Islamic law and representatives from the Department of Religious Affairs.
103 Stephen, I, 'Hard times bring upsurge in divorce cases' *Borneo Bulletin,* 1 April 2001.
104 Emergency (Islamic Family Law) Order (1999), s 43.
105 *Ibid,* s 42(13). The officer has to submit to the court a certificate to that effect that he or she is unable to being about a reconciliation and persuade the parties to resume conjugal relations.
106 Emergency (Islamic Family Law) Order (1999), s 43(2). Where the wife proves to the court her claims of mistreatment, assault or harmful acts to her body, modesty or property by her husband, and the court fails to reconcile them, there a divorce *(talaq baain)* can be given. *Talaq baain* means the divorce does not allow for a *ruju,* or return to the original state of the marriage and resumption of conjugal relations.
107 *Ibid,*.
108 This means a family member, based on lawful blood lineage. Defined in the Order at s 2 *ibid.*
109 *Ibid,* s 43(3).

and endeavour to reconcile the parties.[110] This is to be a concerted process, because if the *hakam* are unable to agree in arbitration, the court has the power to order them to keep trying, and if the dispute continues for a longer period without reconciliation, the court can dismiss the *hakam* and appoint new ones.[111] When the point is reached where the disagreement and disharmony between husband and wife continues unabated, and the *hakam* consider reconciliation unlikely, they can decide that the parties are to divorce, in *talaq baain*. The *hakam* refer the divorce to the *Syariah* court, where it is accordingly registered and certified.[112]

The retention of the role for *hakam* in this new legislation demonstrates a clear affirmation of traditional Islamic dispute resolution practices. The delineation of the respective circumstances for intervention of *hakam* and of the Family Advice Service officer serves to guarantee the place of Islamic arbitration, as endorsed by the Prophet, in Brunei. As prescribed in the *Syariah,* the primary focus of *takhim* continues to be on reconciling differences between the disputing parties.[113] Where amicable resolution is not possible, *hakam* have authority to reach a conclusive settlement, which is recognised as binding and conclusive by the *Syariah* courts. One significant difference from arbitration in the western model is that Islamic arbitration is considered a religious act, so the *Syariah* must guide and inform any arbitral process. With these parameters, *hakam* must ensure that the process, and any settlement, accords with the *Syariah*. Additionally, under Brunei legislation the *hakam* will be chosen precisely for their knowledge of, and family relationship with, the parties.

Although *takhim* had been declining in marital disputes, its resurrection as a process integrated with those provided by the new *Syariah* courts is likely to generate a revival in Islamic arbitration that may not be limited to disputes between husbands and wives. It is possible that its role in the settlement of commercial and other disputes could be also resurrected. If Brunei Darussalam continues in its implementation of Islamic principles and processes into its commercial and financial practices, it is likely to follow other Islam nations, such as Saudi Arabia, Egypt, Qatar, Oman, Iraq and the United Arab Emirates, in ensuring arbitration accords with *Syariah* principles.

Mediation in Brunei

Mediation is a process in which a third person or persons seek to assist the parties to resolve a dispute without imposing a binding decision. The parties in dispute are assisted by the mediator, who facilitates a process of discussion

110 *Ibid,* s 43(4).
111 *Ibid,* s 43(6).
112 *Ibid,* s 43(7).
113 This stage is akin to mediation. See Powell-Smith, *op cit,* fn 41, 4.cf

to enable them to reach an outcome to which each can assent.[114] Whilst there are many variants and permutations of mediation, with the word meaning different things to different people, it is acknowledged as a process that has had a long and diverse history in most cultures around the world.[115] The cultural context is recognised as directing and informing the nature of the process, so it is not surprising that a mediation in the kampongs and longhouses of Brunei will differ from a mediation informed by the western ADR philosophy. The consequence is that in Brunei it is relevant to deal with two forms of mediation: that which is informed by traditional Bruneian culture and practices, and that which the west tries to export to Brunei. Western mediation as a process was not introduced during the British residency, but is a product of the contemporary common law integration of ADR with adjudicative processes in the courts of law.

There has been considerable discourse on the apparent diversity that exists under the label of mediation in western countries.[116] Greenhouse considers 'mediation' now represents a residual category, filling the gap between formal judicial processes and systems of violent self-help.[117] That there is an on-going terminological debate on what exactly mediation is,[118] is in itself a feature of western culture, where mediation has been theorised, evaluated, researched, and professionalised. This does not happen in the context of traditional mediations, where the long-standing, more informal and localised nature of the process obviates any need for theorising, analysing or evaluating. Western mediation, which has been variously labelled modern mediation,[119] or independent mediation,[120] was consciously formulated and promoted to be an alternative process either in competition with, or complementary to, other dispute resolution options, notably litigation, in the common law countries. The common law setting has informed the process, so that some features were intended to ameliorate perceived problems identified with litigation, whilst others were considered so important that they were incorporated into western mediation process and theory. Significant amongst the latter was the principle of independence of the judiciary. Hence similar features of independence,[121]

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114 Boulle, L, *Mediation: Principles, Process and Practice,* 1996, Sydney: Butterworths, 3.

115 A brief overview of the historical practice is in Moore, CW, *The Mediation Process: Practical Strategies for Resolving Conflict,* 1996, San Francisco: Jossey-Bass, 20–22.

116 A overview of the diverse styles and approaches to mediating conflict is in Folberg and Taylor, *op cit,* fn 35, 130; and Boulle, *op cit,* fn 114, 3–11.

117 Greenhouse, C, 'Mediation: a comparative approach' (1985) 20 Man 90.

118 See Wade, JH, 'Mediation—the terminological debate' (1994) Australian Dispute Resolution Journal 204; Tillet, G, *The Myth of Mediation,* 1993, Macquarie University: Centre for Conflict Resolution; Kurien, GV, 'Critique of myths of mediation' (1995) Australian Dispute Resolution Journal 43; Folberg and Taylor, *op cit,* fn 35, 7.

119 Also referred to as the North American model of mediation, *ibid,* 51.

120 Moore, *op cit,* fn 11, 41–53.

121 Zilinskas, A, 'The training of mediators—is it necessary?' (1995) Australian Dispute Resolution Journal 58 at 65.

impartiality[122] and neutrality[123] for mediators were engrafted onto the process of mediation. In assisting parties to explore options for settling the dispute, the goal of western mediation is to bring about a consensual outcome rather than to coerce parties to settle[124] against their wishes, or on terms with which they feel dissatisfied. The emphasis in the western model is on the participants' own responsibilities for making decisions that affect their lives, and that this personal investment will engender more commitment than one imposed upon them.[125] Although this factor of individual control is not present in every type of mediation found in western nations,[126] it is a representative feature in the type of mediation being 'exported' from the west to Asia. This exported form of mediation is to be labelled 'western' mediation in this paper to distinguish it from the traditional forms found in Brunei.

'Traditional' mediation therefore refers to the processes that evolved and have been used for centuries on the island of Borneo to resolve disputes. It also seeks to bring about a consensual settlement through the intervention of a third party mediator. Like its western counterpart, mediation here is not rigid or unvarying in application. However, there are differences in roles, goals and procedures between the two, which arise from the underlying dimensions of a collectivist culture which prevails in Brunei, in contrast with the more individualistic culture in the west.

Factors impacting upon the role of traditional mediation in Brunei

As has been noted earlier, Brunei is society with a very long tradition in mediation. This applies to the Brunei Malays and the six other indigenous ethnic groups, known as *puak jati* (original tribes),[127] who form the majority of the population (67%). It also applies to the 'other indigenous people', who account for 6% of Brunei's population. That term is used for the indigenous Borneans from contiguous parts of the island who came to reside in Brunei during the early part of 20th century.[128] They are mainly the Iban, Kadazan,

122 Impartiality refers to the constant requirement for 'even-handedness, objectivity and fairness towards the parties'. See Boulle, *op cit,* fn 114, 19.

123 Mediators are described as third party neutrals, being 'comparatively neutral as to outcome', in Astor and Chinkin, *op cit,* fn 35, 102–05; Pengilley considers the neutrality of the intervener as a defining feature. Cf Boulle, *op cit,* fn 114, 18.

124 Folberg, and Taylor, *op cit,* fn 35, 7, 10. However the degree of consensuality in mediation is questioned by Boulle, who demonstrates how pressure to settle can be indirectly or directly imported into the process. See Boulle, *op cit,* fn 114, 26–28.

125 Folberg and Taylor, *op cit,* fn 35, 10.

126 This is the why Moore classifies this process as independent mediation to be distinguished from authoritative mediation and social network mediation. See Moore, *op cit,* fn 11,41.

127 Kedayan, Tutong, Belait, Dusun, Bisaya and Murut.

128 Brunei Nationality Enactment (1961) denies automatic citizenship on the grounds of Sarawak or other Bornean origin.

Punan and Melanau, who are loosely characterised as 'Dayaks' because of shared features of indigenous Bornean social organisation.[129] Chinese, who immigrated to Brunei and brought with them their own preferences and practices for dispute resolution, make up 15%. From earliest times, Brunei, like all of Borneo, has been poly-ethnic.

As in other non-western, indigenous or traditional forms of mediation found throughout much of Asia,[130] the traditional mediation process in Brunei places a greater focus on ensuring an outcome—that is, settlement of the dispute, than is seen in the western model. This arose because traditional mediation was not an alternative to litigation, but was the dominant means for dispute resolution, and the alternatives to it were not courts of law, but physical ordeal, combat and retributive, institutionalised forms of vengeance. For the dayaks in Borneo, that meant headhunting.[131] A mediated outcome became an imperative in traditional small communities, for the survival of the group could, in practice, depend upon keeping harmony between its members. These past imperatives can explain some of the characteristics of the traditional forms that continue today.

The person who, by tradition, intervenes as a mediator for local community disputes is typically the headman, either of the kampong or village, or of the longhouse. Unlike western mediators, headmen also assume preventative roles in their communities,[132] to minimise the transformation of conflict into a dispute. Because of long-standing membership of that community, they can use their cumulative knowledge of people and events occurring to deal with grievances that experience suggests could escalate into a dispute. When a dispute develops and intervention of a third party is sought, the disputants approach the headman either directly, jointly or singly, or another person in the community can bring the dispute to his attention. Generally, the mediation will be informal, so that the venue, dress and behaviour will not differentiate it. Also a headman's mediation will occur within a short time frame after notification, often the same or the next day. Western mediation is also identified as being informal, inexpensive, and able to occur within a quick time frame. However, this is in comparison to the formality, cost and delays that mark litigation in western nations, rather than to 'the *in situ*' availability of traditional mediations.

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129 Malayo-Polynesian language, material culture, farming and hunting practices, longhouse domicile, animistic beliefs, taking omens from birds and animals, and headhunting.

130 China for over 2000 years has used mediation as the preferred method of dispute resolution. See Utter, RF, 'Dispute resolution in China' (1987) Washington Law Review; Mills, M, 'China: some lessons in mediation' (1993) Australian International Law News 31: Also Japan, see Davis, JWS, *Dispute Resolution in Japan,* 1996, Netherlands: Kluwer.

131 Hoskins, J (ed), *Headhunting and the Social Imagination in Southeast Asia,* 1996, Stanford: Stanford University Press.

132 Traditional and contemporary Chinese mediation has this character as does traditional dispute resolution in Africa. See Mensah-Brown, AK, 'The nature of Akan native law: a critical analysis' (1970) Sociologus 143.

Identifying and isolating the issues in the dispute is a feature of most mediations. Whilst the headman typically knows the parties involved, he will seek additional background information on the events and behaviour proximate to the dispute. As well as gathering details from the parties, the opinions and accounts of others who know them is also ascertained. The headman, either alone or with the assistance of other elders in the community, will use these to try to facilitate a settlement with the disputants. If it seems to the headman that one of the disputants has been largely responsible for the conflict, this can be identified. In contrast to the western model, where there is avoidance of 'who is right or wrong',[133] mild chiding by the headman is acceptable. Once wrongs or mistakes have been isolated and identified, these can be apologised for and, if necessary, reparations or appropriate changes can be made. Examples of 'good role models',[134] and how they may have acted in circumstances similar to those of parties in dispute, may be drawn on to guide one or both disputants to a particular outcome. The 'role model' is informed by the ideological underpinnings of that group, so that in a Malay context, Muslim role models, whether Malay or from the times of the Prophet,[135] are used. Malay *adat* (customary law), with a range of proverbs,[136] metaphors, legal maxims,[137] the *hukum syara*[138] and fatwas,[139] can be employed to guide outcomes. On the other hand, in an indigenous non-Malay community, such as Iban, Dusun or Murut, it is the *adat,* and the heros[140] of their own cultural tradition, that inform the process.

The headman is chosen on the basis of his standing and authority in that community. There is respect and deference accorded to one holding this position. In both Malay and Dayak communities, the headman is elected. The headman of a longhouse is chosen not through a formal ballot, but through discussion and debate until a consensus is reached by the members. Although the position is not hereditary, kinship ties continue to have relevance.[141] Since 1992, the election of a kampong headman is by secret ballot and is held in accordance with rules prescribed by the government. To nominate for the

133 Folberg and Taylor, *op cit,* fn 35, 10.
134 For example a 'good' wife, husband, child, friend, worker.
135 The lives of the Prophet, his wives, daughter Fatima, her husband Ali, as well as the Prophets companions and successors are seen as models for all Muslims.
136 Proverbs and the advice contained with them play an important role in Malay culture in Brunei. See Haji Hakim bin HM Yassin, 'The folk literature of Brunei Darussalam', in *ASEAN Folk Literature: An Anthology,* 1995, Manila: ASEAN Committee on Culture and Information. Bruneian Proverbs are listed at 591–99.
137 Hooker, MB (ed), *Readings in Malay Adat Laws,* 1970, Singapore: Singapore University Press.
138 *Syariah* law as applied in Brunei.
139 A legal ruling given by a *Mufti,* an Islamic jurisconsult.
140 Dayak people have an oral tradition of recounting the exploits of ancestors and deities in epics and legends. See King, VT, *The Peoples of Borneo,* 1993, Oxford: Blackwell, 234; on Sengalang Burong see Sandin, B, *Iban Adat and Augury,* 1980, Penang: Pererbit Universiti Sains Malaysia
141 For a genealogical study of relationships in headman see Freeman, D, *The Iban of Borneo,* 1992, Kuala Lumpur: S Abdul Majeed & Co, 114.

position, one must be over 30 and under 65 years of age, have good knowledge of Islam, some formal education, and not be involved with any political party.[142] Requirements prescribed by the government are part of the ongoing bureaucratisation of the role, so that these headmen are having an increasing administrative and liaison role to perform for the government. This is likely to see a shift in the type of mediation in the direction of what Moore described as 'authoritative mediation',[143] so that the headman's more official authority requires bargaining parameters that allow for what is mandated by the government.

Unlike western mediations, where some training in mediation is required,[144] headmen acquire their skills through acculturation by observation and participation in community life and experience. Headmen are expected to be knowledgeable, and to demonstrate personal qualities seen as desirable by that community. Actual knowledge of the particular disputants is regarded as desirable, and, as has been found in traditional Chinese mediations, mediation can be particularly effective where parties share an on-going relationship, since 'this forces co-operation'.[145] Equally important is for the mediator to have good knowledge of the rules to apply, which could include *adat,* local government regulations, *syariah* (in a Malay *kampong*) or to augury in a Dayak community. These are used to determine what is the right or fair outcome, and then to direct and guide the parties towards a similar solution. An ability to persuade—even to coerce—parties by moral imperatives to a settlement is an attribute.

The settlement must be an appropriate outcome for the community as a whole as well as for the actual disputants.[146] The group's interests guide the process. This is consistent with collectivist culture generally, where communal and societal interests will preside over individual party interests. It enables this form of mediation to serve an educative role by articulating the social norms and providing acceptable behaviours and solutions for the disputants and for the community as a whole. In this way, it differs from western mediations where confidentiality and privacy constraints, for the benefit of the individuals involved, limits a wider instructive role. Although there may be 'take-home' knowledge for individuals[147] having experienced a western mediation, which

142 Mani, A, 'Brunei', in Sachsenroder, W and Frings, U (eds), *Political Party Systems and Democratic Development in East and Southeast Asia,* 1998, Aldershot: Ashgate, 92.

143 Moore, *op cit,* fn 11, 41.

144 In the western sense of courses taken or evaluative standards achieved.

145 Woo, L, 'Sweet and sour law: does Chinese mediation suit the Australian palate?' (1996) 7 Polemic 91.

146 This is a typical feature of traditional mediation. See Merry, S, 'The social organization of mediation in nonindustrial societies', in Abel, RL (ed), *The Politics of Informal Justice,* 1982, New York: Academic Press.

147 Folberg and Taylor, *op cit,* fn 35, 9.

may provide those individuals with a model for future conflict resolution, the educative component is limited to the parties involved.

Whether traditional mediation by headmen and community elders continues will depend on several factors. One is whether these communities can maintain their social cohesion and shared values. Aubert found that dissensus, or divergence in values, corresponded with mediation being less amenable in those communities.[148] Witty also argues that indigenous processes of mediation are characterised by a shared cultural or community identity derived from a shared belief system of rules, obligations, procedures and sanctions.[149] The government of Brunei seeks to maintain traditional values, but has chosen an assertive national culture policy aimed at cementing Brunei Malay culture as the source of values and national identity. This is on the basis that 'undeniably, the Brunei Malay culture is the soul of the Brunei national culture' and can serve to 'unite different ethnic groups, and defend indigenous values and interests against harmful foreign influence'.[150] Whilst it may reinforce cohesion amongst the Malays, so there is no discrepancy between internal moral values and the external national code of ethics, for others, such as the non-Malay indigenous people including Dusun, Iban, Murut and Penan, absorption into the Malay is at odds with their culture, identity and values. As conversions occur their social cohesion fractures, and traditional ways of social control become less viable. Dispute resolution in these communities requires an assumption that there are benefits from adherence to the traditional means over that of the external institutions of courts, police and lawyers. Unless the traditional is seen as a legitimate and effective process relevant to the issues arising in the community, other options will be chosen. In addition to the dissonance with Islamic Malay values, it has been noted that some of the non-Malay groups are finding traditional *adat* generally ineffective in dealing with modern problems and issues.[151]

Linked to shared values is the need for an on-going personal relationships and interaction between disputants.[152] Traditional and homogenous communities, as exist in the *kampongs* and longhouses, have complex kinship networks, with strong reciprocal social and economic ties, among their members. When these breakdown, usually with younger members leaving for educational or employment opportunities in urban centres, traditional mediation declines. Whilst those who leave may retain a preference for

148 Aubert, V, 'Competition and dissensus: two types of conflict and conflict resolution' (1963) 7 Journal of Conflict Resolution 26.

149 Witty, CJ, *Mediation and Society: Conflict Management in Lebanon,* 1980, New York, Academic Press, 13.

150 Matussin bin Omar, *op cit,* fn 24, 12.

151 Berstein, JH, 'The deculturation of the Brunei Dusun', in Winzeler, RL (ed), *Indigenous Peoples and the State: Politics, Land, and Ethnicity in the Malayan Peninsula and Borneo,* 1997, New Haven: Yale University Southeast Asia Studies, 167.

152 Witty, *op cit,* fn 14, 10.

consensual resolution, the previously reflexive intervention of the headman is not available, plus the urban environment is generally less conducive to it. This is because social and economic independence and anonymity replace the consistent personal interdependencies and kin relationships of the traditional community. It is a pattern that has been evident in many societies.[153] A further way in which traditional mediation can be undermined is by government interference and regulation. This introduces changes to both the functions and role ascribed for the headman. The bureaucratisation of their role, and the increased reliance upon the government for delineating functions, can weaken the relationship between the community and the headman. Prior reliance on community consensus for obtaining and maintaining the position is being supplemented by the government's confidence in the headman's ability to fulfil these and other tasks. Headmen now receive remuneration from the government, and in turn, government policy informs their role.

Lastly, adherence to traditional means can be affected by structural changes in the society that could decrease its effectiveness, or perceptions of it, through comparison with newer or competing processes. Just as *takhim* was seen to be less effective once the new option of counselling services of the Department of Religious Affairs was introduced, so too could traditional mediation be seen as ineffective as other options are presented or tested.

Factors impacting upon the role of western mediation in Brunei

The existence of the a traditional Bruneian mediation, as outlined above, has limited the role and scope for western mediation in Brunei to date. Apart from the provisions dealing with it as a condition precedent to arbitration under specific sections of the Arbitration Act, and reference to conciliation in Trades Dispute Enactment (1961)[154] for employment and industrial disputes, there is scant statutory recognition.[155] The use of mediation in commercial and other disputes would be a matter of contract. There are no centres providing mediation, and it was not widely regarded as a service to be offered by the law firms. This may be because lawyers in Brunei see this type of mediation as less effective than other processes offered, or that the clients who come to law firms do so with the expectation of more typical legal services being provided. It did not seem to be the case that lawyers felt they needed more training in mediation techniques, but rather that their area of expertise lay in traditional adversarial-based lawyering services. Whilst the lack of a law society and of continuing legal education programmes may mean that lawyers

153 Such as in early New England colonial villages in America.

154 The Act provides resolution procedures for 'trade disputes' by conciliation and arbitration. Labour disputes are reported to be infrequent, and membership of trade unions small. *Borneo Bulletin Borneo Yearbook 2000* at 149.

155 In contrast, Australian states have legislation providing obligations on litigants to use ADR processes, such as mediation and case appraisal. See Uniform Civil Procedural Rules (1999).

in Brunei have had less exposure to courses and information on mediation, all lawyers in Brunei have been trained in other common law countries (particularly England and Malaysia), and graduates in the last decade would have acquired knowledge and training in mediation as part of their law courses. Additionally, as intervention by way of traditional mediation is taking place informally in the social setting in which most disputes arise, it is likely to be viewed as a more appropriate forum than a lawyer's office. There was anecdotal evidence supporting this latter view. One lawyer in a major city practice responded to a question as to whether his firm offered mediation for their clients by asking: 'Isn't that what friends and family are for?' Mediation, as an ADR process provided by lawyers or others so trained, was generally dismissed as not needed in Brunei Darussalam.

This has been the experience of bodies that have considered the promotion of western mediation. The British-based international firm currently promoting arbitration for the construction and engineering sector can also provide services including conciliation, mediation and dispute review boards. However, their prime focus to date has been in the 'selling' of arbitration, with the promotion of the other ADR services being a possibility for the future. Other organisations have run seminars and courses on mediation targeted at lawyers and the government of Brunei. These were referred to by several lawyers as 'visits from the lovey people', indicating a sceptical reaction. In the mid 1990s, APEC determined that it should assume a role in providing additional dispute resolution services for the region by creating a Dispute Mediation Service (DMS)[156] that emphasises mediation rather than arbitration, and which would be a voluntary and non-adversarial process. The service was to be made available to APEC governments and to private entities.[157] However, it did not become operational and the Mediation Services Expert Group formed to establish it has been disbanded.

Conclusion

Brunei Darussalam may have been one of the more recent nations in Asia to discard colonial ties and achieve independence, but the adoption of MIB as a nationalistic ideology has ensured that Bruneian traditions, values, morals, faith and practices are neither devalued or subsumed by their western secular counterparts. In the two decades since independence, Brunei has used MIB as a means to balance the products of its traditional heritage with the legacies from almost a century of British dominance. During this period of British goverance, dispute resolution in the Sultanate was fundamentally changed. This was not only through the implementation of the common law and the

156 Protocol on ASEAN Dispute Settlement Mechanism was agreed to 1996.

157 Hughes, V, Chair of Dispute Mediation Experts' Group—APEC International Commercial Disputes: www.arbitration.co.nz/apec/forward.htm.

courts of law, but in the domination of secular and western concepts and models. The change in priorities and directions under MIB has meant not a rejection of its British legacy, but instead, a shift in emphasis back towards Bruneian and Islamic concepts, values and processes. This is clearly evident in the rejuvenation and reform of the *Syariah* courts, but this paper has shown that the changing emphasis can be observed in the alternative dispute resolution processes of arbitration and mediation.

Arbitration is offered by lawyers and is available for a range of commercial and construction disputes. As its role is seen as an alternative form of litigation, and given the general level of satisfaction and confidence in the courts, this mitigates against its use by Bruneians. International companies operating in Brunei are more in tune with arbitration than local Bruneian ones. In keeping with the collectivist perspective, Bruneians wherever possible want to avoid adversarial means, so that business and social relationships can be preserved. The limited utilisation of arbitration is consistent with findings in other southeast Asian countries, where APEC research has found that 'resort to arbitration has not grown as rapidly as expected given the growth in the numbers of transactions in the region'.[158] The small role that Islamic arbitration had been playing in marital and family disputes has been revitalised by the Emergency (Islamic Family Law) Order Given this, and the increasing Islamisation of commercial and administrative practices throughout Brunei Darussalam, it is likely that traditional *takhim* may become an option for commercial and financial disputes, as it is in the Middle East.

With mediation, the western ADR model has had to compete with the traditional and informal means of settling conflict. The reality is that most disputes occur in the local community and continue to be resolved there. The continuance in the 21st century of the *kampong* and the longhouse as the basic social entities, and as the smallest units of local administration, together with the retention and recognition of the position of headman, has assisted in long-standing practices and values being retained. The more remote and removed a community is from the capital city, and the stronger the social and kinship ties, the greater is the adherence to traditional and collectivist ways of keeping harmony. The mindset is to co-operate rather than to confront, and the assistance of a traditional mediator is culturally and historically appropriate. Going to a lawyer, or to court, is an option when all else fails. Although Malays, Chinese and the indigenous non-Malays all share a preference for informal and consensual means of dispute resolution, cultural and structural factors combine to maintain their own traditional avenues for this, so far restricting the scope for western mediation. Whether the incremental modernisation and westernisation in Brunei will impact on culture and tradition in a way that lessens the relational and collective foundations seems unlikely.

158 APEC Report on International Commercial Disputes: www.arbitration.co.nz/apec/introduction.htm.

Brunei vigorously resists what are seen as the counter-cultural forces of the west, prioritising instead retention of the 'inherent norms of our own internal lifestyle that is collectively practiced by our society'.[159] By rejecting the concept of individualism on the basis that in the west 'it has been the prime cause of moral decadence, degradation of social values and cultural demoralization, disrespect of elders, family and authority',[160] Brunei is turning to Islam to enhance its Malay culture. This means that, as well as strengthening the role of the *Syariah* courts, alternative means compatible with Islamisation will be more accepted than offerings from the modern western ADR movement. This is how Brunei is attempting to find the right equilibrium between its British legacy and its Malay identity.

159 Abdul Latif bin Haji Ibrahim, 'Cultural and counter-cultural forces in contemporary Brunei Darussalam', in Thumboo, *op cit,* fn 24, 23.

160 *Ibid.*

American Offshore Business Tax Planning: Can Australian Lawyers Get a Piece of the Action?[1]

J Clifton Fleming, Jr[2]

Introduction

This paper will investigate: (1) a pair of important American offshore income tax planning strategies; (2) opportunities for Australian lawyers to participate in the implementation of those strategies; and (3) opportunities for Australian lawyers to employ those strategies for the benefit of Australian clients. First, however, a brief explanation is required of the US federal approach to taxing business income. Without this explanation, the information in Part III below would invite incredulity.

The US federal system for classifying business organisations and taxing their incomes

US income tax law regards a branch or sole trading operation as inseparable from the single individual or entity that is the owner.[3] Income earned by the branch or sole trading operation is treated as the owner's and it generally bears only the tax imposed on the owner. Except for a branch profits tax on the US branches of foreign corporations,[4] there is no separate US income tax on a branch or sole trading activity.

Matters are different with respect to corporations (companies) and partnerships. The US federal system of taxing corporate (company) income is, generally speaking, a classical regime, with separate corporate and shareholder taxes and no imputation credits.[5] Stated differently, corporations are treated as non-transparent and income distributed to shareholders suffers double taxation.

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3 See United States Code of Federal Regulations, Title 26 (hereinafter cited as Reg) § 301.7701–2(a).

4 See US Internal Revenue Code of 1986 (US Code, Title 26) (hereinafter cited as IRC) § 884.

5 See IRC §§ 1, 11, 63, 301(c), 316(a).

For US income tax purposes, partnerships are also treated as entities separate from the partners, in that partnerships are required to compute their own income, expenses and losses.[6] In contrast to corporations, however, partnerships are transparent, that is, taxed under a passthrough regime (no tax on the entity; a direct tax on the partners with respect to their shares of the partnership's income, but no tax on distributions to the partners),[7] unless the partnership elects to be taxed as a corporation under the check-the-box Regulations[8] explained below, or unless ownership interests in the partnership are regularly traded in a public capital market.[9] In other words, partnerships that are not publicly traded generally avoid the double taxation that obtains when income earned by corporations is distributed to shareholders.

Before 1997, however, a non-publicly-traded partnership would nevertheless be treated as a corporation for tax purposes if it bore a sufficient resemblance to a corporation.[10] The rules that gave content to this resemblance test were theoretically controversial, complex and subject to manipulation through careful planning. Attempts to enforce the rules could result in unpredictable litigation.[11]

The resemblance test might, nevertheless, have persisted in US income tax law had it not been for a state law development. Beginning in the 1970s, the legislatures of all 50 US states enacted laws creating a highly flexible new form of business organization: the limited liability company (LLC). Like a corporation, an LLC restricts its owners' personal liability for debts of the business to the amount of their investment. The LLC does not, however, have a corporate charter,[12] and it allows the owners greater freedom than corporate shareholders to determine their rights and duties by agreement. This freedom often results in LLCs having important partnership characteristics. Since its emergence, The LLC has become a highly popular form for organizing new US businesses.

In the 1990s, the unpredictability of the resemblance test collided with the LLC's growing popularity. Specifically, the LLC's mixture of corporate and partnership characteristics, the freedom under state law to vary those

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6 See IRC § 703.

7 IRC §§ 701, 702. Corporations are also treated as transparent if they qualify for, and make an election under, IRC § 1362. However, corporations whose shares are publicly traded, foreign corporations and corporations whose shares are owned by another corporation or by a nonresident alien are not eligible to make this election. See IRC § 1361. Thus, the election is not generally useful in international tax planning and will be ignored for purposes this paper.

8 See Reg § 301.7701–3.

9 See IRC § 7704.

10 See *Morrisey v Commissioner* 296 US 344 (1935).

11 See *Larson v Commissioner* 66 TC 159 (1976).

12 An LLC is required, however, to make a public filing that discloses certain organizational details and the relevant public officer will generally issue an official document evidencing the LLC's existence as a juridical entity. See Delaware Limited Liability Company Act §§ 18–201, 18–206; Uniform Limited Liability Company Act (1995) §§ 201, 206, 208.

characteristics and the uncertainty of the resemblance test, caused insecure taxpayers to flood the Internal Revenue Service (IRS) with a plethora of requests for fact-specific rulings that their proposed LLCs would be treated as transparent entities, like partnerships, and not as double-taxed corporations. IRS employees were also uncertain and in need of guidance in their enforcement activities. Finally, the IRS concluded that the costs of administering the resemblance test were no longer worth the benefits.[13] A radically different approach to classifying business organisations for tax purposes was adopted—the so-called check-the-box Regulations.[14]

These Regulations became effective on January 1 1997. In their aftermath, US federal income tax law now treats the following business organisation forms as *per se* corporations that are subject to double taxation:

1 all entities formed under US federal or state business corporation acts;[15]
2 certain specifically identified foreign entities (including an Australian public limited company);[16]
3 publicly-traded unincorporated organisations.[17]

Speaking broadly, other business organisations, domestic or foreign, including LLCs, Australian general and limited partnerships and Australian proprietary limited companies,[18] can elect between classification as corporations and classification as transparent entities.[19] The presence or absence of personal liability on the part of the owner for a business organisation's debts affects the procedure for making the election, but is irrelevant to the election's availability.[20]

An organisation that is not a *per se* corporation, and that elects not to be taxed as a corporation, is classified as a partnership if it has more than one owner, and as a disregarded entity (that is, as a sole proprietorship or branch) if it has only one owner.[21] This latter category includes single-owner US LLCs and single-shareholder Australian proprietary limited companies that make the

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13 See Notice 95–14, 1995–1 CB 297.
14 See Reg §§ 301.7701–1 to –3.
15 See Reg § 301.7701–2(b)(1).
16 See Reg § 301.7701–2(b)(8)(i).
17 See IRC §§ 7704(a), (b); Reg § 301.7701–2(a). Actually, certain narrow classes of publicly-traded unincorporated organisations escape *per se* corporate classification. See IRC §§ 7704(c), (g). These organisations, however, have little importance with respect to current offshore business tax planning and will be ignored in this paper.
18 For this purpose, Australian company law determines whether an entity is a public limited company or a proprietary limited company. See Reg § 301.7701–2(b)(8)(iii). With respect to the distinction between public and proprietary limited companies in Australian company law, see The Laws of Australia 4.1[103] to [116] (Law Book Co, 1999).
19 See IRC § 301.7701–3(a). Actually, a few other forms of business organisation are treated as *per se* corporations, see Reg §§ 301.7701–2(b)(1), (3)–(7), but because they are of little importance in most offshore tax planning, this paper will ignore them.
20 See Reg § 301.7701–3(b)(2).
21 See Reg §§ 301.7701–2(a), (c), 301.7701–3(b)(1), (2).

election. In other words, a single-owner LLC or Australian proprietary limited company that elects under the check-the-box Regulations not to be taxed as a corporation will, for US tax purposes, be treated as a directly-owned activity of the single owner instead of as a separate legal entity.[22]

The check-the-box Regulations were a bold simplification move and a remarkable departure from the rigidity that often characterises administrators. However, as will be seen in the remainder of this paper, these Regulations also provide important tax planning opportunities that cause them to serve as a demonstration of the law of unintended consequences.

Offshore transactional structures that exploit the check-the-box Regulations

The first structure: uncoupling the foreign tax credit from the related foreign income and accelerating the benefit of the credit

Assume the following parties:

1 US Co, a *per se* US corporation under the check-the-box Regulations.

2 US Sub, a *per se* US corporation whose shares are entirely owned by US Co.

3 Pship, an Australian general partnership[23] carrying on an active business entirely in Australia through a permanent establishment. The partners are US Co (above), with a 99.9% interest and US Sub (above), with a 0.1% interest.[24] Pship is

22 Obviously, however, an election or non-election under the Regulations has no effect on an organisation's classification for Australian tax purposes.

23 This structure will not produce the desired tax results unless Pship is a foreign entity for purposes of US tax law. See text at fns 28–29. To achieve that result, Pship will be organised in Australia under Australian law. See IRC §§ 7701(a)(3), (4); Reg § 301.7701–1(d). Pship will nevertheless, be viewed as a US partnership for certain purposes of Australian tax law, see Income Tax Assessment Act of 1936 (hereinafter cited as ITAA 36) § 317 Australian partnership, but that fact is irrelevant in the context of this paper. See ITAA 36 § 92.

24 To achieve the desired tax results, Pship must be organized as an Australian partnership, which means that Pship must have at least two partners. Reg § 1.7701–2(c)(1). That is the reason for involving US Sub. To be considered a partner, however, US Sub must be a form of business organisation that is recognised as legally distinct from US Co. American lawyers would generally prefer that US Sub be an LLC entirely owned by US Co. However, the status under Australian income tax law of a US LLC with only one owner is uncertain. Such an LLC is clearly not a partnership for Australian tax purposes because partnership classification requires two or more owners. See Income Tax Assessment Act of 1997 (hereinafter cited as ITAA 97) § 995–1(1) partnership. For the same reason, a single-owner US LLC is also not a company under the portion of Australian income tax law that classifies 'any other unincorporated association or body of persons' as a company. See ITAA 97 § 995–1(1) company. LLCs, nevertheless, have certain characteristics of companies. To be specific, LLCs must publicly file a document disclosing certain internal details, they may obtain a certificate from a state official evidencing that they have a legal existence separate from their owner or owners and they confer limited liability on investors. See authorities cited in fn 12. Thus, single-owner LLCs might be treated

classified as a transparent entity for Australian tax purposes,[25] and elects to be classified as an Australian corporation for US purposes.

The income tax consequences of this structure are:

1 As Pship earns its income, Australia taxes US Co on 99.9% of the income and US Sub on .1% of the income, because US Co and US Sub are the taxpayers under Australian law with respect to Pship's income.[26]

2 Under US rules, this gives US Co and US Sub immediate foreign tax credits summing up to 100% of the Australian tax[27] (99.9% to US Co and 1% to US Sub).

3 However, for US tax purposes, Pship's election causes it to be treated as a foreign corporation.[28] Therefore, the United States does not tax Pship's Australian income until it is actually distributed to US Co and to US Sub (or until US Co and US Sub sell their interests in Pship).[29]

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as companies under the portion of Australian income tax law that defines a company as 'a body corporate'. See ITAA 97 § 995–1 (1) company. But this conclusion is open to serious doubt because US LLCs are formed under LLC acts, not corporation laws. Thus, they might not be regarded as companies for Australian tax purposes and since a single-owner US LLC is clearly not a partnership, it might be treated as a branch or sole trading operation under Australian law. If US Sub were an LLC wholly-owned by US Co and if US Sub were regarded as US Co's branch or sole trading operation for Australian tax purposes, then Pship might be regarded as having only one owner, US Co, for purposes of the check-the-box regulations. See generally, Phillip R West, 'Foreign law in US international taxation: the search for standards', 3 Fla Tax Rev 147 (1996). If so, Pship would not be a partnership. Instead, it would also be a branch or sole trading operation of US Co. This would likely be disastrous because a branch or sole trading operation is probably not an entity that can elect to be classified as a corporation for US tax purposes under the check-the-box Regulations. See Reg §§ 301.7701–1 (a)(2), 1(b), 301.7701–2(a); 2 Joseph Isenbergh, International Taxation 49:9–49:10 (3d edn, 2002). Because of these uncertainties, US Sub will be organised as a US corporation so that it will clearly be an entity separate from US Co.

25 Ie, Pship is subject to the look-through regime in ITAA 36 §§ 91–92 and is not subject to the corporate limited partnership regime in ITAA 36 §§ 94A–94Y.

26 See ITAA 36 §§ 91, 92(1). Because US Sub is a company, its share of Pship's income should not be vulnerable to the penalty tax imposed by ITAA 36 § 94(9). See ITAA 36 § 94(1).

27 See Reg §§ 1.901–1(a)(2), 1.901–2(00), 1.904–6(a)(1)(i), (iv); Rev Rul 72–197, 1972–1 CB 215; West, *op cit,* fn 24, at 157. See also David S Miller, 'The strange materialization of the tax nothing', 87 Tax Notes 685, 699 n. 112 (2000). To the extent that the contrary holding in *Abbott Laboratories Int'l Co v United States* 160 F Supp 321 (ND III 1958), aff'd 267 F 2d 940 (7th Cir 1959), cannot be distinguished, it appears to have been overturned by the subsequent promulgation of Reg § 1.901–2(f)(1). See generally, West, *op cit,* fn 24, 177–78.

28 See Reg § 301.7701–3(a) and fn 23.

29 See generally *Moline Properties, Inc v Commissioner* 319 US 436 (1943); Reg § 1.11–1 (a); IRC §§ 7701(a)(4), (5). This result is referred to in US international tax jargon as 'deferral'. For purposes of US income tax law, Pship is a controlled foreign corporation (see Reg. §§ 301.7701–1(d)–3(a); IRC § 957(a)) and US tax law contains a controlled foreign corporation regime and other antideferral provisions. These provisions, however, are easily avoided when the controlled foreign corporation principally earns active business income, as is the case with Pship. See Robert J Peroni, J Clifton Fleming, Jr and Stephen E Shay, 'Getting serious about curtailing deferral of US tax on foreign source income' 52 SMU L Rev 455, 460–64, 501–05 (1999).
Assuming that none of Pship's income is of a character that causes the Australian withholding tax regimes to apply, there will be no Australian tax on actual distributions of Pship's income to US Co and US Sub. See Robin Woellner, Stephen Barkoczy, Shirley Murphy and Chris Evans, Australian Taxation Law 2002, 1033–34 (12th edn, 2001) (hereinafter cited as Woellner).

At that point, US Sub's share of Pship's income can be distributed by US Sub to US Co without incurring further US tax.[30]

4 Thus within the US income tax system, both US Co and US Sub get immediate foreign tax credits without having to pay US tax on the related foreign income until that income is repatriated to the United States.[31] This means that the present value of the credits is greater than the present cost of the US tax which the credits are meant to offset—a highly advantageous result that boosts the profitability of the operations carried on by US Co in Australia through Pship.[32]

5 In a variation of this structure, US Sub can be replaced by an independent Australian partner which owns a substantially larger interest in Pship than does US Sub (say 50%). In other words, the efficacy of this transactional structure within the US tax system does not depend on US Co having a US partner.[33] Thus, if US Co enters into an Australian business venture with a substantial Australian partner, US Co can still get the US tax benefits of this structure with respect to its share of Pship's income.

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30 See IRC § 243.

31 See authorities cited in fns 27, 29. The tax credits will be usable only against US tax on foreign-source income in the IRC § 904(d)(1)(I) general limitation basket. See Reg §§ 1.904–6(a)(1)(i), (iv). Thus, the text assumes that US Co and US Sub have active business income from countries other than Australia and that there is residual US tax on that income.

32 The time period between the present availability of the credits for the Australian tax and the later recognition of Pship's Australian income for US tax purposes is likely to be quite long. A recent empirical study has found that there were virtually no repatriations to the United States of controlled foreign corporation income in the first 15 years after such a corporation had been formed in a low-tax foreign country. See Harry Grubert & John Mutti, Taxing International Business Income: Dividend Exemption Versus the Current System 13 (AEI Press, 2001). Thus, assume that US Co and US Sub pay a total of $100 of Australian tax on Pship's year 1 Australian income and that this income is not distributed, and US tax is not incurred thereon, until 15 years after the Australian tax payment. When the income is repatriated, it will not be accompanied by $100 of foreign tax credits because the pay or of the dividend (Pship) is not considered to have paid the $100 of Australian tax. See ITAA 36 § 91; Reg § 1.901–2(f)(1). Thus, US Co and US Sub will pay $100 more US tax at the time of the repatriation than they would have paid if they had not accelerated the credits. But if the correct after-tax discount rate were 7%, then at the time US Co and US Sub enjoyed the benefit of $100 of credits for payments of year 1 Australian tax, the $100 of US tax due 15 years later would have a present cost of only about $36. In other words, US Co and US Sub could use $36 of the $100 of credits to save $36 of year 1 US tax and set this saving aside at 7% interest to grow into $100 for paying tax in the repatriation year. The approximately $64 of year 1 excess credits could then be used to offset year 1 US tax on other US Co and US Sub foreign-source income in the IRC § 904(d)(1)(I) general limitation basket. See Reg § 1.904–6(a)(1)(i), (iv). From the standpoint of the policy underlying the foreign tax credit (relief from international double taxation) this is an egregious result because US Co and US Sub get considerably more than double taxation relief. The hybrid entity rules of IRC § 894(c) and the Regulations thereunder have no constraining effect on taxpayers in this context. In January, 1998, the US Treasury expressed concern, see Notice 98–5, 1998–91 CB 334, 337, but no action has been taken or proposed in the intervening five years. Moreover, in two recent important decisions, US courts have allowed US taxpayers the benefit of foreign tax credits generated in transactions that, although different from the transaction under discussion, depended on the credits to yield a profit. See *Compaq Computer Corp v Commissioner* 2002–/1 USTC (CCH) 50, 144 (5th Cir 2002); *IES Indus, Inc v United States* 253 F 3d 350 (8th Cir 2001).

33 The efficacy of this structure with respect to US Co's US tax results depends on Pship being an Australian partnership which elects to be treated as a corporation for US tax purposes. These conditions remain satisfied if US Sub is replaced by an independent Australian partner.

6 The role for Australian practitioners in this transactional structure is focused on setting up Pship, advising on Australian law and advising any Australian entity that is substituted for US Sub. The provision of advice is, however, facilitated by Australian practitioners understanding what the Americans are trying to accomplish.

An abortive Australian ploy

Because Australian income tax law has nothing like the US check-the-box Regulations, the preceding structure cannot be directly transferred to an Australian setting, but it does suggest an Australian foreign tax credit ploy that should be briefly investigated.

To do so, assume the following parties:

1 Oz Co, an Australian public or private limited company.

2 US Branch, an unincorporated US branch wholly-owned by Oz Co and exclusively engaged in an active business carried on entirely in the US through a US permanent establishment.

The income tax consequences of this structure are:

1 US taxes Oz Co on 100% of US Branch's net income.[34]

2 US Branch's income is exempt from Australian income tax under the branch profits exemption.[35]

Can the US tax on US Branch's exempt income be taken into account for purposes of calculating the Australian foreign tax credit regarding active business income earned by Oz Co in unlisted countries?[36] Australia's foreign tax credit provisions can be read as directing that all of an Australian company's foreign active business income, including exempt income, and all of the foreign taxes paid thereon, must be aggregated for purposes of determining the company's allowable foreign tax credit.[37] Under this approach, the US tax paid on US Branch's income would be incorporated into the computation of the foreign tax credit allowable with respect to active business income earned by Oz Co in unlisted countries.[38] However, the ATO has expressly ruled that neither exempt foreign income nor the foreign tax paid

34 See Australia-US Income Tax Convention, Arts 7(1), 10(6); IRC §§ 882(a), 884 and text at fns 1–2.

35 Oz Co is an Australian company, the US is a broad-exemption listed country (see Income Tax Regulation 1936,152J, Schedule 10) and all of US Branch's income is active business income earned at or through a US permanent establishment and subject to regular US income taxation as it is earned. Thus, the branch profits exemption applies. See ITAA 36 § 23 AH.

36 The branch profits exemption is not available for business income earned in unlisted countries, see ITAA 36 § 23 AH(1)(b). Such income is includable in the assessable income of an Australian company and foreign tax paid thereon may be eligible for inclusion in the foreign tax credit calculation. See Woellner, *op cit,* fn 29, 1407–08, 1437.

37 See ITAA 36 § 160 AF(7).

38 Indeed, this is arguably the position taken by the ATO in IT 2508 (1988).

thereon is taken into account for purposes of computing the Australian foreign tax credit.[39] Although no valiant (or contumacious) Australian taxpayer has tested this conclusion in litigation, the ATO position seems to be the most reasonable interpretation of the Australian foreign tax credit provisions.[40] Thus, it is unlikely that foreign tax paid on income exempt under the branch profits exemption can be used to enhance the amount of the Australian foreign tax credit.[41]

The second structure: converting business profits into interest and royalties

Double tax agreements often provide that interest and royalties are taxed at rates lower than the tax rates applicable to ordinary business income. Thus, to the extent that ordinary business income can be converted into deductible payments of interest or royalty income, tax savings may be possible. To investigate this prospect, assume the following parties:

1 US Co, a *per se* US corporation under the check-the-box Regulations.

2 Japan Co, which carries on an active business in Japan through a permanent establishment. Japan Co is a Japanese *yugen kaisha* (limited company). It is a company for purposes of Japanese law, but it elects under the check-the-box Regulations to be a branch for US purposes. It is wholly owned by US Co.

Assume that Japan imposes a 40% tax on corporate business profits and a 10% withholding tax on interest and royalties paid to a US resident.[42] Also assume that the US taxes corporate profits at a 35% rate.[43]

The following transactions occur:

1 US Co loans cash and licenses intangibles directly to Japan Co; the loans and license are not made by a permanent establishment of US Co in Japan.

2 Japan Co pays 50% of its business profits to US Co in the form of interest and royalties. Assume that such payments, when made in connection with carrying on a business, are deductible expenses for purposes of Japanese tax law, including Japanese transfer pricing rules.

The income tax consequences of this structure are:

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39 See TR 96/15 paragraphs 7–8 (1996). See also IT 2527 para 9 (1989).

40 See ITAA 36 § 160 AF(1). In addition, the purpose of both the branch profits exemption and the foreign tax credit is to relieve double taxation of international income. Either one of them is fully sufficient to achieve this purpose. If a taxpayer is permitted to combine them, the result is to go beyond relieving double taxation and to confer a tax windfall.

41 See The Laws of Australia 31.11[37] (Law Book Co, 1999); Woellner, *op cit,* fn 29, 1410, 1437.

42 This is, in fact, the withholding tax limit set by Arts 13 and 14 of the US-Japan Double Tax Agreement.

43 The US rate of tax on corporate profits ranges from 15% on the first $50,000 of taxable income to 35% on taxable income exceeding $10,000,000. See IRC § 11(b).

1 Because Japan Co is a juridical entity for Japanese tax purposes, Japan allows Japan Co to deduct the interest and royalty payments. This causes the Japanese company tax on half of Japan Co's business profits to drop from 40% to zero. The 10% Japanese withholding tax applies, however, to the deductible interest and royalty payments.

2 Because Japan Co is a branch for US purposes, US tax law regards the interest and royalty payments as intra-corporate transfers that have no US tax significance,[44] and the US views Japan Co's entire net income (calculated with no deduction for the interest and royalty payments) as part of US Co's income. The half of Japan Go's income that was not paid out to US Co bears a 40% Japanese tax and a zero US tax, after crediting the Japanese tax against the 35% US tax on US Co's profits (this effectively leaves US Co with five percentage points of excess credit). The other half of Japan Co's income that was paid to US Co as interest and royalties (deductible from a Japanese perspective, but treated as disregarded intra-corporate payments from a US perspective), incurs a 35% US tax against which US Co claims a foreign tax credit for the 10% Japanese withholding tax and the five percentage points of excess credit.[45]

3 Thus, the 50% of Japan Co's income that has been paid as deductible interest and royalties to US Co has swung from a 40% Japanese tax to a combined Japanese and US tax of only 35%. Five percentage points of tax have been eliminated on half of Japan Co's income—a 12.5% reduction.

Clearly, the advantageous tax consequences of this structure are available only where the foreign country's tax rate on ordinary business profits is higher than the US rate. Therefore, this transactional approach often is not attractive for US corporations investing in Australia, but as the next portion of this paper will demonstrate, this structure is efficacious for Australian companies doing business in the US.

The 'second structure' done by on Australian company

Assume the following parties:

1 Oz Co, an Australian public or proprietary limited company.

2 Oz Sub, an Australian proprietary limited company wholly-owned by Oz Co.

3 Pship, which carries on an active business exclusively in the US through a US permanent establishment. Pship is a general partnership organized in the US under US law and owned 99.9% by Oz Co and .1% by Oz Sub. Pship elects under the check-the-box Regulations to be treated as a corporation for US purposes, but

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44 See Miller, *op cit,* fn 27, 690, 699.

45 See Miller, *op cit,* fn 27, 690, 699. The hybrid entity rules of IRC § 894(c) and the Regulations thereunder have no effect on these conclusions.

Pship is transparent (that is, a partnership) for Australian tax purposes. Pship's management is performed entirely in the US.

Assume that the US imposes a 35% tax on corporate business profits,[46] a 5% branch profits tax on foreign-owned US permanent establishments,[47] and withholding taxes of 10% on interest payments to Australian residents, with 5% on royalties paid to Australian residents.[48] Also assume that Australia taxes corporate profits at a 30% rate.

The following transactions occur:

1 Oz Co loans cash and licenses intangibles to Pship and provides management and technical services to Pship from Australia by fax, telephone and Internet communications.
2 Pship pays 75% of its business profits (calculated before such payments) to Oz Co in the following proportions: one-fourth as interest, one-fourth as royalties and one-fourth as fees for management and technical services. Assume that these payments are deductible for purposes of US tax law.[49]

The income tax consequences of this structure are:

1 The US deductions allowed to Pship for the interest, royalty and fee payments reduce Pship's US taxable income. Thus, Pship pays no US corporate profits tax on 75% of its US income.[50] Because Pship is a US corporation for US tax purposes, its income escapes the US branch profits tax.

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46 See fn 43.

47 When Art 6 of the 2001 protocol to the Australia-US Double Tax Agreement becomes effective, the US rate of branch profits tax on Australian companies will generally be set at 5%. See Kevin A Bell, Australia, United States Sign Protocol to Tax Treaty, 24 Tax Notes Int'l 95, 96 (2001).

Because Pship does no business in Australia and its management is performed entirely in the United States, Pship will not be considered a dual resident corporation excluded from the benefits of the Australia-US Double Tax Agreement. See Australia-US Double Tax Agreement, Art 3; Woellner, *op cit,* fn 29, 1386–88. However, even if Pship were considered a dual resident corporation under the Double Tax Agreement, its payments of interest and royalties would nevertheless qualify for the withholding rates prescribed in the Agreement. See US Treas Dept, Technical Explanation of the Convention Between the Government of the United States of America and the Government of Australia for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income, 1986–2 CB 246, 252–53.

48 When Art 8 of the 2001 protocol to the Australia-US Double Tax Agreement becomes effective, the US rate of withholding tax on royalties paid to Australian residents will be 5%. See Bell, *op cit,* fn 47, 96. The protocol generally has no effect on the withholding tax rate with respect to interest received by Australians. That rate generally remains 10%. See Australia-US Double Tax Agreement, Art 11; IRC §§ 871(a)(1)(A), 881(a)(1).

49 Deductibility will be constrained by the arms-length standard of IRC § 482.

50 In an earlier draft of this paper, Pship paid 100% of its profits to Oz Co as deductible interest, royalties and fees, with the result that Pship's US taxable income in this scenario was zero. Stephen E Shay, a leading US international tax lawyer and former International Tax Counsel for the US Treasury Department, had the following reaction:

'While I understand the pedagogical objective, it rings (very) unrealistic to a practitioner's ear. Under the Bulls make money and Bears make money, but Pigs get slaughtered rationale, almost no practitioner would push such planning to the limit. I would prefer leaving some income for the…[US] taxing jurisdiction and noting in a footnote that as a theoretical matter, there is no apparent limit on application of the technique to zero out the income [of Pship]'.

2 Although Pship's deductible interest payments to Oz Co bear no US corporate profits tax, they do incur a 10% US withholding tax. This is so because, for US purposes, Pship is a US corporation that is paying US-source interest to a separate foreign corporation.[51] For Australian tax purposes, these payments are also treated as interest income of Oz Co from a loan to Pship, and not as part of Oz Co's share in the business income of Pship's US permanent establishment.[52] Therefore, Oz Co's interest receipts do not qualify for the branch profits exemption.[53] Instead, they are includable in Oz Co's assessable income and subject to Australian tax at a 30% rate.[54] The 10% US withholding tax is, however, creditable against this 30% Australian tax, which leaves a 20% Australian residual tax.[55] Thus, the one-fourth of Pship's profits that are paid to Oz Co as interest swings from a 35% US corporate profits tax to an aggregate tax of 30% (10% US withholding tax and 20% Australian residual tax)—a 14.3% reduction.

E-mail from Stephen E Shay to J Clifton Fleming, Jr (June 24, 2002) (on file with the author). Being an academic, I feel compelled to defer to Steve Shay's sense of practical realities. Consequently, I have provided in the final version of this paper that Pship pays only 75% of its income to Oz Co as deductible interest, royalties and fees. As Steve suggests, supra, however, there is neither a principled rationale for stopping short of having Pship pay 100% of its profits to Oz Co as deductible expenditures (assuming that the arm's length standard of IRC § 482 is satisfied) nor an objectively determinable amount of income that, if left in Pship for taxation by the US, will clearly placate the Internal Revenue Service and ensure that it will not search for a theory on which to challenge the tax planning advocated in this scenario.

51 See IRC §§ 861(a)(1), 7701(a)(4). The Australia-US Double Tax Agreement does not interfere with Pship's classification as a corporation for US purposes and as a partnership for Australian purposes. See Australia-US Double Tax Agreement, Article 3(1)(g), (2) and see generally, Richard L Doernberg and Kees van Raad, Hybrid Entities and the US Model Income Tax Treaty, 19 Tax Notes Int'l 745,757 (1999).

Assuming that the transactional formalities, the behavior of the parties and the interest rate regarding Oz Co's loans to Pship are consistent with a *bonafide* debtor-creditor relationship, Pship's interest payments to Oz Co will be treated as real interest payments for US tax purposes. See eg, *Fin Hay Realty Co v United States* 398 F 2d 694 (3d Cir 1968); *Tomlinson v 1661 Corp* 377 F 2d 291 (5th Cir 1967). In addition, the US earnings striping rules are avoided, see §§ 163(j)(1), (2).

52 See Robert Deutsch, Stephen Gates, Margaret Gibson, Peter Hanley, Gary Payne and Wayne Plummer, *1999 Australian Tax Handbook* 1051 (1999) (hereinafter cited as Deutsch); The Laws of Australia 31.7[20] (Law Book Co, 1999); Woellner, *op cit,* fn 29, 1038.

53 See ITAA 36 § 23 AH(1)(b).

54 See authorities cited in *op cit,* fn 29, 52.

55 See Australia-US Double Tax Agreement, Art 22(2); Woellner, *op cit,* fn 29, 1433–36.

3 Pship's deductible fee payments to Oz Co for services bear no US withholding tax or any other US tax.[56] Moreover, for Australian tax purposes, they are considered part of Oz Co's interest in Pship's US business profits[57] and are exempt from Australian tax under the branch profits exemption.[58] Therefore, the one-fourth of Pship's profits that are paid to Oz Co for services swings from a 35% US tax to a zero US and zero Australian tax—a 100% reduction.

4 Pship's deductible royalty payments to Oz Co bear no US corporate profits tax, but do incur a 5% US withholding tax. The treatment of these payments for Australian tax purposes is not entirely clear, because there are two possible outcomes but no authority directly in point. In the best-case scenario, the royalty payments are treated like the fee-for-service payments—that is, characterised as simply an allocation of Pship's US profits to Oz Co and exempted from Australian tax under the branch profits exemption. Accordingly, in the best-case scenario, the one-fourth of Pship's profits paid to Oz Co as royalties swings from a 35% US tax to a 5% US tax and no Australian tax. In the worst-case scenario, however, the royalties are treated similarly to the interest payments—that is, subjected to both a 30% Australian tax and to the 5% US royalty withholding tax. But the 5% US royalty withholding tax is creditable against the 30% Australian tax on Pship's US income. Thus, in the worst-case scenario, the one-fourth of Pship's profits that are paid to Oz Co as royalties swings from a 35% US tax to an aggregate tax of 30% (5% US withholding tax and 25% Australian residual tax). Which of these

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56 The facts state that Oz Co's services are performed in Australia and delivered to Pship by fax, telephone and Internet communications. Because these services are not performed through a permanent establishment maintained by Oz Co in the US, Oz Co does not incur US tax on payments received from Pship for the services. See Australia-US Double Tax Agreement, Art 7. See also *Piedras Negras Broadcasting Co v Commissioner* 43 BTA 297 (1941), nonacq. 1941–1 CB 18, aff'd, 127 F 2d 260 (5th Cir 1942). Indeed, the fee income generated by Oz Co's services to Pship would be free of US tax even if Oz Co employees made periodic visits to the US to provide management and technical services at Pship's premises. This is so because Oz Co would not be carrying on a services business through an Oz Co permanent establishment. See Australia-US Double Tax Agreement, Art 5(6); Senate Exec Rept No 98–16, 1986–2 CB 229, 234; Rev Rul 77–45, 1977–1 CB 413; OECD, Model Tax Convention on Income and Capital, Commentary on Art 5, para 40.

57 Notice of Withdrawal, IT 2218 (May 22, 2002); Woellner, *op cit,* fn 29, 1037–38.

58 Partners that are companies (in this case Oz Co and Oz Sub) are entitled to the ITAA 36 § 23AH branch profits exemption with respect to their interests in partnership foreign income that otherwise qualifies for the exemption. See ITAA 36 §§ 23AH(3), 90, 92(1): Deutsch, *op cit,* fn 52, at 1305; Woellner, *op cit,* fn 29, 1410. See also Art 4 of the 2002 protocol to the Australia-US Double Tax Agreement. There are no exemption qualification issues regarding Pship's income that is paid to Oz Co for services except for the requirement that the income be subject to tax in a listed country. See ITAA 36 § 23AH(1)(d). As noted in the text, the one-fourth of Pship's income that is paid to Oz Co for services bears no US tax. If, however, it had not been deducted as a business expense for US purposes, it would have been taxed by the US as part of Pship's net profits at the regular 35% US rate. This is significant because in TD 96/38, paras 2 and 3 (1996), the Commissioner held that income is considered subject to tax in a listed country where, but for a generally available deduction under the law of the listed country, the income would have been taxed in the listed country. The one-fourth of Pship's income that is paid to Oz Co for services satisfies this test. Accordingly, the branch profits exemption is available with respect to this income.

scenarios is the more likely? In *Poole and Dight v FC of T,*[59] it was held that a partnership's rent payments to a partner for the use of real property were rental income to the partner and not part of his interest in the partnership's income. In other words, the rent payments were treated like Pship's interest payments to Oz Co, above. Because the royalties paid by Pship to Oz Co are for the use of Oz Co's intangible property, they are analogous to the partnership's rent payments in *Poole and Dight.* Accordingly, it seems probable that the royalties will be treated like Pship's interest payments for Australian tax purposes, and that the worst-case scenario described above will apply.

5 If Oz Co had operated the US business through a branch, the branch's net income would likely have been calculated for US and Australian purposes with a deduction for the interest payments,[60] with a deduction for the services payments that was limited to Oz Co's actual cost for providing the services—rather than their market value[61]—and with no deduction for the royalty payments.[62] The net income thus computed would have been eligible for the Australian branch exemption,[63] but would have borne a 35% US tax[64] plus a 5% US branch profits tax,[65] neither of which would be creditable in Australia.[66]

6 If Oz Co had operated the US business through a wholly-owned US corporation, and had repatriated all of the US income by receiving dividends, the dividends paid to Oz Co would have been exempt for Australian purposes.[67] They would, however, have been paid entirely out of profits which incurred a non-creditable[68] 35% US tax and, after the dividend withholding tax provisions of the 2002 Protocol to the Australia-US Double Tax Agreement become effective, the dividends would bear

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59 (1970) 122 CLR 427; 70 ATC 4047.

60 See TR 2001/11, paras 3.42–3.43 (2001). The amount of the deduction for a permanent establishment's interest expense is the subject of a dispute under US law that is outside the scope of this paper. Compare Rev Rul 89–115, 1989–2 CB 130, with *National Westminster Bank v United States* 99–2 USTC (CCH) ¶ 50, 654 (Ct of Fed Cls 1999). See also Jessica L.Katz, *Treaties and Interest Expense Allocation: Moving in a Natwesterly Direction* 86 Tax Notes 403 (2000).

61 See TR 2001/11, para 3.38 (2001); Staff of Senate Finance Committee, Senate Executive Rept. No. 98–16, 1986–2 CB 229, 236; 4 Joseph Isenbergh, International Taxation 103:27–103:28 (3d edn, 2002). See also American Law Institute, *Federal Income Tax Project, International Aspects of United States Income Taxation II: Proposals of the American Law Institute on United States Income Tax Treaties* 210–11 (1992).

62 See TR 2001/11, para 3.38 (2001); US Treas Dept, United States Model Income Tax Convention of 20 September 1996, Technical Explanation 32–33. See also American Law Institute, *Federal Income Tax Project, International Aspects of United States Income Taxation II: Proposals of the American Law Institute on United States Income Tax Treaties* 210–11 (1992).

63 See ITAA 36 § 23AH.

64 See Australia-US Double Tax Agreement, Art 7.

65 See fn 47.

66 See text fns 34–41.

67 See ITAA 36 § 23AJ; Woellner, *op cit,* fn 29, 1411–12.

68 See Woellner, *op cit,* fn 29, 1412, 1443.

a non-creditable 5% US dividend withholding tax, unless Oz Co satisfied certain stock exchange listing requirements, in which case there would be no US withholding.[69]

7 If Oz Co had operated the US business through a wholly-owned US corporation, and had repatriated the US income by having the US corporation make deductible payments to Oz Co of interest, royalties and fees for services, the branch profits exemption would not be available with respect to the fees received by Oz Co because they would not be income of a business carried on by Oz Co, at or through an Oz Co permanent establishment located in the US.[70] Thus, the deductible fees would escape the 35% US corporate profits tax but would bear the 30% Australian tax. The tax consequences for the interest payments would be as outlined in paragraph 2 of the tax consequences discussion, above, and the tax consequences for the royalty payments would be the same as stated for the worst-case scenario in paragraph 4, above, because the branch profits exemption would clearly be unavailable.

Accordingly, the 'second structure' outlined above for Oz Co is better than the alternatives. Moreover, it is an attractive approach for Australian lawyers to present to Australian clients because it provides that there is no tax on Oz Co's services compensation and only a 30% tax on the interest and royalties (with a remote chance that there will be only a 5% tax on the royalties).[71]

From the above comparison of the 'second structure' with the other alternatives available to Oz Co, it is clear that Oz Co has two routes to achieving the Australian branch profits exemption for the one-fourth of Pship's income received by Oz Co as fees for services. Those alternatives are the 'second structure' or a directly-owned US branch.[72] It is also clear that the superiority of the 'second structure' over the directly-owned US branch is that the 'second structure' reduces US tax vis à vis the directly-owned US branch. The 'second structure' does not lower Australian taxes vis à vis the directly-owned branch. Hopefully, these facts will protect the 'second structure' against an attack under the Australian general anti-avoidance rule.[73]

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69 See 2002 Protocol to Australia-US Double Tax Agreement, Art 6.

70 See ITAA 36 § 23AH(1)(b); Woellner, *op cit,* fn 29, at 1408. Moreover, ITAA 36 § 23AH(3), which passes the branch profits exemption through a partnership to the partners, would be inapplicable because, in this scenario, the business is carried on by a corporation.

71 The hybrid entity rules of IRC § 894(c) and the Regulations thereunder have no effect on these conclusions. See Angela W Yu and Cleve Lisecki, *Recharacterization of Payments by Domestic Reverse Hybrid Entities* 27 Tax Notes Int'l 1399 (2002).

72 See text at fns 60–66.

73 This rule is found in ITAA 36 §§ 177A–177H.

The Rise and Fall of National Sovereignty

Alun A Preece[1]

Introduction

National sovereignty has always impacted on international trade and business. In the 20th century, sovereignty has effected commerce most significantly through the operation of sovereign risk. This article examines the development of national sovereignty, from its 16th and 17th century origins to its increasing curtailment in the latter part of the 20th century.

The rise of national sovereignty and the development of international law

The origins of national sovereignty and the major trigger for the development of international law are usually ascribed to the Peace of Westphalia. 'The Peace of Westphalia' refers to the series of settlements, concluded in 1648, which brought to an end the Eighty Years War, in which Spain was the notable protagonist, and the Thirty Years War, which involved mainly Holland, Germany and Sweden. The Peace was negotiated from 1644, in the Westphalian towns of Münster and Osnabrück. The Spanish-Dutch treaty was signed on 30 January 1648, and the main treaty—involving the Holy Roman Emperor Ferdinand III, the other German princes, France and Sweden—on 24 October 1648. England, Poland, Russia and Turkey, not being directly involved, were the only unrepresented European powers. In recognising the independence of Switzerland from Austria and the Netherlands from Spain, the Westphalian settlement went beyond merely securing peace amongst the warring states: it recognised that each state was protected by a principle of 'sovereignty'.

The central proposition of Westphalian 'sovereignty' is the non-interference of states in each other's internal affairs. This is generally referred to as 'internal sovereignty'. However, sovereignty also has external aspects, such as the making of treaties or declarations of war and peace, and the use of

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military force against other states. Another important principle behind sovereignty is that of equality, which holds that, while some states will necessarily be militarily more powerful that others, all are juridically equal in international law. Today, sovereignty survives in Art 2(7) of the United Nations Charter, which provides that:

> Nothing contained in the present Charter shall authorize the United Nations to intervene in matters which are essentially within the domestic jurisdiction of any state or shall require the Members to submit such matters to settlement under the present Charter…

The immediate consequence of the enunciation of sovereignty in 1648 was to strip powerful international players, such as the Holy Roman Emperor, of any legal justification for intervening in the *internal* affairs of other states. Prior to the Westphalian settlement, the dominant political configurations in Europe were entirely inimical to sovereignty. For example, Pope Innocent X, who reigned from 1644–55, refused to recognise the independence of Portugal, then at war with Spain. Further examples are found in English legislation of the 1530s. As part of its attempts to withdraw from the common system of Papal authority, England declared itself 'an Empire'.[2] The declaration implies that, there being no clearly accepted concept of an independent sovereign state, only 'empires' were exempt from external authority.

Perhaps only a catastrophe as immense as the Thirty Years War could have brought about such a fundamental change in the international system. No other war prior to that time had wreaked such havoc, and only the Black Death of the 14th century had caused greater destruction of life in Europe as a whole. The Westphalian doctrine involved the recognition that, in order to avoid perpetual conflict as a result of religious differences, states must be allowed to differ on fundamental aspects of their internal organisation. In particular, it was recognised that attempts to impose Catholicism or protestantism by force could not be pursued any further. Protestantism had to be accepted as part of the political and religious landscape of Europe, at least for the foreseeable future. Only Spain, which was supported by Pope Innocent X, remained unreconciled, continuing its war with France until 1659.

The Treaty of Westphalia is also recognised as one of the first moves towards the protection of human rights in international affairs. Enslavement of enemy soldiers, originally common, had declined in Europe during the Middle Ages, although ransoming was still widely practised. The use of mercenary soldiers tended to create a slightly more tolerable climate for prisoners, as the victor in one battle knew that he might be the vanquished in the next. In the 16th and early 17th centuries, some European political and legal philosophers expressed their thoughts about the amelioration of the effects of capture upon

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2 See Act of Appeals 1533 (24 Hen VIII, cl12), discussed by Plucknett, T, in Taswell-Langmead's *English Constitutional History,* 11th edn, 1960, 276.

prisoners.[3] The idea was taking hold that, in war, no destruction of life or property beyond that necessary to decide the conflict was sanctionable. The Treaty of Westphalia, which released prisoners without ransom, is generally taken to mark the end of the era of widespread enslavement of prisoners of war. An echo of this was the declaration against the slave trade included in the settlement of the Congress of Vienna, at the insistence of the British statesman, Viscount Castlereagh.

The Westphalian settlement was also successful in preventing the widespread destruction of Europe through war. From 1648–1914, European wars were generally of limited scope and duration. They were fought over disputed border provinces, successions or commercial and colonial rivalries. Not until the activities of revolutionary and Napoleonic France, from 1793–1815, did states again seek to conquer or impose their religious, political or ideological views on their neighbours.

In 1793, the reign of terror and mass execution of the French aristocracy, following the French Revolution, proved too much for the reactionary European powers.[4] Napoleon's orgy of conquest over other European countries in 1805–06 led to the establishment of an 'Empire'. However, there being room for only one empire, the Holy Roman Empire was finally abolished (one might say, put out of its misery) in 1806. At the Congress of Vienna, held from 1814–15, the European leadership found no reason to question national sovereignty when drawing up the European peace. Indeed, external sovereignty was developed further at the Congress, with important principles being laid down regarding protocol, drawing up of treaties and diplomatic representation.

Another development from the Napoleonic period was the systematic use of economic sanctions as an instrument of policy to bring a country to its knees. Napoleon's 'Continental System' closed the parts of Europe over which he held sway to British goods. Britain retaliated by issuing the Orders in Council, under which continental Europe was blockaded. Assertion of the right to board and search neutral ships in pursuance of this policy eventually led to the war of 1812 between the United Kingdom and the United States.[5]

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3 The most famous of these, Hugo Grotius, stated in his *De jure belli ac pacis,* 1625, *On the Law of War and Peace,* that victors had the right to enslave their enemies, but he advocated exchange and ransom instead.

4 Many aristocrats in other countries had family links with members of the French aristocracy. In particular, the execution of Marie Antoinette was bound to have major diplomatic repercussions, given that she was of the Austrian Royal House.

5 This curious war included several dramatic events, notably the sacking of Washington, the burning of the White House and the Battles of Lake Champlain and New Orleans. The latter Battle took place after peace had been made but before the news had arrived. It also elevated General Andrew Jackson to hero status, which propelled him to a two-term presidency half a generation later (1828–36). Generally, the war of 1812 laid the foundation for the long periods of *pax Britannica/Americana* in international affairs as both countries realised that peaceful relations were essential, given the long indefensible border between the United States and Canada. Restrictions of naval forces in the Great Lakes of North America also followed.

Apart from the tumultuous Napoleonic interlude, the quarter-millennium from 1648 to 1914 was marked by longer periods of peace than had hitherto been enjoyed since the *Pax Romana*. Helped by the long peace, economic prosperity spread immensely during this period. For the first time in history, famine disappeared on a permanent basis from Europe in the late 19th century.[6] This was in marked contrast to the immediately preceding period, from the start of the reformation until 1648, in which conflicts often resulted in great suffering on the part of the civilian population, as well as great disturbance to civil and economic life.[7]

Historians generally note a fundamental transition from the Middle Ages to the modern era at around 1500. The Middle Ages and before, back to the Ancient World, is seen as an age of empires, in contrast to the domination of the modern era by the concept of nation states. Inherent in the modern formulation is the Westphalian concept of 'national sovereignty'. Except in relation to the hereditary territories of the Hapsburg family, the 1648 Westphalian Settlement reduced the position of the Holy Roman Emperor to a largely ceremonial role,[8] albeit one enjoying great prestige. The age of European, as opposed to colonial, empires was over, except for occasional resurrections when tyrants such as Napoleon, Hitler and Stalin acquired control over other countries. Where and when such empires existed, concepts of national sovereignty were temporarily blurred.

In pre-1648 Europe, with its lack of a clear definition of national sovereignty, but rather a patchwork of rambling and competing feudal empires, there was no clear distinction between internal and external affairs. The territorial boundaries of these empires ebbed and flowed with their political and military fortunes. Consequently, interference in 'internal' affairs of territories was easily justified on the basis of some alleged feudal right, or, after 1517, in the name of maintaining the true universal Christian religion against allegedly heretical reformers.

Prior to the Protestant Reformation, the Pope was regarded, by himself and others, as the head of a united Christendom. The Vatican was a form of medieval United Nations in the European context.[9] In legal terms, the Vatican was the final court of appeal on matters of marriage and divorce, although in England it also controlled succession to property other than land. In addition, the Pope was an influential political player. An example of the Pope's power was the imposition of the six-year *interdict* during the reign of King John.[10]

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6 Some richly endowed settler colonies such as those in North America and Australasia had achieved this outcome earlier.

7 Eg, the St Bartholomew's Day Massacre in France on 24–25 August 1572.

8 Hence, enabling Voltaire's famous quip that in the 18th century the Holy Roman Empire 'was neither holy, nor Roman nor an Empire'. It was certainly not an empire after 1648.

9 Perhaps a medieval version of the European Union is a more apt description!

10 1199–1216.

King John eventually resolved the matter by resigning his crown to the Pope and having it regranted. Once he had escaped from the influence of the Barons who had constrained him to sign *Magna Carta,* he appealed to the Pope, who promptly purported to release him from its terms. In 1571, Pope Gregory issued the infamous Bull, *Gloria in Regnans,* absolving subjects from allegiance, *inter alia,* to Elizabeth I as an excommunicate sovereign, and, indeed, going further in declaring it their duty to rise up and overthrow her—by violence if necessary.

In the century or more prior to 1648, a limited number of European countries succeeded in establishing the essentials of national sovereignty by breaking away from allegiance to the Pope. For example, in 1521, Sweden established Lutheranism as the state religion, on the assumption of the throne by Gustavus Vasa.[11] Similarly, Denmark adopted Lutheranism in the mid-1530s, and independent-minded Swiss cities[12] and Cantons went their own way. At the same time, Henry VIII terminated papal jurisdiction in England by securing the passage of the Act of Appeals and the Act of Supremacy.[13]

Although the major break-away from the Pope came with the Protestant Reformation in the 16th century, English kings had previously attempted to limit papal jurisdiction. In the late 13th century, Edward I had sought to curtail foreign ecclesiastical influence indirectly through the Law of Mortmain, by limiting the accumulation of ecclesiastical property upon which feudal dues would not be payable to the same extent.[14] Later, the Statutes of Praemunire, dating from 1351,[15] attempted to reduce the influence of the Pope in England.

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11 Sweden and Denmark, who at this time included the territory of present day Norway within their jurisdiction, had been ruled by a joint monarchy since the Union of Kalmar of 1389. Vasa assumed the throne after the deposition of the despotic King Christian II of Denmark. He had escaped the massacre of large numbers of leading nobles by King Christian II a few years before. The support of the Catholic bishop of Stockholm for this action was fatal to the catholic cause. For general information on the Swedish history of this period, see www.utb.boras.se/uk/se/projekt/history/ns4.htm.

12 Notably Geneva, which was the home of *Calvinism.*

13 It has been argued (by R Evans at the 11th Conference of the Sir Samual Griffith Society) that English national sovereignty was established much earlier, in 1295, when Edward I summoned the first Parliament to raise taxes, and demonstrated by the Statutes of Praemunire 1351 and 1393, passed in the reigns of Edward III and Richard II respectively. Blackstone (in volume 4 of *Blackstone's Commentaries,* 103) defined the essence of the offence of praemunire as 'introducing a foreign power into the land and creating *imperium in imperio,* by paying that obedience to alien process which constitutionally belonged to the King alone'.

14 The accumulation of church property during the late Middle Ages was huge, from approximately a fifth of all property at the Norman Conquest in 1066 to as much as a third by the time of Henry VIII. His dissolution of the monasteries and associated reforms probably reduced this to one tenth or less, releasing more property into commerce; probably the major factor in England's leading role in economic development from this time.

15 Under Edward in. Another Statute was passed in 1593 under Richard II Much earlier Henry II's attempts to clip the wings of the church had ended in disaster when the murder of Thomas A Becket by four of his knights led to a major reaction which forced the King to do penance. Reaction to King John's excesses also resulted in the privileges of the Church being entrenched in *Magna Carta*. There is a detailed history of the legal and constitutional relations between Church and State in England up to the Reformation by Plucknett, *op cit,* fn 2, 256–88.

However, the primary motivation for the enactment of the Statutes of Praemunire was the Hundred Years War, which began in 1337. The Pope was a key player, and the papal courts were of great importance in this prolonged struggle between the English and French monarchs. In order to ensure that the diplomatic processes would operate to French advantage, the French King, Philip the Fair, kidnapped Pope Boniface VIII, and forced him to march from town to town until he died of a heart attack. He then persuaded the cardinals to choose a French bishop as the new Pope, and relocated the papacy to Avignon.

Of course, it was one thing to attempt to break away from the universal world of Christendom, and quite another to succeed. Various dissident groups had been ruthlessly suppressed by the authorities at various times in the Middle Ages, one of the last being the Bohemians in the early 15th century. The crucial difference for the Protestant Reformation of 1517 was that it gained the backing of rulers who could resist immediate suppression. Either they were sufficiently powerful in their own rights, were allied to powerful nations—as was the case with the Germans and the Dutch—or were geographically situated so as to avoid conquest—as was the case with England, Sweden, Denmark and Switzerland.[16] It is significant that Germany and the Netherlands, which did not enjoy such geographic advantages, suffered the brunt of religious warfare between 1517 and 1648. There are some parallels to this in the modern era.

It seems that the development and long enjoyment of democracy has a close link with early attainment of national sovereignty. It is a remarkable coincidence that England, Sweden and Switzerland, of the only seven countries which enjoyed continuous democracy throughout the 20th century, are the only three that existed prior to 1776, and were, with Denmark,[17] the first to establish national sovereignty as nation states rather than as empires. After 1648, the concept of national sovereignty spread beyond Europe, as relations developed with countries in other continents, and as European and other countries gained independence by war, rebellion[18] or peaceful legal processes.[19] The independence of the United States added it to the Eurocentric world of nation states, especially once the other American states gained their independence. This process was greatly facilitated by the enunciation by

16 For a more detailed discussion of the close relationship between geographic remoteness, adoption and maintenance of protestantism shortly after the reformation and early development and long enjoyment of democracy, see Sampford, C and Round, T (eds), *Democracy: Its Survivability, Beyond the Republic,* a chapter by the author AA Preece, Federation Press, ISBN 1 86287 377 1, 111–12.

17 Denmark only failed to enjoy continuous democracy throughout the 20th century through its conquest by the Nazis in the Second World War. The same applies to Norway, which was part of Sweden and Denmark in earlier times, and to Finland, also part of Sweden in earlier times, from its independence from Russia in 1917.

18 The independence of the United States was recognised by Great Britain in 1783 by the Treaty of Versailles. The successful war of independence by the American colonists led to the Spanish colonies in the New World following their example in the early part of the 19th century.

19 Eg, the separation of Norway from Sweden in 1905.

President Monroe of the Monroe Doctrine, in 1823, as the fundamental principle of United States foreign policy. This stated that the United States was not a European power, and so would not take sides in European conflicts. However, it also stated that the United States would regard any further[20] colonial activity in the Western hemisphere as a threat to its security. The Monroe Doctrine placed the Americas off-limits to further European colonialism, thereby guaranteeing national sovereignty to the newly independent former Spanish colonies of South and Central America.

While colonial activity may have brought about relative peace in Europe in the period after 1648, imperial ambitions were still nascent. They eventually exploded under Napoleon, Hitler and Stalin. The desire to recreate the 'glories' of the Roman Empire seems to be rooted deep in the continental European psyche.[21] Even today, this can be seen in the creation of the European Union. By contrast, Britain has remained largely aloof from European trends,[22] as have Switzerland and Scandinavia. British colonisation seems initially to have been motivated by a desire to find new trading opportunities, rather than an expansion of empire. Exploration was undertaken predominantly by commercial companies,[23] or self-help initiatives of groups of individuals seeking greater religious freedom,[24] although the grandeur associated with empire became more influential later.

Eventually, the principles of international law, which had governed the relations between the European states since 1648, had become so well established in state practice that they could not be ignored by the Founding Fathers in establishing the United States of America.[25] Also, the principle of maintaining diplomatic relations is evidenced by the several references to ambassadors[26] and treaties[27] in the Constitution of the United States.

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20 It excepted existing colonies; eg, from 1815 it enjoyed peaceful relations with the United Kingdom and Canada and supported the United Kingdom in the Falklands War in 1982.

21 Mussolini saw himself as a latter-day Caesar, and a number of European countries have described themselves at times as empires and emulated Rome by titling the ruler 'Caesar'; eg, Russia, which saw its empire as the third Rome after the fall of the second, Constantinople, from which it had taken the Orthodox religion, was ruled by a *Czar,* a term derived from Caesar. The title *Kaiser,* used in the German 'Empire' after unification in the 1860s, has a similar origin.

22 Eg, the contagion of revolution which swept most of continental Europe in 1848 and 1968 had no counterpart in the United Kingdom.

23 Eg, the East India Company and the Hudson Bay Company.

24 Such as the voyage of the Pilgrim Fathers to Massachusetts on the Mayflower in 1620.

25 The Law of Nations is mentioned in Art I, s 8(10): Congress to have power to define and punish offences against the law of nations.

26 *Ambassadors* are mentioned in Art II, s 2(2): President's power to appoint ambassadors; and Art II, s 3: duty to receive them; Art III s 2(1): power of Supreme Court to try cases involving them.

27 United States Constitution, Art I, s 10(3): no state to make a compact or agreement with a foreign power; Art II, s 2(2): President's power to make treaties with the consent of two thirds of the Senate.

Aspects of national sovereignty

Initially, internal sovereignty—that is, the power to rule over a country—was largely untrammelled, and exercised by absolute monarchs. However, later it came to be limited by *constitutionalism.* For example, in the 17th century, England went through a long struggle between King and Parliament, culminating in the establishment of a constitutional monarchy as a result of the Glorious Revolution[28] of 1688. This led to the concept of parliamentary sovereignty, whereby internal sovereignty of England and Wales[29] was henceforth exercised by Parliament, although the Monarch's assent to legislation was still required to transform a Bill passed by both houses of Parliament into law. However, these changes did not limit the internal sovereignty of England, and later Great Britain[30] and the United Kingdom;[31] they merely redefined which persons and bodies were to exercise it. This was to remain the case until British sovereignty was limited by the European Communities Act 1972, which paved the way for accession to the European Community, and finally to the European Union.

The British example demonstrates how a country may limit its internal sovereignty by adopting a constitution, or by entering indefinitely into binding treaties from which it is constitutionally bound not to deviate. In the case of the United Kingdom, this was a return to a situation somewhat akin to that of England in the medieval period, when England was subject to papal jurisdiction. Frequently, England found itself in a state of tension over attempts to expand or limit the power of the Pope over its internal affairs.

Not all constitutions limit internal sovereignty, or do so to a significant degree, however. Some permit amendment, in which case internal sovereignty will only be limited to the extent that it is transferred to the bodies empowered to amend the constitution. Accordingly, the Swiss Constitution of 1848 did not limit internal sovereignty, as amendment of any provision was permissible only by a majority vote in a referendum involving the majority of Cantons.[32] By contrast, if some provisions of the constitution are unamendable, then the adoption of the constitution limits internal sovereignty. In the United States and Australia, the amending process is only limited in that the federal government may not deprive the states of their equal representation in the Senate, nor change State boundaries, without first gaining their consent. Theoretically, amendment is not blocked entirely, although in practice a state's consent to a reduction in representation or territory will be

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28 So named because it involved no bloodshed.
29 Which had been incorporated with England for purposes of law and government by the Act of Union of 1536.
30 Through the Union with Scotland in 1707.
31 Through the Union with Ireland in 1800.
32 *Quaere* whether the new 1999 Constitution does so in its attempt to restrict changes contrary to international law. This issue is discussed below.

extremely difficult to obtain. Similarly, the American Bill of Rights, consisting of constitutional amendments passed in 1791, could be repealed on the approval of three quarters of the States' legislatures. In both cases, ultimate sovereignty lies with the body whose consent is required under the amendment provisions.

Still other constitutions purport to debar certain changes altogether. For example, the post-war German *Grundgesetz* (the German 'Basic Law') specifically prohibits amendments to the free democratic order which it establishes. Amendments may also be practically barred where certain provisions are, by their nature, particularly difficult to restrict. For example, in Australia, it is unclear how an amendment might be drafted to change implied rights to freedom of political expression discovered by the High Court of Australia in the Australian Constitution.[33] Some courts, such as the Indian Supreme Court in the early 1970s, have gone so far as to declare some constitutional rights and freedoms so fundamental as to be irremovable by constitutional amendment.

Internal sovereignty may also be affected by a State's entry into a treaty if this obligation cannot be unilaterally terminated, and is unlimited in time.[34] Difficult issues of sovereignty arise if a State feels constrained not to escape through threat of sanctions or under the terms of its own agreement.[35] A prime example is the United Kingdom's entry into the European Union. It is possible that the European Communities Act 1972 may fall into the category of an unamendable act, since it is uncertain how, if at all, the United Kingdom might legally repeal the law without securing the agreement of the European Union.

Internal sovereignty is also increasingly threatened by the development of international law, which purports to outlaw certain state activity irrespective of the assent of the State concerned. For example, the concern over genocide or ill-treatment of ethnic minorities led to the intervention against Serbia in Kosovo in 1999. Similar compunctions led to the outlawing of aggressive war in international law, as seen in the trials and convictions of Nazis at Nuremberg. Moreover, the United Nations Charter outlaws unilateral aggressive war by prohibiting wars which have not been authorised by the Security Council. The merits and legality of all of these action are currently the subject of heated debate.

Twentieth century developments

Just as the destructiveness of the Thirty Years War was required to generate the notion of sovereignty, so it was that the next change in the international system

33 *Australian Capital Television Pty Ltd v Commonwealth* (1992) 177 CLR 106.

34 If it is limited in time then sovereignty is only in abeyance during its duration and not permanently lost.

35 Some aspects of the threat of sanctions are discussed briefly below.

occurred only in the 20th century, after the violence and bloodshed of two World Wars.[36]

The first conflict of 1914–18 dictated a fundamental change towards democracy in the international system. As a political principle, democracy was non-existent in 1648, and even in 1815 Britain had not sought in any significant way to export its more enlightened political system.[37] Consequently, before 1918 international law was almost completely devoid of any democratic input. In calling upon Congress to declare war on 2 April 1917, President Woodrow Wilson invoked the need to 'make the world safe for democracy', so the post-war world would be fundamentally different. The League of Nations, set up by the Versailles Treaty of 1919, was designed to prevent international conflicts leading to major war. It enjoyed some success in dealing with minor conflicts, but failed when it came to those involving major powers.[38]

In 1919, the major players in the peace negotiations were, for the first time in such an event, predominantly democratic countries. Generally, the Versailles Treaty of 1919 did not seek to curtail national sovereignty. Only Germany, which had been defeated, was restricted in relation to armaments. It was still largely business as it had usually been conducted since 1648 in relation to national sovereignty. Each state, large or small had an equal vote in the League of Nations. Even the League of Nations could be argued to be only a more formalised and sophisticated version of the Concert of Europe, established in 1815.[39]

It took a yet more destructive war to lead to the establishment of the United Nations in 1945. The massive violation of the rights of civilians that occurred in the Second, as opposed to the First, World War sparked a much greater concern with human rights: hence, the adoption of human rights covenants, beginning with the International Declaration of Human Rights in 1948, and the spawning of a plethora of international organisations aimed at enforcing these rights.

Despite the conspicuousness of democracy in the post-1918 international order, a disturbing trend of not accepting the freedom of people to democratically choose a government of a particular political direction has

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36 The era of the Napoleonic Wars had led in 1815 only to a fine-tuning of the system in the development at Vienna of the concept of a comprehensive Peace Conference involving all the victors and vanquished. The ultimate success of this venture, following the near disaster occasioned by Napoleon's escape from his exile at Elba, terminated by his final defeat at Waterloo in June 1815, led to the further concept of the *Concert of Europe,* whereby the major European powers would meet in conference to defuse conflicts or potential conflicts.

37 This echoes the end of treating prisoners of war as slaves at Westphalia in 1648.

38 The same may be arguably true of the United Nations.

39 Indeed it is questionable whether it enjoyed as much success. The *Concert of Europe* only functioned as designed for seven years until 1822, but was essentially resurrected at various times of crisis. The League of Nations did not function effectively after 1933.

recently emerged. In early 2000, sanctions were imposed upon Austria when an allegedly far-right party was included in a coalition government. There was no question that the election had not been properly conducted, or that the election result had not been a proper reflection of the will of the Austrian people. Mostly, sanctions were imposed by other members of the European Union, and, as such, were extremely questionable, given the guarantees of free trade and non-discrimination inherent in European Union membership. Similar protests were voiced during the Italian election in the Spring of 2001, with a call for sanctions from no less than the Belgian foreign minister.[40] Following the Austrian debacle, the European Union has instituted a system of inquiring into members' internal affairs to see if sanctions are, in its view, justified. Sweden, holding the rotating presidency for the first half of 2001, offered to set this process in train in relation to Italy.

An earlier example of the pressuring of electorates was the bullying of Denmark in June, 1992, after its voters initially rejected the ratification of the Maastricht Treaty to enlarge the powers of the European Union.[41] Also, the massive selling of the Swedish kronor a few days before the referendum vote on European Union membership in late 1994 may have caused the pronounced late swing toward a 'yes' to accession.[42]

The establishment of the European Union has caused a particularly great loss of national sovereignty amongst its members. Perhaps we are witnessing a reversion to the pre-Westphalian domination of the Western part of Europe by an empire. Paradoxically, this is taking hold at much the same time as the Eastern part of the continent has escaped from domination by the Soviet empire.[43]

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40 One of the grounds for outrage was the inclusion in the prospective governing coalition of the *Forza Nationale,* described as 'neo-fascists' or derived from the pre-1946 fascists and so supposedly 'undemocratic', although the talk is generally more of possible violations of 'human rights', particularly those of foreigners or minorities, rather than of democracy. Interestingly, no similar outrage is expressed when former communists take office.

41 A similarly undemocratic attitude is currently on display in the defeat of the Nice Treaty at referendum in Ireland on 7 June 2001, with representatives of the European Union stating categorically that the European Union could not be held up by one country. This approach renders nugatory in practice the provision in the European Union Treaties that changes must be approved by countries in accordance with their respective constitutional requirements; a provision that has historically always been highly emphasised when the voters of a country are deciding whether to enter the European Union.

42 Norway still voted 'no'. Perhaps, it is significant that large oil revenues make the Norwegian currency less susceptible to manipulation.

43 Umberto Bossi, the leader of the Northern League, a small part of the Right coalition triumphant in the May 2001 Italian elections, is in the habit of describing the European Union as the 'Soviet Union of the West'!

The democratic legitimacy of international law and international organisations

Customary international law is inherently vulnerable to the criticism that it is not democratically legitimate, as many of its 'customs' have resulted from the practice of undemocratic states. The United States and the United Kingdom, as permanent members of the Security Council of the United Nations, are two of only seven countries to have maintained unbroken democracy throughout the 20th century.[44] However, throughout the history of the United Nations, at least one of the permanent members of the Security Council has been a dictatorship.[45] Although a majority of founders were democratic countries, the prompt discarding of democracy in many newly independent colonies, combined with the spread of communist rule, has made the majority of member states undemocratic for most of the existence of the United Nations. This has brought about widespread cynicism regarding its operation in democratic countries since the early 1960s.

While the activities of the United Nations have generally been inimical to national sovereignty, through its encouragement of treaties backed by the threat of sanctions, they have not been entirely consistent. While sovereign statehood is a prerequisite for United Nations membership, this requirement has not been enforced. During the Cold War, the satellites of the Soviet Union in Eastern Europe, who clearly did not enjoy effective sovereignty, were allowed to remain members, as were several republics of the Soviet Union. Even if this were defensible on the basis that to do otherwise would have involved a highly political process of inquiry into all states' affairs—allowing parts of the Soviet Union, such as Byelorussia, to also be members certainly was not.

Consequently, there is extant tension between international law and national sovereignty. Countries with long democratic traditions often evince strong majority support for the maintenance of national sovereignty at the expense of international law. The latter is seen as less legitimate than the long democratic traditions expressed by the country's own national sovereignty. Prime examples are:

- the repeated rejection by the Swiss voters at referendum of proposals to join the European Union;
- the refusal of the United States Senate to ratify treaties seen as limiting national sovereignty in favour of international organisations;[46]

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44 The others being Australia, Canada, New Zealand, Sweden and Switzerland.
45 At first Russia and later China.
46 Recent examples are the proposal to establish an International Criminal Court and the Kyoto Agreements on action to counter emissions of 'greenhouse' gases.

- the refusal the United States and the United Kingdom to participate fully in the United Nations Educational, Scientific and Cultural Organisation (UNESCO) for upwards of a decade, from the early 1980s; and
- recent refusals by Australia to co-operate with United Nations committees dealing with human rights.

The problem is compounded by the ease with which any country can sign and ratify treaties opposed by a majority of voters. Probably only the United States and Switzerland enjoy adequate safeguards in this respect.[47] In the United States, the constitutional requirement of a two-thirds majority in the Senate for ratification[48] has meant that a very broad consensus is needed before ratification can take place. Although the Swiss appear in their new Constitution approved in 1999 to have limited national sovereignty in favour of international law,[49] it is probable that ultimate sovereignty still lies with the Swiss voters, through their control of the amending procedure via the process of initiative and referendum.[50] In Switzerland, treaties which are of unlimited duration and may not be terminated provide for entry into an international organisation and involve a multilateral unification of law, which must be submitted for referendum approval at the request of 50,000 voters, or eight Cantons.[51] In the English legal tradition, ratification only requires legislative approval to alter domestic law, although this at least provides greater safeguards than exist in countries with a *monist* tradition, where any international obligation assumed by the state may automatically override domestic law. Dissatisfaction in the United Kingdom over European Union membership may largely be attributed to the lack of referendum approval to original membership, and subsequent variations of the European Union treaties.

Since the 1980s, Australia, which inherited the English position on the ratification of treaties, has seen acute controversy over the use of international

47 Ireland has also been constrained by its constitution to hold a referendum with each amendment of the European Union Treaties, most recently in connection with the ratification of the Nice Treaty, when it was defeated at referendum on 7 June 2001. Ireland was the only member of the European Union to hold a referendum as an element of the ratification process. Denmark held a referendum in connection with the Maastricht Treaty, which was defeated intitially in June 1992. The Norwegian voters have twice rejected at referendum proposals for membership of the European Union: in 1972 and 1994.

48 United States Constitution, Art II, s 2(2): President's power to make treaties with the consent of two thirds of the Senate.

49 See Swiss Constitution, Art 5(4), which provides: 'The Confederation and the Cantons shall respect international law.' See also Arts 139(3), 193(4) and 194(2), which provide that the constitution may not be amended so as to violate 'mandatory principles of international law'. This would not seem necessarily to preclude a three stage process of proceeding first by removal of Art 139(3), then by removal of the other two provisions.

50 See Swiss Constitution, Art 139–41.

51 In February 2003, the Swiss voters approved constitutional amendments extending the need for approval of treaties by referendum.

treaties by the Federal Government to undermine State autonomy.[52] Peculiarly, the constitutional balance in Australia can be affected by ratification of a treaty. This is because entry into a treaty by the Commonwealth executive transforms a matter into an 'external affair', upon which the Federal Parliament can legislate, even though the States would otherwise have exclusive power to legislate in that matter.[53] Accordingly, treaty implementation amounts to a backdoor method of amending the Australian constitution by ordinary legislation, without obtaining the approval of electors at a referendum.[54] The controversy is increased by opponents who see international law and treaties as devices to impose a new form of universality, in the form of political correctness, upon them.[55] Recently, the Parliamentary Treaties Committee has been much more active in publicising treaties and engaging in public consultation.

Australian sovereignty

In 1931, the United Kingdom Parliament passed the Statute of Westminster, which gave legislative form to decisions agreed to at the Imperial Conferences held in 1926 and 1930. In particular, the self-governing Dominions were to be regarded as:

> …autonomous communities within the British Empire, equal in status, in no way subordinate one to another in any aspect of their domestic or external affairs, though united by a common allegiance to the Crown, and freely associated as members of the British Commonwealth of Nations.

The Royal assent was given to the Statute of Westminster on 11 December, 1931 and that date is, in constitutional terms, the birthday of Australia as a sovereign nation. However, it was not until the mid-1980s that the Australian Commonwealth and States could agree to a joint request to the United Kingdom Parliament, under the Statute of Westminster, for legislation to terminate the residual areas of the United Kingdom responsibility. The result was the Australia Act 1985, which formally removed the last vestiges of responsibility of the United Kingdom Parliament, by providing that it would not, in future, legislate with respect to Australia.[56]

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52 It is able to do this by virtue of the external affairs power in the Australian Constitution, s 51(xxix) as expansively interpreted in *The Commonwealth of Australia v Tasmania* (1983) 158 CLR 1 (the *Tasmanian Dam* case).

53 *Tasmanian Dam* case (1983) 158 CLR 1.

54 As required by s 128 of the Constitution.

55 See 'Upholding the Australian Constitution', Proceedings of the Eleventh Conference of The Samuel Griffith Society, Rydges Carlton Hotel, Melbourne, 9–11 July, 1999, vol 11.

56 A similar provision was included in the Canada Act 1982, which patriated the Canadian Constitution, which had remained in the British North American Act 1867, as amended, owing to a 50-year impasse between the Provinces and the Canadian Government over terms.

Nonetheless, Australia has suffered comparatively little reduction in national sovereignty during the 20th century. It has not surrendered sovereignty to a regional grouping, such as the European Union. Also, it is—at least theoretically—able to terminate most, if not all, of its treaty obligations, should it wish to do so. Recent rejection of criticism by United Nations committees indicates a willingness to robustly defend its national sovereignty on occasion. Furthermore, its internal sovereignty is not compromised by parts of its constitution being unamendable, or by answerability to international courts, until and unless the treaty establishing International Criminal Court jurisdiction is ratified.[57]

The changing concept of sovereign risk

When considering the national and international legal framework underpinning international trade and business, national sovereignty may have been seen as a negative phenomenon through the operation of sovereign risk. 'Sovereign risk' may be defined as the risk of adverse and unreasonable government action targeted at international trade, or at international business projects. Traditionally, the main concerns in sovereign risk were the imposition of selective and punitive taxation on a project operator, expropriation of assets—or their nationalisation—without adequate compensation, prohibition of operations without reasonable cause, or imposition of trade sanctions. Action may be undertaken by any of the organs of government—executive, legislative or judicial—although, traditionally, sovereign risk was associated with the executive branches of autocratic regimes where there was no independent legislature or judiciary.

During the Cold War, when sovereign risk was especially great, Australia and Canada were favoured states for resource projects. Indeed, they were the only large landmasses which were both well endowed with resources and politically stable, with independent judiciaries, democratically elected parliaments, and moderate politics. By contrast, Socialist and Communist regimes could nationalise foreign assets or repudiate debt, safe from military—and, to a large extent, financial and trade—consequences under the Soviet umbrella. Military regimes in Africa and Latin America could act likewise, knowing they could use the geopolitical divide to avoid isolation. A prime example was Cuba's expropriation of US assets in 1959–60. In the 19th and early 20th centuries, before the world was ideologically divided, countries were sometimes blockaded by European powers to coerce them into paying debts. This operated as a

57 It is true that Australia is subject to the jurisdiction of the World Trade Organisation (WTO). However, the only sanction that can be awarded for breach of WTO rules is authorisation of retaliatory customs duties, which is precisely the action that the other State involved would be most inclined to take unilaterally in the absence of the WTO structure.

sanction against behaviour which flaunted accepted norms of international trade and finance

In the late 1980s, the collapse of the Soviet Empire, as well as China's embrace of capitalism, changed the nature of sovereign risk. Now, a country that expropriates property by executive or legislative action will not only find it virtually impossible to attract foreign investment, but may face retaliatory trade measures and sanctions. No longer can states take refuge in the succour of the communist bloc. There is also a much greater appreciation of the advantages of being part of the global free market economy and trading system, and of the inability of countries to advance economically if they 'go it alone' and try to operate without foreign investment.[58]

The result is that many previous no-go areas for resource investment, particularly in South America and the former communist bloc, are now reasonably secure places to do business. Consequently, the former 'triple A' democracies of Australia, Canada and New Zealand face far more competition in attracting resource investment. Paradoxically, at the same time they have become areas of higher sovereign risk, through judicial activism in the area of native title. In Australia, the *Mabo*[59] and *Wik*[60] decisions, and the consequent legislation,[61] have created huge uncertainty and driven almost all mineral exploration offshore. The situation is, if anything, worse in Canada, through extremely liberal interpretations of native title rights. These moves were encouraged by the concern shown by international bodies, such as United Nations committees, in respect of these issues. By contrast, Argentina and Chile have, during the 1990s, enjoyed times of booming mining exploration.

Judicial activism, as a significant element of sovereign risk, has been on the increase in recent decades, and has also been triggered by environmentalism, or a desire to further other political agendas. These may bring about a *de facto* federal system, as with the jurisprudence of the European Court of Justice in respect of the European Union, or a strengthening of central power in the case of an existing federal system, as in the case of the High Court of Australia, particularly in the 1980s and early 1990s.[62] International tribunals seem to have been particularly prone to these activities, such as the already mentioned

58 An example is Fiji after the 1987 coup. In 1997 they adopted a new, more moderate constitution, abandoning many of the original objectives of the coup, after the coup leader Rambuka had become convinced that it was essential for economic reasons.

59 *Mabo and Others v Queensland* (1992) 175 CLR 1 FC 92/014.

60 *The Wik Peoples v The State of Queensland and Others; The Thayorre People v The State of Queensland and Others* Matters Nos B8/B9 of 1996.

61 Native Title Act 1993 (Cth).

62 See, eg, the *Tasmanian Dam* case (1983) 158 CLR 1.

European Court of Justice, and, more recently, the World Trade Organisation disputes panels and appellate bodies.[63]

The decline in national sovereignty is not necessarily as good for international trade and business as may initially be supposed. First, restrictions on sovereign power at the national level merely transfer sovereignty to the international level, where it may be exercised by officials unsympathetic to business. Where competing nation states enjoy sovereignty, they may modify their policies to vie for business and investment. States operating under an anti-business—or anti-free trade—policy, or ideologies such as socialism or communism, or states with corrupt political systems, will generally be punished economically, and may eventually collapse for this reason.[64] There is no such in-built check where there is international regulation. John Quiggin[65] has argued that the Amsterdam Treaty, concluded in 1998, effectively entrenched 'social democracy' as the constitutional framework of the European Union, and would enable its members to defy the market forces that have furthered free market capitalism in recent years. Of course, such 'entrenchment' severely limits the scope of democratic choice in the member states, as the rules of the European Union cannot be changed except by a *qualified majority* of the member states, or, in some cases, by unanimity. Accordingly, socialists and social democrats were able to capitalise on their control of most European Union governments in 1998 to 'lock in' their political agenda indefinitely. This also occurs frequently at the international level, since most bureaucrats on these bodies share a similar set of values and political opinions on key issues which tend to oppose free market capitalism.

Also, the invasion of international law into national legal systems renders the law subject to much greater uncertainty. For example, business projects supported by a national government and/or backed by national legislation may be impeached before international bodies, or even national courts, on the basis of international conventions or treaties dealing with such matters as human rights, minorities rights or environmental protection. Finally, the expanded role of international law has led to greatly increased use of economic—and even military—sanctions, many of which are directed at, or even triggered by, economic, trade or business activity internationally and internally.

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63 See reports in the *Financial Review,* 16 January 2002, on the rejection of a US provision designed to relieve double taxation, on the one hand, and the introduction of environmental considerations as wholesale justifications of trade restrictions on the other.

64 Economic failure is widely regarded as the main underlying cause of the sudden collapse of Soviet-led communism in 1989–91.

65 John Quiggin, of the Queensland University of Technology, and a Research Fellow at the Australian National University, Research School of Social Sciences, in an article in the *Financial Review,* 17 January 2001, p 46.

Conclusion

Both modem democracy and modern free market capitalism emerged and flourished under the Westphalian regime of national sovereignty. It is unclear that either can survive in a 'post-modern' era where international law overrides national sovereignty. It may emerge that the burgeoning international political order is more akin to the pre-modern era of imperial regulation and legal uncertainty.

A Comparison of Model Laws as a Starting Point for the Development of an Enforceable International Consumer Protection Regime

Daril Gawith[1]

Introduction

This article is concerned primarily with an examination and comparison of select aspects of the model international consumer protection laws proposed by the United Nations (UN),[2] the European Union (EU),[3] and the Organisation for Economic Co-operation and Development (OECD),[4] using the Trade Practices Act 1974 (Australia) as a basis for examination and comparison. As a secondary consideration, it also broadly examines the content of, and differences between, the model laws.

The motive for this article is that any future enforceable international consumer protection regime (possibly in the form of an international treaty or convention) would need to take into account the UN, EU and OECD guidelines. A cross-comparison of those model laws, and a comparison of them with the consumer protection provisions of a well established national consumer protection law, should provide a useful starting point for the development of such a regime. The 'select aspects' of the model laws in question are the various provisions of those laws which could relate to situations involving the wrong delivery or non-delivery of goods.

The terms 'non-delivery' and 'wrong delivery' need some explanation, and the narrow focus upon such problems needs some justification. 'Non-delivery' is mostly self-evident: the goods which are the subject-matter of the consumer contract are not delivered, either to the purchaser or their agent—within the terms of the contract—by the contractual delivery date, or by some reasonable date, or within some reasonable period of time. Alternatively, the goods are not delivered to the contractually-agreed place of delivery—be that place express or implied in the contract. The term 'non-delivery', as used here, also

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1 Associate Lecturer, TC Beirne School of Law, University of Queensland.

2 The United Nations Guidelines for Consumer Protection (1985).

3 Directive 97/7/EC Protection of Consumers in Respect of Distance Contracts (1997), and Directive 2000/31/EC Certain Legal Aspects of Information Society Services, in Particular Electronic Commerce (2000).

4 Recommendation of the OECD Council Concerning Guidelines for Consumer Protection in the Context of Electronic Commerce (1999).

encompasses a proper physical and contractual delivery, but without appropriate transfer of ownership because, for example, the goods are not free from some sort of encumbrance to title—potentially making the delivery a mere bailment.

The meaning of 'wrong delivery', however, can be less obvious. For the purposes of this article, 'wrong delivery' shall mean a delivery of goods which fail to achieve reasonable conformity with the specification of the goods named in the relevant contract. It will therefore include delivery of goods of a fundamentally different nature to that specified by the contract (for example—a computer was contracted for, but a book was delivered); delivery of goods of a 'slightly' different nature to that specified, where exact conformity to a contractual description is a condition of the contract; delivery of goods unfit for a contractually-stated purpose; delivery of goods of unmerchantable quality; delivery of goods which do not correspond to a contractual description; and so on.

So *why* does this article focus narrowly on provisions relating to wrong-delivery and non-delivery? Apart from the need simply for selection and limitation of the field of study, it focuses on these situations because it is believed that the majority of consumer complaints will arise in these areas—that most consumer grievances will not arise until after the contract has been notionally concluded by the completion of payment by the consumer and by a purported contractual performance by a supplier.

Conversely, the kinds of consumer protection provisions which will *not* be examined here include, for example, those that relate to the supply of services, privacy standards, product liability, representations concerning land or employment, the offering of gifts or prizes, advertising, pyramid selling, and so on, unless they relate at least indirectly to wrong delivery or non-delivery of goods. A useful side-effect of this study, though, may be that any conclusions that a reader may draw from it concerning 'optimal', 'harmonised', 'integrated' or 'complete' provisions relating to a future international consumer protection regime may also, to some extent, be applicable to some or all of these other situations.

The Trade Practices Act 1974 (Australia)[5]

The basic purpose underlying the creation of the Trade Practices Act 1974 (the TPA) can be discerned from the Australian Federal Parliament's Second Reading Speech,[6] which states that:

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5 No general explanations of the Australian law will be given—a basic understanding of consumer protection law is assumed.

6 *Hansard,* 30 July 1974, 540–41.

> The purpose of the Bill is to control restrictive trade practices and to protect consumers from unfair commercial practices… The principle known as *caveat emptor*...[which] may have been appropriate for…village markets…has ceased to be appropriate as a general rule…[because] now the marketing of goods or services is conducted on an organised basis and by trained executives…[with whom] the untrained consumer is no match…[and thus now] the consumer needs protection by the law…

A further need for government intervention in consumer transactions has been the growing disparity in product knowledge as between suppliers and consumers since the Second World War. This is because of the increasing sophistication in the goods and services available since that time. Whereas once, in 'village markets', the seller and the buyer had a roughly equal knowledge about the subject of their negotiations, the widespread availability and complexity of goods—such as motor cars, computers, television sets, etc—means there is now an inequality of bargaining power in the market, thus prompting governments to try to achieve a level playing field.

In a sense, then, the TPA is two acts rolled into one: on the one hand, it contains laws concerning business-to-business transactions, such as laws about restrictive trade and anti-competitive practices; however, it also contains laws promoting the protection of consumers engaged in business-to-consumer transactions with corporations. It is this second type of laws which are of general concern here, and specifically, certain provisions contained especially in Part V, but also in Parts IVA and VI (indirectly), in connection with transactions involving the wrong-delivery or non-delivery of goods.

Part IVA

Section 51AB(1) of this Part prohibits unconscionable conduct of a corporation in connection with the supply of goods to a consumer. We know that s 51AB(1) applies to consumer transactions because of ss 51AB(5) and (6).

While the term 'unconscionable' is not defined in the TPA, s 51AB(2) provides a list of non-exhaustive but reasonably foreseeable[7] factors which the court may have regard to in determining whether conduct has been unconscionable. These include the relative strengths of bargaining position; the consumer being required to comply with conditions that are not reasonably necessary; whether any document is comprehensible to the consumer; and whether undue influence or unfair tactics is a factor. Hill J in *Zoneff v Elcom Credit Union Ltd*[8] held that 'conduct will be unconscionable when it can be seen in accordance with the ordinary concepts of mankind to be so against

7 Section 51AB(4)(a).
8 (1990) ATPR 41–009 at 51–157.

conscience and fairness that a court would intervene'. Unconscionable conduct also includes both active and passive misrepresentations which result in injustice arising accidentally.[9]

The s 51AB provisions are relevant here where breach results in wrong delivery or non-delivery of goods to the consumer; but, of course, since an aggrieved consumer will be more likely to bring an action for such occurrences under the Part V provisions, Part IVA may be of only limited relevance.

Part V

Part V, the main consumer protection part of the TPA, contains the catch-all s 52 prohibition against corporations engaging in 'misleading or deceptive conduct'. It also contains the s 53 prohibitions against various kinds of false representations, such as false representations in regard to the supply of goods:

- being of a particular standard, quality, value or grade (s 53(a));
- being new (s 53(b));
- having particular performance characteristics or uses (s 53(c));
- having corporate sponsorship, approval or affiliation (s 53(d));
- having a particular price (s 53(e));
- being available (s 53(ea));
- having a particular place of origin (s 53(eb)); and
- concerning the existence of any condition, warranty, guarantee, right or remedy (s 53(g)).

Obviously these provisions are relevant to non-delivery or wrong delivery. For example, s 53(eb) would relate to wrong-delivery where the relevant contract stipulated that the goods delivered were to derive from (or not derive from) a particular country of origin, and such contractual term was breached.

The presumption of *mens rea* (knowledge of the wrongfulness of an act) is displaced by s 53 of the TPA, according to *Given v CV Holland (Holdings) Pty Ltd.*[10] Therefore, even if a supplier lacks awareness that goods delivered did not have, for example, the particular performance characteristics claimed, in breach of s 53(c), the supplier is still liable, as the representation will come within the meaning of 'falsely represent' in s 53.

Division 2 of Part V deals with conditions and warranties in consumer transactions. It contains provisions concerning:

- warranty as to title to goods (s 69(1)(a));

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9 Nathan J in *George T Collings (Aust) Pty Ltd v HF Stevenson (Aust)* (1991) ATPR 41–104 at 42–622.

10 (1977) ATPR 40–029.

- warranty of quiet possession and enjoyment of goods (s 69(1)(b));
- warranty that goods are free from encumbrance (s 69(1)(c));[11]
- conditions that goods supplied by description comply with description (s 70);
- goods being fit for purpose (s 71); and
- supply of goods by sample (s 72).

Division 2A of Part V enumerates the statutory rights of consumers to take actions against manufacturers and importers of goods, where goods:

- are not reasonably fit for purpose (s 74B);
- do not correspond to description (s 74C);
- are not of merchantable quality (s 74D);
- do not correspond where there is a supply by sample (s 74E).

Part VI

Part VI of the TPA contains the enforcement and remedies provisions in relation to consumer protection and other provisions of the Act. The sections of most relevance here are: s 75B—which defines a person who has assisted with or has directly contravened the TPA; s 79—which specifies applicable penalties; s 80—which grants powers to the court to order injunctive remedies; s 80A—powers of the court to order corrective advertising; s 84—which provides that the conduct of an agent is that of the offending corporation; s 85—providing defences available to corporations allegedly in breach of Part V; and s 87—providing a range of further orders a court can make regarding contraventions.

There is nothing in the TPA which makes it expressly applicable or inapplicable to ecommerce transactions, or transactions conducted via the Internet. However, for our purposes, this express inclusion or exclusion is irrelevant, since we only wish to refer to the TPA to ask the following questions: [12]

- do the model consumer protection laws of the UN and other bodies contain provisions similar to s 71 of the TPA?
- if not, why not?
- if not, should they?

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11 The s 69 provisions relate to non-delivery where there is no transfer of ownership of goods to the consumer.

12 In fact, the TPA *is* applicable to ecommerce and internet consumer transactions, but only where they are conducted entirely within Australia.

The United Nations Guidelines for Consumer Protection (1985)

The United Nations Guidelines for Consumer Protection (the Guidelines) were released on 9 April 1985 by resolution 39/248 of the United Nations General Assembly. The Guidelines were re-released in amended and expanded form by the UN's Economic and Social Council resolution 1999/7 of 26 July 1999, and were adopted by the General Assembly in late 1999.

The reason for release of the 1999 version was largely to include elements on sustainable consumption, which was intended to bolster the perceived relationship between this and consumer interests. Since the detailed differences between the old version, which contained 46 clauses, and the new version, containing 69 clauses, are not important here, a comparison between them is not addressed. Thus, examination of the Guidelines here is restricted entirely to the current version.

The structure of the Guidelines is as follows:

I Objectives (cl 1)
II General principles (cll 2–8)
III Guidelines (cll 9–10)
  A Physical safety (cll 11–14)
  B Promotion and protection of consumers' economic interests (cll 15–27)
  C Standards for the safety and quality of consumer goods and services (cll 28–30)
  D Distribution facilities for essential consumer goods and services (cl 31)
  E Measures enabling consumers to obtain redress (cll 32–34)
  F Education and information programs (cll 35–41)
  G Promotion of sustainable consumption (cll 42–55)
  H Measures relating to specific areas (cll 56–62)
IV International co-operation (cll 63–69)

The Guidelines commence with a preamble consisting of 10 paragraphs, which note historical precedents and declare statements of principle. In summary, these state that resolution 1999/7:

- recalls resolution 39/248 of 9 April 1985;
- notes that the Guidelines be expanded to include sustainable consumption provisions;
- recalls various intermediate resolutions and recommendations made between 1985 and 1999;

- notes the continuing need for consumer protection in developing countries;
- recognises the impact already made by the Guidelines, and the role of non-governmental organisations in promoting the Guidelines; and
- urges various entities to implement the Guidelines.

I Objectives (cl 1)

In summary, the Objectives assert that the interests and needs of consumers *world-wide* are within the contemplation of the Guidelines. This echoes the TPA Second Reading Speech by stating that 'consumers often face imbalances in…bargaining power'. However, it extends beyond the Second Reading Speech (apart from its express general international application) by arguing for a consumer right to safe products with 'just, equitable and sustainable economic and social development and environmental protection'. The specific objectives of the Guidelines are:

(a) to assist countries in achieving or maintaining adequate protection for their population;

(b) to facilitate production and distribution patterns responsive to the needs and desires of consumers;

(c) to encourage high levels of ethical conduct for those engaged in the production and distribution of goods and services to consumers;

(d) to assist countries in curbing abusive business practices by all enterprises at the national and international levels which adversely affect consumers;

(e) to facilitate the development of independent consumer groups;

(f) to further international co-operation in the field of consumer protection;

(g) to encourage the development of market conditions which provide consumers with greater choice at lower levels; and

(h) to promote sustainable consumption.

II General principles (cll 2–8)

The description of these clauses, as follows, has been made so that the essential meaning of the individual clause can be seen, with little or no added commentary. Thus the description is complete but it is inevitably list-like, to some extent.[13]

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13 The alternatives are that commentaries could be made on each clause—requiring a book; and over-summarisation by grouping like clauses would leave out sufficient detail. This approach is taken throughout the whole article.

In summary, the general principles urge governments to adopt the Guidelines, setting local consumer protection priorities 'in accordance with local circumstances and needs', bearing in mind the relevant costs and benefits of the policies they apply (cl 2); and provide a list of needs that are defined as 'legitimate'[14] in the sense of being needs worthy of pursuing through government-run consumer protection programs (cl 3). In other words, there can be a relationship between (i) government consumer protection programs and (ii) social/economic/environmental needs, and the former should be designed to pursue satisfaction of the latter, so long as the needs are 'legitimate'. The 'legitimate' needs, according to cl 3, are:

(a) the protection of consumers from hazards to their health and safety;

(b) the promotion and protection of the economic interests of consumers;

(c) access of consumers to adequate information to enable them to make informed choices according to individual wishes and needs;

(d) consumer education, including education on the environmental, social and economic impact of consumer choice;

(e) availability of effective consumer redress;

(f) freedom to form consumer and other relevant groups or organisations and the opportunity of such organisations to present their views in decision-making processes affecting them; and

(g) the promotion of sustainable consumption patterns.

The general principles also tell us that a major cause of global environmental degradation is unsustainable production and consumption patterns, and that developed countries should lead the way in correcting the problem (cl 4). It continues that, in pursuing cl 4 objectives, policy-makers must take into consideration policies to eradicate poverty, satisfy basic human needs, and reduce 'inequality' within and between countries (cl 5). Clause 6 provides that consumer protection programs require 'infrastructure' in order to be implemented and monitored, and that a consumer protection program should benefit all, especially the rural and the poor. Clause 7 sets out that enterprises should obey the laws (including the provisions of any binding international laws) of countries in which they do business, and cl 8 proposes that public and private research enterprises should be involved in the development of local consumer protection policies.

An obvious difference between the Guidelines (and the other model laws generally) and the TPA is that, as a body of national law, the TPA contains actual specific enforceable provisions, whereas the Guidelines are just that: they are 'guidelines', and are meant to be *converted* into enforceable provisions for local application. Interestingly, that difference could arguably

14 Apparently *universally* legitimate needs, despite the fact that in cl 2, the 'needs' are meant to be understood as *local* needs.

detract from the 'internationality' of the Guidelines, in the sense that they could potentially be a set of *internationally*-enforceable rules. Nonetheless, they have much merit as potential provisions in a future international consumer protection law in initial form.

III Guidelines (cll 9–62)

These clauses are the core provisions of the document. They commence with two clauses of general application to this part, and are then divided up into eight sections: A-H. Clause 9 provides that cll 10–62 apply to 'home-produced' goods and services, and to imports. Clause 10 states that consumer protection laws generally should not become barriers to international trade, and that they should be consistent with international trade obligations.

A Physical safety

According to cll 11–14, governments should take all appropriate steps to ensure that consumer goods are safe for reasonable use.[15] Clause 12 provides that distributors should ensure that goods in their care do not become unsafe, and that consumers should be informed of proper usage and relevant risks through international symbols. If manufacturers or distributors become aware of unforeseen hazards after products are placed on the market, cl 13 states that they should notify the relevant authorities and the public without delay. Further, under cl 14, if a product is a severe hazard even when properly used, manufacturers and/or distributors should recall it and replace it within a reasonable period of time, or the consumer should be compensated.

B Promotion and protection of consumers' economic Interests

Under cll 15–27, government policies should enable consumers to obtain optimum benefit from their economic resources, and to achieve satisfactory production and performance standards, distribution methods, business practices, informative marketing and effective protection against adverse practices.[16] Governments should ensure manufacturers—and others—adhere to established laws and standards and monitor adverse practices, according to cl 16.

Clause 17 sets out that governments should control abusive business practices harmful to consumers, being guided by General Assembly resolution 35/63 of 5 December 1980.

Under cl 18, governments should make clear (a) the responsibility of the producer to ensure that goods meet reasonable demands, and (b) that the seller should see that these requirements are met, and similar policies should apply for the supply of services.

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15 Clause 11.
16 Clause 15.

Under cl 19, governments should encourage fair and effective competition to provide consumers with choice at the lowest cost. In accordance with cl 20, governments should also ensure manufacturers and/or retailers guarantee availability of after-sales service and spare parts. Consumers should be protected from one-sided contracts, exclusion clauses, and unconscionable conditions under cl 21.

Marketing and sales practices should be fair and legal to enable informed and independent decisions by consumers, and to ensure that information provided to consumers is accurate, under cl 22. Governments should encourage the free flow of accurate information on all aspects of consumer products under cl 23; and under cl 24, information about the impact of products and services should be available through reports, information centres, eco-labelling and hotlines.

Governments should take measures regarding misleading environmental claims, and relevant advertising codes and standards, under cl 25; and should encourage codes of marketing and other business practices to ensure adequate consumer protection under cl 26, which also provides that these codes should receive adequate publicity. Lastly, under cl 27, governments should regularly review legislation pertaining to weights and measures.

C Standards for the safety and quality of consumer goods and services

Clauses 28–30 indicate that governments should formulate standards at national and international levels for the safety and quality of goods and services.[17] Where a standard is lower than the applicable international standard, under cl 29 every effort should be made to raise that standard. Finally, governments should encourage and ensure the availability of facilities to test and certify the safety, quality and performance of essential consumer goods and services in accordance with cl 30.

D Distribution facilities for essential consumer goods and services

This section contains only cl 31, which states that governments should consider ensuring the efficient distribution of goods and services to consumers and encouraging the establishment of consumer co-operatives.

E Measures enabling consumers to obtain redress

Clauses 32–34 say that governments should establish legal and/or administrative measures to enable consumers to obtain redress through procedures that are expeditious, fair, inexpensive and accessible (cl 32); that governments should encourage all enterprises to resolve consumer disputes in a fair, expeditious and informal manner, and to establish mechanisms which can provide assistance to consumers (cl 33); and that information on available redress should be made available to consumers (cl 34).

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17 Clause 28.

F Education and information programs

Clauses 35–41 provide that governments should develop, or encourage the development of, general consumer education and information programs, to enable people to act as discriminating consumers. In so doing, governments should give special attention to the needs of disadvantaged consumers (cl 35). Furthermore, cl 36 sets out that consumer education should become an integral part of the basic curriculum of the educational system as a component of existing subjects. Such consumer education programs should cover:

(a) health;

(b) product hazards;

(c) product labeling;

(d) relevant legislation;

(e) information on weights and measures, price, quality, etc;

(f) environmental protection; and

(g) efficient use of materials, energy and water (cl 37).

Under cl 38, governments should encourage consumer organisations and the media to undertake education programs on the environmental impact of consumption patterns. Additionally, cl 39 states that businesses should undertake, or participate in, consumer education, whilst cl 40 sets out that governments should develop consumer information programs in the mass media. Finally, under cl 41, governments should organise or encourage training programs for educators and consumer advisers.

G Promotion of sustainable consumption

Clauses 42–55 say that sustainable consumption includes meeting the needs of present and future generations for goods and services in ways that are sustainable.[18] Clause 43 states that the responsibility for sustainable consumption is shared by all; that informed consumers have an essential role in promoting sustainable consumption through the effect of their choices on producers; and that governments, business, consumer and environmental organisations have a responsibility for promoting public participation and debate on sustainable consumption.

Under cl 44, governments should promote sustainable consumption through regulation; under cl 45, governments should encourage products and services that are safe and energy and resource efficient, and should encourage recycling programs; and under cl 46, governments should promote environmental health and safety standards for products and services. However, cl 46 also states that those standards should not result in disguised barriers to trade.

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18 Clause 42.

According to cll 47 and 48 respectively, governments should encourage impartial environmental testing of products, and should manage environmentally-harmful substances and encourage sound alternatives. Moreover, governments should promote awareness of health-related benefits of sustainable consumption and production patterns under cl 49, and should encourage the transformation of unsustainable consumption patterns under cl 50. Clause 51 encourages governments to create or strengthen effective regulatory mechanisms for the protection of consumers, including aspects of sustainable consumption; whilst cl 52 suggests that governments consider a range of economic instruments to promote sustainable consumption. According to cl 53, governments should also develop publicly-available indicators for measuring progress towards sustainable consumption. Similarly, under cl 54, governments and international agencies should take the lead in introducing sustainable practices in their own operations, and encourage the use of environmentally-sound products and services. Finally, under cl 55, governments should promote research on consumer behaviour related to environmental damage.

H Measures relating to specific areas

Clauses 56–62 provide that governments should give priority to areas of essential concern for the health of the consumer—such as food, water and pharmaceuticals—for quality control; adequate and secure distribution facilities; and standardised labeling and information; as well as education and research programs.[19] With regard to food, cl 47 sets out that governments should adopt accepted international food standards. Under cl 58, governments should promote sustainable agricultural policies. Clause 59 provides that governments should formulate policies to improve supply and quality of drinking water, whilst cl 60 states that governments should assign high priority to the formulation of policies concerning the multiple uses of water. Governments should also develop adequate standards for ensuring the quality and use of pharmaceuticals, according to cl 61, and should adopt appropriate measures in other areas under cl 62.

Comparing Part III of the Guidelines with the TPA, the following points may be noted. Sections A and C (on the safety of goods and services) can be compared with Part VA (product liability) of the TPA, and with Division 1A of Part V. Section A, however, consists of 'guidelines' meant for conversion into enforceable provisions by national governments, with Part VA of the TPA being an application of the principles expressed in Section A of the Guidelines.

Section B, which covers the economic interests of consumers, contains provisions found only indirectly or impliedly in the TPA. It exemplifies the Guidelines at their most abstract and generalised.

19 Clause 56.

Section D, which deals with efficient distribution of goods and services, has no direct counterpart in the TPA. Thus national governments may consider that market forces will ensure goods are distributed efficiently without government intervention. Measures enabling consumer redress, contained in Section E of the Guidelines, would relate, to a limited extent, to Part VI of the TPA, which deals with enforcement and remedies. Section F, on consumer education, and Section G, on sustainable consumption, have no parallels in the TPA.

Section H contains some provisions with only an indirect relationship to provisions in the TPA: for example, quality control principles in respect of food and pharmaceuticals can be related to product safety provisions in the TPA.

The foregoing review raises the question: are there *any* Part III clauses which relate directly to Part V of the TPA or, more specifically, to the issue of wrong delivery or non-delivery of goods, in more than an abstract way? The short answer is no. There is nothing in the Guidelines like s 74 of the TPA. The only clauses that come close are cll 17, 20 and 21, all of which are contained in Section B. As a consequence, either the Guidelines are *extremely* generalised, or they have a 'blind spot'. That is to say, there are no provisions in the Guidelines that assist consumers who fall victim to a wrongftil or non-delivery. However, his may not be a weakness in the Guidelines. It may mean merely that it was not intend by its drafters to extend into these areas of consumer protection. The Guidelines, as they are, may nonetheless be a valuable addition to international law. We shall return to the Guidelines when we look at all the model laws together.

IV International co-operation (cll 63–69)

The relationship of this part to the TPA speaks for itself. The TPA says nothing about international co-operation, for it is a domestic statute dealing with consumer protection law in Australia. Clauses 63–69 state that governments should:

(a) exchange information on national policies in the field of consumer protection (cl 63);

(b) co-operate in the implementation of consumer protection policies (cl 63);

(c) co-operate to improve the conditions under which essential goods are offered to consumers (cl 63);

(d) develop information links regarding products which have been banned, withdrawn or restricted (cl 64);

(e) work to ensure that the quality of products and information does not vary from country to country (cl 65);

(f) ensure that policies for consumer protection do not become barriers to international trade (cl 69).

All parties concerned should work together to develop environmentally sound technologies and mechanisms for financing their transfer among all countries under cl 66, and should facilitate capacity-building in the area of sustainable consumption under cl 67. Finally, according to cl 68, those same parties should promote programs relating to consumer education.

Directive 97/7/EC of the European Parliament and of the Council of 20 May 1997 on the protection of consumers in respect of distance contracts (Distance Sales Directive)

Pursuant to Art 15 of the Distance Sales Directive (DSD), EU member states were required to implement the DSD by June 2000. The DSD, which aims to protect consumers engaging in 'distance contracts' (Art 2), applies to all companies engaging in online transactions with EU consumers (Art 6). Notably, the DSD includes a right of withdrawal in favour of consumers that cannot be waived by contract.

The structure of the DSD is as follows:

Article:

1 Object

2 Definitions

3 Exemptions

4 Prior information

5 Written confirmation of information

6 Right of withdrawal

7 Performance

8 Payment by card

9 Inertia selling

10 Restrictions on the use of certain means of distance communication

11 Judicial or administrative redress

12 Binding nature

13 Community rules

14 Minimal clause

15 Implementation

16 Consumer information

17 Complaints system

18 The Directive shall enter into force on the day of its publication in the *Official Journal of the European Communities.*

19 This Directive is addressed to the member states.

The DSD also commences with a lengthy preamble. Under cl 2 of the preamble, consumers should have access to the goods and services of another member state on the same terms as the population of that state. Similarly, cl 4 notes that the diverging measures to protect consumers in respect of distance selling has had a detrimental effect on competition between businesses, and that it is therefore necessary to introduce a minimum set of common rules in this area.

Under cl 11 of the preamble, distance communication must not lead to a reduction in the information provided to the consumer. Thus, under cl 13, consumers must receive written notice of information necessary for proper performance of contracts. Clause 14 deals with the consumer's rights of withdrawal from contracts. It requires that the costs to the consumer should be limited to the direct costs of returning goods, and without prejudice to the consumer's rights under national laws. Clause 14 has particular regard to the receipt of damaged products or of products which do not correspond to the description given in the offer.

Clauses 18 to 22 deal with the administrative and procedural principles that underlie the DSD. Clause 18 provides that the minimum binding rules in the DSD are to be supplemented by voluntary arrangements among the traders concerned. Further, cl 21 notes that the Commission, on 14 February 1996, published a plan of action on consumer access to justice and the settlement of consumer disputes, including specific initiatives to promote out-of-court procedures. Lastly, cl 22 provides that the burden of proof should be shifted to the supplier, as consumers are not in control of the means of communication used.

In summary, the 19 Articles of the DSD provide as follows. Article 1 provides that the object of the DSD is to approximate the laws of the EU member states in the field of distance contracts between suppliers and consumers. Article 2 defines important terms—'distance contract' is defined as a contract organised by a supplier who makes use of a means of distance communication for the purpose of the contract; 'consumer' is a natural person acting outside his trade business or profession; 'supplier' is a natural or legal person acting in their commercial or professional capacity in relation to contracts covered by the DSD; and 'means of distance communication' is deemed to include ordinary mail, telephone, radio, email, etc.

Article 3 specifies that the DSD does not apply to contracts for financial services involving vending machines, or public payphones or auctions, or relating to immovable property. Article 3 also notes that Arts 4–7(1) are inapplicable to contracts relating to goods of daily consumption (for example, foodstuffs) or the provision of accommodation, transport, and catering or leisure services in certain circumstances.

Article 4 specifies the items of information which the supplier must provide to the consumer prior to conclusion of the contract. These include information concerning the supplier's identity and address, the goods, the price, delivery costs, arrangements for payment, delivery or performance, and the rights of withdrawal. These must be provided in a clear and comprehensible manner.

Article 5 specifies that the consumer must receive written confirmation of the information required to be provided under Art 4 during performance, or, at the latest, at time of delivery of goods.

Article 6 provides that the consumer has the right of withdrawal for a period of seven working days from the day of receipt of the goods, without penalty and without giving any reason, the only charge to the consumer being the direct cost of returning the goods. If, however, the supplier has failed to comply with Art 5, the period shall be three months, beginning on the day of receipt by the consumer. In any case, the supplier must reimburse the sums paid by the consumer, free of charge, within 30 days. The rights of withdrawal are subject to some noted exemptions—for example, where goods were made or personalised to the consumer's specifications.

Article 7 provides that, unless agreed otherwise, the supplier must deliver the goods within 31 days of receipt of the consumer's order, but if the goods ordered are unavailable, the consumer must be informed and be able to obtain a refund of any sums paid, in any case, within 30 days.

Articles 8–10 deal with inappropriate behaviour by the seller, either in soliciting for custom or after the contract has been concluded. Article 8 provides that a consumer may cancel a payment where fraudulent use has been made of a payment card, and be recredited with sums paid where appropriate. Article 9 provides that member states shall prohibit supply of goods not ordered by the consumer, where such supply involves a demand for payment—silence of the consumer not constituting consent. Article 10 provides that suppliers are prohibited from the use of automatic calling and facsimile machines without the prior consent of the consumer, and that other means of distance communication may be used only where there is no objection from the consumer.

Articles 11–13 govern the scope and enforcement of the DSD. Article 11 provides that member states shall ensure compliance with the DSD in the interests of consumers, by allowing appropriate bodies with standing to take action before competent judicial or administrative bodies (the burden of proof in some cases being on the supplier), or by direct enforcement measures, or by measures taken through self-regulatory bodies. Article 12 provides that consumers cannot contract out of rights conferred on them by the DSD if they have close connection with a member state. Article 13 provides that the DSD applies unless there are EU Community rules which prevail in particular cases, or in relation to particular parts of supply contracts. This provision is reminiscent of the *generalia specialibus non derogant* rule of statutory interpretation in common law.

Articles 14–18 deal with the application and implementation of the DSD itself. Article 14 provides that member states may introduce more stringent provisions than currently found in the DSD, in the interest of consumers. Article 15 provides for the timing of the introduction of, and the implementation of, the DSD. Article 16 provides for measures to keep consumer residents of member states informed of developments relating to the implementation of the DSD. Article 17 provides for a proposed consumer complaint mechanism in respect of distance selling. Article 18 provides for the date of the DSD entering into force, and Art 19 provides that the DSD is addressed to the member states.

At this point we can see what the DSD has to say about our matters of primary interest. Probably the provision of the DSD closest to the Part V TPA provisions of relevance here is Art 6. Although Art 6 is quite different in specific content to Part V, it could result in an identical—or better—effect in some cases. For example, if the consumer under Part V complains of non-compliance with contractual description of goods, the seven-day right-of-withdrawal period under Art 6 may provide a superior remedy in some cases, although an issue remains as to whether a seven-day period is sufficient. In addition, the mechanism which allows the consumer to return goods may prove more convenient in some cases. However, given the range of the provisions covered under Part V of the TPA, Art 6 undoubtedly provides less consumer protection on balance.

Directive 2000/31/EC of the European Parliament and of the Council of 8 June 2000 on certain legal aspects of information society services, in particular electronic commerce, in the internal market (Directive on Electronic Commerce)

The Directive on Electronic Commerce (DEC), in force since 17 July 2000, provides a general legal framework for the conduct of ecommerce within the EU, and by the EU member states with outside parties. It commences with a lengthy preamble (65 clauses), and is contained in 24 Articles in the following structure:

Chapter I General provisions
Art 1 Objective and scope
Art 2 Definitions
Art 3 Internal market

Chapter II Principles
Section 1: Establishment and information requirements
Art 4 Principle excluding prior authorisation

Of the clauses set out in the preamble, the following are of particular interest to this article. Clause 11 states that the DEC is without prejudice to the level of protection for consumer interests as established by the DSD. Clause 18 provides that information society services consist, *inter alia,* in the selling of goods online and in services giving rise to on-line contracting. Under cl 22, information society services should be regulated at the source of activity in order to ensure an effective protection of public interest objectives—not only for the citizens of the competent authorities' own countries, but for all consumers, in order to improve mutual trust between states. However, cl 23 provides that the rules of private international law must not restrict the freedom to provide information society services established in the Directive. Under cl 26, member states may apply their national rules on criminal law and criminal proceedings with a view to taking all measures necessary in respect of criminal offences.

Clause 52 provides that the effective exercise of the freedoms of the internal market makes it necessary to guarantee victims effective access to means of settling disputes. It provides that the Directive requests members states to ensure that appropriate court actions are available. Member states should also examine the need to '*provide access to judicial procedures by appropriate electronic means* [emphasis added]'. However, cl 55 of the Directive does not affect the law applicable to contractual obligations relating to consumer contracts.

Clause 58 states that the Directive is without prejudice to the results of discussions within international organisations, such as the UN and the OECD, on legal issues. Clause 60 states that the legal framework on ecommerce must be clear and simple, predictable and consistent with the rules applicable at international level. Under cl 65, the Commission is to examine the degree to which existing consumer protection rules provide sufficient protection; if need be, the Commission should make specific additional proposals.

In summary, the 24 Articles of the DEC provide as follows. Article 1 provides that the object of the DEC is to contribute to the proper functioning of the internal market by ensuring the free movement of information society services between member states, and Art 2 contains definitions of certain terms used in the DEC.

Article 3 sets out rules for the purposes of ecommerce which regulate the EU as an 'internal market': for example, a member state may not prevent its citizens from providing the information society services of another member state unless it is necessary for the prevention of a criminal offence.

Article 4 provides that the activities of information service providers (see preamble, cl 18) may not be made subject to prior authorisation. Article 5 provides that, in addition to other information requirements established by Community law, service providers shall provide various items of information, including their name, geographic address and details of the service provider which allow him *[sic]* to be co ntacted rapidly. Article 6 stipulates a further information requirement that a 'commercial communication' shall be clearly identifiable as such; and its originator and promotional offers, etc, shall be clearly identifiable.

Article 7 provides that, subject to the DSD and Directive 97/66/EC, where any member state permits unsolicited commercial email, it shall be identifiable clearly and unambiguously, but that persons not wishing to receive such communications shall be able to register themselves appropriately.

Article 8 provides rules regarding the so-called 'regulated professions' (law, accountancy, etc)—such as their commercial communications being subject to compliance with any rules regarding the dignity and honour of the profession and fairness towards clients.

Article 9 provides that member states shall ensure that their legal system allows contracts to be concluded by electronic means, except in some cases with contracts in respect of the creation or transfer of interests in real property.

Article 10 provides that, in respect of information to be provided in relation to electronic contracts, and in addition to other information requirements under EU law, member states shall ensure that service providers clearly, comprehensibly and unambiguously—and prior to the order being placed by the recipient of the service—provide information regarding the steps to be followed to conclude the contract, or for the filing of, access to, and means of correction of errors in the contract document.

Article 11 provides that member states shall ensure that where the recipient places his order through technological means, the service provider must acknowledge its receipt without undue delay and by electronic means, and that the order and the acknowledgement of receipt are deemed received when parties to whom they are addressed are able to access them.

Articles 12, 13 and 14 include provisions reminiscent of the 'innocent dissemination defence' in defamation actions at common law. They provide that, where an information society service consists of the transmission or storage, etc, of information supplied by the recipient of the service, the service provider may not be liable for the information transmitted.

Under Art 15, member states shall not impose a general obligation on providers, when providing the services covered by Arts 12, 13 and 14, to monitor the information which they transmit or store.

Article 16 provides that member states shall encourage the drawing up—and compliance with—codes of conduct (by consumer and other organisations), designed to contribute to the proper implementation of Arts 5 to 15.

Under Art 17, member states shall ensure that their legislation does not hamper the use of out-of-court schemes—for example, alternative dispute resolution.

Similarly, Art 18 requires member states to ensure that available court actions allow for the rapid adoption of measures designed to terminate any alleged infringement of the information society service interests involved.

Article 19 provides that member states shall ensure that service providers supply them with the requisite information, and that member states shall co-operate with other member states.

Article 20 provides that member states shall determine and enforce effective, proportionate and dissuasive sanctions applicable to infringements of national provisions adopted pursuant to the DEC.

According to Art 21, before 17 July 2003, and thereafter every two years, the Commission shall submit a report on the application of the DEC, accompanied where necessary by proposals for adapting it to developments in information society services, in particular with respect to crime prevention and consumer protection.

Article 22 provides that member states shall bring into force laws necessary to comply with the DEC before 17 January 2002; Art 23 sets out the date on which the DEC will enter into force; and Art 24 provides that the DEC is addressed to the member states.

The Annex is headed 'Derogations from Article 3', and provides that Arts 3(1) and 3(2) do not apply in relation to a range of matters, including copyright, industrial property rights and contractual obligations concerning consumer contracts.

It is clear at this point that the DEC is quite different in purpose from Part V of the TPA and the DSD. In fact, the DEC contains no real consumer protection provisions at all in the sense used in the TPA. More shall be said about comparing the DEC with the TPA and the DSD at the conclusion of this article.

Recommendation of the OECD[20] Council Concerning Guidelines for Consumer Protection in the Context of Electronic Commerce (1999)

These guidelines (the OECD Guidelines) were released by the OECD on 9 April 1999. The Guidelines are 'designed to help ensure that consumers are no less protected shopping on-line than they are when they buy from their local store or order from a catalogue'. These Guidelines are 'non-binding'. Moreover, 'the overarching principle of the Guidelines is that consumers shopping on-line should enjoy transparent and effective protection that is not less than the level of protection that they have in other areas of commerce'.[21]

The OECD Guidelines commence with a brief preamble, followed by an 'annex' containing the guidelines in the following structure:

Part One Scope

Part Two eneral principles

I Transparent and effective protection

II Fair business, advertising and marketing practices

III Online disclosures

(a) Information about the business

(b) Information about the goods and services

(c) Information about the transaction

20 Organisation for Economic Co-operation and Development.
21 OECD news release dated 9 April 1999.

IV Confirmation process

V Payment

VI Dispute resolution and redress

(a) Applicable law and jurisdiction

(b) Alternative dispute resolution and redress

VII Privacy

VIII Education and awareness

Part Three Implementation

Part Four Global co-operation

In summary, the preamble to the OECD Guidelines states that consumer laws limit fraudulent and unfair commercial conduct, and that they are indispensable in building consumer confidence. It continues by stating that the inherently international nature of the electronic marketplace requires a global approach to consumer protection, and that disparate national policies may impede the growth of ecommerce. Accordingly, it provides that consumer protection may be addressed most effectively through international co-operation. Finally, the preamble elucidates that the OECD Guidelines are a set of general guidelines to protect consumers participating in ecommerce without erecting barriers to trade, and which represent the core characteristics of effective consumer protection for ecommerce. After having regard to certain matters,[22] the preamble concludes by recommending that member countries implement the OECD Guidelines at international, national and local levels, and instructs the OECD Committee on Consumer Policy to exchange information on progress with respect to implementation progress, and to report to the OECD Council in 2002.

Part One Scope

The scope of the OECD Guidelines is succinctly stated: they apply only to business-to-consumer transactions and not to business-to-business transactions.

22 The preamble states that regard is had to the following matters: the OECD Convention, the Recommendation Governing the Protection of Privacy, the Ministerial Declaration on Authentication, the Recommendations Concerning Guidelines for the Security of Information Systems and Cryptography, and recognising that ecommerce, which offers new and substantial benefits, may create situations which may put consumers at risk; that confidence in ecommerce is enhanced by effective consumer protection mechanisms, and considering that governments should devote special attention to the development of effective cross-border redress systems.

Part Two General principles

I Transparent and effective protection

This principle states that consumers shopping online should enjoy transparent and effective protection that is not less than the level of protection they have in other areas of commerce. It further states that all parties concerned should work together to achieve such protection.

II Fair business, advertising and marketing practices

This principle requires that businesses engaged in ecommerce should act fairly. Specifically they should not:

- engage in any practice that is likely to be deceptive, misleading, fraudulent or unfair or is likely to cause unreasonable risk of harm to consumers; or
- hide their identity or location, or avoid compliance with consumer protection standards and enforcement mechanisms.

Such businesses should:

- provide information about themselves which is accurate and accessible;
- comply with representations made concerning policies regarding their transactions with consumers, both for as long as the representations are maintained and for a reasonable time thereafter;
- consider the regulatory characteristics of the markets they target;
- make any advertising and marketing they engage in clearly identifiable as such;
- take special care when targeting children and others with reduced capacity to understand, when advertising or marketing; and
- allow consumers to easily choose whether or not they wish to receive commercial email.

As general principles, there is everything in common here with the principles underlying, at least, ss 52 and 53 of the TPA. Moreover, while the TPA sections are detailed and enforceable, the principles here are far less general than the provisions of the UN Guidelines, which are also analogous to ss 52 and 53 of the TPA.

III Online disclosures

(a) *Information about the business*

This principle states that businesses should provide accurate and accessible information about themselves to allow, at minimum:

- identification of legal and trade names, geographic and email addresses, telephone numbers, and any relevant government licenses, etc;
- easy communication with the business;

- effective resolution of disputes;
- service of legal process; and
- location of the business principals for law enforcement.

Where a business publicises its membership in any self-regulatory scheme, the business should provide consumers with the relevant contact details and method of verifying that membership.

(b) *Information about the goods and services*

This principle states that businesses should provide accurate and accessible information describing the goods or services offered and make it possible for consumers to maintain an adequate record of such information.

(c) *Information about the transaction*

Businesses should, under this principle, provide information about the terms, conditions and costs associated with a transaction, and such information should be clear, accurate and accessible, and provided in a manner that gives adequate opportunity for review before entering into the transaction. Where multiple languages are used, all information given should be provided in all applicable languages.

Information should include:

- an itemisation of costs;
- the terms of delivery or performance;
- the terms and methods of payment;
- conditions of purchase, such as parental approval, geographic or time restrictions;
- safety and health care warnings;
- information relating to after-sales service;
- conditions relating to withdrawal, termination, return, exchange and refund; and
- available warranties and guarantees.

Information should also be provided concerning relevant currency.

IV Confirmation process

This principle states that the consumer should, before purchase, be able to identify precisely the relevant goods or services, and correct any errors in the order, and be able to retain an accurate record of the transaction.

V Payment

This principle states that consumers should be provided with easy-to-use, secure payment mechanisms.

VI Dispute resolution and redress

(a) *Applicable law and jurisdiction*

Business-to-consumer cross-border transactions are subject to the existing framework on applicable law and jurisdiction. Thus businesses are also subject to the existing problems associated with cross-border transactions—such as conflicts of laws, uncertainty, expense, complexity and potential language difficulties. However, the principle also acknowledges that ecommerce challenges this framework. It therefore provides that '*consideration should be given to whether the existing framework should be modified* [emphasis added]' to ensure effective consumer protection in the context of the continued growth of ecommerce. The prospect of an enforceable international regime is left open as a possibility.

In considering whether to modify the existing framework, governments should ensure that, while facilitating ecommerce, the framework provides no less fairness to consumers and businesses than in other forms of commerce. Consumers should also be provided with redress mechanisms without undue cost or burden. This last point also seems to indicate the need for an enforceable international consumer protection regime, as arguably only such a regime could provide this solution; an international in-court redress mechanism 'without undue cost or burden' is impossible in the present circumstances.

(b) *Alternative dispute resolution and redress*

This principle enunciates that consumers should be provided with meaningful access to fair redress, including to alternative dispute resolution, again without undue cost or burden. It also provides that governments should develop policies to resolve consumer disputes arising from business-to-consumer cross-border transactions. Governments are also called upon to employ information technologies innovatively in implementing these policies.

VII Privacy

This principle states that business-to-consumer transactions should be conducted in accordance with the OECD Guidelines Governing the Protection of Privacy and Transborder Flow of Personal Data (1980), and the OECD Ministerial Declaration on the Protection of Privacy on Global Networks (1988).

VIII Education and awareness

Under this principle, all parties should work together to educate consumers about ecommerce and the consumer protection framework that applies to their online activities.

Part Three Implementation

When implementing the OCED principles, Part 3 requires that member countries should:

(a) adopt laws applicable to ecommerce, having in mind the principles of technology and media neutrality;

(b) encourage self-regulatory mechanisms that contain rules for dispute resolution and compliance;

(c) encourage the development of technology as a tool to protect and empower consumers;

(d) promote the Guidelines as widely as possible; and

(e) facilitate consumers' ability to access information and to file complaints related to ecommerce.

Part Four Global co-operation

This principle states that member countries should facilitate communication, co-operation and enforcement of joint initiatives at the international level to provide effective consumer protection. This should be achieved, *inter alia,* through their judicial, regulatory, and law enforcement authorities and, importantly, '*by entering into multi-lateral agreements to accomplish such co-operation* [emphasis added]' based on consensus regarding core consumer protection at the international levels. They should also work towards developing agreements for the mutual recognition and enforcement of judgments resulting from actions taken to combat unfair commercial conduct.

So what do the OECD Guidelines say about the matters of primary interest to this article? As with the UN Guidelines, the OECD Guidelines are cast as relatively abstract matters of general principal, and do not equate directly to any provision in Part V of the TPA. The closest identification is found between the first two 'General principles'—concerning how consumers should enjoy 'protection that is not less than the level of protection they have in other areas of commerce', and how businesses engaged in ecommerce 'should act fairly'. Specifically, they are required to 'not engage in any practice that is likely to be deceptive, misleading, fraudulent or unfair or is likely to cause unreasonable risk of harm to consumers'.

Comparisons and overall conclusions

We are now able to conclude that there is, in fact, very little in the way of 'select aspects' of any of the four model laws which are directly and/or extensively similar to the consumer protection provisions under Part V of the

TPA. Clearly the purpose of the model laws differs from the TPA, both in terms of *their level of abstraction,* and in terms of the comparative *aims* of all the laws studied here.

In general, the model laws are *intended* to be relatively abstract. Moreover, whilst overlapping in their application to some extent, they do address different fields. While the UN Guidelines are concerned with the broad principles of global consumer protection, however conducted, the DSD is concerned with the regulation of consumer contracts formed by using any means of distance communication, for the benefit of citizens of the EU member states. The DEC, by comparison, is concerned with general principles for the conduct of ecommerce for the benefit of EU citizens, whether they are participating in ecommerce *as consumers or not*. Finally, the OECD Guidelines are concerned with the broad principles of consumer protection specifically where consumer transactions are concluded by means of ecommerce technology.

Of the four model laws, the most readily applicable in its present form is the DSD. The DSD is formulated more like an actual set of 'black letter' laws, even when compared to the DEC—which more resembles the abstract principles found in the two Guidelines. In a sense, though, these distinctions are of little importance. The relative degree of generality or specific applicability of these model laws would make little difference to the construction of an enforceable multi-lateral international consumer protection convention, based on considerations such as those found in the four model laws and something like Part V of the TPA. For such a task, all of this material would be useful, whether it be principles or provisions from current enacted law, or the abstract provisions of multilateral guidelines.

The European Union's Approach to Legal Non-Retrospectivity: Are There Problems for International Businesses?

Des Taylor[1]

Introduction

The European Union (EU) is one of the major and important trading areas of the world.[2] As a consequence, many international businesses are likely, at some stage, to be involved in transactions which have a 'European Union' aspect to them. Whilst such business transactions will, essentially, occur in one of two ways—they will arise from business transactions conducted entirely *within* the EU, or they will arise by virtue of business transactions conducted *with* the EU—it is not important that there are different circumstances giving rise to such transactions; what is important is that such transactions will all, to varying degrees, be subject to the laws and legal order of the EU.

For such businesses—like *any* business—it is very important that there be legal certainty. This involves the business knowing, or at least being able easily to ascertain, what is the governing law that applies to the particular transaction in which they are (or are likely to become) involved. If businesses cannot ascertain the applicable law that governs an existing or contemplated venture, they run the risk of being in a situation of legal uncertainty. Such a prospect can easily deter businesses from embarking on commercial ventures. This is because business persons—whilst they might be prepared to take risks (regarding the success or otherwise of their contemplated undertaking) based on the merits of their particular product or service—they are unlikely to embark on a project if the legal ground rules of the environment in which they are to operate are uncertain. Hence, legal certainty is an important factor in the encouragement or discouragement of international business.

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The author is genuinely grateful to Professor Gabriel Moens and the TC Beirne School of Law at the University of Queensland for having been given the opportunity, during recent years, to give various visiting lectures in order to present ideas on the principle of legal certainty and to gain constructive and useful feedback. The author accepts sole responsibility for the opinions and views expressed herein.

2 See, eg, the EU's publication, *The European Union and the World,* March 2001, available at www.ecdel.org.au/eu_global_player (28 June 2002).

Before explaining further and examining the concept of legal certainty and the sub-concept of non-retrospectivity as it occurs in the EU legal order, it is first necessary to briefly describe the nature of the EU and its legal order.

The EU and its legal order

The EU is a grouping of 15 European states—Austria, Belgium, Denmark, France, Finland, Germany, Greece, Ireland, Italy, Luxembourg, the Netherlands, Portugal, Spain, Sweden, and the United Kingdom—in which, *inter alia,* goods, services, people and capital circulate freely.[3] Approximately 378 million people are citizens of the EU,[4] which is still growing. By virtue of the agreement between the EU and the EFTA (European Free Trade Association) countries,[5] which came into force on 1 January 1994, the EU's Single Market has been extended to the EFTA countries other than Switzerland. The entire area now covered by the Single Market is known as the European Economic Area (EEA). Its population is approximately 382 million people.[6] In addition to this, countries such as Turkey, Cyprus, Malta, Hungary, Poland, Romania, Slovakia, Latvia, Estonia, Lithuania, Bulgaria, the Czech Republic and Slovenia have all lodged applications to join the EU.[7]

In the area of international trade, the EU is already the world's largest trading entity, accounting for approximately one-fifth of the total global trade in goods.[8] In addition, the EU is emerging as an important 'collective' world power.[9] In the future, the EU's importance both in relation to trade and political clout will no doubt increase even further. As Lester Thurow has argued, it is even possible that it will be the EU, not Asia (or especially China), which writes and dominates the agenda for the 21st century.[10]

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3 The EU's Single Market was—at least in theory—completed on 31 December 1992. This was achieved following the signing of the Single European Act (SEA) on 17 February 1987. Subsequently, there has been the introduction of a single currency (the euro). As from January 1 2002, 12 European countries have given up their national currency forever and adopted a common currency: the euro. The new euro banknotes and coins circulated alongside the respective national currencies during a changeover period, which varied slightly from country to country. On 1 March 2002, however, it became sole legal tender throughout the euro zone.

4 Source: Eurostat. Its website is at: http://europa.eu.int/comm/eurostat.

5 The EFTA countries are Norway, Iceland, Liechtenstein and Switzerland.

6 See fn 3.

7 Many of these countries are already linked to the EU by 'Europe Agreements' which provide for free trade in industrial products as well as economic co-operation in a range of areas.

8 Source: European Commission, *The European Union and World Trade,* 1995, Brussels: Office for Official Publications of the European Communities.

9 By this, it is meant that the EU (as such) is becoming an important world power in its own right (as distinct from the world power importance of individual Member States such as France, Germany and the United Kingdom). In this regard, see also the EU publication, *op cit,* fn 2.

10 Thurow, L, *Head to Head: The Coming Economic Battle Among Japan, Europe and America,* 1992, New York: William Morrow and Company.

There are, in fact, three European Communities, namely the European Coal and Steel Community (ECSC), the European Atomic Energy Community (Euratom) and the European Community (EC). The combined ECSC, Euratom and EC are, however, now often collectively referred to as simply the 'European Community', or 'EC'.[11] The members of all three Communities at the present time are the aforementioned 15 states. Initially, the three Communities had different institutions, but this was changed by the Merger Treaty of 1965 which made the same institutions common to all three Communities. In the discussion which follows, whenever reference is made to the European Communities, the focus will be primarily on the most important Community of the three, namely the European Community.

The comparatively new EU was created by the Treaty on European Union (TEU) which came into force on 1 November 1993. The EU is something of a hybrid. It is not vested with a 'legal personality' as such, nor has there been any transfer to it of sovereign powers by the member states. Rather, it has been created as a superstructure over 'three pillars'. The first pillar comprises the aforementioned three Communities (namely the ECSC, Euratom and the EC). The second pillar comprises co-operation among the member states with a view to adopting joint action in the field of foreign and security policy (CFSP). The third pillar comprises co-operation among the member states with a view to framing common policies in justice and home affairs (CJHA). The EU is served by the same institutional framework that applies to the European Communities.

Consequently there is, at the present time, both an EC and an EU, with the former being part of the 'three pillars' structure of the latter. For the sake of simplicity, and in keeping with what seems to have become the accepted practice (since the entering into force of the TEU), the term 'European Union' (or 'EU') has herein generally been used even when, strictly speaking, the term 'European Community' (or 'EC') may be the correct terminology. Likewise, when mention is made herein of, for example, 'an institution of the EU', strictly speaking it may actually be 'an institution of the EC'. Similarly, even though a country may now be, and may be referred to herein as, an 'EU member state', at the time of the particular happening under discussion, it may actually have been an 'EC member state' or even an 'EEC member state'.

The EU legal order is, essentially, the law of the European Communities as it applies throughout the EU. It is a *separate* legal order in the sense that it is distinct from—though closely linked to—the legal systems of the EU member states.[12] This is because the Treaties upon which the EU is founded are more

11 This occurred with the coming into force of the Treaty on European Union (TEU).
12 Case 26/62 *Van Gend en Loos v Nederlandse Administratie der Belastingen* [1963] ECR 1.

than just international agreements: they form the 'Constitution' of the EU.[13] An important consequence of this separate legal existence is that the national legislatures of the EU member states have no power to amend or repeal any part of EU law.[14] Furthermore, in the event of conflict, EU law is *supreme* (that is, it overrides national law).[15] Another important characteristic of EU law is its ability, provided certain conditions are satisfied, to confer rights or obligations directly on the citizens of the EU. This is known as the doctrine of direct effect.

EU law comes in two forms: 'written' and 'unwritten'. There are three main sources of written EU law, namely:

(a) the three founding Treaties (as amended) and their various annexes and protocols;

(b) the secondary legislation (for example, the Regulations, Directives, Decisions, Recommendations and Opinions made by the EU institutions in the exercise of the powers conferred on them in the founding Treaties);

(c) the agreements the EU has concluded with non-EU member states and other international organisations.[16]

As with all written legal systems, gaps do appear from time to time in the written law of the EU. It is the role of the 'unwritten EU law' to fill in such gaps. Such unwritten law comprises the 'general principles of EU law' recognised by the ECJ in its judgments.[17] These general principles of EU law include:

(a) the principle of respect for fundamental human rights;

(b) the principle of proportionality;

(c) the principle of natural justice;

(d) the principle of equality;

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13 Case 294/83 *Partie Ecologiste 'Les Verts' v Parliament* [1986] ECR 1339. See also the Opinion of Advocate General Lagrange in Case 8/55 *Fédération Charbonnière de Belgique v High Authority* [1954–56] ECR 245 at 277.

14 For further information on this aspect, see, eg, St JN T Bates, 'European Community legislation before the House of Commons' (1991) 12 Statute Law Review 109.

15 Case 6/64 *Costa v ENEL* [1964] ECR 585.

16 These agreements range from association treaties and complex trade and co-operation agreements to more simple sectoral trade agreements. A further category of written EU law, in addition to those mentioned, consists of the Conventions between the EU member states distinct from, but concluded within the context of, the founding Treaties (eg, the Brussels Convention on Jurisdiction and the Enforcement of Judgments in Civil and Commercial Matters).

17 The general principles of EU law are those which the ECJ has derived both from the treaties and from the legal principles recognised in the national legal systems of the EU member states. In certain circumstances, the general principles of EU law are treated as being superior even to any of the forms of legislation (eg, Regulations, Directives and Decisions) defined in the treaties. For further information in this regard, see, eg, Toth, AG, *The Oxford Encyclopaedia of European Community Law (Volume 1 Institutional Law),* 1990, Oxford: Clarendon, 277.

(e) the principle of legal professional privilege;

(f) the principle of legal certainty.

One of the sub-concepts of the principle of legal certainty is ' non-retrospectivity', which is the focus of this article.

To this point, there has been mention of the importance of the EU to international businesses and the problems generally that legal uncertainty (in *any* environment) can cause. There has also been given a brief description of the structure of the European Union and its legal order as well as an indication that one of the general principles of EU law is the principle of legal certainty, of which non-retrospectivity is a sub-concept. Such sub-concept of non-retrospectivity in the EU legal order will now be further examined and discussed, and thereafter some conclusions will be proffered that, the writer submits, can be drawn as to whether or not the EU's approach to legal non-retrospectivity causes any problems for international businesses.

Non-retrospectivity in EU law

A sub-concept of legal certainty

As already mentioned, non-retrospectivity is a sub-concept of the overriding principle of legal certainty. This latter principle (legal certainty) is not something which requires the law to be rigid (that is, fixed and inflexible). Rigidity is synonymous with being impervious to change. The law, almost always, needs to have some degree of flexibility so that judges, using their discretion, can apply it to different situations and different persons. As Lord Lloyd and Michael Freeman have noted, a legal system which does not allow, within certain limits, room for judges to manoeuvre will be unworkable.[18] In fact, it would seem that only a totally static society could tolerate a completely rigid system of law.[19] Rather, legal certainty is all about *legal predictability*. This, essentially, means that the applicable law should be clear and precise—and its effect should be predictable. If this is just not possible, then persons and entities are in a most precarious and unsatisfactory situation—namely, one of legal *un*certainty. For business persons, especially, a state of legal uncertainty can be, at the least, a hindrance and, more seriously, a deterrent.

With legal certainty, there is the main principle—the principle of legal certainty, and there are various sub-concepts, or special applications, of the main principle—namely, the protection of vested rights,[20] the protection of legitimate

18 Lord Lloyd and Freeman, MDA, *Lloyd's Introduction to Jurisprudence,* 5th edn, 1985, London: Stevens & Sons, at 1106 (7th edn, 2001, London: Sweet & Maxwell).

19 *Ibid.*

20 In some writings, the term 'acquired rights' is used instead of 'vested rights'. However, the two terms are generally synonymous.

expectations[21] and non-retroactivity. These sub-concepts are found amongst the various major 'characteristics' of legal certainty which have been identified by the European Court of Justice (ECJ) in its judgments. Such major characteristics of legal certainty are what the ECJ principally looks for when a question arises as to whether legal certainty is or is not present in relation to a particular EU law (or administrative act). They are as follows:

1 *EU laws must be clear, precise and predictable.* In *Kloppenburg,* the ECJ said that the principle of legal certainty means that 'Community legislation must be unequivocal and its application must be predictable for those who are subject to it'.[22] Likewise, in *Gondrand,* the ECJ spoke of the need for EU law to be 'clear and precise so that those concerned may know without ambiguity what are their rights and obligations and may take steps accordingly'.[23] In another case, *Commission v United Kingdom,* the ECJ spoke of the need for 'legal clarity'.[24]

2 *EU laws must be in a language understandable by the person to whom they are directed.* This was emphasised in *Farrauto,*[25] where the ECJ observed that The national courts of the Member States must…take care that legal certainty is not prejudiced by a failure arising from the inability of the worker to understand the language in which a decision is notified to him'.[26]

3 *Any factual situation should normally, in the absence of any contrary legal provision, be examined in the light of the legal rules existing at the time when that situation took place.*[27] What this means is that laws should be contemporaneous with the situation under review. *Laws should not apply retrospectively.* This links in with the fundamental 'core aspect' of legal certainty that persons should at all times know, or at least be able to ascertain, the legal consequences of a contemplated course of action—and they cannot do this if laws are not contemporaneous with situations. An example of this requirement can be seen in *Pedro Burdalo Trevejo and Others v Fondo Garantía Salarial.*[28] This was an Art 234 (ex Art 177) EC reference by a

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21 Even in England which, as mentioned, has no general principle of legal certainty, there has been a clear recognition of, eg, the principle of protecting legitimate expectations. See, eg, *Schmidt v Secretary of State for Home Affairs* [1969] 2 Ch 149 at 170–71; *Attorney General of Hong Kong v Ng Yuen Shiu* [1983] 2 AC 629; and Forsyth, CF, 'The provenance and protection of legitimate expectations' (1988) 47 Cambridge Law Journal 238.

22 Case 70/83 *Kloppenburg v Finanzamt Leer* [1984] ECR 1075 at 1086. See also Joined Cases 212–2177 80 *Amministrazione delie Finanze dello Stato v Sri Meridionale Industria Salumi and Others* [1981] ECR 2735 at para 10.

23 Case 169/80 *Administration des Douanes v Societe Anonyme Gondrand Frères and Societe Anonyme Garancini* [1981] ECR 1931 at 1942.

24 Case 32/79 *Commission v United Kingdom* [1980] ECR 2445 at para 46.

25 Case 66/74 *Alfonso Farrauto v Bau-Berufsgenossenschaft* [1975] ECR 157.

26 *Ibid* at 162.

27 See, eg, Case 10/78 *Belbouab v Bundesknappschaft* [1978] ECR 1915.

28 Case C-336/95 *Pedro Burdalo Trevejo and Others v Fondo Garantía Salarial* [1997] ECR 1–2115.

Spanish court to the ECJ concerning the interpretation of a Council Directive 77/187 of 14 February 1977 regarding the safeguarding of employees' rights in the event of transfers of undertakings. The ECJ ruled that it followed from the facts that, irrespective of the material scope of the Directive in circumstances such as those described by the national court, the Directive could not assist the employees concerned 'since the transfer of the undertaking which was at issue took place prior to the date on which the directive first produced legal effects in the Member State concerned'.[29] The date of the 'transfer' (19 May 1978) preceded the accession of Spain to the Communities, which produced legal effects only from 1 January 1986. Thus the Directive could not be relied on because the transfer of the undertaking occurred before the Directive had begun to produce legal effects in Spain (the member state concerned).[30] In line with this requirement of legal certainty (that is, that laws should be contemporaneous with situations), EU laws generally only take effect on a particular date after their publication in the *Official Journal* (OJ).[31] Publication in the OJ is deemed to be notification to everyone of the existence and content of the particular laws—and the date on which they will take effect.[32] Only in exceptional cases, where the purpose to be achieved so demands, and where the legitimate expectations of the persons concerned are duly respected, is it possible for an EU law to take effect before the date of its publication in the OJ (that is, to apply retroactively).[33]

4 *EU laws should not (generally) come into force immediately.*[34] Otherwise, there may be legal uncertainty because, whilst persons may know of the existence of the particular laws, they may not know or appreciate the extent of their obligations thereunder. In *Neumann,* for example, the ECJ said that an 'institution cannot, without having an adverse effect on a legitimate regard for legal certainty resort without reason to the procedure of an immediate entry into force'.[35] Likewise, in *Deuka,* the ECJ held that any amending legislation should have adequate transitional provisions so that the people and entities covered or affected by such legislation can adjust themselves to the new régime.[36] It is not invariably the case that there can be no immediate application of EU law: it is just that

29 *Ibid* at para 14.
30 *Ibid* at paras 15 and 16.
31 Article 254(1) (ex Art 191(1)) EC.
32 This is not an uncommon procedure. In many countries, publication in the *Government Gazette* (or similar) is deemed to be notice to all and sundry of the coming into force of a particular law.
33 Case 99/78 *Decker v Hauptzollamt Landau* [1979] ECR 101 at 111; Case 258/80 SPA *Metallurgica Rumi v Commission* [1982] ECR 487 at 503; Case 276/80 *Padana v Commission* [1982] ECR 517 at 525; Case 84/81 *Staple Dairy Products Limited v Intervention Board for Agricultural Produce* [1982] ECR 1763 at 1777; Case 108/81 *Amylum v Council* [1982] ECR 3107 at 3178; Case 114/81 *Tunnel Refineries v Council* [1982] ECR 3189 at 3206; Case 224/82 *Meiko-Konservenfabrik v Germany* [1983] ECR 2539 at 2548–49.
34 Case 98/78 *Racke v Hauptzollamt Mainz* [1979] ECR 69 at 84.
35 Case 17/67 *Neumann v Hauptzollamt Hof/Saale* [1967] ECR 441 at 456.

normally this is the situation. In exceptional circumstances, an immediate application of the particular law may be justified—and, in *Neumann,*[37] this was held to be the case.

5 *In order to ensure legal certainty, there should be time limits.* Time limits are, essentially, periods of time within which proceedings[38] must be commenced or some other action[39] taken; otherwise—after the expiration of the particular period of time (that is, the time limit)—such proceedings or other action are barred. Time limits ensure legal certainty because the uncertainty brought about by the possibility of laws being annulled, or of a state of inaction being changed, is removed once the prescribed time limit has passed.[40]

6 *Vested rights should normally be protected.*[41] Basically, the position regarding the protection of vested rights is as follows: where individual rights are conferred by individual administrative measures, the rights that arise are vested (or acquired) rights. If the vested rights arise from lawful measures, they are protected by the principle of legal certainty and cannot be withdrawn retroactively. Whether they can be withdrawn for the future (that is, prospectively) depends on the terms of the measure by which they were conferred. If the EU measure which gave rise to the vested rights is unlawful, the vested rights can always be revoked, at least prospectively, provided (a) this is done within a reasonable time and (b) the EU institution concerned gives sufficient regard to how far the persons affected by the measure may have been led to rely on its 'lawfulness'.[42] One of the leading cases in this area is *Algera.*[43] As regards the retroactive revocation of vested rights conferred by unlawful measures, basically the situation is that retroactive withdrawal of vested rights conferred by an unlawful measure is only possible if (a) the particular measure was adopted on the basis of false or incomplete information provided by the persons affected by the measure,[44] or (b) the particular measure is illegal or erroneous.[45] If the ECJ does allow the retroactive revocation of vested rights conferred by an unlawful measure, such revocation is, generally,

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36 Case 78/74 *Deuka (No 1)* [1975] ECR 421 at 433–34; Case 5/75 *Deuka (No 2)* [1975] ECR 759.
37 Case 17/67 *Neumann v Hauptzollamt Hof/Saale* [1967] ECR 441. See also Case 57/72 *Westzucker GmbH v Einfuhr und Vorratsstelle fur Zucker* [1973] ECR 321.
38 Eg, to enforce rights.
39 Eg, by the Commission.
40 In this regard, see, eg, Case 3/59 *Germany v High Authority* [1960] ECR 53; Case 48/69 *ICI v Commission* [1972] ECR 619.
41 In some writings, 'acquired rights' is used rather than 'vested rights'—however, these terms are synonymous.
42 Joined Cases 7/56 and 3–7/57 *Algera v Common Assembly* [1957] ECR 39; Case 54/77 *Herpels v Commission* [1978] ECR 585; Case 14/81 *Alpha Steel Ltd v Commission* [1982] ECR 749.
43 Joined Cases 7/56 and 3–7/57 *Algera v Common Assembly* [1957] ECR 39.
44 Joined Cases 42 and 49/59 *SNUPAT v High Authority* [1961] ECR 53 at 87.

subject to very strict conditions.[46] In *Consorzio Cooperative d'Abruzzo,*[47] unreasonable delay was held to be a bar to the retroactive revocation of an unlawful measure.

7 *Legitimate expectations should normally be protected.* Essentially this means that EU law should not be different from that which could reasonably be expected. Eleanor Sharpston has correctly commented in this regard that a 'legitimate expectation' is a belief that it was legitimate for him or her to entertain as to the way in which he or she would be treated by an EU institution in the application of EU laws and measures.[48] It is fairly clear from the ECJ's case-law that the mere fact that a trader is disadvantaged by a change in the law will not, in itself, give any cause for complaint based upon disappointment of legitimate expectations.[49] As Jurgen Schwarze has stated: '[The] Court has emphasised the essential freedom enjoyed by the legislature to alter for the future the fundamental legal conditions in which traders operate, even if the changes made work to the disadvantage of all firms in a certain industrial sector.'[50] It seems that, in order to establish a claim for infringement of legitimate expectations, essentially what an individual must be able to do is to point either to 'a bargain' of some form which has been entered into between the individual and the authorities, or to 'a course of conduct or assurance' on the part of the authorities which can be said to generate the legitimate expectations.[51] As regards an overall appraisal of the protection of legitimate expectations, it seems the case-law of the ECJ pivots around the question of 'the foreseeability of change'. A distinction is drawn between 'quantitative change'—for example, an adjustment to the monetary compensatory amounts, which is usually considered to be foreseeable, and 'qualitative change'—for example, a modification of the underlying system, where foreseeability depends, to a large extent, on the nature of the change effected. A distinction can also be detected between 'changes of view by the authorities'—which are not usually considered to be foreseeable, and 'changes in underlying circumstances'—which may well be foreseeable by the alert or prudent trader.

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45 Case 111/63 *Lemmerz-Werke GmbH v High Authority* [1965] ECR 677 at 690.

46 Case 54/77 *Herpels v Commission* [1978] ECR 585 at 599. See also Joined Cases 42 and 49/59 *SNUPAT v High Authority* [1961] ECR 53; Case 14/61 *Hoogovens v High Authority* [1962] ECR 253.

47 Case 15/85 *Consorzio Cooperative d'Abruzzo v Commission* [1987] ECR 1005.

48 Sharpston, E, 'Legitimate expectations and economic reality' (1990) 15 European Law Review 103 at 105.

49 See, eg, Case 78/77 *Lührs v Hauptzollamt Hamburg-Jonas* [1978] ECR 169; Case 52/81 *Faust v Commission* [1982] ECR 3745; Case 245/81 *Edeka v Germany* [1982] ECR 2745; Case T-521/93 *Atlanta AG and Others v Council and Commission* [1996] ECR II–1707.

50 Schwarze, J, *European Administrative Law,* 1992, London: Sweet & Maxwell, 1131.

51 Craig, PP, 'Substantive legitimate expectations in domestic and Community law' (1996) 55 Cambridge Law Journal 289 at 307.

8 *In order to ensure legal certainty, there should be continuity of existing legal concepts and organisation whenever legislation is amended or altered* (unless the legislature expresses a contrary intention).[52]

The aforegoing are just the 'major' characteristics of legal certainty identified by the ECJ. There are also various other characteristics of legal certainty, such as:

(i) *Agreements (such as those falling under Art 81 (ex Art 85) EC) should not be rendered automatically void without any examination.* This was so held in *Bosch.*[53] In that case, the ECJ ruled that in general it would be contrary to the general principle of legal certainty to render agreements automatically void before it is even possible to tell which are the agreements to which Art 85 EC (now Art 81 EC) as a whole applies.[54]

(ii) *Every EU institution should abide by and respect its own rules and decisions.* This principle is known as *patere legem quam ipse fecisti.* It has often been raised before the ECJ but seldom applied.[55] A typical case where this principle was raised is *Mulcahy*.[56]

From characteristics 3 and 6, it can be seen that the EU legal order recognises the need generally for non-retroactivity. By virtue of characteristic 3, EU laws should not be made to apply retrospectively and any factual situation should normally, in the absence of any contrary legal provision, be examined in the light of the legal rules existing at the time when that situation took place. From characteristic 6, it can be seen that not only does the EU legal order recognise the need to protect vested rights, it also takes the attitude that:

(i) if the vested rights arise from lawful measures, they are protected by the principle of legal certainty and cannot be withdrawn retroactively; and

(ii) a retroactive withdrawal of vested rights conferred by an unlawful measure is only possible if the particular measure was adopted on the basis of false or incomplete information provided by the persons affected by the measure, or the particular measure is illegal or erroneous—and, in any event, if the ECJ does allow the retroactive revocation of vested rights conferred by an unlawful measure, such revocation is, generally, subject to very strict conditions.

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52 Case 23/68 *Klomp v Inspecktie der Belastingen* [1969] ECR 43 at 50.

53 Case 13/61 *Kledingverkoopbedrijf De Geus en Uitdenbogerd v Robert Bosch GmbH* [1962] ECR 45.

54 *Ibid* at 52.

55 See, eg, Case 110/77 *Mulcahy v Commission* [1978] ECR 1287; Case 432/85 *Souna* [1987] ECR 2229; Case 148/73 *Louwage* [1974] ECR 81; Joined Cases 219 to 228, 230 to 235, 237, 238 and 242/80 *Andre and Others v Commission and Council* [1984] ECR 165; Joined Cases 87, 130/77, 22/83, 9 and 10/84 *Salerno v Commission and Council* [1985] ECR 2523.

56 *Mulcahy, ibid.* See also Case C-137/92P *Commission v BASF AG* [1994] ECR I–2555.

This approach to non-retroactivity is reinforced by characteristics 4 and 8. Characteristic 4 supplements the requirement for there to be non-retrospectivity by requiring that, also, adequate forewarning should be given of future changes to the laws of the EU *(EU laws should not generally come into force immediately).* Businesspersons should thus be able to proceed in the knowledge that, normally, there will not only be no changes to the law as it applies to past transactions, but also as regards future transactions they will be given adequate forewarning to enable them to adapt to any changes in the law. Characteristic 8 *(there should be continuity of existing legal concepts and organisation)* further complements the attempt to ease the adaptation to future changes in the law. An example of how characteristic 8 works can be seen in the continuity arrangements which were made by the EU regarding the introduction of the euro currency: the EU, *inter alia,* adopted rules designed to guarantee the continuity of contracts denominated in national currencies between the start of the final stage of Economic and Monetary Union (EMU) on 1 January 1999 and the ending of national currencies by 1 July 2002, so as to provide legal certainty for businesses (and consumers).

From the aforegoing, it can be clearly seen that the ECJ has extensively and comprehensively identified the 'characteristics' of legal certainty—and amongst these is 'non-retrospectivity'. The nature of non-retroactivity in EU law will now be examined further.

The nature of non-retroactivity in EU law

Essentially, non-retroactivity (in EU law) means that, in the interests of legal certainty, acts, events, situations and legal relationships which occurred or arose before the entry into force of an EU law should not be affected by that law. There are two contexts in which non-retroactivity can be considered and discussed, namely:

1 the acts of the EU institutions;

2 the judgments of the ECJ.

The acts of the EU institutions

The ECJ has developed various rules concerning non-retroactivity in relation to the acts of the EU institutions. These are as follows (some have already been mentioned).

The first rule is that, whilst in principle the EU institutions are free to determine the date on which their laws come into force,[57] normally such laws cannot apply retroactively, that is, they cannot produce legal effects in respect of

57 Article 254 (ex Art 191) EC.

events taking place prior to the date of their actual publication in the OJ.[58] The basis for this is, of course, the principle of legal certainty which, as has been mentioned earlier, equates with legal predictability. There cannot be legal predictability if laws are made to apply retroactively.

The second of the rules developed by the ECJ (in relation to non-retroactivity and the acts of the EU institutions) is that, as also mentioned previously, whilst EU laws such as Regulations may enter into force on the day of their actual publication in the OJ and thus produce immediate legal effects, this is something which is normally incompatible with the principle of legal certainty. In order for there to be legal certainty, persons affected by new laws should not only be made aware of the existence of such laws, they should also be allowed sufficient time to make themselves fully acquainted with the laws' content, ramifications and scope. In general, the immediate entry into force of a measure (such as a Regulation) is justified only where there are serious reasons for holding that any interval between the publication and the entry into force of the measure would have been prejudicial to the EU.[59]

The third of the rules developed by the ECJ (in relation to non-retroactivity and the acts of the EU institutions) is that—notwithstanding the aforementioned previous rules—in certain circumstances where special conditions are met, a degree of retroactivity will, however, be allowed. Initially, the ECJ, in cases such as *Siemers,* stated quite categorically that a measure which is of a legislative nature cannot have retroactive effect.[60] By this the ECJ meant, for example, that a Regulation could not be used for the purposes of determining the classification of products imported, before its entry into force. Subsequently, however, the ECJ subjected its ruling in *Siemers* to certain exceptions. In *Racke,* for example, the ECJ stated that, although in general the principle of legal certainty precludes a Community measure from taking effect from a point in time before its publication, it may exceptionally be otherwise where the purpose to be achieved so demands and where the legitimate expectations of those concerned are duly respected.[61]

An example of a situation where retroactivity was *not* acceptable can be seen in *Diversinte SA & Another v Adminstracion Principal de Aduanas e Impuestos Especiales de La Junquera.*[62] The background facts were as follows:

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58 Case 88/76 *Société pour l'Exportation des Sucres v Commission* [1977] ECR 709 at 726. In the *Société pour l'Exportation des Sucres* case, a Regulation was involved which provided that it was to enter into force on 1 July 1976. As the Regulation was published on 2 July 1976, the ECJ rejected accidental retroactivity and ruled that it could only properly be applied as from 2 July 1976, since there were no factors capable of attributing to it retroactive effect.

59 See, eg, Case 17/67 *Neumann v Hauptzollamt Hof/Saale* [1967] ECR 441; also Case 57/72 *Westzucker GmbH* v *Einfuhr und Vorratsstelle für Zucker* [1973] ECR 321.

60 Case 30/71 *Siemers v Hauptzollamt Bad Reichenhall* [1971] ECR 919 at 928.

61 Case 98/78 *Racke v Hauptzollamt Mainz* [1979] ECR 69 at para 20.

62 Joined Cases C-260/91 and C-261/91 *Divesinte SA and Another v Adminstracion Principal de Aduanas e Impuestos Especiales de La Junquera* [1993] ECR I–1885.

(a) Between 28 February 1987 and 2 March 1987, Iberlacta (one of the plaintiffs) had exported to Germany 207 tonnes of denatured milk powder containing 12% fat.

(b) Between 3 and 5 March 1987, Diversinte (the other plaintiff) had exported to the same destination 120 tonnes of a similar product containing 18% fat.

(c) As at those dates (when the exporting was actually done), the denatured milk powder was exempt from a certain agricultural tax.

Subsequently, however—on 17 March 1987—Regulation 744/87 was published in the OJ. According to its terms, the particular agricultural tax on the export of milk powder was extended to certain previously exempt products (including those of the plaintiffs) with effect from 12 February 1987. The plaintiffs contested their liability to such tax. According to them, Regulation 744/87 was invalid because it was retroactive and did not satisfy the conditions under which the ECJ permitted retroactivity. In its judgment, the ECJ noted firstly that it has been consistently held that, although in general the principle of legal certainty precludes a Community measure from taking effect before its publication, it may exceptionally be otherwise where the purpose to be achieved so demands and where the legitimate expectations of those concerned are duly protected.[63] It then went on to note, however, that although—according to the case-law of the Court—it is not impossible for measures to have retroactive effect, measures having such effect must include, in the statement of reasons on which they are based, particulars which justify the desired retroactive effect.[64] The ECJ thereafter observed that, in the instant case, the Regulation in dispute (dated 16 March 1987) did not explain anywhere why it had a retroactive effect as from 12 February 1987. In fact, the third recital in the Regulation's preamble merely stated that 'in order to prevent speculation in the product covered by the Regulation the latter's provisions should be introduced as a matter of urgency'. At best, that recital enabled it to be understood why the Regulation was immediately applicable—but it did not state why the charge had to affect traders who exported non-skimmed milk in the month prior to the adoption of the Regulation.[65] That lack of information made it impossible for the ECJ to review the extent to which the retroactive effect was justified by the objective of the Regulation, or whether the legitimate expectation of the traders in question was protected.[66] Consequently, in those circumstances the ECJ had no alternative but to declare that the Regulation in dispute did not meet the requirement of stating reasons laid down by Art 190 EC. This, in turn, meant that the second paragraph of Art 3 of Commission Regulation (EEC) No 744/87 of 16 March 1987—amending Regulation (EEC) 805/86 introducing a charge on denatured skimmed-milk powder coming from Spain and derogating from Regulation

63 *Ibid* at para 9.
64 *Ibid* at para 10.
65 *Ibid* at para 12.
66 *Ibid* at para 13.

(EEC) 1378/86 as regards the accession compensatory amounts in trade with Spain—was invalid in so far as it declared that the Regulation was applicable with effect from 12 February 1987 (that is, retroactively).[67]

The fourth of the rules developed by the ECJ (in relation to non-retroactivity and the acts of the EU institutions) is that, although procedural rules are generally held to apply to all proceedings pending at the time when they enter into force, this is not the case with substantive rules. On the contrary, the latter are usually interpreted as applying to situations existing before their entry into force only in so far as it clearly follows from their terms, objectives or general scheme that such an effect must be given to them.[68] As the ECJ said in *Salumi:* 'This interpretation ensures respect for the principles of legal certainty and the protection of legitimate expectations, by virtue of which the effect of Community legislation must be clear and predictable for those who are subject to it.'[69]

In *Salumi,* the Corte Suprema di Cassazione in Rome referred to the ECJ for a preliminary ruling under Art 177 EC various questions on the interpretation of Council Regulation (EEC) 1697/79 of 24 July 1979 (which entered into force on 1 July 1980) on the post-clearance recovery of import duties or export duties which had not been required of the person liable for payment at the time the goods passed through the customs procedures. Various traders had challenged amended notices, issued by the Italian State Finance Administration (Amministrazione delle Finanze dello Stato), requiring them to pay a sum equal to the difference between the agricultural levy calculated at the rate applicable on the day of acceptance of the import declaration and the levy calculated at the more favourable rate introduced between the import declaration and the release of the goods for home use. The Italian State Finance Administration claimed that the more favourable rate had been applied in error.[70] In its judgment, the ECJ noted that it was clear from the documents before the court that until 1976 the Italian authorities had always calculated the levies by applying the more favourable rate at the request of the importer.[71] The ECJ had, however, in its earlier judgment of 15 June 1976 in *Frecassetti,*[72] held that that method could not be applied to agricultural levies on imports from non-member states, which had to be calculated at the rate applicable on the day when the import declaration was accepted by the customs authorities. To give effect to this decision of the ECJ, Regulation 1697/97 was enacted. By virtue of such Regulation, where the competent authorities found that the correct amount of

67 *Ibid* at paras 14 and 15.
68 Joined Cases 212 to 217/80 *Amministrazione delle Finanze dello Stato v Srl Meridionale Industria Salumi and Others* [1981] ECR 2735 at para 9.
69 *Ibid* at para 10.
70 *Ibid* at para 2.
71 *Ibid* at para 3.
72 Case 113/75 *Frecassetti v Amministrazione delle Finanze dello Stato* [1976] ECR 983.

duties had not been charged, they were obliged to take action to recover them. Essentially, what the ECJ was now being asked in this reference was to determine the Regulation's effect *ratione temporis* (that is, whether it applied retrospectively). After indicating (as mentioned above) that substantive rules are usually interpreted as applying to situations existing before their entry into force only in so far as it clearly follows from their terms, objectives or general scheme that such an effect must be given to them, the ECJ stated that the provisions of the Regulation could not be accorded retroactive effect unless sufficiently clear indications led to such a conclusion.[73] The ECJ then stated that, far from indicating any retroactive effect, both the wording and the general scheme of the Regulation led it to the conclusion that the Regulation provided only for the future.[74]

The fifth of the rules developed by the ECJ (in relation to non-retroactivity and the acts of the EU institutions) is that the principle of non-retroactivity does not apply to interpretations of EU laws. If an EU law is not clear and is clarified by a subsequent EU law, the clarification contained in the later rule may be used for cases which occurred prior to the later law's coming into existence.[75] For example, in *Osram,*[76] the Council implemented, subsequently, certain rules for the interpretation of the Common Customs Tariff. The ECJ accepted that such rules were applicable to goods imported even prior to the date of implementation of the rules. In its judgment, the ECJ observed: '[These] Rules for interpretation were devised with the aim of co-ordinating, for the tariff as a whole, interpretation practices laid down by special provisions, so that they do not form a legal innovation but apply to imports effected even before 1 January 1972.'[77] However, in deciding whether something really is just an interpretative provision, the ECJ adopts a restrictive approach. This can be seen from cases such as *Biegi.*[78]

Judgments of the ECJ

In relation to non-retroactivity and the judgments of the ECJ, the position is as follows. ECJ judgments which are:

(a) given in direct actions for annulment declaring an act of an EU institution void;[79]

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73 Joined Cases 212 to 217/80 *Amministrazione delle Finanze dello Stato v Sri Méridionale Industria Salumi and Others* [1981] ECR 2735 at paras 9 and 12.
74 *Ibid* at para 12.
75 Case 183/73 *Osram GmbH v Oberfinanzdirektion Frankfurt* [1974] ECR 477.
76 *Ibid.*
77 *Ibid* at para 8.
78 Case 158/78 *Biegi v Hauptzollamt Bochum* [1979] ECR 1103 at para 11.
79 Article 230 (ex Art 173) EC.

(b) given in reference proceedings for a preliminary ruling declaring an act of an EU institution invalid;[80]

(c) interpretative judgments and, in particular, interpretative preliminary rulings[81]

are normally regarded as having retroactive effect going back in time to the coming into force of the particular law or measure to which they relate. However, the ECJ may, exceptionally, 'in application of the general principles of legal certainty inherent in the Community legal order', restrict the retroactive effect of its interpretative judgments in order not to upset legal relationships established in good faith in the past.[82] Likewise, for reasons of legal certainty, the ECJ may restrict the retroactive effect of a judgment declaring a Regulation void or invalid.[83]

In the following discussion, there is separate consideration of:

(a) the ECJ's preliminary rulings on interpretation; and

(b) the ECJ's preliminary rulings on validity.

The ECJ's preliminary rulings on interpretation

It is generally considered that the ECJ's Art 234 (ex Art 177) EC preliminary rulings on interpretation apply retrospectively. As the ECJ said in *Salumi:*

> The interpretation which, in the exercise of the jurisdiction conferred on it by Art 177 of the EEC Treaty, the Court of Justice gives to a rule of Community law clarifies and defines where necessary the meaning and scope of that rule as it must be or ought to have been understood and applied from the time of its coming into force. It follows that the rule as thus interpreted may, and must, be applied by the courts even to legal relationships arising and established before the judgment ruling on the request for interpretation, provided that in other respects the conditions enabling an action relating to the application of that rule to be brought before the courts having jurisdiction are satisfied.[84]

However, notwithstanding the above-mentioned 'normal' position regarding the ECJ's Art 234 (ex Art 177) EC interpretative preliminary rulings (that is, that they apply retrospectively), *exceptionally* the court may—in application of the general principle of legal certainty inherent in the Community legal order and in taking account of the serious effects which its judgment might have, as regards the past, on legal relationships established in good faith—be moved to restrict for any

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80 Article 234 (ex Art 177) EC.

81 *Ibid.*

82 Case 61/79 *Amministrazione délie Finanze dello State v Denkavit Italiana* [1980] ECR 1205 at 1223, citing Case 43/75 *Defrenne v Sabena (No 2)* [1976] ECR 455 at 481 where the ECJ referring to 'important considerations of legal certainty' restricted the application of its judgment establishing the direct effect of Art 141 (ex Art 119) EC to future cases.

83 Case 45/86 *Commission v Council* [1987] ECR 1493 at 1522. See also the second paragraph of Art 231 (ex Art 174) EC.

84 Joined Cases 66, 127 and 128/79 *Amministrazione delle Finanze v Salumi* [1980] ECR 1237 at para 9.

person concerned the opportunity of relying upon the provisions as thus interpreted, with a view to calling in question those legal relationships.[85] In other words, *in exceptional situations,* in the interests of legal certainty, the ECJ can declare that its interpretative judgment will only apply prospectively (that is, for the future). The 'exceptional situations' when the ECJ might be moved to do this arise when it gives a 'new' interpretation to some aspect of EU law. Here the word 'new' is used in the sense of 'completely different and unexpected' as compared to earlier case law. Because such new interpretation is completely different and unexpected, the ECJ, by imposing a temporal limitation, endeavours to preserve a state of legal certainty for persons who organised their affairs and otherwise acted on the basis of the law as it was understood to be previously. The effect of a temporal limitation in an interpretative judgment is to prevent anyone other than the plaintiff in the particular case—and those persons who have already instituted proceedings as at the date of the judgment—from relying on the ruling in respect of the period preceding the date on which it was delivered.

The following are some examples of the cases where the ECJ has imposed temporal limitations in its interpretative judgments.

Defrenne (No 2)

In *Defrenne (No 2),*[86] the ECJ held that the equal pay provision of Art 119 (now Art 141) EC had direct effect, in the sense that any female worker could rely on it in proceedings against her employer before courts of any of the member states. However, because this was a 'new' interpretation which was contrary to the conclusions previously reached by most of the authors on the subject,[87] the ECJ added a 'temporal limitation' to its judgment. The ECJ decided that 'important considerations of legal certainty affecting all the interests involved' made it impossible to reopen the question as regards the past and, therefore, although Art 119 (now Art 234) EC was directly effective, only workers who had already brought legal proceedings at the date of the judgment could benefit from the ruling as to such direct effect.[88] An analysis of the *Defrenne (No 2)* judgment shows that—in relation to the issue as to whether or not it should impose a temporal limitation—the ECJ regards the following as important and relevant:

(a) the practical (for example, financial) consequences;

(b) the misapprehension of the parties as to the state of the law; and

(c) the conduct on the part of the EU institution (in this case, the Commission).

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85 Joined Cases 66, 127 and 128/79 *Amministrazione délie Finanze v Salumi* [1980] ECR 1237 at para 10.

86 Case 43/75 *Defrenne v Sabena (No 2)* [1976] ECR 455.

87 See, eg, Kapteyn, PJG and VerLoren van Themaat, P, *Introduction to the Law of the European Communities,* 1973, London: Sweet & Maxwell, 296.

88 Case 43/75 *Defrenne v Sabena (No 2)* [1976] ECR 455 at paras 74 and 75.

At this point, it is also mentioned that, in various judgments handed down in cases subsequent to *Defrenne (No 2),* such as *Ariete SpA*[89] *and Salumi Srl,*[90] the ECJ emphasised that *Defrenne (No 2)* was an 'exceptional' case and that temporal limitations will only be imposed in exceptional cases. The 'general rule' is that an interpretation applies retrospectively. Moreover, such a temporal limitation may be allowed only by the ECJ and only in the interpretative judgment itself.[91]

Blaizot

The ECJ also imposed a temporal limitation when giving its judgment in *Blaizot.*[92] That case involved a demand for restitution of university fees which a French citizen (Vincent Blaizot) and 16 other students had made to the University of Liège in Belgium. The fees at issue were supplementary registration fees *(Minerval)* paid by non-Belgian students prior to 13 February 1985. This was the date on which the ECJ had decided in *Gravier*[93] that the imposition of such fees constituted discrimination on the grounds of nationality which was prohibited by the EC Treaty. In their submissions to the ECJ, the University of Liège and the other defendants in *Blaizot* emphasised that the judgment in *Gravier* constituted a 'new development in Community law' which 'would have serious repercussions if it were to have effect from 1 September 1976 onwards' (that is, be retrospective).[94] The situation was, they submitted, comparable to that in *Defrenne (No 2)*[95] They therefore asked the ECJ to impose a temporal limitation. In agreeing to grant this request, the ECJ pointed out that, as it had recognised in its judgment in *Defrenne (No 2),* 'it is only *exceptionally* that [the ECJ] may, *in application of the general principle of legal certainty inherent in the Community legal order,* be moved to restrict for any person concerned the opportunity of relying upon the provision as thus interpreted with a view to calling in question legal relationships established in good faith',[96] and that 'such a restriction may be allowed only in the actual judgment ruling upon the interpretation sought'.[97]

In support of its decision to impose a temporal limitation in its *Blaizot* judgment, the ECJ initially stated (at para 29):

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89 Case 811/79 *Amministmzione delle Finanze dello Stato v Ariete SpA* [1980] ECR 2545.
90 Cases 66, 127 and 128/79 *Amministrazione delle Finanze dello Stato v Salumi* [1980] ECR 1237.
91 *Ibid* at para 11.
92 Case 24/86 *Blaizot v Universite de Liege and Others* [1988] ECR 379. For a very good commentary on this case, see de Lacey, P and Moens, GA, *The Decline of the University,* 1990, Tahmoor: Law Press, 29.
93 Case 293/83 *Gravier v City of Liège* [1985] ECR 593.
94 Case 24/86 *Blaizot v Universite de Liège and Others* [1988] ECR 379 at para 26.
95 *Ibid.*
96 *Ibid* at para 28. Emphasis added.
97 *Ibid.*

> This judgment *deals for the first time* with the question whether university education may be regarded as constituting vocational training for the purposes of Art 128 of the EEC Treaty.

(At para 30):

> As the Court has held [in Defrenne (No 2)], in determining whether or not to limit the temporal effect of a judgment it is necessary to bear in mind that although *the practical consequences of any judicial decision must be weighed carefully,* the Court cannot go so far as to diminish the objectivity of the law and compromise its future application on the ground of the possible repercussions which might result, as regards the past, from a judicial decision.

(And at para 31):

> This case marks *a development* with regard to the inclusion of university studies in the scope of the term 'vocational training' for the purposes of Community law.[98]

The ECJ then went on to point out that, before *Gravier,* the scope of the term 'vocational training' was uncertain. It was only when the ECJ gave its judgment in *Gravier* that such previous uncertainty was ended (because it was then known that the university studies preparatory to the exercise of a trade or profession were covered by the term 'vocational training').[99] These comments display the ECJ's acceptance that there was a 'new' development in the law (in the sense of it being 'completely différent and unexpected'). The ECJ also indicated, in paras 32 and 33 of the judgment, how the national authorities were mislead by the conduct of the Commission as to the true legal position:

> Indeed, with regard to university education, that development is reflected in the *conduct of the Commission.* Letters sent by the Commission to Belgium in 1984 show that at that time the Commission did not consider the imposition of the supplementary enrolment fee to be contrary to Community law. It was not until 25 June 1985, in the course of an informal meeting with officials of the Belgian Education Ministries, that the Commission stated that it had changed its position. Two days later, more than four months after the delivery of the Judgment of 13 February 1985, it stated during a meeting of the education committee established by the Council that it had not completed its review of the matter; that is to say, it had not yet formed a definite opinion of the conclusions to be drawn from that judgment, which itself concerned technical education, as was pointed out above. *The attitude thus adopted by the Commission might reasonably have led the authorities concerned in Belgium to consider that the relevant Belgian legislation was in conformity with Community law.*[100]

98 Emphasis added.
99 *Ibid* at para 31.
100 *Ibid* at paras 32 and 33. Emphasis added.

As a result, the ECJ concluded that, in those circumstances, pressing considerations of legal certainty precluded any reopening of the question of past legal relationships where that would retroactively throw the financing of university education into confusion and might have unforeseeable consequences for the proper functioning of universities.[101] Therefore, in so far as access to university studies was concerned, the direct effect of (then) Art 7 of the Treaty could not be relied on in support of claims regarding supplementary enrolment fees improperly charged prior to the date of this judgment, except in respect of students who had brought legal proceedings or submitted an equivalent claim before that date.[102] Thus, in *Blaizot*—as it has subsequently done in other cases[103]—the ECJ, in deciding whether or not to impose a temporal limitation, looked for and highlighted the same type of criteria as it gave prominence to in *Defrenne (No 2),* namely:

(a) the practical (that is, financial) consequences;

(b) the misapprehension of the parties as to the state of the law; and

(c) the conduct on the part of the particular EU institution.

This is basically what Advocate General Tesauro was referring to when, in his Opinion in *Simitzi v Kos*[104] he stated that, in taking a decision to impose a temporal limitation, the ECJ has consistently applied two principles, namely:

> First, it weighs *the possible practical consequences of its judgments* in the absence of any temporal limitation, while pointing out that this cannot go so far as to diminish the objectivity of the law and compromise its future application on the ground of possible repercussions which might result, as regards the past, from a judicial decision. Secondly, the Court considers *whether there were any objective uncertainties as to the scope of the provisions of Community law* which are the subject of the interpretative judgment *and to what extent the actual conduct of the Community institutions might have nurtured those uncertainties.*[105]

From the comments of the ECJ in its judgments in cases such as *Defrenne (No 2),* it seems fairly obvious that financial considerations are an important factor, but they will not *by themselves* justify the imposition of a temporal limitation.

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101 *Ibid* at para 34.
102 *Ibid* at para 35.
103 See, eg, Case C-262/88 *Barber v Guardian Royal Exchange Assurance Group* [1990] ECR 1–1889; Case C-163/90 *Administration des Douanes et Droits Indirects v Leopold Legros and Others* [1992] ECR I–4625; Case C-415/93 *Union Royale Belge des Sociétés de Football Association v Bosman* [1995] ECR I–4921.
104 Joined Cases C-485/93 and C-486/93 *Simitzi v Kos* [1995] ECR I-2655.
105 Opinion of Advocate General Tesauro (para 17) in Joined Cases C-485/93 and C-486/93 *Simitzi v Kos* [1995] ECR I–2655. Emphasis added.

This can also be seen from the ECJ's judgments in *Dansk Denkavit,*[106] *Roders*[107] and *Richardson*.[108] To justify the imposition of a temporal limitation, there must also be present the other factors, namely misapprehension as to the state of the law (that is, legal uncertainty) and conduct on the part of an EU institution which caused the parties to be mislead.

In a number of cases—such as *Worringham and Humphreys,*[109] *Francovich,*[110] *Lancry*[111] and *Richardson*[112]—the ECJ has chosen not to impose temporal limitations, even though it was requested to do so by the parties. In *Worringham and Humphreys,*[113] for example, the ECJ ruled that a contribution to a retirement benefits scheme which was paid by an employer on behalf of employees by means of an addition to the gross salary and which, therefore, helped to determine the amount of that salary constituted 'pay' within the meaning of the second paragraph of Art 119 (now Art 141) EC. The defendant employer (Lloyd's Bank) asked the ECJ to impose a temporal limitation in its ruling because, otherwise, the judgment would lead to claims for the retrospective adjustment of pay scales covering a period of years.[114] After first stating that although the consequences of any judicial decision must be carefully taken into account (but not if it diminished the objectivity of the law and compromised its future), the ECJ then went on to point out that, in its *Defrenne (No 2)* judgment, it had accepted that a temporal restriction on the direct effect of Art 119 (now Art 141) EC might be taken into account, exceptionally, having regard:

(a) to the fact that the parties concerned, in the light of the conduct of several Member States and the views adopted by the Commission and repeatedly brought to the notice of the circles concerned, had been led to continue, over a long period, with practices which were contrary to Art 119 (now Art 141) EC; and

(b) to the fact that important questions of legal certainty affecting not only the interests of the parties to the main action but also a whole series of interests, both public and private, made it undesirable in principle to reopen the question of pay as regards the past.[115]

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106 Case C-200/90 *Dansk Denkavit and Poulsen v Skatteministeriet* [1992] ECR I–2217.
107 Joined Cases C-367/93 to C-377/93 *FG Roders BV and Others v Inspecteur der Invoerrechten en Accijnzen* [1995] ECR I–2229.
108 CaseC-137/94 *The Queen v Secretary of State for Health ex p Richardson* [1994] ECR I–3407.
109 Case 69/80 *Worringham and Humphreys v Lloyds Bank Ltd* [1981] ECR 767.
110 Joined Cases C-6 and 9/90 *Francovich v Italy* [1991] ECR I–5357.
111 Joined Cases C-363/93, C-407/93, C-408/93, C-409/93, C-410/93 and C-411/93 *René Lancry SA v Direction Générale des Douanes* [1994] ECR I–3957.
112 Case C-137/94 *The Queen v Secretary of State for Health ex p Richardson* [1994] ECR I–3407.
113 Case 69/80 *Worringham and Humphreys v Lloyds Bank Ltd* [1981] ECR 767.
114 *Ibid* at para 30.
115 *Ibid* at para 32.

The ECJ then said that, in this case neither of these conditions has been fulfilled.

In *Francovich,*[116] the ECJ held that where an EU member state (in this case, Italy) had failed to implement an EU Directive, it was obliged to compensate individuals for the damage suffered (as a result of its failure to implement the Directive), provided certain conditions were satisfied. In his Opinion, the Advocate General had proposed the imposition of a temporal limitation; his view was that this was justified given the uncertainty regarding the legal ground of the liability of the EU member states, its required conditions, its extent and the financial consequences that might be entailed. However, the ECJ did not follow the Advocate General's suggestion and no temporal limitation was imposed. It would seem that the ECJ's reason for not imposing a temporal limitation in its judgment in *Francovich* was that it wanted clearly to show that it desired to penalise quite harshly Italy, as well as any other EU member states, for failing to implement Directives.[117]

It was previously mentioned that, in relation to non-retroactivity and the judgments of the ECJ, there needs to be consideration of:

(a) the ECJ's preliminary rulings on interpretation; and
(b) the ECJ's preliminary rulings on validity.

The above discussion has concerned the ECJ's preliminary rulings on interpretation. The ECJ's preliminary rulings on validity will now be considered.

The ECJ's preliminary rulings on validity

Article 234 (ex Art 177) EC gives the ECJ jurisdiction not only in relation to 'interpretation' of the Treaty and acts of the EU institutions, but also in relation to the 'validity' of acts of the EU institutions. The validity of EU laws can be challenged either under Art 230 (ex Art 173) EC—an action for annulment)[118] or under Art 234 (ex Art 177) EC—a preliminary ruling as to validity. Consequently, before analysing the Article 234 (ex Art 177) EC preliminary rulings as to validity, it is first necessary to consider the position regarding Art 230 (ex Art 173) EC actions for annulment.

Actions for annulment are brought under Art 230 (ex Art 173) EC. However, Art 231 (ex Art 174) EC and Art 233 (ex Art 176) EC are also relevant, particularly the second paragraph of Art 231 (ex Art 174) EC which provides that, in the case of a Regulation, the ECJ 'shall if it considers it necessary state which of the effects of the Regulation which it has declared void be considered as definitive'. In other words, normally a ruling of annulment applies *ad initio*

116 Joined Cases C-6 and 9/90 *Francovich v Italy* [1991] ECR I-5357.

117 See, eg, Carmen Plaza Martin, 'Furthering the effectiveness of EC directives and the judicial protection of individual rights thereunder' (1994) 43 International and Comparative Law Quarterly 26 at 46.

118 Article 241 (ex Art 184) EC ('the plea of illegality') is an adjunct to Art 230 (ex Art 173) EC. However, no action can be brought directly against a Regulation under Art 241 (ex Art 184) EC.

but, if it is a Regulation which is being annulled, the ECJ can impose a temporal limitation in its judgment for the purpose of preserving legal certainty. On a number of occasions, the ECJ has utilised this power.[119] In fact, in the interests of maintaining legal certainty, the ECJ has even, in some instances, gone so far as to declare that the effects of an annulled act should continue in force until the adoption of new legislation.[120]

An Article 234 (ex Art 177) EC preliminary ruling declaring an EU act invalid is like an action for annulment under Art 230 (ex Art 173) EC in that, generally, it also has retrospective effect.[121] In addition, even though the Treaty does not make any provision for the imposition of temporal limitations in its Article 234 (ex Art 177) EC preliminary rulings, the ECJ has held, in such cases as *Roquette Frères*[122] and *Pinna,*[123] that the ECJ can, when making a declaration of invalidity in the context of an Article 234 (ex Art 177) EC preliminary ruling, 'apply by analogy the second paragraph of Article 174 (now 231) of the Treaty'.[124] This is 'for the same reasons of legal certainty as those which form the basis of that provision'.[125] In other words, the second paragraph of Article 231 (ex Art 174) EC enables the ECJ to impose a temporal limitation both in its judgments annulling an act under Art 230 (ex Art 173) EC and in its declaration of invalidity in Art 234 (ex Art 177) EC preliminary references.

One of the cases in which the ECJ discussed the imposition of temporal limitations in its judgments concerning invalidity was *Lomas & Others v United Kingdom.*[126] In that case, the legality of an agricultural clawback was in issue. The common organisation of the market in relation to sheep meat provided for the payment of premiums on sheep. If the sheep were subsequently exported, an amount equal to the premium (the clawback) had to be repaid. The ECJ held that the operation of this system was in breach of EU law. Essentially this was because Art 4(1) of Commission Regulation 1633/84 was invalid in as much as—by providing for the charging, by way of clawback, of an amount which in most cases was not exactly equal to that of the slaughter premium actually granted—the Commission had exceeded the

119 Case 34/86 *Council v Parliament* [1986] ECR 2155; Case 45/86 *Commission v Council* [1987] ECR 1493; Case 51/87 *Commission v Council* [1988] ECR 5459.

120 Case 275/87 *Commission v Council* [1989] ECR 259. See also Case 81/72 *Commission v Council* [1973] ECR 575; Case 59/81 *Commission v Council* [1982] ECR 3329; Case 264/82 *Timex v Council and Commission* [1985] ECR 849; Case C-295/90 *European Parliament v Council* [1992] ECR I-4193; Case C-41/95 *Council v Parliament* [1995] ECR 1–4411.

121 Case 130/79 *Express Dairy Foods v Intervention Board* [1980] ECR 1887.

122 Case 145/79 *SA Roquette Frères v French State—Customs Administration* [1980] ECR 2917.

123 Case 41/84 *Pinna v Caisse d'allocations familiales de la Savoie* [1986] ECR 1.

124 Case 145/79 *SA Roquette Frères v French State—Customs Administration* [1980] ECR 2917 at para 52. Reference to new treaty section added.

125 *Ibid.*

126 Joined Cases C-38/90 and C-151/90 *Thomas Edward Lomas and Others v United Kingdom* [1992] ECR I–781.

power conferred on it by Art 9(3) of Regulation 1837/80.[127] In relation to a question to it on the temporal effects of its judgment, the ECJ referred to its case law and stated that it could limit the temporal effect of a finding that an EU measure was invalid on the basis of *'overriding considerations of legal certainty involving all the interests at stake in the cases concerned'*.[128] In considering whether such criteria were met in *Lomas & Others v United Kingdom,* the ECJ held that to permit the invalidity of the illegal Regulation to be relied upon in relation to past situations would 'give rise to significant financial consequences and serious organisational difficulties as a result of the reopening of accounts long since closed and the need for the clawback to be recalculated in respect of the past'.[129] Therefore, in the view of the ECJ, there were overriding considerations of legal certainty and these prevented the effects of the invalid provisions of the Regulation from being called into question. [130] An exception was, however, made in favour of those persons who had already instituted legal proceedings.[131]

The ECJ has resorted to the imposition of temporal limitations in its Article 234 (ex Art 177) EC preliminary rulings in only a very small number of cases. Normally, the ECJ's preliminary rulings, both in relation to interpretation and validity, apply retrospectively. Furthermore, when the ECJ does impose a temporal limitation, it is obviously endeavouring to maintain legal certainty by protecting persons who have been relying on previous interpretations of EU law against sudden changes in that interpretation. The ECJ does not impose a temporal limitation without any good reason. In every case where it does impose a temporal limitation, the ECJ needs to be convinced that there are indeed justifying 'overriding considerations of legal certainty'.

Conclusion

From the above, the writer argues, it can be seen the EU takes a mature and sophisticated approach to the concept of legal non-retrospectivity. In its legal order, the EU has not only recognised as important both the main principle of legal certainty and the sub-concept of non-retrospectivity, it has also clearly identified the *nature* of non-retrospectivity and formulated *rules* that apply when issues concerning non-retrospectivity arise. Thus, provided they follow the

127 The ECJ additionally held that Art 4(2) of Regulation 1633/84 was also invalid in so far as it required a security to be lodged in order to ensure that the amount due pursuant to Art 4(1) was charged.
128 *Ibid* at para 24. Emphasis added.
129 *Ibid* at para 27.
130 *Ibid* at para 28.
131 *Ibid* at para 29.

established guidelines and ground-rules concerning same, international businesses contemplating doing business with or within the EU do not have to fear that any such business transaction will be unexpectedly or unfairly prejudiced by EU legislation and/or acts of the EU institutions which might be made to apply retrospectively.

The New Belgian Legislation on Euthanasia

Walter De Bondt[1]

Introduction

On 28 May 2002, the Belgian Chamber of Representatives passed the so called Euthanasia Act.[2] Previously, namely on 25 October 2001, the Senate had already adopted the new bill. Meanwhile, the statute came into force on 22 September 2002.

According to the Euthanasia Act, the physician who performs euthanasia does not commit a crime if he complies with the substantial and formal statutory requirements.

Taking into account the text of the Act, the preparatory work and the advice of the Belgian *Conseil d'état,* the present paper tries to sketch an objective picture of the new legislation. Personal interpretations and appreciations of the author are not under discussion.

First, the rationale of the new legislation is dealt with (2), then the structure of the statute is analysed (3) and finally the different provisions of the bill are discussed (4–9).

Rationale

It was the Senate—this is the so called reflection chamber of the Belgian Parliament, as opposed to the Chamber of Representatives, being the political chamber—which took the initiative for the new legislation. The bill was introduced into Parliament by six senators, who are all part of the governmental majority of liberals, socialists and ecologists. The initiators of the proposal emphasise that the act whereby a physician takes the patient's life, at the request of the latter, is still legally qualified as murder. Only the application of the legal concept of the *state of emergency* allows the judge not to condemn the physician. The latter concept, however, is subjective and is established on a case by case basis. This leads to legal insecurity, to semi-secret practices, to the absence of any state control and renders more difficult a genuine dialogue between the patient and the physician.

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1 Professor of Law, University of Ghent and Free University of Brussels; also a member of the Federal Commission on Control and Evaluation on Euthanasia.

2 Euthanasia Act, BS, 2002, 28515.

The new legislation aims for the following objectives:

- to guarantee the incurable patient that his request for euthanasia will be granted;
- to protect the patient, who suffers from a serious and incurable disease, by establishing clear and precise conditions and procedures;
- to offer legal security to the physician who performs euthanasia in accordance with the conditions and procedures of the statute; and
- to have a better understanding of the reality of euthanasia, by evaluating the practical application of the statute.

Structure of the statute

First, the Act defines the concept of euthanasia (Art 2). Then it enumerates the conditions and the procedures the physician has to comply with when he accepts a request for euthanasia (Art 3). Concerning this point, a distinction is made in accordance with the fact whether or not the patient will die within the foreseeable future. If clearly the patient will not die within the foreseeable future, the physician has to observe additional formal requirements and some extra conditions with respect to the content.

Thus, the object of Art 3 is the actual request for euthanasia by a patient who is conscious. Article 4, on the other hand, deals with the situation of the beforehand formulated and registered request for euthanasia (the so called 'living will'): the facility is created to ask in advance for euthanasia in case one should become unconscious and this situation be irreversible.

By virtue of Art 5, the physician who performs euthanasia has to inform the Federal Commission on Control and Evaluation (hereafter referred to as the Commission). This has to be done by means of a registration document, the content of which is determined by Art 7. Articles 8 and 9 lay down the competences of the Commission. If the Commission is of the opinion that the conditions provided for by the Act are not fulfilled, it sends the file to the Public Prosecutor of the place where the patient has died (Art 8). In the event of Art 8, the Commission fulfils its control function. Besides this, the Commission has an evaluation task. Article 9 prescribes that the Commission has to make a biennial report on the implementation of the Act. On this occasion, the Commission can formulate recommendations which may lead to a legislative initiative or to measures of the executive. A debate on the implementation of the Act has to be organised in the Senate and the Chamber of Representatives within a period of six months after the Commission has presented its first report (Art 13).

Article 14 explicitly states that a physician cannot be compelled to perform euthanasia. According to Art 15, a person who dies as a result of euthanasia is held to have died a natural death.

Finally, Art 16 states that the Act comes into force at the latest three months after its publication in the Belgian State Journal. Since the Act was published on 22 May 2002, it has come into force on 22 September 2002.

The definition of euthanasia

Euthanasia is described as an act on purpose, performed by a third person, in order to end the life of a person who has requested this act.[3] This definition implies that the so called 'medically assisted suicide' does not fall within the scope of the new legislation. This political choice of the Belgian legislator is questioned by the *Conseil d'état*. The only objective difference between euthanasia and medically assisted suicide consists in the fact that the actual act which leads to the death is committed by the physician or by the patient himself. The question is whether this sole consideration justifies the absence of a legal regulation. In the opinion of the *Conseil d'état,* the constitutionally guaranteed principle of non-discrimination requires the legislator either to regulate the medically assisted suicide or to indicate the objective reasons that legally justify the absence of a regulation of this aspect of terminal care.[4]

The actual request for euthanasia by a conscious patient

Conditions concerning the content

Only a physician is allowed to perform euthanasia. The doctor who performs euthanasia does not commit a crime when he has ascertained that:

- the patient is of age, or is an emancipated minor who has full legal capacity, and is conscious at the time of his request;
- the request is voluntary, well considered and repeated and is not made under any external pressure;
- the patient is dealing with a hopeless medical condition of persistent and unbearable physical or psychological pain or suffering which cannot be alleviated and which is caused by a serious and incurable disorder due to an accident or a disease.[5]

The Act expressly states in Art 3 § 1 that the physician who complies with the conditions of the Act does not commit a crime. An earlier proposal of the Euthanasia Act contained a change of the Penal Code. It stated that the

3 *Ibid,* Art 2.
4 Advice of the legislative section of the *Conseil d'état* on the bill on euthanasia, Parl Stukken Senaat, No 2–244/21, 15.
5 Euthanasia Act, Art 3 § 1.

provisions concerning murder were not applicable, when the conditions of the Act were observed. To meet the objection that was raised by some senators that no exceptions can be made to the rule Thou shalt not kill', the legislator ultimately decided not to change the Penal Code.[6]

Obligations of information, consultation and examination

Without prejudice to additional conditions which the physician wants to attach to his intervention, he must meet the following information, consultation and examination obligations:

1 Inform the patient about his health condition and his life expectancy, consult with the patient about his request for euthanasia and discuss with him possible remaining therapeutic options as well as the option of palliative care and their outcome. Both he and the patient have to become persuaded that there is no alternative to this situation than euthanasia and that the request of the patient is entirely based on voluntarism.

2 Be certain of the persistent physical or psychological suffering of the patient and of the sustained nature of his request. He will therefore have several talks with the patient which, taking into account the evolution of the medical condition of the patient, will be spread over a reasonable period of time.

3 Consult another physician about the serious and incurable nature of the disorder and convey the reasons for this consultation. The consulted physician assesses the medical record, examines the patient and has to persuade himself of the persistent and unbearable physical or psychological suffering which cannot be alleviated. He draws up a report of his findings. The consulted physician has to be independent vis à vis both the patient and the attending physician and has to be competent to assess the disorder in question. The attending physician will inform the patient of the results of this consultation.

4 Discuss the request of the patient with the nursing staff or members of that team if there is a nursing team which has regular contact with the patient.

5 Discuss the request of the patient with relatives appointed by him if this is the patient's wish.

6 Be certain that the patient has had the opportunity to discuss his request with the persons he wishes to meet.[7]

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6 *Ibid,* Amendements, Parl Stukken Senaat, No 2–244/4, 3–4.
7 *Ibid,* Art 3 § 2.

Additional obligation of consultation and stipulation as to time in the case where the request is from a patient who will not die within the foreseeable future

If the physician is of the opinion that apparently, the patient will not die within the foreseeable future, he has to observe two additional obligations.

First, he has to respect a period of at least one month between the written request of the patient and the performance of euthanasia.

Secondly, he has to consult a second physician. The latter is a specialist in the disease concerned or a psychiatrist. The physician consulted assesses the medical record, examines the patient and has to persuade himself of the persistent and unbearable physical or psychological suffering which cannot be alleviated. He also has to verify the voluntary, well considered and repeated nature of the request. He draws up a report of his findings. The consulted physician has to be independent vis à vis both the attending physician and the first physician consulted. The attending physician informs the patient of the results of this consultation.[8]

Formal conditions of the request for euthanasia

The request of the patient has to be made in writing. This document has to be written, dated and signed by the patient in person. If the patient is not capable of doing this, the request is written by an adult person who is chosen by the patient and has no material interest in the death of the patient.

This person mentions that the patient is not capable of writing the request and gives the reasons for this. In this case, the request will be written in the presence of the physician. The name of the doctor is mentioned in the request. The document has to be added to the medical record.

The patient can withdraw the request at any time. The document is then removed from the medical record and returned to the patient.[9]

Medical record

All requests formulated by the patient, as well as the interventions of the attending physician and their results, including the report(s) of the physician(s) consulted, are reported in the patient's medical record on a regular basis.[10]

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8 *Ibid,* Art 3 § 3.
9 *Ibid,* Art 3 § 4.
10 *Ibid,* Art 3 §5.

The beforehand formulated request for euthanasia, in case one should no longer be able to express oneself at a later moment

The regulations discussed so far concern the actual request of a conscious patient. Besides this, the Act also regulates the situation of the unconscious patient, who previously has drawn up a living will in which he expresses a request for euthanasia. This request will be complied with if the following conditions are fulfilled.

Conditions concerning the content

First, the person who draws up a living will has to be an adult (or an emancipated minor), who has full legal capacity. Furthermore the physician has to ascertain that:

- the patient suffers from a serious and incurable disorder caused by an accident or a disease;
- he is no longer conscious; and
- this condition is irreversible according to current scientific knowledge.[11]

Formal conditions

The living will can be drawn up at any time. It has to be drawn up in writing in the presence of two adult witnesses, of whom at least one has no material interest in the death of the patient. The will has to be dated and signed by the person who makes the statement, the witnesses and, if so desired, by one or more confidants.[12]

If the person who wishes to draw up a living will is physically and permanently incapable of writing and signing the will, he can appoint an adult who has no material interest in the death of the person in question to draw up the request in the presence of two adult witnesses, of whom at least one has no material interest in the death of the patient. The living will mentions that the patient is incapable of signing and explains why. The living will has to be dated and signed by the person who draws up the will, by the witnesses and, if applicable, by the confidant(s). A medical declaration is added to the living will to prove that the patient is persistently incapable of writing and signing the living will.

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11 *Ibid,* Art 4 § 1, s 1

12 One or more confidants, who will inform the attending physician of the will of the patient, can be appointed in the living will in order of preference. Every confidant replaces his or her predecessor mentioned in the will in case of a refusal, hindrance, incapacity or disease. The attending physician of the patient, the consulted physician and the members of the nursing staff cannot act as a confidant.

The living will can only be taken into consideration if it is drawn up or confirmed less than five years before the moment at which the patient can no longer express his will. The living will can be modified or withdrawn at any time.

A Royal Decree will determine how this living will has to be drawn up, registered and reconfirmed or withdrawn, and how it has to be communicated to the attending physicians via the services of the Registry Office.[13]

Examination and consultation obligations

The physician who performs euthanasia on the basis of a living will commits no crime if he ascertains that the patient:

- suffers from a serious and incurable disorder caused by an accident or disease;
- is no longer conscious; and
- that this condition is irreversible according to current scientific knowledge.

Furthermore, the physician must in advance:

1 Consult another physician about the irreversibility of the medical condition of the patient and convey the reasons for this consultation. The physician consulted assesses the medical record and examines the patient. He draws up a report of his findings. If a confidant is appointed in the living will, the attending physician will inform this person of the results of this consultation. The physician consulted has to be independent vis à vis both the patient and the attending physician and be competent to assess the disorder.

2 Discuss the content of the living will with the nursing staff.

3 Discuss the request of the patient with the confidant if such person has been appointed in the living will.

4 Discuss the content of the living will with relatives of the patient who are appointed by the confidant if a confidant is appointed in the living will.

Finally, the Act explicitly states that the physician has the right to attach additional conditions to his intervention, if he thinks fit to do so.[14]

13 Euthanasia Act, Art 4 § 1, ss 2–7.
14 *Ibid*, Art 4 § 2, ss 1 and 2.

Medical record

The living will as well as all interventions of the attending physician and their results, including the report of the physician consulted, are mentioned in the medical record of the patient on a regular basis.[15]

The Federal Commission on Control and Evaluation on Euthanasia

A Federal Commission on Control and Evaluation (hereafter referred to as the Commission) is established.[16]

Composition

The Commission consists of 16 members. They are appointed on the basis of their knowledge and experience in the matters falling within the competence of the Commission. Eight members are medical doctors. At least four of them are professor at a Belgian university. Four members are law professors at a Belgian university or practising lawyers. Four members come from circles charged with the problem of incurable medical patients. The members of the Commission are appointed on the basis of a pluralistic representation. The members are appointed by the government on the basis of a double list submitted by the Senate. The Commission can only decide lawfully if two thirds of the members are present. As appears from the name of the Commission, it has a control and an evaluation function.[17]

The control function

The document of registration

The Euthanasia Act organises the control task of the Commission by means of a document of registration. This document consists of two parts. The first part has to be sealed by the physician. In principle, the Commission does not read the first part. It contains the identity of the patient, of the attending physician, of the physician(s) consulted, of all persons who were consulted by the attending physician if there is a living will and, if this applies, the identity of the confidant(s).

The second part of the registration document is read by the Commission. It contains the following data:

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15 *Ibid,* Art 4 §2, s 3.
16 *Ibid,* Art 6§ 1.
17 *Ibid,* Art 6 §2.

1 the sex, date of birth and the place of birth of the patient;

2 the date, place and time of death;

3 the nature of the serious and incurable disorder caused by an accident or a disease from which the patient suffered;

4 the nature of the persistent and unbearable pain;

5 the reasons why this pain could not be alleviated;

6 the elements which were taken into account to verify whether the request was voluntary, well considered and repeated and was not made under any external pressure;

7 whether it was conceivable that the patient would die in the near future;

8 whether a living will was drawn up;

9 the procedure which was followed by the physician;

10 the capacity of the physician of physicians consulted, the advice and the dates of these consultations;

11 the persons who were consulted by the physicians and the dates of these consultations; and

12 how the euthanasia was performed and the means used.[18]

The examination of the document of registration

The Commission verifies on the basis of the second part of the registration document whether the euthanasia was performed according to the conditions and procedures specified in the Act. If there is any doubt, the Commission can decide by ordinary majority to rescind the anonymity. It will then take into consideration the first part of the registration document. The Commission can request from the attending physician any part of the medical record which deals with the euthanasia. If it is the opinion of the Commission, based on a decision taken by a majority of two thirds, that the legal requirements are not met, it will forward the file to the Public Prosecutor of the place of death of the patient.

The evaluation function

The Commission will draw up for the legislative chambers, at first within a period of two years and thereafter every two years:

1 a statistical report comprising the information which is drawn from the second part of the registration document;

18 *Ibid,* Art 7.

2 a report in which the application of the law is reported and evaluated; and

3 if applicable, recommendations which could lead to a legislative initiative and/or other measures with regard to the application of the law.

In order to accomplish its task, the Commission can request additional information from various governmental bodies and institutions. The information obtained by the Commission is confidential.

The Commission can decide to communicate statistical and purely technical data, but no personal data, to university research teams that have submitted a motivated request for that. It can hear experts.[19]

Within six months after the submission of the first report and, if applicable, of the recommendations of the Commission, there will be a debate within the legislative chambers.[20]

Refusal of the physician to perform euthanasia

No physician can be forced to perform euthanasia; no third party can be forced to assist in the performance of euthanasia. If the attending physician refuses to perform euthanasia, he has to inform the patient or possible confidant thereof in time and explain the reasons for his refusal. If his refusal is based on a medical ground, it will be mentioned in the patient's medical record. The physician who refuses to perform euthanasia has to communicate the medical record of the patient to the physician who is appointed by the patient or his confidant at the request of his patient or his confident.[21]

Execution of contracts, in particular insurance policies

A person who dies as a result of euthanasia performed in accordance with the conditions specified in the Euthanasia Act, is considered to have died from a natural cause with regard to the execution of agreements to which he was a party, and notably, the insurance agreements.[22]

19 *Ibid,* Art 9.
20 *Ibid,* Art 15.
21 *Ibid,* Art 14.
22 *Ibid,* Art 15.

The Willem C Vis International Commercial Arbitration Moot 2002–2003

Sabine Erkens, Ryan Allan Goss, Andrew Edward Hodge,
Marion Alice Jane Isobel, Benjamin John Jackson, Siobhan Maree McKeering
Elena Christine Zaccaria, and Gabriël Moens

Introduction

The TC Beirne School of Law of the University of Queensland participated in the prestigious Willem C Vis International Commercial Arbitration Moot, the orals of which were held in Vienna between 21–28 March 2002. In the general round, our team defeated the University of Athens, Greece; the University of Fribourg, Switzerland; Xiamen University, People's Republic of China, and the University of the Americas, Mexico. In the octo-final, our students defeated the University of Potsdam, Germany. This was followed by a win in the quarter-final against the University of Muenster, Germany. In the semi-final, Queensland triumphed over the University of Zagreb, Croatia. The TC Beirne School of Law team proceeded to the Grand Final, which was held in the Rathaus (City Hall) of Vienna. In a closely contested final, the arbitral panel awarded the Moot to the University of Singapore. However, the members of the panel described the performance of the T C Beirne School of Law team as 'brilliant' and our two speakers, Marion Isobel and Ryan Goss, were given a standing ovation. In addition, our team also won the prestigious Pieter Sanders Award for Best Memorandum for the Claimant (First Prize). This is a stunning achievement in view of the fact that 108 teams representing 36 countries participated in the Moot and prepared a Memorandum for the Claimant. Also, Marion Isobel obtained the Martin Domke Award, first prize, best oralist and her colleague, Ryan Goss, received an honourable mention as best oralist. Finally, our Memorandum for the Respondent was also awarded an Honourable Mention, which means that it was in the top ten best memoranda of the entire Moot.

On their way to Vienna, the team also participated in a regional American Vis competition, known as the Gambit Cup (named after a newspaper in New Orleans that donated the Cup). Our team performed in the Grand Final of the Cup against Tulane University and won the Cup! The Final of the Gambit Cup was conducted before the Supreme Court of Louisiana, with the Chief Justice of that State presiding over the arbitral tribunal.

The Willem C Vis Moot has previously been won by the TC Beirne School of Law in 1997 and 2000. In the next section, the 2001–2002 Moot problem and its clarifications are reproduced. This is followed by the Memorandum for

the Claimant (which won the Pieter Sanders Award for best memorandum and the Memorandum for the Respondent). The problem, clarifications and the memoranda are useful resources in the teaching of the CISG, and of international commercial arbitration law. It also serves as a historical record of the Ninth Willem C Vis International Commercial Arbitration Moot 2001–2002.

The Moot Problem

NINTH ANNUAL WILLEM C VIS INTERNATIONAL COMMERCIAL ARBITRATION MOOT

Vienna, Austria
March 22 to 28, 2002

THE PROBLEM

Revised October 11, 2001

Organized by:
Institute of International Commercial Law
Pace University School of Law
78 North Broadway
White Plains, NY 10603
USA

5 June 2001
International Center for Dispute Resolution
American Arbitration Association
1633 Broadway 10th Floor
New York, NY 10019–6708
USA

Dear Sirs:

I represent Futura Investment Bank, which hereby gives notice that it wishes to commence an arbitration against West Equatoriana Bobbins SA under the American Arbitration Association International Arbitration Rules. A copy of this letter with the Notice of Arbitration has been sent to West Equatoriana Bobbins SA as called for in Article 2.1 of the Rules.

Futura Investment Bank became the assignee of the right to receive the payments due from West Equatoriana Bobbins SA to Tailtwist Corp under a contract dated 1 September 1999. The contract between West Equatoriana Bobbins SA and Tailtwist Corp included an arbitration clause providing for arbitration by the American Arbitration Association. Futura Investment Bank claims as assignee of the rights of Tailtwist Corp. I enclose five copies of the Notice of Arbitration with its supporting exhibits. I also enclose US$8,500 for the Initial Filing Fee as an advance payment on the administrative costs, as provided in the Rules.

Sincerely,

(Signed) _____
Counsel for Futura Investment Bank
cc: West Equatoriana Bobbins SA

Futura Investment Bank
Claimant
v
West Equatoriana Bobbins SA
Respondent

NOTICE OF ARBITRATION

I Parties

1 Futura Investment Bank (hereafter referred to as 'INVESTMENT') is a corporation organized under the laws of Mediterraneo. It has its principal office at 395 Industrial Place, Capitol City, Mediterraneo. The telephone number is 483–5800 and the fax number is 483–5810. INVESTMENT is an investment bank with interests in numerous countries.

2 West Equatoriana Bobbins SA (hereafter referred to as 'BOBBINS') is a corporation organized under the laws of Equatoriana. It has its principal office at 214 Commercial Ave, Oceanside, Equatoriana. The telephone number is 555–1212 and the fax number is 555–1214. BOBBINS is a producer of textiles for use in clothing and table linens from natural and synthetic fibers.

II Non-party entities

3 Tailtwist Corp (hereafter referred to as 'TAILTWTST') was a corporation organized under the laws of Oceania. It had its principal office at 14 Seaside Boulevard, Sea Part, Oceania. The telephone number was 523–6910 and the fax number was 523–6920. It was a manufacturer of machinery and production processes for the textile trade, some of which were of a type used by BOBBINS. TAILTWIST is currently in insolvency proceedings.

III The facts of the dispute

A The contract of sale

4 On 1 September 1999 BOBBINS and TAILTWIST concluded a contract whereby TAILTWIST agreed to manufacturer and install at BOBBINS' facilities in Equatoriana a manufacturing line for spinning polyester yarn. (Claimant's Exhibit No 1) The total price was $9,300,000. Payment was to be made in five installments: 20% with order; 20% on completion of tests at the TAILTWIST works; 25% on delivery to site; 25% on completion of commissioning on site; the balance of 10% after three months satisfactory performance.

5 The TAILTWIST equipment was delivered and installation by TAILTWIST's personnel was completed on 18 April 2000. As provided in the contract, TAILTWIST's personnel remained on site until 10 May 2000 to train the personnel of BOBBINS in the operation, adjustment and maintenance of the machinery. The three-month period at the end of which final payment was due closed on 10 August 2000.

B Payments, assignment and non-payment

6 As provided in the contract, BOBBINS paid to TAILTWIST 20% of the contract price ($1,860,000) on the signing of the contract on 1 September 1999, a further 20% ($1,860,000) on 6 January 2000 upon completion of tests of the equipment at the TAILTWIST works and 25% of the contract price ($2,325,000) upon delivery of the equipment to BOBBINS site on 20 February 2000.

7 On 29 March 2000 TAILTWIST assigned to INVESTMENT the right to receive the remaining two payments of 25% of the contract price ($2,325,000) on completion of commissioning on site and 10% of the contract price ($930,000) after three months satisfactory performance. Notice of the assignment was sent to BOBBINS on 5 April 2000 (Claimant's Exhibit No 2) with return receipt requested. Delivery of the notice of assignment was signed for on 10 April 2000. Although the original notice was in German, the fact that it contained the names of Tailtwist Corp and West Equatoriana Bobbins SA, the date of the contract between the two, the amount remaining due under the contract, the name of Futura Investment Bank and an account number, all of which were easy to read by an English-speaking person who did not know German, clearly indicated the nature of the document. At the very least, it should have put BOBBINS on notice to inquire further and not to make any payment on the contract without making such an inquiry. A simple telephone call would have sufficed. A translation of the notice into English is contained in Claimant's Exhibit No 3.

8 Since that time no payment has been made by BOBBINS to INVESTMENT. In the case of the payment due upon commissioning on site, BOBBINS paid it to TAILTWIST on 19 April 2000, ie, nine days after having received notice of the assignment. BOBBINS has claimed that the notice was defective in form and that it was not received in time to be acted upon prior to payment to TAILTWIST (Claimant's Exhibit No 4). These objections are manifestly unfounded.

9 In the case of the payment due after three months satisfactory performance, BOBBINS has refused to pay it at all. It has claimed that the training called for in the contract was not adequate and that the machinery as delivered was not able to operate at the promised capacity (Claimant's Exhibit No 4). As a result it has claimed the right to reduce the price of the contract by the unpaid amount of the contract, namely $930,000 (Claimant's Exhibit No 5).

10 INVESTMENT is in no position to ascertain whether the complaints that BOBBINS raises in regard to the performance of TAILTWIST are accurate or not. However, INVESTMENT would like to point out that the contract of sale included a clause in which BOBBINS agreed not to assert defenses against any assignee of TAILTWIST should TAILTWIST assign the right to receive the payments (Claimant's Exhibit No 1). Although the clause provided that it did not apply to deficient performance under the contract that TAILTWIST did not attempt in good faith to remedy, to the best of belief of INVESTMENT, BOBBINS did not give notice to TAILTWIST of either any deficiency in the training it received or in the equipment itself. As a result, TAILTWIST could not have attempted to remedy the deficiencies and BOBBINS has lost the right to assert them as defenses against INVESTMENT.

IV Arbitration clause

11 The contract between BOBBINS and TAILTWIST provides: Any controversy or claim between Tailtwist Corp and West Equatoriana Bobbins SA arising out of or relating to this contract shall be determined by arbitration by the American Arbitration Association by a panel of three arbitrators with the place of arbitration being Vindobona, Danubia and the language of the arbitration English.

12 When INVESTMENT was assigned the right to payment under the contract between BOBBINS and TAILTWIST, it was necessarily assigned the right to enforce its rights in the same manner as the assignor, TAILTWIST, would have had.

13 According to Article 1(1) of the American Arbitration Association International Rules currently in force, where parties have provided for arbitration by the American Arbitration Association without specifying which rules shall apply and the dispute is international, the arbitration shall take place in accordance with the International Rules, BOBBINS and TAILTWIST, parties to the original arbitration agreement, are from Equatoriana and Oceania respectively, while INVESTMENT is from Mediterraneo. Therefore, the dispute is international and the International Rules apply to the arbitration.

14 As provided in the arbitration clause, the arbitration tribunal should consist of three arbitrators and the arbitration should be held in Vindobona, Danubia. The language of the arbitration should be English, that being the language specified in the arbitration agreement.

15 INVESTMENT hereby nominates Dr XXXX as its arbitrator.

V Applicable law

16 Equatoriana and Oceania are parties to the United Nations Convention on Contracts for the International Sale of Goods and it, therefore, governs the contract of sale. Furthermore, the contract itself provides that the contract is governed by the Convention and, in regard to any questions not governed by it, by the law of Oceania.

17 Mediterraneo and Oceania are party to the [draft] Convention on the Assignment of Receivables in International Trade. [Note: At the time of writing the Problem UNCITRAL had adopted the draft Convention on the Assignment of Receivables in International Trade and had recommended to the General Assembly that it adopt the draft convention as a convention and open it for signature. The General Assembly is expected to follow the recommendation in December 2001.]

18 Danubia has adopted the UNCITRAL Model Law on International Commercial Arbitration.

19 Equatoriana, Oceania, Mediterraneo and Danubia are all party to the Convention on the Recognition and Enforcement of Foreign Arbitral Awards.

VI Relief requested

20 INVESTMENT requests the arbitral tribunal:

- to find that it has jurisdiction to consider the claim brought by INVESTMENT against BOBBINS;
- to order BOBBINS to pay the sum of $3,255,000 to INVESTMENT;
- to order BOBBINS to pay interest on the said sum from the date payment was due until the date of payment;
- to order BOBBINS to pay all costs of the arbitration.

(Signed)_____ XXXX _____
Counsel for Futura Investment Bank

Date 5 June 2001

Claimant's Exhibit No 1

Contract (Excerpts)

Tailtwist Corp agrees to sell and West Equatoriana Bobbins SA agrees to purchase the following 'Spin-a-Whizz' equipment:
Item 1—One complete six-end manufacturing line for pre-oriented polyester yarn (POY), with High Speed (6,000 rpm) automatic winders, each complete with inverter drive and automatic reel change, all as our standard manufacture, illustrated in the attached diagram. Price $1,300,000 per single end.
Item 2—One 'Auto-Swop' Doffer, to service the above line, remove filled bobbins and deliver them automatically to a pin-store, provided by you, at the end of the production aisle. Price $1,420,000.
Item 3—Training for three weeks on site. Price $80,000.
Total Price $9,300,000, payable as follows:
20% with order; 20% on completion of tests at our works; 25% on delivery to site; 25% on completion of commissioning on site; the balance after three months satisfactory performance. Each stage to be certified by consultants for West Equatoriana Bobbins SA.
Delivery, six calendar months from receipt of first payment. Installation and commissioning, two months from delivery.
Included in the price, Tailtwist Corp will provide all installation work, setting to work and commissioning on site, West Equatoriana Bobbins SA to have carried out all building work, including the preparation of floors and the installation of doffer rails to Tailtwist specification. On completion of commissioning tests, Tailtwist personnel will remain on site for three weeks, during which West Equatoriana Bobbins personnel will be trained in the correct operation, adjustment and maintenance of the machinery.
All rights in the automation software to remain the property of Tailtwist. West Equatoriana Bobbins shall not reveal to others any information provided by Tailtwist nor permit any person not authorised by Tailtwist to have access to the software or source code.
If Tailtwist should assign the right to the payments due from West Equatoriana Bobbins, the latter agrees that it will not assert against the assignee any defense it may have against Tailtwist arising out of defective performance of this contract, unless Tailtwist does not in good faith attempt to remedy the deficiency.
This contract is subject to the United Nations Convention on Contracts for the International Sale of Goods and, in regard to any questions not governed by it, to the law of Oceania.
Any controversy or claim between Tailtwist Corp and West Equatoriana Bobbins SA arising out of or relating to this contract shall be determined by arbitration by the American Arbitration Association by a panel of three arbitrators with the place of arbitration being Vindobona, Danubia and the language of the arbitration English.

(Signed)	(Signed)	September 1999
Tailtwist Corp	West Equatoriana Bobbins SA	Date

Claimant's Exhibit No 2

Futura Investment Bank
395 Industrial Place
Capitol City, Mediterraneo
Telephone 483–5800
Telefax 483–5810

5 April 2000

Bekanntgabe der Zession

Hiermit wird bekanntgegeben, dass das Recht noch verbliebene Zahlungen von West Equatoriana Bobbins SA an die Tailtwist Corp in der Höhe von $3.255.000, gernäß dem Vertrag vom 1. September 1999, entgegenzunehmen, an die Futura Investment Bank am 25. März 2000 zediert wurde.

Künftige Zahlungen sind gernäß diesem Vertrag an die Futura Investment Bank, Capitol City, Mediterraneo, Kontonr. 123456, Referenz Tailtwist/Bobbins 010999, zu leisten.

(Untergeschrieben)
Harold Fine
Vizepräsident

Claimant's Exhibit No 3

Futura Investment Bank
395 Industrial Place
Capitol City, Mediterraneo
Telephone 483–5800
Telefax 483–5810

(Translation)

5 April 2000

Notice of Assignment

Notice is hereby given that the right to receive the remaining payments totalling $3,255,000 due from West Equatoriana Bobbins SA to Tailtwist Corp under a contract dated 1 September 1999 were assigned by Tailtwist Corp to the Futura Investment Bank on 29 March 2000.

Future payments under this contract should be made to Futura Investment Bank, Capitol City, Mediterraneo, account 123456, reference Tailtwist/Bobbins 010999.

(Signed)
Harold Fine
Vice-President

Claimant's Exhibit No 4

West Equatoriana Bobbins SA
214 Commercial Ave
Oceanside, Equatoriana
Telephone 555–1212
Telefax 555–1214

16 May 2001

Mr Harold Fine
Vice-President
Futura Investment Bank
395 Industrial Place
Capitol City, Mediterraneo

Dear Mr Fine

I wish to make the position of West Equatoriana Bobbins SA completely clear. West Equatoriana Bobbins SA has no intention of making any further payments in respect of the contract with Tailtwist Corp dated 1 September 1999. There is no basis for further discussions between our two companies.

The notice of assignment sent by Futura Investment Bank on 5 April 2000 was totally deficient when received on 10 April 2000. It was written in the German language, which no one at West Equatoriana Bobbins SA could read. It therefore gave no notice whatsoever. Furthermore, even if it could have been read, it was fatally defective in form, since it called upon West Equatoriana Bobbins SA to make the payments to a different country from that to which payments were being made under the contract itself.

Although the English translation finally sent to us by fax on 19 April 2000 eliminated the language problem, it did nothing in regard to the change of country of payment. Moreover, it arrived after the commencement of the payment process within West Equatoriana Bobbins SA of the $2,325,000 due to Tailtwist Corp. Futura Investment Bank simply acted too late in regard to that payment.

As far as the final payment of $930,000 is concerned, you are aware that the training given our personnel was not that called for by the contract. You are also aware that there have been problems with the machinery delivered to us by Tailtwist that our personnel have not been capable of fixing. You are also aware that we have not been able to call upon Tailtwist for assistance from the time they entered insolvency proceedings on 20 April 2000. As a result, our agreement not to assert defenses in certain circumstances does not apply. You have received a copy of the letter we addressed to the administrator for Tailtwist Corp on 10 January 2001 in which we declared a reduction of the price by $930,000.

There is no further sum due from West Equatoriana Bobbins SA in respect of its contract with Tailtwist Corp. If you wish to pursue this matter further, the courts of Equatoriana are open to you.

Sincerely,
Simon Black
Vice President

Claimant's Exhibit No 5

West Equatoriana Bobbins SA
214 Commercial Ave
Oceanside, Equatoriana
Telephone 555–1212
Telefax 555–1214

10 January 2001

Dr Herbert Strict
Administrator in Insolvency
14 White Horse Place
Sea Part, Oceania

Reference: Contract with Tailtwist Corp dated 1 September 1999

Dear Mr Strict

On 18 April 2000, immediately prior to the opening of the insolvency proceedings of Tailtwist Corp on 20 April 2000, our consultant certified that the equipment contracted for in the referenced contract had been installed and that the commissioning tests had been completed by the Tailtwist personnel. Consequently, on 19 April 2000 West Equatoriana Bobbins SA made the payment of $2,325,000 as called for in the contract.

Our consultant's certification did not, of course, imply that the equipment was in full working order. That was to be determined by a three month period of satisfactory operation by West Equatoriana Bobbins SA. Prior to the three-month period and subsequent to the installation and commissioning tests a team of four from Tailtwist was to remain on site to train our personnel in the operation, adjustment and maintenance of the equipment. Only two of the team remained on site to conduct the training and they were so distracted by the opening of the insolvency proceedings that their training was grossly insufficient.

At no time has West Equatoriana Bobbins SA been able to operate the equipment in a fully satisfactory manner. The problems may lie in difficulties with the equipment itself or in the inadequate training given to our personnel. The result is the same in either case.

West Equatoriana Bobbins SA has determined that the deficiencies in the performance of the equipment has reduced its value by 10%. Therefore, West Equatoriana Bobbins SA hereby declares a reduction in the price of 10%, or $930,000.

Sincerely,
Simon Black
Vice President
cc: Futura Investment Bank

— —

June 5, 2001
VIA FEDERAL EXPRESS

Joseph Langweiler
Counsel
Futura Investment Bank
14 Capitol Boulevard
Capitol City, Mediterraneo

West Equatoriana Bobbins SA
Legal Department
214 Commercial Avenue
Oceanside, Equatoriana

Re: Futura Investment Bank and West Equatoriana Bobbins SA

Dear Parties

This will acknowledge receipt by the International Centre for Dispute Resolution on June 5, 2001 from Claimant of a Demand for Arbitration dated June 5, 2001 of a controversy arising out of a contract between the above-captioned parties, containing a clause providing for administration by this Association. We understand that a copy was sent to Respondent. A copy of our International Arbitration Rules is enclosed.

Pursuant to Article 3, within thirty days of the date of this letter, a Respondent shall file a statement of defense in writing with the Claimant and this Association. If Respondent wishes to counterclaim, file three copies of same with the appropriate administrative fee and send a copy directly to Claimant.

Claimant has requested that the hearing be held in Vindobona, Danubia. Please review Article 13 of the Rules regarding the locale of hearings.

We note that the arbitration clause of the contract in this matter provides that three arbitrators will be appointed to resolve this dispute. We therefore acknowledge receipt of Claimant's nomination of Dr XXXX as its Arbitrator.

This will also serve to confirm your participation in an Administrative Conference Call on June 15, 2001 at 2:00 pm local New York time. The purpose of this call is to address matters that will assist the Association in administering your case as efficiently and expeditiously as possible. The Association has found that such calls greatly improve the administrative process. Please be prepared to discuss the following items:

Whether mediation or other methods of dispute resolution might be appropriate.

As an option for resolution of this dispute, we propose mediation, as outlined in the enclosed Commercial Mediation Rules. It is our experience that mediation is expeditious, cost saving and highly successful. No additional administrative fee will be required for this process in the event the Parties desire to first attempt to mediate this dispute. Please note that the process is non-binding and the Parties must consent to these procedures.

We note that the arbitration clause of the contract in this matter provides for that three arbitrators will be appointed to resolve this dispute. We therefore acknowledge receipt of Claimant's nomination of Dr XXXX as its Arbitrator. Please be prepared to further discuss the appointment method and process during the call.

Please provide a brief description of the case, the specification of the claims and the anticipated length of hearing.

Parties are advised to consider the information to be exchanged during the arbitral proceedings. Please note that at this stage all discovery will be voluntary and any difficulties that may arise will be decided by the arbitrators once appointed.

Parties are also encouraged to prepare a stipulation for uncontested facts, which will be reviewed by the arbitrators again, once appointed.

Please limit your discussions to the administrative process. Any discussions regarding issues of arbitrability or the merits of the dispute should be reserved for the arbitrators.

Once appointed we will schedule the preliminary hearing where all substantive matters will be brought to the attention of the arbitrator(s). It should be noted that failure to participate in the arbitral proceedings will not prevent the arbitrators from issuing an arbitration award that may be enforced pursuant to the New York Convention.

The call will be initiated by our office on that date. If the Parties are not able to participate on the scheduled date of the call, we kindly request that the parties mutually agree on an alternate date and advise the undersigned so that the call may be scheduled accordingly.

The Association encloses herewith to each Party a form entitled 'Checklist for Conflicts' and requests that each Party fill out the document with the required information and return it to this office by June 14, 2001, be treated as confidential information, and not required to be exchanged by the Parties, unless the Parties agree otherwise. This is only a preliminary list to identify potential witnesses and for the arbitrator to perform a conflicts check. It will not commit the Parties at this point.

This matter is now being administered by the International Centre for Dispute Resolution of the American Arbitration Association in New York City, and has been assigned to Sara Matathias. Please address all future correspondence to her. In the event I can be of assistance throughout the administration of this matter and to respond to any questions or issues that may arise, regarding the administrative process, please feel free to contact me directly. My contact information is set forth below. Please note that all our case administrators are supervised by multilingual attorneys trained in international arbitration and mediation. We look forward to working with you and to providing you with assistance during your participation in the arbitral process.

Thank you for selecting the American Arbitration Association, a leader in worldwide alternative dispute resolution.

Sincerely,
Eleni Lappa
ICDR Supervisor
212–484–3270
Lappae@adr.org

— —

Smart & Smart
Advocates at the Court
14 Court Street
Oceanside, Equatoriana
13 June 2001

International Center for Dispute Resolution
American Arbitration Association
1633 Broadway
10th Floor
New York, NY 10019–6708
USA

Dear Sirs

We are in receipt of a Notice of Arbitration filed with your Center by Futura Investment Bank against West Equatoriana Bobbins SA, whom we represent.

It is stated in the Notice of Arbitration that the arbitration clause that is relied upon was in a contract between Tailtwist Corp and West Equatoriana Bobbins SA. My client, West Equatoriana Bobbins SA, has had no relations whatsoever with Futura Investment Bank, with the exception of receipt of a notice of assignment indicating that Futura Investment Bank is the assignee of rights held by Tailtwist Corp. Even though the rights held by Futura Investment Bank are based on an assignment of rights from Tailtwist Corp arising out of the contract between Tailtwist and my client, it is clear that my client has never entered into any arbitration agreement with the claimant. Furthermore, I can assure you that my client would not enter into an arbitration agreement with it.

If Futura Investment Bank believes that it has a claim against my client, it should bring an action in the proper court, which in this case would seem to be the Commercial Court in Oceanside, Equatoriana.

I ask you, therefore, to inform Futura Investment Bank that its request for arbitration at the American Arbitration Association must be denied without the trouble and expense that would result from constituting an arbitral tribunal.

(Signed)
Jonathan Smart

— —

June 13, 2001
Joseph Langweiler
Counsel
Futura Investment Bank
14 Capitol Boulevard
Capitol City, Mediterraneo

West Equatoriana Bobbins SA
Legal Department
214 Commercial Avenue
Oceanside, Equatoriana

Re: Futura Investment Bank and West Equatoriana Bobbins SA

Dear Parties

This acknowledges receipt of a letter dated June 13, 2001 from Counsel for West Equatoriana Bobbins. We note that a copy of said letter was not sent to Joseph Langweiler thus we have attached a copy for your reference. The parties are hereby advised to please copy each other on all correspondence.

This will serve to invite Mr Langweiler's comments regarding this letter by June 18, 2001. If no response is received by said date we will proceed with the next administrative step in this matter. Please note that pursuant to Article 15 of the International Arbitration Rules that govern this matter, pleas as to jurisdiction will be determined by the tribunal, as soon as it constituted.

Sincerely,

Eleni Lappa
ICDR Supervisor
212–484–3270
Lappae@adr.org

American Arbitration Association
Moot Case No 9
Futura Investment Bank
Claimant
v
West Equatoriana Bobbins SA
Respondent

STATEMENT OF DEFENCE

I Parties

1 The information given in the Notice of Arbitration in respect of the name and address of West Equatoriana Bobbins SA and Tailtwist Corp are accurate. West Equatoriana Bobbins SA has no independent knowledge in respect of Futura Investment Bank.

II Arbitration clause

2 The arbitration clause set forth in paragraph 14 of the Notice of Arbitration reproduces the clause to be found in the contract between Tailtwist Corp and West Equatoriana Bobbins SA. Therefore, any arbitration based on the clause would be at the American Arbitration Association, would take place in Vindobona, Danubia before a tribunal of three arbitrators and in the English language. Respondent also agrees that any such arbitration would be conducted under the AAA International Arbitration Rules that came into force on 1 September 2000.

3 Respondent denies, however, that Futura Investment Bank can rely upon the clause to commence an arbitration against it. Respondent neither has nor has ever had any business or contractual relationship with Futura Investment Bank and specifically has never contemplated agreeing to arbitrate any dispute, current or in the future, with it. It will be noted that the arbitration clause specifically states that it applies to any dispute between Tailtwist Corp and West Equatoriana Bobbins SA. Since Tailtwist is not a party to the Notice of Arbitration, it is clear that the attempt is to apply the arbitration clause to a dispute that is not contemplated by it.

4 While Respondent has no reason to contest that Futura Investment Bank is the assignee of the right to payment under the contract between Tailtwist Corp and Respondent, the assignment is of the right to payment, not to the dispute settlement mechanism in the contract. If Futura Investment Bank wishes to pursue its claim against Respondent further, the courts of Equatoriana are available to it.

5 Recognizing that the American Arbitration Association has decided that an arbitral tribunal should decide whether Futura Investment Bank can bring an arbitration against Respondent based upon the arbitration clause in the Tailtwist contract, Respondent appoints Attorney XXXX as its arbitrator.

III Response on the merits

A Payment of $2,325,000

6 Although Respondent is firmly convinced that it is not bound to arbitrate against Futura Investment Bank, an explanation will be given as to why there is no substantive claim against Respondent.

7 As is stated in the Notice of Arbitration, Respondent received the notice of assignment to Futura Investment Bank of the right to payment from Respondent to Tailtwist Corp under the contract of 1 September 1999 on 10 April 2000. As can be seen from Claimant's Exhibit No 2, the notice of assignment was in the German language, the language spoken in Méditerranée but not in Equatoriana. No one who worked for Respondent could read the notice. Nevertheless, since the name of Tailtwist Corp and the date of the contract were mentioned, the notice was sent to Mr Simon Black, Vice-President of Respondent and the person responsible for the Tailtwist contract. Mr Black was on a business trip at the time and did not return to his office until 13 April 2000. Although Mr Black also could not read the notice, the references to Tailtwist and to the date of the contract led him to send a fax on 15 April 2000 to Futura Investment Bank inquiring as to the nature of the communication (Respondent's Exhibit No 1). A reply was received the morning of 19 April 2000 stating that the earlier communication was a notice of assignment of the right to payment under the Tailtwist contract and containing a translation of the notice of assignment into English (Respondent's Exhibit No 2). The English translation that was included with the fax is set out as Claimant's Exhibit No 3, though without indication that it was transmitted to Respondent on 19 April 2000.)

8 It was not clear to Mr Black what actions should be taken in regard to the purported assignment, especially since the notice had been sent by Futura Investment Bank and not by Tailtwist Corp. Nevertheless, he sent a memorandum to the accounting department not to make any payments to Tailtwist until further notice (Respondent's Exhibit No 3). The accounting department received the memorandum late the same afternoon. Mr Black's intention was to inquire of Tailtwist as to whether there had been such an assignment. The eventual confirmation came in the form of a notice from the insolvency administrator dated 17 October 2000 (Respondent's Exhibit No 4).

9 The day previous to receipt of the notice of assignment in English, 18 April 2000, the consultant for Respondent certified that the installation and commissioning tests of the Tailtwist equipment had been completed and sent his certification to the accounting department. The accounting department acted upon the certification in the early afternoon of 19 April 2000 prior to receipt of the memorandum from Mr Black. It sent the requisite payment order to the Equatoriana Commercial Bank directing payment of $2,325,000 to Tailtwist Corp.

10 The payment made by Respondent on 19 April 2000 entered into the assets of the insolvent. The administrator of the Tailtwist insolvency has approved the sale (assignment) and there is no reason to doubt that it is fully effective between Tailtwist and Futura Investment Bank (Respondent's Exhibit No 5). Futura Investment Bank undoubtedly has a claim to the amount of the payment in the Tailtwist insolvency proceedings.

11 As can be seen, the effective indication that there had been an assignment came subsequent to the payment by Respondent to Tailtwist. Furthermore, we note that the notice of assignment directed us to change the country of payment from Oceania, where Tailtwist and its bank are located, to Mediterraneo, where Futura

Investment Bank is located. The notice of assignment was, therefore, formally defective since a change in the country to which the debtor (West Equatoriana Bobbins SA) must make payment is not permitted under the Convention on Assignments of Receivables in International Trade. The formal invalidity of the notice of assignment was rectified by Futura Investment Bank only on 5 July 2000 (Respondent's Exhibit No 5).

B Payment due after three months satisfactory performance

12 According to the contract with Tailtwist two periods began upon the certification of successful installation and commissioning tests on 18 April 2000. The first was a period of three weeks during which the Tailtwist personnel would remain to train the Respondent's personnel in the correct operation, adjustment and maintenance of the machinery and a further three month period of satisfactory performance of the Tailtwist equipment, at the end of which Respondent was required to pay the final balance of $930,000 of the contract price.

13 The sale (assignment) by Tailtwist to Futura Investment Bank of its right to payment from Respondent was apparently a final effort to save Tailtwist from insolvency. The effort failed and insolvency proceedings were opened in Oceania on 20 April 2000.

14 The commencement of insolvency proceedings had an immediate effect on the implementation of Tailtwist's remaining obligations under the contract. A team of four persons had been expected to carry out the training of Respondent's personnel. However, on the opening of the insolvency proceedings on 20 April 2000 two of them were ordered to return immediately to Oceania. On their return they were notified that their employment was terminated effective immediately. The two remaining Tailtwist employees would have had a difficult time at best to conduct the training that was called for under the contract for which four persons had been anticipated. Under the circumstances, they were obviously upset and concerned about their own future. As a result, they were not able to give even the amount and quality of training that they otherwise might have given. In total, the training given by Tailtwist's personnel under the contract was totally unsatisfactory.

15 The result for Respondent has been that the Tailtwist equipment has not performed satisfactorily. Full production has not been attained. Respondent's personnel have had to experiment with adjusting the equipment for different raw materials, with constant fear that an incorrect adjustment would result in damage to the product and perhaps to the equipment itself.

16 Since there has been no period of three months satisfactory performance, Respondent's consultant has given no such certification and Respondent has not paid the final balance of $930,000. Finally, in order to bring a close to the open aspects of the Tailtwist contract, on 10 January 2001 Respondent declared a reduction of the price of $930,000 in accordance with Article 50 of the United Nations Convention on Contracts for the International Sale of Goods (Claimant's Exhibit No 5). Consequently, there is no balance due on the contract and no sum due to be paid to Futura Investment Bank. That West Equatoriana Bobbins SA considered the matter to be closed and not subject to further discussion was communicated to Futura Investment Bank on 16 May 2001 (Claimant's Exhibit No 4).

C Agreement not to assert defenses; notice of defective goods

17 In the Notice of Arbitration, Futura Investment Bank refers to the clause in the contract by which Respondent agreed not to assert against an assignee of Tailtwist's right to receive payments from Respondent 'any defense it may have against Tailtwist arising out of defective performance of this contract, unless Tailtwist does not in good faith attempt to remedy the deficiency'.

18 During the negotiation of the contract, Tailtwist insisted upon a clause of this nature. It anticipated that it might wish to assign the right to receive the payment from Respondent and it would receive better terms from the assignee if such a clause were present. Respondent did not wish to have such a clause in the contract, since it would make reclamations against defective performance more difficult. Finally, it was agreed that there would be a clause, but that deficiencies Tailtwist did not in good faith attempt to remedy would be excluded from its operation. If there would be a deficiency in Tailtwist's performance of the contract, Tailtwist would be bound to attempt in good faith to remedy the deficiency (which at the time of negotiating the contract Respondent was convinced would remedy all likely difficulties) or Respondent would be able to assert the deficiency as a defense against the assignee.

19 The opening of the Tailtwist insolvency proceedings on 20 April 2000 upset all of the calculations. As already mentioned, the first consequence was that two of the four men expected to remain at Respondent's place of business for training Respondent's personnel were immediately called back and their employment was terminated on their arrival in Oceania. On 13 June 2000 the insolvency administrator recommended to the court in Oceania that all further business activities of Tailtwist be terminated immediately and that the company be liquidated. The recommendation was accepted by the court on 16 June 2000. From then on the only activities carried on in respect of Tailtwist were in connection with the liquidation.

20 The contract provided that at the end of a three month period of satisfactory performance the final 10% of the purchase price ($930,000) was to be paid. The anticipated period of three months ended on 10 August 2000, but the machinery had not worked in a satisfactory way. Full production has not been attained. As noted above, Respondent's personnel have had to experiment with adjusting the equipment for different raw materials, with constant fear that an incorrect adjustment would result in damage to the product and perhaps to the equipment itself. It is not clear to Respondent whether the problem lies in the equipment or in the inadequate training given to Respondent's personnel by Tailtwist. In either case, the result has been the same.

21 The obvious response would normally have been that Respondent would have notified Tailtwist of the problems and would have expected the arrival of Tailtwist personnel who would either have fixed the machinery or have given additional training, or both. However, with the insolvency of Tailtwist and the complete cessation of all its operations except those devoted to liquidating the company, there was no one to whom to send any such notice.

22 In respect of the agreement not to assert defences, it is obvious that Tailtwist did not attempt in good faith to remedy the deficiencies in its performance. It is also obvious that Tailtwist would not have remedied the defects, or attempted in good

faith to do so, even if Respondent had sent a notice to the insolvency administrator, who was the only available addressee to whom such a notice could theoretically have been sent. Consequently, Respondent is not precluded from asserting its defenses against Tailtwist's assignee (Futura Investment Bank) either as a result of the clause or as a result of not having given notice of the deficient performance of the equipment.

IV Request of the tribunal

23 The Respondent requests the arbitral tribunal:

- to declare that it does not have jurisdiction to hear the claim brought against the Respondent for lack of an arbitration agreement;
- to award Respondent all costs of the arbitration.

24 If the arbitral tribunal should find that it has jurisdiction to hear the claim, the Respondent requests the arbitral tribunal to declare:

- that the notice of assignment sent by Futura Investment Bank was ineffective against Respondent since it was in the German language;
- that the notice of assignment sent by Futura Investment Bank was ineffective against Respondent because it changed the country to which payment should be made;
- that the notice of assignment was not binding on Respondent until it was confirmed by the assignor;
- that the English language translation of the notice of assignment sent by Futura Investment Bank on 19 April 2000 arrived too late to stop the payment of $2,325,000 due on the completion of the installation of the equipment and the commissioning tests;
- that the agreement not to assert defenses against an assignee of Tailtwist Corp does not preclude Respondent from asserting the defective performance of the contract since Tailtwist Corp did not in good faith attempt to remedy the deficiencies;
- that there was no effective person to whom Respondent could have sent a notice of defective performance once all of Tailtwist's business activities were terminated by the court in Oceania handling its insolvency proceedings.

Respondent further requests the arbitral tribunal to award Respondent all costs of the arbitration.

(Signed)
Counsel for West Equatoriana Bobbins SA 14 June 2001

Respondent's Exhibit No 1

West Equatoriana Bobbins SA
214 Commercial Ave
Oceanside, Equatoriana
Telephone 555–1212
Telefax 555–1214
15 April 2000

Harold Fine
Vice-President
Futura Investment Bank
395 Industrial Place
Capitol City, Mediterraneo

Dear Mr Fine

We are in receipt of a communication from you dated 5 April 2000 that we do not understand. Since it contains the name of Tailtwist Corp and the date 1 September 1999, which is the date of a contract between Tailtwist and ourselves, we inquire as to the nature of your communication to us.

I must ask you to reply in the English language, since that is the only language that I and my colleagues are able to read.

In anticipation of your reply, I remain

Sincerely yours,
Simon Black
Vice President
FAX

Respondent's Exhibit No 2

Futura Investment Bank
395 Industrial Place
Capitol City, Mediterraneo
Telephone 483–5800
Telefax 483–5810
19 April 2000

Mr Simon Black
Vice President
West Equatoriana Bobbins SA
214 Commercial Ave
Oceanside, Equatoriana

Dear Mr Black

The correspondence from us dated 5 April 2000 was a notice of assignment. Tailtwist Corp has assigned to us the right to receive the payments due to it under your contract with Tailtwist dated 1 September 1999.

I apologize for the fact that the notice of assignment sent to you was in German. A translation into English is attached.

Please be sure that all future payments in regard to your contract with Tailtwist are made to our account.

Sincerely,

Harold Fine
Vice-President

Encl: Notice of Assignment (English) [Note: the enclosed translation of the notice of assignment is set forth as Claimant's Exhibit No 3.]

Fax and Mail

Respondent's Exhibit No 3

West Equatoriana Bobbins SA
214 Commercial Ave
Oceanside, Equatoriana

To: Accounting Department
From: Simon Black

Date: 19 April 2000

Re: Tailtwist contract

I have just received a notice that Tailtwist assigned to Futura Investment Bank the right to receive the payments from us due on the Tailtwist contract. One of them will soon be due. Please be sure not to make any payment to Tailtwist until I receive confirmation from Tailtwist that they have indeed made the assignment.

Respondent's Exhibit No 4

Dr Herbert Strict
Administrator in Insolvency
14 White Horse Place
Sea Part, Oceania

MATTER OF THE INSOLVENCY OF TAILTWIST CORP

On 29 March 2000 Tailtwist Corp assigned to the Futura Investment Bank, 395 Industrial Place, Capitol City, Mediterraneo, the right to receive the remaining payments due from West Equatoriana Bobbins SA under a contract dated 1 September 1999. The amount of the payments assigned was $3,255,000. Futura Investment Bank paid to Tailtwist the sum of $3,150,000 in exchange for the assignment.

Transfers of property made by an insolvent within 90 days of the opening of the insolvency proceedings may be set aside by the Insolvency Administrator under certain circumstances. The assignment referred to above was made within 90 days of the opening of the insolvency proceedings.

I find that the transfer did not contravene the policies set forth in the Insolvency Law of Oceania. Therefore, the assignment is confirmed.

Signed
17 October 2000
Date

Respondent's Exhibit No 5

Futura Investment Bank
395 Industrial Place
Capitol City, Mediterraneo
Telephone 483–5800
Telefax 483–5810
5 July 2000

Mr Simon Black
Vice President
West Equatoriana Bobbins SA
214 Commercial Ave
Oceanside, Equatoriana

Dear Mr Black

I refer to the notice of assignment dated 5 April 2000 in which Futura Investment Bank notified you that your payment obligations under the contract with Tailtwist Corp had been assigned to the Bank.

In the notice of assignment you were instructed to make payment to Futura Investment Bank, Capitol City, Mediterraneo, account 123456, reference Tailtwist/Bobbins 010999.

You are hereby instructed to make future payments to Oceania Commercial Bank, Part City, Oceania, account of Futura Investment Bank, account number 345678, reference Tailtwist/Bobbins 010999.

(Signed)
Harold Fine
Vice-President

June 14, 2001
Joseph Langweiler
Counsel
Futura Investment Bank
14 Capitol Boulevard
Capitol City, Mediterraneo
West Equatoriana Bobbins SA
Legal Department
214 Commercial Avenue
Oceanside, Equatoriana

Re: Futura Investment Bank and West Equatoriana Bobbins SA

Dear Counsel

This will acknowledge receipt on June 14, 2001 from Respondent of a Statement of Defense to the Demand for Arbitration which was initiated by Claimant on 5 June, 2001. We understand that a copy was sent to the Claimant.

We further note that Respondent has appointed Attorney **XXXX** as its arbitrator.

The Parties are kindly reminded of our administrative conference call set for tomorrow, June 15, 2001, at 2:00 pm local New York time.

Sincerely,

Eleni Lappa
ICDR Supervisor
212–184–3270
Lappae@adr.org

— —

June 15, 2001
Joseph Langweiler
Counsel
Futura Investment Bank
14 Capitol Boulevard
Capitol City, Mediterraneo

West Equatoriana Bobbins SA
Legal Department
214 Commercial Avenue
Oceanside, Equatoriana

Re: Futura Investment Bank and West Equatoriana Bobbins SA

Dear Counsel

This will serve to confirm that an administrative conference call took place on June 15, 2001, wherein the following matters were discussed. Participating on the call were Joseph Langweiler representing the Claimant and YYYYY representing the Respondent.

Although mediation was discussed, the parties felt that mediation was not an option at this time.

Number of arbitrators:

The parties agree that the arbitration will be heard by a tripartite panel. Method of appointment:

Your arbitration agreement provides for party-appointed arbitrators. The parties have each appointed their respective arbitrators and we will be confirming said appointments and assisting in the appointment of the third Arbitrator shortly.

Locale:

Your arbitration agreement provides for the arbitration to be held in Vindobona, Danubia Thank you for your participation in today's conference call.

Sincerely,

Eleni Lappa
ICDR Supervisor
212–484–3270
Lappae@adr.org

— —

October 6, 2001
Joseph Langweiler
Counsel
Futura Investment Bank
14 Capitol Boulevard
Capitol City, Mediterraneo

West Equatoriana Bobbins SA
Legal Department
214 Commercial Avenue
Ocean side, Equatoriana

Re: Futura Investment Bank and West Equatoriana Bobbins SA

Dear Counsel

This acknowledges receipt of Procedural Order No 1 issued by the Arbitrator. A copy of said Order is attached herewith for your review and compliance.

Sincerely,

Eleni Lappa
ICDR Supervisor
212–484–3270
Lappae@adr.org

American Arbitration Association
Moot Case No 9
Futura Investment Bank
Claimant
v
West Equatoriana Bobbins SA
Respondent

PROCEDURAL ORDER NO 1

1 The Arbitral Tribunal, composed of Mr ___, Dr ____, and myself as chairman, has authorized me in conformity with AAA International Arbitration Rules, Article 26.2, to make procedural rulings alone.

2 On 30 September 2001 I met with _____, counsel for the Claimant, Futura Investment Bank, and _____, counsel for the Respondent, West Equatoriana Bobbins SA. We discussed the procedures that should be followed in the arbitration. Counsel agreed that the Tribunal might be able to decide the arbitration on legal issues alone, without the need for an extensive procedure to determine facts beyond those already set forth in the Notice of Arbitration and the Statement of Defense. The factual issues that may need to be developed at this first stage of the arbitration will be determined in accordance with the procedures found in the Rules of the Ninth Annual Willem C Vis International Commercial Arbitration Moot. In accordance with those Rules questions may be submitted to Professor Eric Bergsten, preferably by e-mail at eric.bergsten@chello.at, by Friday, 26 October 2001. The answers will be distributed to all parties by 5 November 2001.

3 West Equatoriana Bobbins SA has contested the jurisdiction of the arbitral ttribunal to consider this dispute on the grounds that there is no arbitral agreement between it and Futura Investment Bank. Futura Investment Bank in reply argues that as the assignee of Tailtwist Corp, it can rely on the arbitration clause in the contract between Tailtwist and West Equatoriana Bobbins SA

4 West Equatoriana Bobbins SA has also contested on the merits the claims put forward by Futura Investment Bank. In respect of the sum of $2,325,000 due from West Equatoriana Bobbins SA on the completion of the commissioning tests, it claims that the notice of assignment dated 5 April 2000 from Futura Investment Bank, was:

- defective in form when received in that it was in the German language, which no one at West Equatoriana Bobbins SA could read;
- defective in form, whether in German or in the English translation later received, in that it called for payment to be made in Mediterraneo rather than in Oceania as in the contract with Tailtwist;
- did not bind West Equatoriana Bobbins SA until confirmation of the assignment was received from Tailtwist Corp, the assignor; and
- received too late in the readable English translation to affect the payment to Tailtwist already in process.

Futura Investment Bank counters with the argument that even if the German text was not fully readable to the personnel of West Equatoriana Bobbins SA, there were sufficient indications in it as to its nature to give notice that payment should not be made to Tailtwist Corp until further inquiry was made.

5 In respect of the sum of $930,000 due upon the completion of three months satisfactory operation of the equipment, West Equatoriana Bobbins SA claims that the machinery did not perform satisfactorily and that it was justified in reducing the price by the outstanding sum due, namely $930,000. In response to the argument raised by Futura Investment Bank that it had signed an agreement not to assert against an assignee of Tailtwist Corp defenses arising out of the deficient performance of the contract, West Equatoriana Bobbins SA states that the agreement did not apply to deficient performance that Tailtwist Corp did not in good faith attempt to remedy. It goes on to say that, because of the insolvency of Tailtwist Corp, there was no attempt to remedy the deficient performance. Futura Investment Bank in reply has stated that West Equatoriana Bobbins SA did not give Tailtwist Corp notice of the deficient performance. Not only did that preclude Tailtwist Corp from attempting to remedy the deficient performance, but by itself would have been grounds for precluding West Equatoriana Bobbins SA from asserting the deficient performance against Tailtwist Corp itself. West Equatoriana Bobbins SA replies that Tailtwist Corp was in insolvency proceedings at the time notice would have been given and all functions had ceased, except those associated with liquidating the company. It states that there was no one to whom an effective notice could have been given.

6 It would be normal practice for the Arbitral Tribunal to receive arguments first as to its jurisdiction before it received arguments on the substance of the dispute. However, in the interests of efficient administration of the arbitration, the parties are requested to submit their arguments as to all the issues at the same time. A memorandum for Claimant in regard to these issues is to be submitted by email to Professor Eric Bergsten by 13 December 2001. At least five hard copies must be received in Vienna by 18 December 2001. A further 20 copies are due in Vienna by 10 January 2002. Counsel are reminded that they may need to send the hard copies before 13 December in order for them to arrive by 18 December. Counsel are also reminded that failures of the delivery service, whether the post or a courier service, are at their risk.

7 A memorandum for respondent is to be submitted by e-mail to Professor Eric Bergsten by 8 February 2002. At least five hard copies must be received in Vienna by 13 February 2002 with an additional twenty copies due by 19 February 2002.

8 Oral arguments will be held during the period 22 to 28 March 2002. There swill be an unofficial welcoming party organized by the Moot Alumni Association on Thursday evening, 21 March 2002.

(Signed) 6 October 2001

American Arbitration Association
Moot Case No 9
Futura Investment Bank
Claimant
v
West Equatoriana Bobbins SA
Respondent

PROCEDURAL ORDER NO 2

Following the procedure agreed upon by the parties and set forth in Procedural Order No 1, the parties have submitted a number of requests for clarifications. The responses to those requests are set forth below.

On 2 November 2001 there was a further conference telephone call between the President of the Tribunal and counsel for the parties. During that telephone call it was clarified that there were a certain number of factual questions that might require the taking of evidence at hearings to be held at some time after the hearings in March 2002 [ie, after the Moot is over.] In particular, if the Tribunal were to decide that West Equatoriana Bobbins SA was not precluded from reducing the price by reason of either the clause in the contract in which it agreed not to assert certain defenses against a future assignee of the right to receive payment or the fact that it had not given notice of the deficiencies in performance of the equipment, there might still be a need to determine whether there was in fact such a deficiency in performance and whether the amount of reduction in the price was appropriate. Similarly, if the Tribunal were to find that West Equatoriana Bobbins SA was obligated to pay to Futura Investment Bank either or both of the two payments claimed, the amount of interest would need to be determined at a time after the hearings in March 2002. It was, therefore, agreed that for the purposes of preparing the memoranda to be submitted in accordance with the schedule set forth in Procedural Order No 1 and the oral hearings 22 to 28 March 2002, no issues as to the monetary amount owed by one party to the other should be discussed. Furthermore, all facts alleged in either the Notice of Arbitration or the Statement of Defense, as well as all facts clarified in the present Procedural Order, would be accepted as being correct. That would not prevent either party from contesting any of those facts at later evidentiary hearings after the hearings in March 2002.

Applicable law

1 Was the draft Convention on the Assignment of Receivables in International Trade in force at the time of the contract between Tailtwist and Bobbins and at the time of the conclusion of the contract of assignment between Tailtwist and Futura?

Yes. Even though at the time of distribution of the Problem the text is in fact a draft Convention, for the purposes of the Moot the Convention is in force, and was in force for Mediterraneo and Oceania, but not for Equatoriana, at all relevant times. The existence of the Convention was well known in Oceania and Mediterraneo in the professional circles dealing with trade financing. This included the financial officers of Tailtwist and the relevant personnel in Futura. There is no knowledge whether there is interest in the Convention in Equatoriana.
The Convention may be referred to as the 'Receivables Convention'.

2 Have Equatoriana and Oceania incorporated into their domestic law the United Nations Convention on Contracts for the International Sale of Goods and have Oceania and Mediterraneo incorporated into their domestic law the draft Convention on the Assignment of Receivables in International Trade? Have they made any reservations or declarations to the conventions to which they are party?

The conventions have been incorporated into domestic law by the constitutional procedures of the three countries.

No reservations or declarations have been made by any of the three States to any of the Conventions relevant to this arbitration to which they are party.

3 Were Equatoriana, Oceania or Mediterraneo parties to the UNIDROIT Convention on International Factoring at any of the relevant times?

No, none of the three States is party to that Convention.

4 Are there any trade usages in the sense of Article 11 of the draft Convention on Assignments of Receivables in International Trade that would affect the relations between Tailtwist and Futura?

No.

5 Is there anything in the law of Oceania that would preclude the application of the draft Convention on Assignments of Receivables in International Trade to Bobbins?

There is nothing in the law of Oceania that is contrary to the provisions of the draft Convention. Application of the draft Convention to Bobbins would, of course, have to be justified.

6 Are Equatoriana, Oceania and Mediterraneo common law or civil law countries?

Equatoriana and Oceania are common law countries while Mediterraneo is a civil law country.

7 Have any of the three countries adopted the UNCITRAL Model Law on Cross-Border Insolvencies?

Sadly, no.

Contract, contract terms and prior business relations

8 What language is spoken in Equatoriana, Oceania and Mediterraneo?

English is spoken in Equatorliana and Oceania while German is spoken in Mediterraneo.

9 In what language was the contract between Tailtwist and Bobbins?

English.

10 Had Bobbins had previous dealings with parties who communicated in German?

Basically no, though it had received inquiries in German in regard to its products on several occasions. On those occasions it had sent the letters to a local translation service to have them translated into English. All follow-up correspondence had been in English.

11 Who drafted the contract?

The contract was negotiated, but the negotiations commenced on the basis of the Tailtwist standard contract form. As was noted in the Statement of Defense para 18, the clause relating to the agreement not to assert defenses was specifically negotiated. There were other provisions that have not arisen in this arbitration that were also specifically negotiated.

12 Did the contract specify the country to which payments to Tailtwist were to be made?

The contract specified that payments were to be made to Tailtwist's bank account in Oceania.

13 Had Bobbins had any prior dealings with Tailtwist?

Bobbins had purchased other equipment from Tailtwist on several occasions in the past. There had been no disputes arising from those transactions.

14 Has Bobbins ever had the situation before where its creditor assigned the right to receive payments from Bobbins?

In some countries assignment of trade credit is a common form of business financing. That is the situation in Equatoriana. Therefore, it had happened on many occasions that creditors of Bobbins had assigned to someone else the right to receive payment from Bobbins. Moreover, Bobbins had also on occasion financed its current operations by assigning its receivables to a financing company.

Assignment

15 Was the assignment from Tailtwist to Futura oral or written and in what language was the contract concluded?

It was written in English. It met all formal requirements for being a valid and effective assignment.

16 Was it a factoring contract?

No.

17 Did the contract give Futura a right of recourse against Tailtwist if Bobbins did not make the two anticipated payments to Futura?

Yes, Futura has a right of recourse under the contract of assignment.

18 Did the assignment contract contain an arbitration clause?

No.

19 Did the assignment contract provide which of the two parties would notify Bobbins of the assignment?

It provided that Futura would notify Bobbins.

20 At the time of the assignment did Futura know of the terms of the contract between Tailtwist and Bobbins?

Yes. Futura would not have paid $3,150,000 (see Respondent's Exhibit No 4) if it had not known in detail for what it was paying.

Insolvency

21 When did Bobbins learn of the opening of the Tailtwist insolvency proceedings?

Bobbins learned of the opening of the insolvency proceedings on 23 April 2000. It knew of the decision of the administrator to request the court to terminate all of Tailtwist business operations and the decision of the court to accede to the request on the day on which they were made.

22 Is there anything in the insolvency law of Oceania that would affect the rights of Bobbins or Futura in regard to the assignment of the right of payment from Tailtwist to Futura?

There is nothing other than that which is set forth in the decision of Dr Herbert Strict, Administrator in Insolvency, Respondent's Exhibit No 4. Under the insolvency law and procedure in Oceania, the decision of Dr Strict was a final decision on all matters to which it pertained.

23 In what manner, if any, did the opening of insolvency proceedings in Oceania affect Tailtwist's contractual rights and obligations towards Bobbins?

Under the insolvency law of Oceania the contract remains in force unless and until the court decides otherwise. If Bobbins has an affirmative claim against Tailtwist, it would have to be assert in the insolvency proceedings. Tailtwist would have claims against Bobbins only to the extent that it had fulfilled its contractual obligations. Under the insolvency law of Oceania a reduction of the price for failure by a seller to fulfill its obligations is not considered to be an affirmative claim on the part of the buyer.

24 Did the payment of the $2,325,000 by Bobbins to Tailtwist on 19 April 2000 become part of the assets of Tailtwist in the insolvency proceedings?

Yes, the funds became part of the assets of Tailtwist in the insolvency proceedings. If anyone other than Tailtwist had a right to those funds, he/it would have to file a claim in the insolvency proceedings as a general creditor and would share with all other general creditors of Tailtwist on a *pro rata* basis. A claimant to those funds would have no priority in the insolvency proceedings in regard to them. It is anticipated that general creditors in the Tailtwist insolvency will receive approximately 20% of their claims.

25 When did Bobbins write Tailtwist's administrator in insolvency to request confirmation of the assignment?

It never did. Since it had already paid Tailtwist the $2,325,000, it had no intention of paying Futura as well, even if there was an effective assignment. Similarly, since it had no intention of paying the final amount of $930,000, it had no interest in whether there had been an assignment.

26 Was Bobbins aware at any time prior to the opening of the Tailtwist insolvency proceedings on 20 April 2000 that Tailtwist was in financial difficulties?

There had been some speculation in business circles that Tailtwist might be having financial difficulties, but the opening of insolvency proceedings was a surprise to Bobbins.

Payment procedures

27 Was there anyone besides Mr Black to whom the notice of assignment in German might have been sent?

The secretary who opened the envelope containing the notice of assignment had no idea what it was. She could tell that it involved the contract with Tailtwist, since the name of the company was on the notice. All correspondence dealing with the Tailtwist contract was sent to Mr Black. No one had been delegated to deal with the contract while he was on the business trip.

28 When did Mr Black read the notice?

He did not actually read the notice, since he could not read German. However, he looked at it on Saturday, 15 April 2000, the day he sent the inquiry by fax to Futura.

29 When Tailtwist received the payment initiated by Bobbins on 19 April 2000, was there any instruction from Futura to hold the payment for Futura's benefit?

No, it had been expected that notice would be given to Bobbins of the assignment and that Bobbins would pay directly to Futura.

30 By what procedure did Mr Black send his memorandum to the Accounting Department, Respondent's Exhibit No 3?

Mr Black followed the usual procedure. After he dictated the memorandum, which was one of several he dictated at the same time, it was typed by his secretary and presented to him for signature. After he signed it, the memorandum was placed in the out-going mailbox for the internal messenger service. The memorandum was delivered to the Accounting Department by the internal messenger service. It took about two and a half hours from the time the memorandum was signed to the time it was received in the Accounting Department.

31 Was it necessary for Mr Black to sign or in any other way authorize the payment to Tailtwist?

No. Before he left on his business trip he had discussed with the consultant the progress being made in the installation and commissioning of the Tailtwist equipment. Since there was the possibility that it would be completed while he was still travelling, he had left instructions that the certification would go directly from the consultant to the accounting department and that payment should then be made.

32 Would it have been possible for Bobbins to stop the payment after the accounting department received the memorandum from Mr Black that payment should not be made to Tailtwist until further information in regard to the assignment was received?

The instruction to Equatoriana Commercial Bank to make the payment was transmitted to it by Internet. Since the payment order sent by Bobbins was in the format prescribed by the Bank, the account of Bobbins was debited and the payment order was sent by the Bank to Tailtwist's bank in Oceania within an hour of receipt. That was prior to the time that Mr Black's memorandum was received by the accounting department.

33 Would it have been prejudicial to Bobbins to make payment to a bank in Mediterraneo rather than to a bank in Oceania? Would the transfer have cost more?

No, there would have been no difference as far as Bobbins was concerned.

Quality of the goods and nature of the training

34 Were there specifications of performance set out in the contract?

Yes, there were detailed specifications in the annexes to the contract as to the performance of the Tailtwist 'Spin-a-Whizz' equipment as well as the 'Auto-Swop' Doffer. Bobbins will be prepared to present evidence as to the deficiencies in performance of the equipment, if the arbitration reaches a stage of detailed fact-finding. Such detailed presentation of evidence would take place, if at all, only after the oral hearings scheduled for March 22–28, 2002 [ie, only after the Moot is completed].

35 Did Tailtwist agree that they would provide four of their personnel for the training?

In oral discussions prior to the conclusion of the contract Tailtwist had said that the training would be conducted by four of their personnel. It was also stated that the cost would be $20,000 per person for the three week period. The contract did not specifically state how many persons would conduct the training.

36 Were there any specifications as to what would be covered by the training or the level of competence Bobbins' personnel would achieve in regard to operation, adjustment and maintenance of the Tailtwist equipment?

No. The assertion by Bobbins in paragraph 14 of the Statement of Defense that the training given was totally unsatisfactory would be supported in any later evidentiary hearing by evidence from its personnel as to the training they had been given as to how to operate, adjust and maintain the equipment and why that training was insufficient.

37 Did the two men that remained to give the training know that the other two men had been laid off?

Yes.

38 Did the contract contain any provisions as to the obligations of a party if a problem of performance arose?

There were no special provisions other than what is to be found in the United Nations Convention on Contracts for the International Sale of Goods.

39 Did Bobbins at any time inform an employee of Tailtwist or the insolvency administrator about the problems in operating the equipment or the insufficiency of the training?

Various statements were made to the two men from Tailtwist who gave the training that the training being given was not sufficient. No other complaints were made. As for the performance of the equipment, the deficiencies in performance became evident only after the end of the training period. Although full production was never achieved, it was not before the end of June that Bobbins reached the conclusion that they would not be able to make whatever adjustments might be necessary to achieve the desired level of production. By that time Tailtwist was no longer an operating concern, including that there was no after-sales servicing available. No communications in regard to the operation of the machinery were made to Tailtwist following the end of the training period on 10 May 2000.

40 Is there any reason why Bobbins couldn't have notified Tailtwist or the administrator of the defective performance prior to the letter dated 10 January 2001 (Claimant's Exhibit No 5)?

Although Bobbins did not see the utility of giving notice for the reasons given above, there was no reason why Bobbins could not have notified the administrator of the defective performance.

41 Could Bobbins have obtained the training from any third party or have sought assistance with the machinery from any third party?

The machinery and software were proprietary to Tailtwist. It is unlikely that any third party could have given Bobbins the training or assistance that it could normally have expected to receive from Tailtwist.

42 In the light of paragraph 10 of the Notice of Arbitration, has Futura conceded that the training given by Tailtwist was inadequate?

At this point in the arbitration Futura has neither admitted nor denied that the training given was inadequate, or that there were any deficiencies in the machinery. That is not an issue, of course, if Futura's argument in regard to the lack of notice is upheld by the Arbitral Tribunal. Therefore, at the stage of the arbitration that is the subject matter of the Moot it can be assumed that there are deficiencies in the performance of the Tailtwist equipment. It may still incumbent upon Bobbins to prove those deficiencies in later stages of the arbitration that may take place after the completion of the Moot.

43 Did Bobbins approach any former Tailtwist personnel to give further training after Tailtwist ceased business operations on 16 June 2000?

No, it did not.

44 Was the building and preparation work performed by Bobbins according to the specifications provided by Tailtwist?

Apparently so, since at no time did the personnel of Tailtwist suggest that there were any problems with it.

Other matters

45 How did Bobbins arrive at the figure of a 10% reduction in the price?

The contract provided that 10%, or $930,000 was to be paid at the end of three months satisfactory performance. Bobbins claims there was not satisfactory performance and, therefore, the $930,000 is not due to be paid. It calculated that it would have paid approximately $8,300,000 to $8,400,000 for machinery that would have performed as the Tailtwist machinery was performing.

46 Was it common for Bobbins to enter into contracts for $9,000,000?

Such contracts were not unknown to Bobbins, but they were not common.

47 Were Bobbins or Futura experienced in arbitration law and practice?

Arbitration is common within the textile trade in which Bobbins is engaged. Bobbins had less experience with arbitration outside the trade, though it had happened. Futura had engaged in several arbitrations in the past. Bobbins arbitrations within the textile trade had usually been handled without the assistance of outside counsel, since they were usually quality disputes. All of the disputes outside the textile trade and all arbitrations in which Futura had been engaged had been handled by outside counsel.

(Signed) November 5, 2001
President of the Tribunal

American Arbitration Association
Moot Case No 9
Futura Investment Bank
Claimant
v
West Equatoriana Bobbins SA
Respondent

PROCEDURAL ORDER NO 3

It has been suggested that it is not completely clear what issues will be considered in the memoranda to be submitted by Claimant and Respondent and to be argued in the hearings scheduled for 22–28 March 2002 and what issues should not be considered at this time. It is understood that, at a later time, the Tribunal may consider the issues not considered at the present time, if the occasion calls for it [but not in the Moot].

The memoranda and hearings should consider the following issues:

- whether the Tribunal has jurisdiction to hear the merits of the claim brought by Futura Investment Bank on the basis of the arbitration clause in the sales contract between Tailtwist Corp and West Equatoriana Bobbins SA;
- whether the notice of assignment, either the German text received on 10 April 2000 or the English text received on 19 April 2000, was effective to obligate West Equatoriana Bobbins SA to pay the $2,325,000 to Futura Investment Bank rather than to Tailtwist Corp;
- whether the 'waiver of defense' clause in the sales contract precludes West Equatoriana Bobbins SA from asserting against Futura Investment Bank the alleged deficiencies in the training and in the performance of the equipment;
- whether the failure to give notice of the alleged deficiencies precludes West Equatoriana Bobbins SA from asserting the alleged deficiencies in the training and in the performance of the equipment.

Any matters relevant to these issues may be brought to the attention of the Tribunal in the current memoranda and the hearings in March 2002. The memoranda and hearing should not consider the following issues:

- whether the alleged deficiencies in training and performance of the equipment in fact justified a reduction in the price and, consequently, whether the amount of reduction was appropriate;
- the rate of interest that West Equatoriana Bobbins SA should pay to Futura Investment Bank if it has to pay Futura any amount of the purchase price assigned;
- any calculation or apportionment of the costs of the arbitration.

(Signed) 8 November 2001
President of the Tribunal

The University of Queensland Memorandum for the Claimant

List of abbreviations

§	Section
A	Atlantic Reporter
A2d	Atlantic Reporter, Second Series
AAA Rules	American Arbitration Association International Arbitration Rules, 1993
ABGB	Allgemeines Bürgerliches Gesetzbuch (Austrian Civil Code)
AD2d	New York Supreme Court Appellate Division Reports, Second Series
BGB	Bürgerliches Gesetzbuch (German Civil Code)
BLR	Business Law Reports
BOBBINS	West Equatoriana Bobbins SA
Cal	California
CISG	The United Nations Convention on Contracts for the International Sale of Goods 1980
Ch	High Court of Justice (Chancery Division) (England)
1st Cir	United States Court of Appeal First Circuit
2d Cir	United States Court of Appeal Second Circuit
8th Cir	United States Court of Appeal Eighth Circuit
9th Cir	United States Court of Appeal Ninth Circuit
Co	Company
Corp	Corporation
NY Ct App	New York Court of Appeal
DLR (4th)	Dominion Law Reports, Fourth Series
DNY	United States District Court, Southern District of New York
DColo	United States District Court, District of Colorado
DDel	United States District Court, District of Delaware
ed	Editor
eds	Editors
EDPa	United States District Court, Eastern District of Pennsylvania
F 2d	Federal Reporter, Second Series
F3d	Federal Reporter, Third Series
F Supp	Federal Supplement
FlaDistCtApp 1st Dist	Court of Appeal of Florida, First District
HCJ	High Court of Justice

HG	Handelsgericht
Inc	Incorporated
ICC	International Chamber of Commerce
ICC Rules	Rules of Arbitration of the International Chamber of Commerce 1998
ICDR	International Center for Dispute Resolution
ICSID	International Center for the Settlement of Investment Disputes
INVESTMENT	Futura Investment Bank
JB1	Juristische Blätter
JDI	Journal du droit international
KB	High Court of Justice (King's Bench) (England)
LCIA Rules	London Court of International Arbitration Rules 1998
Lloyd's Rep	Lloyd's Reports
Ltd	Limited
Minn	Minnesota
Misc2d	Miscellaneous Reports (New York), Second Series
Model Law	UNCITRAL Model Law on International Commercial Arbitration 1985
NH	New Hampshire
New York Convention	United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards, 1958
NIPR	Nederlands Internationaal Privaatrecht
NJW	Neue Juristische Wochenschrift
No	Number
Nos	Numbers
NY	New York Court of Appeal Reports *or* New York
NYAppDiv 1st Dep't	Supreme Court of New York, Appellate Division, First Department
NYCtApp	New York Court of Appeal
NYSupCt	New York Supreme Court
OGH	Oberster Gerichtshof (Austria)
OntDivCt	Ontario Divisional Court
PaSuperCt	Superior Court of Pennsylvania
Pty	Proprietary
QB	High Court of Justice (Queen's Bench) (England)
RevArb	Revue de l'arbitrage
RG	Revue générale de droit international public
RGZ	Entscheidungen des Reichsgerichts in Zivilsachen (Germany)
RIW	Recht der Internationalen Wirtschaft
SDNY	United States District Court, Southern District of New York
SDOhio	United States District Court, Southern District of Ohio
Sez	Sezione

So2d	Southern Reporter, Second Series
SpA	Società per azioni
Srl	Società a responsabilità limitata
SupCtPa	Supreme Court of Pennsylvania
TAILTWIST	Tailtwist Corp
Trib Civ	Tribunale Civile
UCC RepServ2d (Callaghan)	Uniform Commercial Code Reporting Service Second Series (Callaghan)
UK	United Kingdom
ULIS	Uniform Law on the International Sale of Goods 1978
UNCITRAL	United Nations Commission on International Trade Law
UNIDROIT	International Institute for the Unification of Private Law
UNBDROIT Principles	UNIDROIT Principles of International Commercial Contracts, 1994
US	United States Supreme Court Reports
USDist	United States District Court
USSupCt	United States Supreme Court
v	Versus
WN	Weekly Notes
YB	Yearbook Commercial Arbitration
ZR	Zivilrecht

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List of legal authorities

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American Arbitration Association International Arbitration Rules, 1 September 2000 [AAA Rules]
Bürgerliches Gesetzbuch (Germany) [BGB]
Code Civil (France)
Codice Civile (Italy)
Codigo para El Distrito Federal en Materia Comun y para toda La Republica en Materia Federal (Mexico)
Contracts (Rights of Third Parties) Act 1999 (UK)
Convention on the Assignment of Receivables in International Trade [Receivables Convention]
Convention on the Recognition and Enforcement of Foreign Arbitral Awards, New York, 10 June 1958 [New York Convention]
London Court of International Arbitration Rules, 1 January 1998 [LCIA Rules]
Schweizerisches Obligationenrecht (Switzerland)
UNCITRAL Model Law on International Commercial Arbitration, 21 June 1985 [Model Law]
UNIDROIT Principles of International Commercial Contracts, Rome, 1994 [UNIDROIT Principles]
Uniform Law on the International Sale of Goods, The Hague, 2–22 April 1964 [ULIS]
United Nations Convention on Contracts for the International Sale of Goods, Vienna, 11 April 1980 [CISG]

Statement of purpose

The Claimant, Futura Investment Bank (INVESTMENT), has prepared this memorandum in compliance with the Arbitral Tribunal's Procedural Order No 1, issued on 6 October 2001.
It is argued that:

- a legally valid arbitration agreement exists between INVESTMENT and the Respondent, West Equatoriana Bobbins SA (BOBBINS);
- INVESTMENT is entitled to payment of $2,325,000 from BOBBINS;

- INVESTMENT is entitled to payment of the final installment of $930,000 from BOBBINS;
- INVESTMENT is entitled to claim interest on the sum of $3,255,000; and that
- BOBBINS should bear the costs of the arbitration.

In arguing these propositions, INVESTMENT will demonstrate the legal and factual bases for its claim, and will respond to BOBBINS' affirmative defences.

Arguments

1 There is a valid arbitration agreement between INVESTMENT and BOBBINS

1.1 The arbitral tribunal has authority to rule on its own jurisdiction

This dispute concerns an arbitration clause originally contained in a contract concluded between TAILTWIST and BOBBINS on 1 September 1999.[1] That clause incorporated the American Arbitration Association International Arbitration Rules (AAA Rules).[2] Art 15(1) AAA Rules states that 'The tribunal shall have the power to rule on its own jurisdiction, including any objections with respect to the existence, scope or validity of the arbitration agreement'.[3] INVESTMENT and BOBBINS recognised the authority of the Arbitral Tribunal to rule on its own jurisdiction in the Notice of Arbitration[4] and in the Statement of Defense[5] respectively. Furthermore, the AAA International Center for Dispute Resolution accepted INVESTMENT'S Demand for Arbitration on 5 June 2001.[6] Therefore, the Arbitral Tribunal has the authority to rule on its own jurisdiction in the dispute between INVESTMENT and BOBBINS.

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1 Claimant's Exhibit No 1.

2 Claimant's Exhibit No 1: The contract states that 'Any controversy or claim between [TAILTWTST] and [BOBBINS] arising out of or relating to this contract shall be determined by arbitration by the American Arbitration Association'. Art 1(1) AAA Rules states that 'Where parties…have provided for arbitration of an international dispute by the American Arbitration Association without designating particular rules, the arbitration shall take place in accordance with these rules'. BOBBINS and TAILTWTST, parties to the original arbitration agreement, are from Equatoriana and Oceania respectively, while INVESTMENT is from Mediterraneo. Therefore this dispute is international in nature and the AAA Rules apply.

3 This is an articulation of a principle in international arbitration that provides that an arbitral tribunal is competent to rule on its own jurisdiction. This principle is usually referred to as 'competence-competence'. It allows the tribunal to make such inquiries as are necessary to resolve the dispute regarding its jurisdiction. See Craig, Park & Paulsson, 59; Derains & Schwartz, 99–102. The principle is also embodied in various arbitration rules, for example, ICC Rules 15(1); LCIA Rules 23.1.

4 Notice of Arbitration, No 11.

5 Statement of Defense, No 5.

6 See letter of 5 June 2001 from Eleni Lappa, ICDR Supervisor.

1.2 There is a valid arbitration agreement between TAILTWIST and BOBBINS

In order to prove the existence of a valid arbitration agreement between INVESTMENT and BOBBINS, it is first necessary to establish the existence of a valid arbitration agreement between TAILTWIST and BOBBINS. BOBBINS and TAILTWIST included in their contract of 1 September 1999 a clause which stated that 'Any controversy or claim between [TAILTWIST] and [BOBBINS] arising out of or relating to this contract shall be determined…by a panel of three arbitrators with the place of arbitration being Vindobona, Danubia and the language of the arbitration English'.[7] Danubia, the country of arbitration,[8] has adopted the UNCITRAL Model Law on International Commercial Arbitration (Model Law),[9] which applies to all international commercial arbitrations conducted in Danubia.[10] Danubia is also a party to the United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards (New York Convention).[11]

According to Art 7(1) Model Law, 'An arbitration agreement may be in the form of an arbitration clause in a contract or in the form of a separate agreement'. The arbitration agreement between TAILTWIST and BOBBINS appears in the form of a clause in their contract, and thus satisfies Art 7(1) Model Law. Article 7(2) Model Law stipulates that 'The arbitration agreement shall be in writing. An agreement is in writing if it is contained in a document signed by the parties'.[12] A writing requirement is also contained in Art II(1) and Art II(2) New York Convention. Article II(1) provides that 'Each contracting State shall recognize an agreement in writing'. According to

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7 Claimant's Exhibit No 1.

8 Notice of Arbitration, No 14 and Statement of Defense, No 2. Further, the letters of 5 June and of 15 June 2001 from Eleni Lappa, ICDR Supervisor, recognised that the arbitration agreement provides for the arbitration to be held in Vindobona, Danubia.

9 Notice of Arbitrati on, No 18.

10 This dispute falls within the Model Law's definitions of 'international' (see Art 1(3)(a)), 'commercial' (see note to Art 1(1) Model Law) and 'arbitration' (see Art 2(a) Model Law). The relevant provisions of the Model Law for the purposes of this dispute are contained in Arts 7 and 19 Model Law. Article 19(1) Model Law states that '*Subject to the provisions of this Law,* the parties are free to agree on the procedure to be followed by the arbitral tribunal in conducting the proceedings' [emphasis added]. Article 19(1) Model Law was described by the UNCITRAL Secretariat as 'the most important provision of the Model Law': Model Law Commentary (A/CN.9/264), No 1. In subjecting the procedure in the arbitral proceedings to the 'provisions' of the Model Law, Art 19(1) effectively limits the discretion of the Arbitral Tribunal to determine the conduct of the proceedings. In particular, the discretion of the Arbitral Tribunal is limited by the 'mandatory' provisions of the Model Law. 'Mandatory [provisions] cannot be derogated from by the contract': Hill, 491. The mandatory provisions were not enumerated in the Model Law because of 'drafting difficulties': Fourth Secretariat Note (A/CN.9/WG.II/WP.50), No 9; Holtzmann & Neuhaus, 1119–20. However, commentators consistently identify Art 7(2) Model Law, which contains the 'in-writing' requirement, as a mandatory provision: Redfern & Hunter, 141; Holtzmann & Neuhaus, 260.

11 Notice of Arbitration, No 19.

12 The specification that 'An agreement is in writing if it is contained in a document signed by the parties' is one of several examples of an agreement 'in writing' contained in Art 7(2) Model Law. The full text of Art 7(2) Model Law 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'.

Art II(2), 'The term 'agreement in writing' shall include an arbitral clause in a contract or an arbitration agreement, signed by the parties'.[13] On 1 September 1999 both TAILTWIST and BOBBINS signed the contract containing the arbitration clause.[14] The clause thus constitutes a written arbitration agreement under Art 7(2) Model Law and Art II(1) and Art II(2) New York Convention. BOBBINS has not disputed the existence of this agreement.[15] Therefore, a valid arbitration agreement exists between TAILTWIST and BOBBINS.

1.3 The arbitration clause was transferred from TAILTWIST to INVESTMENT with the assignment of the right to receive payment

(a) The right to receive payment was validly assigned from TAILTWIST to INVESTMENT under the Convention on the Assignment of Receivables in International Trade

The law applicable to the contract of assignment concluded between TAILTWIST and INVESTMENT is the Convention on the Assignment of Receivables in International Trade (Receivables Convention).[16] Under Art 1(1)(a) Receivables Convention, the Convention applies to 'Assignments of international receivables and to international assignments of receivables…if, at the time of conclusion of the contract of assignment, the assignor is located in a Contracting State'.[17] Under Art 2(a) Receivables Convention, 'assignment' is defined as 'the transfer by agreement from one person ('assignor') to another person ('assignee') of all or part of an undivided interest in the assignor's contractual right to payment of a monetary sum ('receivable') from a third person ('the debtor')'. Under Art 3 Receivables Convention, a receivable is 'international' if 'the assignor and the debtor are located in different States'. An assignment is 'international' under Art 3 Receivables Convention if 'the assignor and the assignee are located in different States'.

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13 Equatoriana, Oceania, Mediterraneo and Danubia are all party to the New York Convention: Notice of Arbitration, No 19. Under Art I(1) New York Convention, the writing requirement of Art II(2) of this Convention must be adhered to if the arbitral award is 'made in the territory of a State other than the State where the recognition and enforcement of such awards are sought'.

14 Claimant's Exhibit No 1.

15 Statement of Defense, No 3.

16 Note that Procedural Order No 2, Clarification No 1 states that 'Even though at the time of distribution of the Problem the text [was] in fact a Draft Convention, for the purposes of the Moot the Convention is in force…at all relevant times'.

17 This provision has the effect of ensuring both the 'broad applicability of the…Convention, and a sufficient level of certainty and predictability for all interested parties': Report on Twenty-Sixth Session (A/CN.9/434), No 20. The territorial scope of the application of the draft Convention has been the subject of detailed discussion in the Working Group: Report on Twenty-Fourth Session (A/CN.9/ 420), Nos 30–31; Report on Twenty-Fifth Session (A/CN.9/432), Nos 29–32; Report on Twenty-Seventh Session (A/CN.9/445), Nos 131–36. See also Sigman & Smith, 345; Smith, 478; Bazinas (2001), 271. The Working Group considered allowing the application of the draft Convention only when all three parties had their places of business in Contracting States. However, it was decided that this would 'unduly narrow the scope of the draft Convention': Report on Twenty-Sixth Session (A/ CN.9/434), No 22. Furthermore, the place of business of the debtor should not be a factor in determining the applicability of the Convention. The debtor receives sufficient protection from the Convention, which is not aimed at changing the debtor's legal position: Report on Twenty-Sixth Session (A/CN.9/434), No 23. See also Ferrari (2000) (Melbourne Journal), 17.

18 Notice of Arbitration, No 17.

TAILTWIST, the assignor, was located in Oceania, a 'Contracting State' under Art 1(1)(a) Receivables Convention.[18] On 29 March 2000 TAILTWIST transferred to INVESTMENT its contractual right to receive payment from BOBBINS of $3,255,000[19] and hence this transaction fulfils the requirements of an 'assignment' under Art 2(a) Receivables Convention. INVESTMENT paid TAILTWIST the sum of $3,150,000 in exchange for the assignment.[20] Under Art 3 Receivables Convention, both the receivable and the assignment are international because at the time of the conclusion of the original contract TAILTWIST, BOBBINS, and INVESTMENT, as the assignor, debtor, and assignee respectively, were all located in different States.[21] Accordingly, under Art 1(1)(a) Receivables Convention, this Convention is the law applicable to the contract of assignment between TAILTWIST and INVESTMENT.

BOBBINS does not dispute that INVESTMENT is the rightful assignee of the right to receive payment.[22] TAILTWISTs Administrator in Insolvency, Dr Strict, confirmed the assignment on 17 October 2000.[23] Accordingly, the right to receive payment of $3,255,000 from BOBBINS was validly assigned from TAILTWIST to INVESTMENT,

(b) BOBBINS is obliged to arbitrate this dispute with INVESTMENT for legal reasons

(i) The arbitration clause was automatically transferred to INVESTMENT

Where a contractual right to receive payment has been validly assigned to a third party, other rights deriving from the original contract are automatically transferred with the assigned right.[24] This rule is commonly referred to as the 'automatic transfer rule'.[25] Specifically, an arbitration clause is automatically transferred with a validly assigned contractual right to receive payment because arbitration clauses would be rendered ineffective and irrelevant 'if either party [to a contract]…could escape the effect of such a clause by assigning a claim subject to arbitration between the original parties to a third party'.[26]

There are several reasons that support the application of the automatic transfer rule to arbitration clauses. First, an arbitration clause can be classed either as an accessory right or as analogous to an accessory right, and because of this, the clause is automatically

19 Notice of Arbitration, No 7.

20 Respondent's Exhibit No 4.

21 Article 5(h) Receivables Convention states that 'A person is located in the State in which it has its place of business'. INVESTMENT is located in Mediterraneo (Notice of Arbitration, No 1); BOBBINS is located in Equatoriana (Notice of Arbitration, No 2) and TAILTWIST was located in Oceania (Notice of Arbitration, No 3). Furthermore, An 1(3) Receivables Convention provides that the Convention does not affect the rights and obligations of the debtor [BOBBINS] unless 'the law governing the original contract is the law of a Contracting State'. The law governing the original contract between TAILTWIST and BOBBINS is 'the United Nations Convention on Contracts for the International Sale of Goods [CISG] and, in regard to any questions not governed by it, to the law of Oceania' which is a Contracting State: Claimant's Exhibit No 1; Notice of Arbitration, No 17. See also Procedural Order No 2, Clarification No 5.

22 Statement of Defense, No 4, states that BOBBINS 'has no reason to contest that [INVESTMENT] is the assignee of the right to payment under the contract between [TAILTWIST] and [BOBBINS]'.

23 Respondent's Exhibit No 4.

24 Girsberger & Hausmaninger, 122–23.

25 Girsberger & Hausmaninger, 122–23.

26 *Hosiery Manufacturing Corp v Goldston* 238 NY 22 (NYCtApp 1924), 28. See also *GMAC Commercial Credit LLC v Springs Industries, Inc* 44 UCC Rep Serv 2d (Callaghan) 903 (SDNY 2001).

transferred with an assigned claim.[27] This reasoning has been employed by, for example, courts in Germany,[28] Austria,[29] Switzerland[30] and France.[31] Secondly, courts in the United States[32] and the United Kingdom[33] have determined that an arbitration clause will be transferred automatically because otherwise the assignment of a contractual right would change the fundamental nature of that right, given that it would be subject to a different dispute resolution mechanism to that agreed upon in the original contract. Finally, arbitral tribunals have held that, as a matter of common sense, an arbitration clause travels with an assignment of a contractual right.[34]

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27 This position is supported by Art 10(1) Receivables Convention, which states that 'A personal or property right securing payment of the assigned receivable is transferred to the assignee without a new act of transfer'.

28 The German Federal Supreme Court has drawn an analogy between an arbitration clause and a security interest (under §401 Bürgerliches Gesetzbuch [BGB]) and has held that an arbitration clause is an attribute of the right to receive payment ('claim'). As such, the arbitration clause is assigned automatically with the claim: Bundesgerichtshof: III ZR 2/96 of 2 October 1997, Bundesgerichtshof: III ZR 18/77 of 28 May 1979, NJW 1979, 1166; Bundesgerichtshof: III ZR 103/73 of 18 December 1975; Reichsgericht: VII ZR 321/09 of 8 December 1903.

29 Austrian law characterises an arbitration clause as an accessory right which is attached to the claim and is automatically transferred with the assignment of the claim: §1394 Allgemeines Bürgerliches Gesetzbuch [ABGB] provides that 'the assignee's rights are identical to the assignor's rights with respect to the assigned claim' [Translated from German by the authors of this Memorandum]. See Girsberger & Hausmaninger, 127.

30 Article 170(1) Schweizerisches Obligationenrecht (Switzerland) states that 'The assignment of a claim includes the transfer of the privileges and accessory rights' [translated from German by the authors of this Memorandum].

31 Article 1692 Code Civil (France) states that The sale of assignment of a claim includes all accessories attaching thereto' [translated from French by the authors of this Memorandum]. Traditionally, French courts have approved the automatic transfer rule. See *Société CCC Filmkunst Gmbh c/ Société Etablissement de Diffusion Internationale de Films* in 1988 Rev Arb 565, 568; *Société Clark International Finance c/ Société Sud Material Service et Autre* in Rev Arb 570, 571. In *Fraser v Compagnie européenne des Pétroles,* Cour de Cassation Première Section Civile of 6 November 1990, it was decided that an arbitration clause does not travel with the assignment of contractual rights unless the assignee has expressly or implicitly agreed to be bound by that clause. This principle was endorsed in *SMABTP v Statinor,* Cour d'Appel de Paris of 22 March 1995. At the time of the assignment from TAILTWIST, INVESTMENT knew of the terms of the contract between BOBBINS and TAILTWIST: Procedural Order No 2, Clarification No 20. INVESTMENT therefore implicitly agreed to be bound by the arbitration clause.

32 *GMAC Commercial Credit LLC v Springs Industries, Inc* 44 UCC Rep Serv 2d (Callaghan) 903 (SDNY 2001), 16: 'an assignment cannot alter a contract's bargained-for remedial measures, for then the assignment would change the very nature of the rights assigned'; *Cone Constructors Inc v Drummond Community Bank* 754 So 2d 779 (FlaDistCtApp 1st Dist 2000), 780; *Banque de Paris et des Pays-Bas v Amoco Oil Company* 573 F Supp 1464 (SDNY 1983), 1469; *Robert Lamb Hart Planners and Architects v Evergreen Ltd* 787 F Supp 753 (SD Ohio 1992). See also Coe, 138.

33 *Montedipe SpA and Another v JTP-RO Jugotanker ('The Jordan Nicolov')* [1990] 2 Lloyd's Rep 11, 15–16 states that the assignee should have 'the benefit of the arbitration clause as well as other provisions in the contract'. United Kingdom law provides that a benefit to be obtained under a contract is assignable and that an arbitration clause will be automatically assigned with the assignment of such a benefit. See s 8 Contracts (Rights of Third Parties) Act 1999; *Schiffahrtsgesellschaft Detlef von Appen GmbH v Wiener Allianz Versicherungs AG and Voest Alpine Intertrading GmbH* [1997] 2 Lloyd's Rep 279, 285–286; *Shayler v Woolf [1946]* 1 Ch 320; *Aspell v Seymour* [1929] WN 152.

34 ICC Arbitration Case No 3281 of 1981; ICC Arbitration Case No 1704 of 1977; ICC Arbitration Case No 2626 of 1977. It should be noted at this point that the doctrine of separability does not affect the transfer of the arbitration clause. The doctrine aims to protect and preserve the agreement to arbitrate and to encourage the use of arbitration, thus using it to preclude the transfer would be contrary to these intentions: Weinacht, 9–10; *AI Trade Finance Inc v Bulgarian Foreign Trade Bank Ltd,* Stockholm Chamber of Commerce, Arbitration Award of 5 March 1997; *Hosiery Manufacturing Corp v Goldston* 238 NY 22 (NYCtApp 1924).

There are several exceptions to the automatic transfer rule. The rule does not apply if the contractual provision containing the right subject to transfer stipulates that it does not bind an assignee.[35] Nor does the rule operate if the right requires 'some performance…of the assignor personally which cannot be rendered by an agent or assignee'.[36] Finally, the right subject to transfer is not automatically transferred if the assignee gives notice to the debtor that the assignee does not intend to be bound by that clause.[37] In the present case, the arbitration clause concluded between TAILTWIST and BOBBINS and contained in their contract of 1 September 1999 does not stipulate that it will not bind TAILTWIST's assignees. Further, the arbitration clause does not require some personal performance by TAILTWIST, especially given that 'the prevailing rule today is…that [arbitration agreements] are entered into because of non-personal reasons, such as expediency, cost-efficiency and other perceived advantages of the arbitration process'.[38] Finally, INVESTMENT has not notified BOBBINS that it intends not to be bound by the arbitration clause.[39] Therefore, in this case, there is no applicable limitation to the operation of the automatic transfer rule and, accordingly, the arbitration clause in the contract of 1 September 1999 was automatically transferred from TAILTWIST to INVESTMENT together with the assignment of the right to receive payment.

(ii) The transfer of the arbitration clause to INVESTMENT does not affect its validity

The arbitration clause remains valid even though INVESTMENT is not a party to the original contract of 1 September 1999. Indeed, once the arbitration clause satisfies the in-writing requirement of Art 7(2) Model Law, the clause's validity is

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35 ICC Arbitration Case No 3281 of 1981. See also Reichsgericht: VII ZR 321/08 of 8 December 1903.

36 *Canister Co v National Can Corp* 71 F Supp 45 (DDel 1947), 49. BOBBINS must establish that when it entered into the contract, TAILTWIST's identity was a fundamental consideration. Generally, BOBBINS must demonstrate that it viewed TAILTWIST 'as possessing the good faith and procedural loyalty necessary for an arbitration to run smoothly and that the assignee [INVESTMENT] may not share those qualities': Gaillard & Savage, 434. There will not be an arbitration clause 'intuitu personae' where there was no particular skill required from the assignor, and where performance of the contract was not based on any relationship of personal confidence between the contracting parties: *Application of Reconstruction Finance Corp In re Harrions & Crosfield Ltd* 106 F Supp 358 (DNY 1952), 360. See also Kelso, 89. In *Maritime Co 'Spetsai' SA v International Commodities Export Corporation* 348 F Supp 258 (SDNY 1972), 259, the court stated that 'it is relatively clear today that an agreement to arbitrate such as the one now before this Court is not an unassignable, personal contract'.

37 The assignee may solicit the debtor's consent to take the claims free from the arbitration requirement: *GMAC Commercial Credit LLC v Springs Industries, Inc* 44 UCC Rep Serv 2d (Callaghan) 903 (SDNY 2001), 10. Alternately, the assignee may be released from the requirement if it can show that it has given 'proper notice of the limited nature of its involvement, or by obtaining a separate and legally sufficient agreement with the account debtor that the debtor will pay without asserting offsets or counterclaims': *Banque de Paris et des Pays-Bas v Amoco Oil Company* 573 F Supp 1464 (SDNY 1983), 1466.

38 Girsberger & Hausmaninger, 141. See also *American Manufacturing & Trading, Inc v Democratic Republic of the Congo,* ICSID Arbitration Case ARB/93/1, in 22 YB 60; *Asian Agricultural Products Ltd v Democratic Socialist Republic of Sri Lanka,* ICSID Arbitration Case ARB/87/3, in 17 YB 106; *Southern Pacific Properties (Middle East) Ltd v Arab Republic of Egypt,* ICSID Arbitration Case ARB/84/3, in 19 YB 51; *Maritime Co 'Spetsai' SA v International Commodities Export Corporation* 348 F Supp 258 (SDNY 1972), 259; *Cottage Club Estates v Woodside Estates Co* (1928) 2 KB 463; *In the Matter of Lowenthal* 233 NY 621 (NYCtApp 1922). See also Weinacht, 12.

39 In fact, INVESTMENT has given notice that it seeks to rely on the clause. Notice of Arbitration, No 12.

not compromised by its transfer to a third party to whom the right of payment has been assigned.[40] At law, an arbitration clause signifies a party's consent to arbitrate a dispute, rather than to arbitrate with a specific party.[41] In the present case, both INVESTMENT and BOBBINS have consented to arbitration of 'any controversy or claim…arising out of or relating to [the original] contract' concluded between TAILTWIST and BOBBINS.[42] BOBBINS consented to arbitrate 'any controversy or claim' by incorporating an arbitration clause in the contract of 1 September 1999.[43] INVESTMENT also indicated its willingness to arbitrate by referring the dispute to the AAA's International Center for Dispute Resolution.[44]

In addition, the automatic transfer of the arbitration clause does not contravene the principle of debtor protection found in Art 15(1) Receivables Convention, which states that 'an assignment does not, without the consent of the debtor, affect the rights and obligations of the debtor'.[45] The automatic transfer of the arbitration clause means that INVESTMENT now stands in TAILTWIST's position and assumes TAILTWIST's right to arbitration.[46] However, the fact that INVESTMENT seeks to exercise its right to arbitration does not alter BOBBINS' legal position. The dispute between INVESTMENT and BOBBINS relates to the same goods, the same prices and the same obligations that were governed by the contract between TAILTWIST and BOBBINS. Therefore, BOBBINS has not been disadvantaged by the fact that the claim is made by INVESTMENT rather than TAILTWIST.[47]

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40 *Fisser v International Bank* 282 F 2d 231 (2d Cir NY 1960), 233; Bundesgerichtshof: III ZR 2/96 of 2 October 1997. This is because an assignee is sufficiently warned in relation to the transfer of an arbitration agreement. The assignee is able to inquire about the existence of an arbitration clause before entering into the contract of assignment: Girsberger & Hausmaninger, 143.

41 The key is that the party is in fact a party to the arbitration agreement, even though there is no agreement to arbitrate *with each other*. 'A natural person or a company who did *not* sign an arbitration agreement may…be precluded from alleging that they are not parties to such an agreement; they may hence be bound and entitled to appear either as defendants or as claimants in the ensuing arbitration proceedings': Sandrock in Dominicé, Patry and Reymond, 635.

42 Claimant's Exhibit No 1.

43 Claimant's Exhibit No 1.

44 Letter sent from Joseph Langweiler (INVESTMENT'S Lawyer) to ICDR on 5 June 2001.

45 While under Art 1(3) Receivables Convention, the Convention may apply generally to the rights and obligations of the debtor (see Note 21 above), this provision is subject to the principle of debtor protection, which is articulated in the more specific provisions of Art 15(1) Receivables Convention. Under Art 15(1) Receivables Convention, the debtor's rights and obligations may only be affected with 'the consent of the debtor'. See also Procedural Order No 2, Clarification No 5.

46 *Technetronics Inc v Leybold-Geaeus GmbH, LeyboldAG and Ley bold Technologies, Inc* 1993 US Dist LEXIS 7683 (EDPa 1993). See also *Boart Sweden AB v NYA Stromnes AB* (1988) 41 BLR 295 (Ont (HCJ)); *Rumput (Panama) SA and Belzetta Shipping Co SA v Islamic Republic of Iran Shipping Lines ('The Leage')* [1984] 2 Lloyd's Rep 259; *Fisser v International Bank* 282 F 2d 231 (2d Cir NY 1960); *Walker v Mason* 116 A 305 (PaSupCt 1922).

47 BOBBINS retains the defences and counterclaims it would have had, prior to the assignment, against TAILTWIST pursuant to the contract of 1 September 1999, as well as any it may have against INVESTMENT separately. An analogous situation was discussed in *Smith v Cumberland and Mass Construction Group* 687 A2d 1167 (PaSup 1997).

(c) BOBBINS is also obliged to arbitrate this dispute with INVESTMENT for policy reasons

There is a strong presumption in favour of arbitration in the field of international commerce.[48] As a matter of policy, it is strongly desirable that 'having made the bargain to arbitrate',[49] BOBBINS should be held to this commitment. BOBBINS agreed to a clause that compelled it to refer to arbitration 'any controversy or claim between [TAILTWIST] and [BOBBINS] arising out of or relating to this contract'.[50] BOBBINS claims that because it would never have entered into an arbitration agreement with INVESTMENT, BOBBINS should not be bound to arbitrate this dispute with INVESTMENT.[51] However, before signing the contract with TAILTWIST, BOBBINS was aware of the possibility that TAILTWIST might assign the right to payment and that the arbitration agreement could thus be transferred.[52] Furthermore, as a business engaged in the textile trade in Equatoriana,[53] BOBBINS should have been particularly aware of this possibility because arbitration is frequently used as a dispute resolution

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48 *Smith v Cumberland and Mass Construction Group* 687 A2d 1167 (PaSup 1997); *ABN AMRO Bank Canada v Krupp Mak Maschinenbau GmbH* 135 DLR (4th) 130 at 135–36 (OntDivCt 1996); *Filanto SpA v Chilewich International Corp* 789 F Supp 1229 (SDNY 1992); *Teledyne, Inc v Kone Corp* 892 F 2d 1404 (9th Cir Cal 1989), 1410; *First City Capital Ltd v Petrosar Ltd* 42 DLR (4th) 738 (HCJ 1987); *Westland Helicopters Ltd (UK) v Arab Organisation for Industrialisation, United Arab Emirates, Kingdom of Saudi Arabia, State of Qatar, Arab Republic of Egypt and Arab British Helicopter Co (Egypt)* Chamber of National and International Arbitration of Milan of 2 February 1986, in (1986) 11 YB 127, 133; *Mitsubishi Motors Corp v Soler Chrysler-Plymouth, Inc* 473 US 614 (USSupCt 1985), 631; *Scherk v Alberto Culver Co* 47 US 506 (USSupCt 1974); *Borough ofAmbridge Water Authority v Columbia* 328 A2d 498 (SupCtPa 1973), 501; *Bremen v Zapata Off-Shore Co* 407 US 1 (USSupCt 1972). See also Bortolotti, 233.

49 *Mitsubishi Motors Corp v Soler Chrysler-Plymouth, Inc* 473 US 614 (USSupCt 1985), 626.

50 Claimant's Exhibit No 1.

51 Letter sent from Smart & Smart, lawyers for BOBBINS, to ICDR on 13 June 2001: 'my client [BOBBINS]…has never entered into any arbitration agreement with the claimant [INVESTMENT]. Furthermore, I can assure you that my client would not enter into an arbitration agreement with it [INVESTMENT]'.

52 Statement of Defense, No 18: 'During the negotiation of the contract [TAILTWIST]…anticipated that it might wish to assign the right to receive the payment from [BOBBINS].' This was recognised in the signed contract between TAILTWIST and BOBBINS, which included a provision covering the situation: 'If [TAILTWIST] should assign the right to the payments due from [BOBBINS]': Claimant's Exhibit No 1.

53 Notice of Arbitration, No 2.

54 Procedural Order No 2, Clarification No 47. BOBBINS is involved in the textile trade: Notice of Arbitration, No 2. In *Helen Whiting Inc v Trojan Textile Corp* 307 NY 360 (NYCtApp 1954), 367, the Court stated that 'we can almost take judicial notice that arbitration clauses are commonly used in the textile industry'. This has been affirmed in subsequent cases. The Court in *Pervel Industries, Inc v TM Wallcovering, Inc* 871 F 2d 7 (2d Cir NY 1989), 8, noted that the specialised nature of the products of the textile industry has led to the widespread use of arbitration clauses. Similarly, in *Genesco, Inc v T Kakiuchi & Co* 815 F 2d 840 (2d Cir NY 1987), 846: The widespread use of arbitration clauses the textile industry puts a contracting party…on notice that its agreement probably contains such a clause'; *Avdon Eng'g v Seatex* 112 F Supp 2d 1090 (D Colo 2000), 1096; *Commercial Credit LLC v Springs Industries Inc* 2001 US Dist LEXIS 5152 (SDNY 2001), 27–28; *Chelsea Square Textiles Inc, Kenneth Lazar, Lester Gribetz v Bombay Dyeing and Manufacturing Co Ltd* 189 F3d 289 (2d Cir 1999), 296–97; *Leadertex v Morganton Dyeing & Finishing Corp* 67 F3d 20 (2d Cir 1995), 25: 'arbitration is a widespread practice in the textile industry'; *Imptex International Corp v Lorprint Inc* 625 F Supp 1572 (SDNY 1986), 1572; *Avila Group Inc v Norma J of California* 426 F Supp 537 (SDNY 1977), 541 n 10; *Gay nor-Stafford Industries Inc v Mafco Textured Fibres, a Division of MacAndrews & Forbes Company* 52 AD2d 481 (NYAppDivlst Dep't 1976), 485: 'arbitration is

mechanism in the textile trade,[54] and because assignment of trade credit is commonly used as a form of business financing in Equatoriana.[55] Anticipating the assignment and the subsequent transferral of the arbitration clause, BOBBINS could have chosen to restrict the application of the clause in the original contract by expressly providing that the clause would not apply to an assignee.[56] However, the wording of the clause is particularly wide.[57] BOBBINS chose not to restrict the clause; BOBBINS chose to arbitrate.

In conclusion, the assignment from TAILTWIST to INVESTMENT of the right to receive payment automatically transferred the right to arbitration from TAILTWIST to INVESTMENT. As a result, a valid arbitration agreement now exists between INVESTMENT and BOBBINS. There are no applicable legal or policy reasons that should exempt BOBBINS from its obligation to arbitrate. BOBBINS must therefore arbitrate this dispute with INVESTMENT.

2 *INVESTMENT is entitled to payment of $2,325,000 from BOBBINS*

2.1 The receivables convention is the law applicable to the notice of assignment

Article 29 Receivables Convention states that 'The law governing the original contract determines…the relationship between the assignee and the debtor, the conditions under which the assignment can be invoked against the debtor and whether the debtor's obligations have been discharged'. Article 5(a) Receivables Convention defines the 'original contract' as 'the contract between the assignor and the debtor from which the assigned receivable arises'. The law governing the original contract of 1 September 1999 is the United Nations Convention on Contracts for the International Sale of Goods (CISG) because TAILTWIST and BOBBINS had their places of business in

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common in the textile industry'; *N&D Fashions Inc v DHJ Industries Inc* 548 F 2d 722 (8th Cir Minn 1976), 726 n 7; *CMI Clothesmakers Inc v ASK Knits Inc* 85 Mise 2d 462 (NYSupCt 1975), 464–65; *London Mfg Inc v American and Efird Mills Inc* 46 AD2d 637 (NYAppDivlst Dep't 1974), 638; *Tanbro Fabrics Corp v Deering Milliken Inc,* 35 AD2d 469 (NYAppDivlst Dep't 1971), 473 (dissent); *Trafalgar Square Ltd v Reeves Bros Inc* AD2d 194 (NYAppDivlst Dep't 1970), 196; *Wachusett Spinning Mills Inc v Blue Bird Silk Manufacturing Co Inc* 12 Misc 2d 938 (NYSupCt 1958), 945.

55 Indeed, 'on many occasions…creditors of BOBBINS had assigned to someone else the right to receive payment from BOBBINS. Moreover, BOBBINS had also on occasion financed its current operations by assigning its receivables to a financing company': Procedural Order No 2, Clarification No 14.

56 See, eg, ICC Arbitration Case No 2626 of 1977; *United States of America v Panhandle Eastern Corp* 672 F Supp 149 (DDel 1987).

57 The wording of the clause is 'any controversy or claim…arising out of or relating to this contract': Claimant's Exhibit No 1. This clause has been widely drafted. This is noticeable especially when it is contrasted with, eg, an arbitration agreement applying to all disputes 'arising under' the contract: *McCarthy v Azure* 22 F3d 351 (1st Cir NH 1994). The phrase 'any controversy or claim' has been held in the United States to have a wide meaning: *Prima Paint Corp v Flood & Conklin Mfg Co* 388 US 395 (USSupCt 1967). Similarly, in the United Kingdom, the word 'claims' has been held to convey a wide meaning: *Woolf v Collis Remerill Service* [1948] 1 KB 11, 18. Furthermore, the phrase 'arising out of conveys a wide meaning: *Ethiopian Oilseeds & Pulses Export Co v Rio Del Mar Foods, Inc* [1990] 1 QB 86. See also Redfern & Hunter, 160–62.

Oceania and Equatoriana respectively, both of which are 'Contracting States' within the meaning of Art 1(1)(a) CISG.[58] Additionally, the original contract expressly provided that it was subject to the CISG 'and, in regard to any questions not governed by it, to the law of Oceania'.[59] Thus the CISG and the law of Oceania govern the relationship between the assignee, INVESTMENT, and the debtor, BOBBINS.

For the purposes of determining whether INVESTMENT is entitled to payment of $2,325,000 from BOBBINS, the central issue is the notification of assignment provided by INVESTMENT to BOBBINS.[60] However, the CISG does not govern the question of assignment, and therefore the applicable law is the domestic law of Oceania. As Oceania has adopted the Receivables Convention and incorporated it into its domestic law,[61] the Receivables Convention is the law applicable to the relationship between INVESTMENT and BOBBINS with regard to the payment of $2,325,000.

2.2 The notice of assignment sent by INVESTMENT to BOBBINS was valid

On 29 March 2000 TAILTWIST assigned to INVESTMENT its right to receive payment of the two outstanding installments due from BOBBINS.[62] On 5 April 2000 INVESTMENT sent BOBBINS a notice of assignment and ordered that the two remaining payments totaling $3,255,000 be made to INVESTMENT instead of to TAILTWIST.[63] BOBBINS received this notice on 10 April 2000.[64] On the afternoon of 19 April 2000, nine days after receipt of this notice, BOBBINS paid the first outstanding installment of $2,325,000 to TAILTWIST.[65]

(a) INVESTMENT had the right to notify BOBBINS of the assignment

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58 Article 1 (1)(a) CISG states that 'This Convention applies to contracts of sale of goods between parties whose places of business are in different States…when the States are Contracting States'. Both Oceania and Equatoriana are parties to the CISG (Notice of Arbitration, No 16) and have incorporated the CISG into domestic law (Procedural Order No 2, Clarification No 2). Article 3(2) CISG states that the CISG 'does not apply to contracts in which the preponderant part of the obligations of the party who furnishes the goods consists in the supply of labour or other services'. This provision does not negate the applicability of the CISG to the contract of 1 September 1999. Services will constitute the 'preponderant part of the obligations' under Art 3(2) CISG if they constitute 'considerably more than 50% of the price': Schlechtriem (1986), 31. Honnold, 58–59, considers that services will be a preponderant part of the obligations if they constitute more than 15% of the price. See also ICC Arbitration Case No 7153 of 1992; Bonell and Ligouri, 1; Ferrari (1995), 11; Gabriel, 18–19; Herber in Schlechtriem (1998), 39. The services in the contract of 1 September 1999 account for $80,000 out of $9,300,000 (Claimant's Exhibit No 1); this is less than 1% of the contract price and clearly is not the preponderant part of the obligations of TAILTWIST, the party who furnished the goods.

59 Claimant's Exhibit No 1.

60 The issue is expressed in Procedural Order No 3 as 'Whether the notice of assignment…was effective to obligate [BOBBINS] to pay the $2,325,000 to [INVESTMENT] rather than to [TAILTWIST]'. See also Procedural Order No 1, No 4; Notice of Arbitration, Nos 7 and 8; Statement of Defense, Nos 7–11.

61 Notice of Arbitration, No 17; Procedural Order No 2, Clarification No 2.

62 Claimant's Exhibit Nos 2 and 3; Notice of Arbitration, No 7.

63 Claimant's Exhibit No 2; Notice of Arbitration, No 7.

64 The notice of assignment was received and signed for on 10 April 2000. Statement of Defense, No7.

65 Notice of Arbitration, No 8; Statement of Defense, No 9.

66 Procedural Order No 2, Clarification No 19.

The contract of assignment between INVESTMENT and TAILTWIST provided that INVESTMENT would notify BOBBINS of the assignment.[66] However, BOBBINS claims that it required confirmation from TAILTWIST that the assignment had taken place,[67] and that because the confirmation did not arrive until 17 October 2000, the notice of assignment was ineffective.[68] This claim is unfounded due to Art 13(1) Receivables Convention, which states: '*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 a payment instruction [emphasis added]'. Hence, Art 13(1) Receivables Convention recognises that parties to a contract of assignment can agree as to whom will inform the debtor. In their contract of assignment, INVESTMENT and TAILTWIST validly exercised their right to agree who would inform BOBBINS of the assignment.[69] Hence INVESTMENT'S right to notify, and to request payment[70] from, BOBBINS without the co-operation or authorisation of TAILTWIST is protected by Art 13(1) Receivables Convention.[71]

If BOBBINS was concerned by the fact that the notice of assignment came from INVESTMENT rather than TAILTWIST,[72] BOBBINS could have requested proof of the assignment from INVESTMENT under Art 17(7) Receivables Convention, which states that 'the debtor is entitled to request the assignee to provide within a reasonable period of time adequate proof that the assignment…[has] been made'.[73] BOBBINS, however, chose not to take this reasonable and relatively simple step.[74] BOBBINS requested no such proof from INVESTMENT, nor did it attempt to confirm the assignment.

(b) The initial notice of assignment fulfilled the requirements of the Receivables Convention

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67 Mr Black expressed an intention to confirm the assignment with TAILTWIST: Statement of Defense, No 8.

68 TAILTWIST's Insolvency Administrator, Dr Strict, confirmed the assignment in the letter of 17 October 2000: Respondent's Exhibit No 4.

69 Procedural Order No 2, Clarification No 19.

70 Commentary to the draft Receivables Convention Part II (A/CN.9/WG.II/WP.106), No 18; Bazinas (1998), 339–40; Bazinas (2001), 277; Trager, 636. In order to facilitate receivables financing and avoid an increase in the cost of credit, the Working Group widely considered that a notice of assignment could be sent by either the assignor or the assignee, without affecting the notification's validity. This principle exists in many legal systems. See Art 1264 Codice Civile (Italy); §409 *BGB* (Germany); Art 2036 *Codigo Civil para El Distrito Federal en Materia Comun y para toda La Republica en Maleria Federal* (Mexico); Art 1689 Code Civil (France). For a comment of these provisions see Torrente & Schlesinger, 40.

71 An assignee does not have to prove that it has authority from the assignor when notifying the debtor of the assignment. The Working Group decided that forcing the assignee to always provide proof of the assignment would make the assignment process 'excessively cumbersome': Report on Twenty-Sixth Session (A/CN.9/434).

72 According to BOBBINS 'It was not clear to Mr Black [Vice-President of BOBBINS] what actions should be taken in regard to the purported assignment, especially since the notice had been sent by [INVESTMENT] and not by [TAILTWIST]': Statement of Defense, No 8.

73 This Article aims to protect the debtor. A debtor should not be subjected to the risk of receiving a notice of assignment and a payment instruction from a party not known to the debtor. The debtor has a right, not a duty, to request additional information. Commentary to the draft Receivables Convention Part II (A/CN.9AVG.II/WP.106), No 47.

74 Procedural Order No 2, Clarification No 25.

75 Notice of Arbitration, No 7; Statement of Defense, No 7.

76 Claimant's Exhibit No 4.

BOBBINS received INVESTMENT'S initial notice of assignment on 10 April 2000.[75] BOBBINS claims that because this notice was written in German, none of its personnel could read it, and as a result the notice was 'totally deficient'.[76] However, there is no requirement in the Receivables Convention that the notification must be drafted in the language of the original contract, nor that it must be in a language that the debtor is able to understand.

Article 16(1) Receivables Convention states that 'Notification of the assignment or payment instructions is effective…if it is in a language that is reasonably expected to inform the debtor about its contents'. The reference in Art 16(1) to 'reasonable' expectations 'is an attempt to introduce an objective standard that must be determined according to the relevant circumstances'. [77] The essence of this objective standard may be gleaned from Art 5(d) Receivables Convention, which requires that the notice must reasonably identify the assignee and the assigned receivables.[78] In the circumstances of this case, the notice received by BOBBINS on 10 April 2000[79] fulfilled the requirements of Arts 16(1) and 5(d) Receivables Convention. Indeed, it identified the assignee by making specific reference to INVESTMENT; it also explicitly referred to TAILTWIST and BOBBINS and to the date on which the contract between TAILTWIST and BOBBINS was concluded. In fact, Mr Black, Vice-President of BOBBINS, acknowledged that the notice contained 'the name of [TAILTWIST] and the date 1 September 1999, which is the date of a contract between [TAILTWIST] and ourselves'.[80] Further, the notice identified the receivables by referring to the figure of $3,255,000.[81] Given that these basic details were apparent to a person who could not understand the German language, then under an objective standard, these details could reasonably be expected to inform the recipient about the content of the notice. Consequently, under Arts 5(d) and 16(1) Receivables Convention, this notice of assignment was effective,

(c) Changing the country of payment does not invalidate the notice of assignment nor prevent payment to INVESTMENT

The contract of 1 September 1999 specified that payment was to be made to TAILTWIST's bank account in Oceania.[82] The payment instructions sent by INVESTMENT to BOBBINS required payment of the two remaining installments to INVESTMENT to be made in

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77 Bazinas (2001), 280.

78 Article 5(d) Receivables Convention states that "Notification of the assignment' means a communication in writing that reasonably identifies the assigned receivables and the assignee'. The Working Group noted the close relationship between Art 16(1) Receivables Convention and Art 5(d) Receivables Convention: Report on Twenty-Sixth Session (A/CN.9/434), No 167. Sigman& Smith, 350.

79 Notice of Arbitration, No 7; Statement of Defense, No 7.

80 Respondent's Exhibit No 1.

81 The document's heading also contained the German word 'Zession' (Claimant's Exhibit No 2). 'Zession' bears a strong resemblance to the English word 'cession'. 'Cession' is synonymous with 'assignment,' and to equivalent words in several European languages: in French and Spanish, 'cession'; in Italian, 'cessione'. These words derive from the Latin root 'cessio'. The use of 'Zession,' therefore, was another aspect of the document that should have alerted Mr Black to the nature of the document.

82 Procedural Order No 2, Clarification No 12.

83 Claimant's Exhibit Nos 2 and 3.

84 Statement of Defense, No 11.

Mediterraneo.[83] BOBBINS claims that the change of the country of payment from Oceania to Mediterraneo renders the notice of assignment formally defective under the Receivables Convention.[84] Article 15(2)(b) Receivables Convention states that 'A payment instruction may not 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'.

A conceptual distinction must be drawn between the payment instruction and the notice of assignment.[85] Article 5(d) Receivables Convention makes this distinction by limiting the definition of 'notification of the assignment' to 'a communication in writing that reasonably identifies the assigned receivables and the assignee'.[86] In accordance with the fact that the payment instruction and the notice of assignment are distinct, the letter sent to BOBBINS on 5 April 2000 refers to the notice of assignment in the first paragraph and the payment instruction in the second.[87] The document of 5 April 2000 is thus constituted of two parts, each separate and distinct from the other. Therefore, contrary to BOBBINS' claim, a technical deficiency in the payment instruction does not invalidate the notice of assignment.

In any event, policy considerations also suggest that a technical deficiency such as changing the country of payment should not invalidate the notice of assignment.[88] Under Art 7(1) Receivables Convention, 'In interpretation of [the Receivables Convention], regard is to be had to its object and purpose as set forth in the preamble'. The Preamble to the Receivables Convention notes that the Convention's aims include reducing technical formalities,[89] increasing the availability and cost effectiveness of credit in international trade[90] and facilitating the availability of credit in greater volume and at lower interest

85 Proposal by United States of America (A/CN.9/WG.II/WP100), No 1 states that 'a clear distinction should be drawn between the notification of the assignment and payment instructions'.

86 Proposal by United States of America (A/CN.9/WG.II/WP100), No 2, discusses expressly the possibility of defining payment instruction and notice of assignment separately. This demonstrates that the notice of assignment and the payment instruction are independent documents, and that the invalidity of the payment instruction does not invalidate the notice of assignment. See also the Commentary to the draft Receivables Convention Part I (A/CN.9/WG.U/WP.105), No 55, 'a notification containing no payment instruction is effective under the draft Convention'. See Report on Twenty-Third Session (A/CN.9/486), No 13: 'In response to a question as to the relationship between a notification and a payment instruction it was noted that…a notification did not need to contain a payment instruction but a payment instruction could only be given in a notification or subsequent to a notification by the assignee'. See also Commentary to the draft Receivables Convention Part I (A/ CN.9/WG.II/WP.105), No 22.

87 Claimant's Exhibit Nos 2 and 3.

88 Article 7(1) Receivables Convention states that 'In the interpretation of this Convention, regard is to be had to its object and purpose as set forth in the preamble, to its international character and to the need to promote uniformity in its application and the observance of good faith in international trade'. See Ferrari (2000) (Private Law), 182; Commentary to the draft Receivables Convention Part I (A/CN.9/ WG.II/WP.105), Nos 63–64.

89 The Preamble to Receivables Convention states: '*Considering* that problems created by uncertainties as to the content and the choice of legal regime applicable to the assignment of receivables constitute an obstacle to international trade'. See also Bazinas (1998), 320; Bazinas (2001), 260–61, 265–66; Schwarcz, 455–56; Oditah, 4–10.

90 Preamble to Receivables Convention, Paragraph (5). See also Ferrari (2000) (Private Law), 182.

91 Commentary to the draft Receivables Convention Part I (A/CN.9/WG.II/WP 105), No 8.

92 Procedural Order No 2, Clarification No 33.

rates.[91] It would be contrary to these aims to allow a deficiency in the payment instruction to render a notice of assignment invalid, especially considering that the change of the country of payment was in no way prejudicial to BOBBINS.[92]

Finally, under the Receivables Convention 'a payment instruction may be changed or corrected until the debtor pays'.[93] In this case, any deficiency in the payment instruction was corrected by INVESTMENT on 5 July 2000 by directing that 'You are hereby instructed to make future payments to Oceania Commercial Bank, Part City, Oceania, account of Futura Investment Bank, account number 345678, reference Tailtwist/Bobbins 010999'.[94] Consequently, there is no remaining impediment to BOBBINS making full and proper payment to INVESTMENT.

2.3 The notice of assignment was received before payment was made by BOBBINS to TAILTWIST

BOBBINS received the initial notice of assignment, written in German, from INVESTMENT on 10 April 2000.[95] Under Art 16(1) Receivables Convention, any notification or payment instruction will become effective when received by the debtor.[96] As BOBBINS received the initial German notice on 10 April 2000, it became effective nine days before BOBBINS paid TAILTWIST on 19 April 2000. Article 17(2) Receivables Convention provides that 'After the debtor receives notification of the assignment…the debtor is discharged only by paying the assignee'. Thus, in failing to make payment of $2,325,000 to INVESTMENT, BOBBINS failed to discharge its obligation under this Article.

Furthermore, Mr Black, Vice-President of BOBBINS, received a facsimile of the English translation of the German notice on the morning of 19 April 2000[97] before any payment was made to TAILTWIST.[98] It was not until the early afternoon of 19 April 2000 that BOBBINS' Accounting Department electronically instructed the Equatoriana Commercial Bank to pay $2,325,000 to TAILTWIST.[99] Mr Black could have promptly ordered that the payment be stopped. Instead, he relied on BOBBINS' usual office procedure[100] to instruct the Accounting Department 'not to make any payments to [TAILTWIST] until further notice'.[101] Mr Black's instruction was in the form of an internal memorandum that took two and a half hours to arrive at the Accounting Department.[102] However, this situation required more than the application

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93 See Bazinas (2001), 281: 'In the case of multiple payment instructions given with respect to one and the same assignment involving a correction or other change of the payment instructions, the debtor is discharged if it pays in accordance with the last payment instruction received by the debtor before payment'.

94 Respondent's Exhibit No 5.

95 Notice of Arbitration, No 7; Statement of Defense, No 7.

96 An analogous principle is articulated in Art 24 CISG.

97 Respondent's Exhibit No 2; Statement of Defense, No 7.

98 Statement of Defense, Nos 8 and 9.

99 Statement of Defense, No 9; Procedural Order No 2, Clarification No 32.

100 Procedural Order No 2, Clarification No 30.

101 Statement of Defense, No 8.

102 'The Memorandum…took about two and a half hours from the time the Memorandum was signed to the time it was received in the Accounting Department': Procedural Order No 2, Clarification No 30.

of the usual office procedure. Mr Black had just received the English translation of a notice which implied that payment of $2,325,000 to TAILTWIST would constitute payment to a company to whom the sum was no longer owed. He was also aware that this payment would soon be due[103] and he had prior notice of a possible assignment.[104] Despite these significant facts, Mr Black chose not to use more rapid means of communication that would have facilitated a prompt halt to the payment, but rather chose to rely merely on the internal office messenger service.[105] In conclusion, INVESTMENT was entitled to send the notice of assignment under Art 13(1) Receivables Convention, and effective notice was received by BOBBINS before it made payment to TAILTWIST. In effecting payment to TAILTWIST, BOBBINS assumed the risk of paying twice. Therefore, BOBBINS has a duty to pay $2,325,000 to INVESTMENT under Art 17(2) Receivables Convention.

3 *INVESTMENT is entitled to the final instalment of $930,000*

3.1 The CISG is the law applicable to payment of the final instalment of $930,000

In considering whether INVESTMENT is entitled to payment of $930,000 from BOBBINS, the central issue is whether BOBBINS is precluded from 'asserting [against INVESTMENT] the alleged deficiencies in the training and in the performance of the equipment'.[106] Under Art 29 Receivables Convention, the law governing the original contract applies to the relationship between the assignee and the debtor. The original contract 'is governed by the [CISG] and, in regard to any questions not governed by it, by the law of Oceania'. [107] As BOBBINS' reliance on the alleged deficiencies and its resulting declaration to reduce the contract price are governed by the CISG, the CISG is the law applicable to the relationship between INVESTMENT and BOBBINS with regard to the payment of $930,000.

Under the contract of assignment, INVESTMENT obtained the right to receive the final installment of $930,000.[108] However, on 10 January 2001 BOBBINS informed the Administrator in Insolvency, Dr Strict, that it had been unable 'to operate the equipment in a fully satisfactory manner' and that the problems 'may lie in difficulties with the equipment itself or in the inadequate training given to our personnel'.[109]

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103 Mr Black stated in the memorandum to the Accounting Department that 'One of [the payments due on the TAILTWIST contract] will soon be due': Respondent's Exhibit No 3. See also Procedural Order No 2, Clarification No 31.

104 The possibility of assignment had been raised in pre-contractual negotiations: Statement of Defense, No 18.

105 Procedural Order No 2, Clarification No 30.

106 Procedural Order No 3. See also Procedural Order No 1, No 5; Notice of Arbitration Nos 9 and 10; Statement of Defense, Nos 12–16.

107 Claimant's Exhibit No 1.

108 Claimant's Exhibit Nos 2 and 3; Respondent's Exhibit No 4. The payment of $930,000 was to be paid by BOBBINS 'after three months satisfactory performance' by the 'Spin-a-Whizz' equipment: Claimant's Exhibit No 1.

109 Claimant's Exhibit No 5.

110 Claimant's Exhibit No 5.

Consequently, BOBBINS declared a $930,000 reduction of the contract price based on 'deficiencies in the performance of the equipment'.[110]

BOBBINS' declaration of a price reduction involves the application of several provisions of the CISG. In particular, BOBBINS claims that its asserted price reduction was in accordance with Art 50 CISG,[111] which states that 'If the goods do not conform with the contract…the buyer may reduce the price in the same proportion as the value that the goods actually delivered had at the time of the delivery bears to the value that conforming goods would have had at that time'. In order to rely on a lack of conformity under Art 50 CISG, a buyer must fulfill one of three requirements. First, under Art 39(1) CISG, the buyer must 'give notice to the seller specifying the nature of the lack of conformity within a reasonable time after he has discovered it or ought to have discovered it'. Secondly, under Art 44 CISG, if the buyer does not give such notice, the buyer must have 'a reasonable excuse for his failure to give the required notice'. Thirdly, under Art 40 CISG, if the buyer neither gives such notice nor has a reasonable excuse, the buyer must be able to demonstrate that 'the lack of conformity relates to facts of which [the seller] knew or could not have been unaware and which he did not disclose to the buyer'. As is argued in Parts 3.2, 3.3 and 3.4 of this Memorandum, BOBBINS has not fulfilled any of these applicable requirements, and thus there is no basis for the assertion of a reduction in price under Art 50 CISG.

In any event, in the contract of 1 September 1999 BOBBINS agreed not to assert any defences against an assignee of TAILTWIST unless TAILTWIST did not in good faith attempt to remedy the deficiency.[112] As is argued below, BOBBINS' failure to fulfil the requirements of Arts 39(1), 40 and 44 CISG meant that TAILTWIST was given no opportunity to remedy the deficiency and thus, under the contract of 1 September 1999, there is no basis for BOBBINS' assertion of a price reduction against INVESTMENT.

3.2 BOBBINS failed to notify TAILTWIST of the lack of conformity within a reasonable time under Article 39(1) CISG

Article 39(1) CISG states that the buyer will lose the right to rely on a lack of conformity 'if he does not give notice to the seller specifying the nature of the lack of conformity within a reasonable time after he discovered it or ought to have discovered it'.[113] BOBBINS identifies the lack of conformity on which it seeks to rely as 'deficiencies in the performance of the equipment'.[114] BOBBINS identifies two possible causes of the lack of conformity: first, the inadequacy of the training provided by the TAILTWIST personnel or, second, a problem in the equipment itself. BOBBINS further asserts that, while it is not clear

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111 Statement of Defense, No 16. A price reduction under CISG is separate from an award of damages: Bergsten & Miller, 1; Burnett, 22.

112 Claimant's Exhibit No 1.

113 Article 35(2)(a) CISG states that a lack of conformity will exist unless goods 'are fit for the purpose for which goods of the same description would ordinarily be used'. In this case, Art 35(2)(a) may also be extended to apply to the provision of services under Art 3(2) CISG: See fn 58. Procedural Order No 2, Clarification No 34 states that, in annexes to the contract, 'there were detailed specifications…as to the performance of the…equipment'.

114 Claimant's Exhibit No 5.

115 Claimant's Exhibit No 5.

which of these two possible causes created the lack of conformity in the performance of the equipment, the result 'is the same in either case'.[115]

(a) BOBBINS discovered the lack of conformity in the performance of the equipment as from 10 May 2000

In the event that the inadequate training caused the lack of conformity, an examination of the record discloses that this inadequacy was manifest as from 10 May 2000, when the training period ended.[116] Indeed, on 20 April 2000, on the commencement of the insolvency proceedings, two of the four TAILTWIST personnel were recalled from their positions and their employment was terminated immediately.[117] The consequence of this was that the two remaining TAILTWIST personnel 'would have had a difficult time at best to conduct the training that was called for under the contract for which four persons had been anticipated'.[118] BOBBINS further asserts that the two remaining personnel, under the circumstances, 'were *obviously* upset and concerned about their own future' [emphasis added].[119] Additionally, according to BOBBINS, it was apparent that the remaining personnel were unable 'to give even the amount and quality of training that they otherwise might have given'[120] and that BOBBINS' staff were later forced 'to experiment with adjusting the equipment for different raw materials, with constant fear that an incorrect adjustment would result in damage to the product and perhaps to the equipment itself'.[121] In order to make these assertions, BOBBINS must have been aware of the inadequacy of the training at the latest by the end of the training period on 10 May 2000. Hence, as from 10 May 2000, BOBBINS was certainly aware of one of the possible causes of the lack of conformity in the performance of the equipment.

If the lack of conformity was caused by problems with the equipment itself, the record discloses that these problems were also evident as from 10 May 2000. Indeed, BOBBINS asserts that the 'equipment has not performed satisfactorily'[122] and it is established that 'full production was *never* achieved' [emphasis added].[123] Accordingly, as from 10 May 2000 at the latest, when the training period ended, BOBBINS was aware that the equipment was not working at full capacity and that, therefore, there was a lack of conformity in the performance of the equipment. Thus, to the extent that the inadequacy of the training did not in fact contribute to the lack of conformity in the performance of the equipment, the lack of conformity was necessarily caused by a problem with the equipment itself.

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116 Notice of Arbitration, No 5.
117 Statement of Defense, No 14.
118 Statement of Defense, No 14.
119 Statement of Defense, No 14.
120 Statement of Defense, No 14.
121 Statement of Defense, No 15.
122 Statement of Defense, No 15.
123 Procedural Order No 2, No 39. See also Statement of Defense, No 20; Procedural Order No 2, Clarification No 42.

Although it is unclear which of the two possible causes in fact created the lack of conformity in the performance of the equipment, the record thus reveals that the inadequacy of the training and any problem with the equipment itself were both evident as from 10 May 2000. These two possible causes manifested themselves in the lack of conformity in the performance of the equipment, which also became evident as from 10 May 2000. As BOBBINS was aware of the lack of conformity as from 10 May 2000, it is immaterial that BOBBINS did not know 'whether the problem lies in the equipment or in the inadequate training'.[124] Consequently under Art 39(1) CISG, the period during which TAILTWIST must be notified of the lack of conformity in the performance of the equipment began as from 10 May 2000.

(b) BOBBINS failed to notify TAILTWIST within a reasonable time

(i) BOBBINS was required to notify TAILTWIST of the lack of conformity within one month after 10 May 2000

In order to claim a price reduction under Art 50 CISG, BOBBINS was required to give TAILTWIST notice of the lack of conformity in the performance of the equipment within a reasonable time after 10 May 2000. 'Reasonable time' under Art 39(1) CISG depends upon the circumstances of each case.[125] Substantial case authority supports the

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124 Statement of Defense, No 20.

125 Ferrari (1995), 3; Honnold, 281; Magnus in Honsell, 431; Schwenzer in Schlechtriem (2000), 415; Sono in Bianca & Bonell, 309; Wautelet in Van Houtte (1997), 177.

126 Oberlandesgericht Karlsruhe: 1 U 280/96 of 25 June 1997; *Sport D'Hiver di Genevieve Culet v Ets Louyes et Fils* Tribunale Civile di Cuneo: 45/96 of 31 January 1996; Bundesgerichtshof: VII ZR 159/94 of 8 March 1995; Amtsgericht Kehl: 3 C 925/93 of 6 October 1995; Handelsgericht Zürich: HG 920670 of 26 April 1995; Hungarian Chamber of Commerce and Industry, Court of Arbitration Award: Vb 94131 of 5 December 1995; Oberlandesgericht München: 7 U 3758/94 of 8 February 1995; Amtsgericht Riedlingen: 2 C 395/93 of 21 October 1994; Oberlandesgericht Düsseldorf: 17 U 136/92 of 12 March 1993; Oberlandesgericht Saarbriicken: 1 U 69/92 of 13 January 1993; Oberlandesgericht Düsseldorf: 17 U 82/92 of 8 January 1993; Landgericht Berlin: 99 O 29/93 of 16 September 1992; Landgericht Mönchengladbach: 7 O 80/91 of 22 May 1992; *Fallini Stefano & Co SNC v Foodik BV* Arrondissementsrechtbank Roermond: 900366 of 19 December 1991; Landgericht Bielefeld: 15 O 201/90 of 18 January 1991; Landgericht Aachen: 41 O 198/89 of 3 April 1990.

127 Obergericht Kanton Luzern: 11 95 123/357 of 8 January 1997; Amtsgericht Augsburg: 11 C 4004/95 of 29 January 1996; Hungarian Chamber of Commerce and Industry, Court of Arbitration Award: Vb 94131 of 5 December 1995; Amtsgericht Kehl: 3 C 925/93 of 6 October 1995; *M Caiato Roger v La Société française de factoring international factor France 'SFF' (SA)* Cour d'appel Grenoble: 93/4126 of 13 September 1995; Oberlandesgericht Stuttgart: 5 U 195/94 of 21 August 1995; Handelsgericht Zürich: HG 920670 of 26 April 1995; Landgericht Landshut: 54 O 644/94 of 5 April 1995; Bundesgerichtshof: VIII ZR 159/94 of 8 March 1995; Oberlandesgericht München: 7 U 3758/94 of 8 February 1995; Amtsgericht Augsburg: 11 C 4004/95 of 29 January 1995; *Calzaturificio Moreo Juniro Srl v SPRLU Philmar Diff* Tribunal Commercial de Bruxelles: RG 1.205/93 of 5 October 1994; Oberlandesgericht Innsbruck: 4 R 161/94 of 1 July 1994; Landgericht Düsseldorf: 31 O 231/94 of 23 June 1994; Oberlandesgericht Düsseldorf: 6 U 32/93 of 10 February 1994; Landgericht Köln: 86 O 119/93 of 11 November 1993; *Gruppo IMAR SpA v Protech Horst* Arrondissementsrechtbank Roermond: 920159 of 6 May 1993; Oberlandesgericht Saarbrücken: 1 U 69/92 of 13 January 1993; Landgericht Berlin: 99 O 123/92 of 30 September 1992; Landgericht Berlin: 99 O 29/93 of 16 September 1992; *Fallini Stefano & Co SNC v Foodik BV* Arrondissementsrechtbank Roermond: 900366 of 19 December 1991.

128 Statement of Defense, No 19.

129 BOBBINS learned of the opening of the insolvency proceedings on 23 April 2000: Procedural Order No 2, Clarification No 21.

proposition that a reasonable time for giving notice may not be more than eight days.[126] While some courts adopt a more generous approach, the longest period generally accepted as a reasonable time for non-perishable goods is one month.[127] In the circumstances of this case, especially given that the TAILTWIST insolvency proceedings commenced on 20 April 2000,[128] of which BOBBINS was aware,[129] it was imperative that TAILTWIST be notified of the deficiencies in the equipment as soon as possible, thereby enabling those deficiencies to be remedied before the complete cessation of TAILTWIST'S business activities. Thus, in accordance with Art 39(1) CISG, BOBBINS was required to notify TAILTWIST of the lack of conformity as soon as possible as from 10 May 2000, or at the very latest within a period of one calendar month.

(ii) The complaints made to TAILTWIST's personnel did not constitute notice under Article 39(1) CISG

BOBBINS made Various statements' to TAILTWIST's personnel indicating that 'the training being given was not sufficient'.[130] No additional complaints were made.[131] For the 'various statements' to constitute notice under Art 39(1) CISG, they must possess two distinct characteristics: first, the notice must be specific; and secondly, the notice must be in an appropriate form.

First, in order to be sufficiently specific, the notice must describe the lack of conformity in detail and the manner in which the buyer wishes it to be remedied.[132] Arbitral tribunals and courts have consistently interpreted the requirement of specificity strictly.[133] However, in the provision of notice to the seller, 'Especially in the case of machines and technical apparatus, the buyer can only be required to give an indication of symptoms, not to indicate their cause'.[134] Therefore, in the present case, which deals with machines and technical apparatus, BOBBINS need not have provided TAILTWIST with specific details of the *causes* of the lack of conformity in the equipment's performance, but merely with a specific description of the *consequences* of these causes. As BOBBINS knew the

130 Procedural Order No 2, Clarification No 39.

131 Procedural Order No 2, Clarification No 39.

132 Oberlandesgericht Koblenz: 2 U 31/96 of 31 January 1997. See also Magnus in Honsell, 429; Resch, 475; Schwenzer in Schlechtriem (2000), 413; Wautelet in Van Houtte (1997), 182–83.

133 The requirement that notice under Art 39(1) CISG must be specific has been strictly interpreted. Eg, in Oberlandesgericht München: 7 U 2070/97 of 9 July 1997, it was held that a notice is not sufficiently specific if the deficiencies are not adequately described. In Landgericht München: 10 HKO 23750/94 of 20 March 1995, a complaint stating that 'the goods are rancid' was deemed to be insufficiently specific. In addition, in Landgericht München: 17 HKO 3726/89 of 3 July 1989, a complaint about the quality of goods which accused the seller of 'poor workmanship and improper fitting' was deemed insufficient. Similarly, in Oberlandesgericht Koblenz: 2 U 31/96 of 31 January 1997, a complaint that 'five rolls of acrylic blankets are missing' was not sufficiently specific because it did not indicate the manner in which the buyer wished the seller to cure the deficiency. See also Bundesgerichtshof: VIII ZR 306/95 of 4 December 1996, which stated that 'in order to meet the requirements of [Art 39(1) CISG], the [buyer] would have been obligated to describe the defect in such detailed manner that any misunderstandings were impossible and to enable the seller to determine unmistakably what was meant'.

134 Schwenzer in Schlechtriem (1998), 312; Schwenzer in Schlechtriem (2000), 413.

135 'The [TAILTWIST] equipment has not performed satisfactorily': Statement of Defense, No 15; 'full production was never achieved': Procedural Order No 2, Clarification No 39.

136 Statement of Defense, No 20.

consequences of whatever caused the lack of conformity,[135] it is irrelevant that BOBBINS may not have known whether the cause was the inadequacy of the training or a problem in the equipment itself.[136] The record discloses only that the 'various statements' made by BOBBINS to TAILTWIST's personnel stated that the training was 'not sufficient'. Such statements do not contain the required description of the lack of conformity in order for them to be considered as notice under Art 39(1) CISG.

Secondly, notice given under the provisions of the CISG must be in a form appropriate to the circumstances.[137] Given that in this case the lack of conformity concerned equipment worth $9,220,000,[138] and that the lack of conformity resulted in the equipment not attaining full capacity,[139] any notice should have been communicated directly to TAILTWIST's management, rather than to two personnel who were not even located at TAILTWIST's principal office.[140] Consequently, the 'various statements' made to the TAILTWIST personnel do not constitute notice under Art 39(1) CISG.

BOBBINS has failed to give notice under Art 39(1) CISG and is thus prevented from relying on a lack of conformity in the performance of the equipment to assert a price reduction under Art 50 CISG.

3.3 BOBBINS has no reasonable excuse for its failure to give notice of the lack of conformity under Article 44 CISG

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137 Article 27 CISG imputes a requirement of 'appropriate means' to the entire Convention: Schwenzer in Schlechtriem (1998), 313. Further, 'In circumstances in which a buyer is expected to give notice quickly, the buyer has to choose a more rapid means of communication than under regular circumstances, eg, sending a fax instead of a letter': Wautelet in Van Houtte (1997), 182

138 Claimant's Exhibit No 1. The full contract price is $9,300,000 minus $80,000 for the training provided.

139 Statement of Defense, No 15; Procedural Order No 2, Clarification No 39.

140 TAILTWIST's principal office was located in Sea Port, Oceania: Notice of Arbitration, No 3. 'Notice given to the employees who install equipment or to the driver who delivers the goods are considered to be given to the incorrect addressee': Magnus in Honsell, 433.

141 In most cases courts have rejected claims of a 'reasonable excuse' under Art 44 CISG. For examples see: *Rheinland Versicherungen v SrlAtlarex and Subalpina SpA* Tribunale di Vigevano: No 405 of 12 July 2000; Bundesgerichtshof: VIII ZR 259/97 of 25 November 1998; NIPR 1998, 226; Oberlandesgericht Koblenz: 2 U 580/96 of 11 September 1998; Oberlandesgericht Bamberg: 8 U 4/98 of 19 August 1998; Thüringer Oberlandesgericht: 8 U 1667/97 of 26 May 1998; Oberlandesgericht München: 7 U 4427/97 of 11 March 1998; Oberster Gerichtshof: 2 Ob 328/97 of 12 February 1998; Landgericht Erfurt: 6 O 1642/97 of 28 October 1997; Oberlandesgericht München: 7 U 2070/97 of 9 July 1997; Oberlandesgericht Karlsruhe: 1 U 280/96 of 25 June 1997; Obergericht des Kantons Luzern: 11 95 123/357 of 8 January 1997; Oberlandesgericht München: 7 U 3758/94 of 8 February 1995; Landgericht Oldenburg: 12 O 674/93 of 9 November 1994; ICC Award No 7331 of 1994; Oberlandesgericht Saarbrücken: 1 U 69/92 of 13 January 1993. The fact that the seller had no opportunity to examine the goods, because they were sent immediately to a sub-contractor, cannot be seen as a reasonable excuse under Art 44 CISG. See NIPR 1997, 284. Kennedy, 319; Sono in Bianca & Bonnell, 328. 'Examples of exceptional circumstances have included cases of a sole trader who became ill and thus was unable to give notice, and cases where notice was given incorrectly to a prior agent of the seller': Magnus in Honsell, 466 [Translated from German by the authors of this Memorandum]; Gillies & Moens, 24, n 24; Resch, 479.

142 Huber in Schlechtriem (1998), 350; Kuoppala, 28. In Oberlandesgericht Koblenz: 2 U 580/96 of 11 September 1998, the Court held that a 'reasonable excuse' required the buyer to act with reasonable care in providing for prompt examination of the goods. The buyer could not prove that it had acted with reasonable care, and thus Art 44 CISG did not apply.

Under Art 44 CISG, if a buyer does not give notice under Art 39(1) CISG, the buyer may still rely on Art 50 CISG if 'he has a reasonable excuse for his failure to give the required notice'. However, arbitral tribunals and courts have only recognised a reasonable excuse under Art 44 CISG in exceptional circumstances.[141] Further, any buyer who discovered a lack of conformity but failed to notify the seller of this deficiency within a reasonable time will always be considered to have acted 'without the care required of a businessman'.[142] However, it is necessary to take into account all the circumstances of an individual case to determine whether the careless actions of the buyer deserve to be treated with leniency.[143] Such circumstances include first, the seriousness of the breach of the duty to notify; secondly, the nature of the buyer's business; and thirdly, the experience of the buyer in its business.[144]

First, a reasonable excuse under Art 44 CISG may exist if, for example, the notification of deficiency is delivered only slightly late.[145] However, BOBBINS' breach of its contractual obligation to notify the seller under Art 39(1) CISG is not a similarly minor breach.[146] Indeed, BOBBINS did not provide notification to TAILTWIST until it wrote to TAILTWIST's Administrator in Insolvency on 10 January 2001.[147] Secondly, BOBBINS' situation as a manufacturer involved in multi-million dollar international transactions[148] can be contrasted with situations in which a reasonable excuse has been applied because the buyer was a sole trader, with few employees and limited resources.[149] Thirdly, for the same reasons, BOBBINS cannot be considered an inexperienced trader with little experience in the purchase of valuable equipment, or in the procedure for giving notice under Art 39(1) CISG.[150] BOBBINS seeks to rely on a reasonable excuse, claiming that it did not send notice to TAILTWIST because 'there was no one to whom to send any such notice'.[151] This claim is unfounded. Although the insolvency proceedings commenced on 20 April 2000, it was not until 16

143 Huber in Schlechtriem (1998), 350; Kuoppala, 28.

144 Huber in Schlechtriem (1998), 350; Kuoppala, 28.

145 In Oberlandesgericht München: 7 U 3758/94 of 8 February 1995 the buyer gave notice two months after discovery of non-conformities in the goods. The court rejected the claim of 'reasonable excuse' under Art 44 CISG, arguing that the normal limit for non-perishable goods was 8 days. See also ICC award No 7331 of 1994.

146 See for examples of a minor breach, Huber in Schlechtriem (1998), 350. See also ICC Award No 7331 of 1994.

147 Claimant's Exhibit No 5.

148 Claimant's Exhibit No 1; Procedural Order No 2, Clarification No 46.

149 See Huber in Schlechtriem (1998), 349–50; Sono in Bianca & Bonell, 326; Honnold, 283; Magnus in Honsell, 466; Official Records, 320–23; Oberlandesgericht München: 7 U 3758/94 of 8 February 1995.

150 In determining the existence of a 'reasonable excuse', it is important to consider the nature of the buyer's business. BOBBINS is a corporation involved in a multi-million dollar transaction. Further, this is not the first time that BOBBINS has been involved in such a transaction: Procedural Order No 2, Clarification No 46. See Oberlandesgericht München: 7 U 3758/94 of 8 February 1995. Art 44 CISG was introduced in response to concerns that buyers from developing countries may have difficulty in satisfying the notice requirements under Art 39(1) CISG: Enderlein & Maskow, 172; Honnold, 283; Schlechtriem (1986), 267–68; Schlechtriem (1991), 26; Van Houtte (1995), 137; Ziegel & Samson, 46–47. Eg, difficulties might occur if buyers, lacking specialist knowledge, failed to discover the deficiencies in the goods or were unaware of the need to give notice within a reasonable time. BOBBINS clearly does not come within this category.

151 Statement of Defense, No 21.

152 Statement of Defense, No 19.

153 Schwenzer in Schlechtriem (1998), 313; Andersen in Pace International Law Review, 106–07. There are several cases in which notice of non-conformity given over the telephone was adequate in

June 2000 that TAILTWIST was liquidated and its business activities terminated.[152] Thus BOBBINS had a period of 36 days, between 10 May 2000 and 16 June 2000, in which it could have sent TAILTWIST notice of the lack of conformity. Even in the event that BOBBINS doubted TAILTWIST's ability to remedy the lack of conformity, a telephone call would have sufficiently fulfilled the notice requirement under Art 39(1) CISG.[153]

Furthermore, an interpretation of Art 44 CISG which allows a corporation to resile from its obligations under Art 39(1) CISG, despite having made no effort to comply with those obligations, is not in accordance with the need to observe good faith in international trade. Article 7(1) CISG, which is used as an interpretative tool, states that 'In the interpretation of [the CISG], regard is to be had to…the need to promote…the observance of good faith in international trade'. In the circumstances of this case, it would be contrary to the need to promote good faith if BOBBINS' failure to make efforts to comply with the notice requirements of Art 39(1) CISG was excused on the basis of Art 44 CISG. Consequently, BOBBINS has no 'reasonable excuse' under Art 44 CISG for its failure to give notice of the lack of conformity, and thus cannot reduce the price in accordance with Art 50 CISG.

3.4 Artcle 40 CISG does not prevent INVESTMENT from relying on Article 39(I) CISG

Article 40 CISG states that 'The seller is not entitled to rely on the provisions of Arts 38 and 39 if the lack of conformity relates to facts of which he knew or could not have been unaware and which he did not disclose to the buyer'. Article 40 CISG 'results in a dramatic weakening of the position of the seller,' and thus 'should only be applied in special circumstances'.[154] The buyer bears the burden of proving that the seller knew or could not have been unaware of the lack of conformity and thus that it was unnecessary for BOBBINS to give notice under Art 39(1) CISG.[155] Under

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accordance with Art 39(1) CISG. However the buyer must prove that the seller received the notice. That is, the buyer must adduce evidence to show who took the telephone call on behalf of the seller, and the time of the telephone call. Oberlandesgericht Frankfurt am Main: 5 U 209/94 of 23 May 1995; Landgericht Frankfurt am Main: 3/3 O 37/92 of 9 December 1992; Landgericht Stuttgart: 3 KfH O 97/89 of 31 August 1989.

154 *Beijing Light Automobile Co Ltd v Connell Limited Partnership,* Stockholm Chamber of Commerce, Arbitration Award of 5 June 1998, 23. See also Wautelet in Van Houtte (1997), 187.

155 Schwenzer in Schlechtriem (1998), 324; Kuppola, 29; Wautelet in Van Houtte (1997), 186. *Fallini Stefano &* Co SNC v Foodik BV Arrondissementsrechtbank Roermond: 900366 of 19 December 1991.

156 Honnold, 295, states that 'could not have been unaware' seems to set a standard close to actual knowledge, in contrast to 'ought to have known' which can imply a duty to inquire. This acts as a limitation on the seller's responsibility. Similarly, the Law Commission of New Zealand, 40, states that 'could not have been unaware' appears to be close to actual knowledge. It can be contrasted with 'ought to have known' or 'discovered' which is used in several other provisions of the convention.

157 Schwenzer in Schlechtriem (1998), 321–22; Honnold, 308; Karollus, 128. The guidelines for determining conformity are contained in Art 35(2) CISG, and include the requirement that the goods must be 'fit for the purposes for which goods of the same description would ordinarily be used'.

158 Commentary on Art 40 Uniform Law on the International Sale of Goods (ULIS) demonstrates that a seller 'could not have been unaware' where there are obvious deficiencies. Commentary on Art 40 ULIS can be used in the interpretation of Art 40 CISG because 'Art 40 [CISG] was taken almost word-for-word from Art 40 ULIS': Schwenzer in Schlechtriem (1998), 321.

159 TAILTWIST was not under an obligation to investigate whether there was any possibility of non-conformity. See also Law Commission of New Zealand, 40; Grosswald Curran, 2; Kuoppala, 30.

the CISG, the standard of 'could not have been unaware' is close to the standard of actual knowledge, and thus there is little practical difference between the two standards.[156] Therefore, if TAILTWIST could not have been *aware* of facts related to the lack of conformity, it necessarily could not have had actual knowledge of those facts.

The record gives no indication that TAILTWIST possessed information that would have alerted it to the lack of conformity in the equipment's performance. In order to establish whether a seller had the requisite degree of knowledge, Art 40 CISG requires that there be an 'obvious lack of conformity'[157] and that the seller 'displayed more than gross negligence'[158] in not recognising this lack of conformity.[159] The lack of conformity in the performance of the equipment was not obvious to TAILTWIST. Indeed, the first indication that BOBBINS had experienced any problems with the equipment arose when BOBBINS asserted the price reduction in its letter of 10 January 2001 to TAILTWIST's Administrator in Insolvency.[160] Prior to this letter, the last communication from BOBBINS to TAILTWIST was to the effect that BOBBINS' own technical consultant had certified 'that the installation and commissioning tests of the TAILTWIST's equipment had been completed'.[161] Furthermore, BOBBINS never communicated to TAILTWIST that the equipment was not working at full capacity.

In addition, TAILTWIST was not grossly negligent in failing to recognise that the inadequacy of the training might lead to the lack of conformity in the performance of the equipment. TAILTWIST was not aware of the inadequacy of the training, nor that this inadequacy might potentially lead to a lack of conformity. Indeed, two of the TAILTWIST personnel remained on site at BOBBINS, which was an acceptable number under the contract,[162] and there was never any indication given to TAILTWIST of the possibility that those two personnel were not performing their work satisfactorily. Although BOBBINS made statements to TAILTWIST's employees concerning the insufficient nature of the training,[163] the employees' knowledge of these complaints is not attributable to TAILTWIST itself because the knowledge of an employee cannot be considered to become automatically part of the knowledge of the employer.[164]

TAILTWIST could not have been aware of the lack of conformity in the performance of the equipment. Consequently, Art 40 CISG does not provide an excuse for BOBBINS to escape its obligation to give notice in accordance with Art 39(1) CISG.

3.5 BOBBINS may not assert defences against INVESTMENT under the contract of 1 September 1999

BOBBINS agreed in the contract of 1 September 1999 that it would not assert against an assignee of TAILTWIST 'any defense it may have against

160 Claimant's Exhibit, No 5.

161 Statement of Defense, No 9.

162 The contract between BOBBINS and TAILTWIST did not require a specific number of personnel for the training. The contract specified that '[TAILTWIST] *personnel* will remain on site for three weeks, during which [BOBBINS] personnel will be trained in the correct operation, adjustment and maintenance of the machinery' [emphasis added]: Claimant's Exhibit No 1. BOBBINS claims that it had anticipated that four TAILTWIST personnel would conduct the training, but this is not reflected in the contract itself: Statement of Defense, No 14; Claimant's Exhibit No 5.

163 Procedural Order No 2, Clarification No 39.

164 The doctrine of *respondeat superior,* that is, that the acts and omissions of the employee are attributable to the employer, cannot be manipulated to suggest that the knowledge of an employee automatically becomes the knowledge of the employer: see, Kritzer, Highlights, 27. The notion of acts or omissions is clearly distinct from the concept of knowledge. See Grosswald Curran, 3. The record does not disclose whether TAILTWIST's employees may be considered as 'agents' or otherwise.

165 Claimant's Exhibit No 1.

[TAILTWIST] arising out of the defective performance of this contract, unless [TAILTWIST] does not in good faith attempt to remedy the deficiency'.[165] BOBBINS claims that this clause does not prevent it from asserting a price reduction in accordance with Art 50 CISG because TAILTWIST did not attempt in good faith to remedy the lack of conformity in the equipment's performance. This clause is subject to Art 19(1) Receivables Convention which provides that 'The debtor may agree with the assignor in a writing signed by the debtor not to raise against the assignee the defences…that it could raise' against the assignor prior to the assignment.[166] A waiver agreement between the debtor and assignor is formed when a specific clause is inserted at the time of the conclusion of the contract.[167] The contract concluded between BOBBINS and TAILTWIST contained a specific waiver clause, inserted into the written document, signed by both BOBBINS and TAILTWIST.[168] The clause is therefore valid under Art 19(1) Receivables Convention.

Hence the agreement between BOBBINS and TAILTWIST prevents BOBBINS from refusing payment to INVESTMENT on the basis of TAILTWIST's defective performance.[169] The only exception is if TAILTWIST did not attempt in good faith to remedy a deficiency in its contractual performance. However, BOBBINS gave TAILTWIST no opportunity to remedy any deficiency in performance. Indeed, under Arts 39(1), 40 and 44 CISG, BOBBINS failed to give notice of a lack of conformity;[170] did not provide a reasonable excuse for that failure;[171] and is unable to claim that TAILTWIST was prevented from relying on this failure.[172] TAILTWIST cannot be expected to remedy deficiencies in its performance if it was not even given the *opportunity* to remedy the deficiencies. Thus BOBBINS remains bound by its agreement not to assert defences against an assignee of TAILTWIST and cannot claim a price reduction in accordance with Art 50 CISG.

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166 Article 19(1) Receivables Convention states that 'The debtor may agree with the assignor in a writing signed by the debtor not to raise against the assignee the defences and rights of set-off that it could raise pursuant to Art 18'. Art 18 Receivables Convention deals generally with the debtor's defences and rights of set-off. The Working Group emphasised the importance of ensuring the validity of such an agreement, since it allows the assignor to increase the value of receivables and the debtor to obtain more credit or better payment terms. See Bazinas (2001), 282; Bazinas, (1998), 342; Commentary to the draft Receivables Convention Part II (A/CN.9/WG.11/WP.106), Nos 55–56.

167 The Working Group decided not to specify the point of time at which an agreement to assert to defences should be made. However during the drafting of Art 19 Receivables Convention the Working Group pointed out that in most cases an agreement not to assert defences is made at the time of the conclusion of the original contract. See Commentary to the draft Receivables Convention Part II (A/ CN.9AVG.II/WP.106), Nos 55–56; Report on Twenty-Fourth Session (A/CN.9/420), No 138.

168 Claimant's Exhibit No 1.

169 As a consequence of this agreement, BOBBINS may not refuse to pay INVESTMENT on the ground that TAILTWIST's performance is defective. BOBBINS would have a cause of action against TAILTWIST for breach of contract. Even where an assignor has become insolvent, the debtor is not allowed to make a claim against the assignee since the debtor cannot be placed in a better situation than it would be if the assignment had not taken place. Thus, under the Receivables Convention, 'the debtor bears the risk of the financial inability of its contractual partner to pay'. See Bazinas (1998), 344–45, referring to Art 21 Receivables Convention. Article 21 Receivables Convention deals with the situation where the debtor, having already payed the assignee, is not entitled to recover that sum if the assignor does not perform its obligation.

170 See Part 3.2 above.

171 See Part 3.3 above.

172 See Part 3.4 above.

4 INVESTMENT is entitled to claim interest on the sum of $3,250,000

Article 78 CISG states that 'If a party fails to pay the price or any other sum that is in arrears, the other party is entitled to interest on it'. Under Art 78 CISG, payable interest begins to accrue on the date from which the sum is due.[173] The first installment of $2,325,000 fell due on 18 April 2000, the date on which BOBBINS' consultants certified the successful installation and commissioning tests.[174] The sum of $930,000 fell due on 10 August 2000, upon completion of three months satisfactory performance of the equipment.[175] Therefore, BOBBINS is compelled to pay INVESTMENT interest on the installment of $2,325,000 from 18 April 2000 and interest on the installment of $930,000 from 10 August 2000 until it makes payment to INVESTMENT. In accordance with Procedural Order No 3, issued on 8 November 2001, this Memorandum need not deal with the *rate* of interest that BOBBINS must pay INVESTMENT[176]

BOBBINS should bear the costs of arbitration

Article 31 AAA Rules provides procedural guidelines for the allocation of costs between the parties to an arbitration. This Article states that The Tribunal may apportion such costs among the parties if it determines that such apportionment is reasonable, taking into account the circumstances of the case'. Apart from the fees and expenses of the arbitrators and the expenses incurred by the administrator and the Tribunal, under Art 31(d), the Tribunal is also allowed to award to the successful party the costs of their legal representation.[177] The failure of BOBBINS to meet its obligations with regards to payment caused the dispute that has led to this arbitration.[178] In the interests of reasonableness, under Art 31 AAA Rules, BOBBINS should pay all costs of the Tribunal. In addition, in accordance with Art 31(d) AAA Rules, BOBBINS should bear INVESTMENT'S legal costs. In accordance with Procedural Order No 3, this memorandum need not address the calculation or apportionment of the costs of arbitration.[179]

INVESTMENT commends the arguments in this memorandum to the Arbitral Tribunal's discretion in order to achieve a just and fair resolution of the dispute.

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173 Eberstein & Bacher in Schlechtriem (1998), 594; Corterier, 39.
174 Claimant's Exhibit No 1; Statement of Defense, No 12.
175 Claimant's Exhibit No 1; Statement of Defense, No 20.
176 Procedural Order No 3 states that The memoranda…should not consider the following issues… The rate of interest that [BOBBINS] should pay to [INVESTMENT] if it has to pay [INVESTMENT] any amount of the purchase price assigned'.
177 According to Art 31(d) AAA Rules, the Tribunal may award 'the reasonable costs for legal representation of a successful party'.
178 The conduct of the parties is generally considered to be a relevant factor in allocating the costs of arbitration. See Huleatt-James & Gould, 104–05.
179 Procedural Order No 3 states that 'The memoranda…should not consider the following issues… Any calculation or apportionment of the costs of the arbitration'.

The University of Queensland Memorandum for the Respondant

List of abbreviations

§	Section
AAA	Rules American Arbitration Association International Arbitration Rules 2000
AATA	Administrative Appeals Tribunal (Australia)
All ER	All England Law Reports
ALR	Australian Law Reports
BGB	Bürgerliches Gesetzbuch (German Civil Code)
BOBBINS	West Equatoriana Bobbins SA
Cass	Corte di Cassazione
CIETAC	China International Economic and Trade Arbitration Commission
2d Cir	United States Court of Appeal Second Circuit
3d Cir	United States Court of Appeal Third Circuit
9th Cir	United States Court of Appeal Ninth Circuit
CISG	The United Nations Convention on Contracts for the International Sale of Goods 1980
Co	Company
Corp	Corporation
D Del	United States District Court, District of Delaware
DDC	United States District Court, District of Columbia
D Mass	United States District Court, District of Massachusetts
Ed	Editor
Eds	Editors
et al	And others
EWHC Admin	High Court of England and Wales
F 2d	Federal Reporter, Second Series
F3d	Federal Reporter, Third Series
F Supp	Federal Supplement
Giust Civ	Giustizia Civile
GmbH	Gesellschaft mit beschränkter Haftung
HCJ	High Court of Justice
ICC	International Chamber of Commerce
ICC	Rules International Chamber of Commerce Rules of Arbitration
ICDR	International Center for Dispute Resolution
IEHC	High Court of Ireland

Inc	Incorporated
INVESTMENT	Futura Investment Bank
KB	High Court of Justice (King's Bench) (England)
LCIA Rules	London Court of International Arbitration Rules 1998
Lloyd's L Rep	Lloyd's Law Reports
Ltd	Limited
Mfg	Manufacturing
Model Law	UNCITRAL Model Law on International Commercial Arbitration 1985
n	Numero
New York Convention	United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards 1958
NJW	Neue Juristische Wochenschrift
No	Number
Nos	Numbers
NSWLR	New South Wales Law Reports
NY	New York Court of Appeal Reports *or* New York
NY2d	New York Court of Appeal Reports Second Series
NY Ct App	New York Court of Appeal
NZLR	New Zealand Law Reports
Ont Sup CJ	Ontario Superior Court of Justice
Pty	Proprietary
QB	High Court of Justice (Queen's Bench) (England)
RGZ	Entscheidungen des Reichsgerichts in Zivilsachen (Germany)
Riv.dir.int.priv.proc.	Rivista di diritto internazionale private e processuale
RIW	Recht der Internationalen Wirtschaft
SA	Société Anonyme
SDNY	United States District Court, Southern District of New York
Soc	Société
SpA	Società per azioni
Srl	Società a responsabilità limitata
SupCt	Supreme Court
TAILTWIST	Tailtwist Corp
UCC	Uniform Commercial Code (United States)
UK	United Kingdom
ULIS	Uniform Law on the International Sale of Goods 1978
UNCITRAL	United Nations Commission on International Trade Law
UNIDROIT	International Institute for the Unification of Private Law
UNIDROIT Principles	UNIDROIT Principles of International Commercial Contracts, 1994
US	United States Supreme Court Reports
US Dist	United States District Court
US Sup Ct	United States Supreme Court

v	Versus
Va App	Virginia Court of Appeal Reports
Va Ct App	Virginia Court of Appeal
WIPO	World Intellectual Property Organisation
YB	Yearbook Commercial Arbitration
ZPO	ZivilprozeBordnung (Germany)
ZR	Zivilrecht

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Statement of purpose

The Respondent, West Equatoriana Bobbins SA (BOBBINS), has prepared this Memorandum in compliance with the Arbitral Tribunal's Procedural Order No 1, issued on 6 October 2001.
It is argued that:

- No valid arbitration agreement exists between BOBBINS and the Claimant, Futura Investment Bank (INVESTMENT);
- BOBBINS is not liable to make payment of $2,325,000 to INVESTMENT;
- BOBBINS is entitled to declare a reduction of $930,000 in the contract price;
- INVESTMENT should bear the costs of arbitration and BOBBINS' legal costs.

In relation to each of these four issues, BOBBINS summarises the arguments made by INVESTMENT in the Memorandum for the Claimant prepared by Université de Fribourg. These summaries are italicised and boxed. Where BOBBINS refers to an issue which is not addressed in the Memorandum for the Claimant, the heading pertaining to that issue is followed by [NEW ARGUMENT]. In arguing these propositions, BOBBINS will demonstrate the legal and factual bases for its claim, and will respond to INVESTMENT'S arguments.

Arguments

I There is no valid arbitration agreement between BOBBINS and INVESTMENT

INVESTMENT claims that BOBBINS is bound to arbitrate this dispute because:

1. *The arbitration clause contained in the original contract of 1 September 1999 was necessarily transferred from TAILTWIST to INVESTMENT as a result of TAILTWISTs assignment to INVESTMENT of the right to receive payment from BOBBINS (Memorandum for the Claimant, Université de Fribourg, 3–4);*
2. *BOBBINS consented to the transfer of the arbitration clause from TAILTWIST to INVESTMENT (Memorandum for the Claimant, Université de Fribourg, 5); and*
3. *The arbitration agreement between BOBBINS and INVESTMENT is formally valid (Memorandum for the Claimant, Université de Fribourg, 6–7).*

1.1 The arbitral tribunal has authority to rule on its own jurisdiction

This dispute concerns an arbitration clause originally contained in a contract concluded between BOBBINS and TAILTWIST on 1 September 1999.[1] INVESTMENT claims that this arbitration clause was subsequently transferred from TAILTWIST to

1 Claimant's Exhibit No 1: The clause states that 'Any controversy or claim between [TAILTWIST] and [BOBBINS] arising out of or relating to this contract shall be determined by arbitration by the American Arbitration Association by a panel of three arbitrators with the place of arbitration being Vindobona, Danubia and the language of arbitration English'.

2 Notice of Arbitration, Nos 11–14; Memorandum for the Claimant, Université de Fribourg, 3–7.

3 Article 1(1) AAA Rules states that 'Where parties…have provided for arbitration of an international dispute by the American Arbitration Association without designating particular rules, the arbitration shall take place in accordance with these rules'. BOBBINS and TAILTWIST, parties to the original arbitration agreement, are located in Equatoriana and Oceania respectively, while INVESTMENT

INVESTMENT, and that as a result, INVESTMENT may now compel BOBBINS to arbitration.[2] The clause contained in the contract of 1 September 1999 incorporated the American Arbitration Association International Arbitration Rules (AAA Rules).[3] Article 15(1) AAA Rules states that the Arbitral Tribunal 'shall have the power to rule on its own jurisdiction, including any objections with respect to the existence, scope or validity of the arbitration agreement'. Therefore, while BOBBINS disputes the existence of any arbitration agreement between it and INVESTMENT, BOBBINS acknowledges that the Arbitral Tribunal is authorised to determine the existence, scope and validity of the alleged arbitration agreement between BOBBINS and INVESTMENT.[4]

1.2 The arbitration clause was not automatically transferred to INVESTMENT

On 29 March 2000, TAILTWIST assigned to INVESTMENT its right to receive payment of the two outstanding installments, of $2,325,000 and $930,000, due from BOBBINS under the contract of 1 September 1999.[5] BOBBINS has no reason to dispute that the right to receive payment was validly assigned to INVESTMENT.[6] However, BOBBINS denies INVESTMENT'S claim that the assignment of the right to receive payment also 'necessarily' transferred to INVESTMENT the arbitration clause contained in the contract of 1 September 1999.[7] This claim is based on an inaccurate application of what is commonly described as the 'automatic transfer rule'.[8] Under this rule, where a contractual right to payment has been validly assigned to a third party, other rights deriving from the original contract may be automatically transferred with the assigned right.[9] BOBBINS does not dispute the existence of the automatic transfer rule, but argues that in this case the rule does not extend to the transfer of the arbitration clause for three reasons. First, the arbitration clause was not automatically transferred because, according to the doctrine of separability, the clause is separable from the main contract. Secondly, the wording of the arbitration clause limits the parties' consent to arbitration only to disputes arising between BOBBINS and TAILTWIST. Thirdly, the automatic transfer of this arbitration clause would be contrary to the mandatory formal validity requirements of the law of Danubia, the seat of arbitration.[10]

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located in Mediterraneo: Notice of Arbitration, Nos 1–3. Thus, because this dispute is international in nature and because the parties have provided for arbitration by the American Arbitration Association (Claimant's Exhibit No 1), the AAA Rules apply.

4 This is an articulation of the principle in international arbitration that an arbitral tribunal is competent to rule on its own jurisdiction. This principle is usually referred to as 'competence-competence'. It allows the tribunal to make such inquiries as are necessary to resolve the dispute regarding its jurisdiction. See Craig, Park & Paulsson, 59; Derains & Schwartz, 99–102; Herrera Petrus, 397. The principle is also embodied in various arbitration rules, eg, Article 15(1) ICC Rules; Article 23.1 LC1A Rules.

5 Notice of Arbitration, No 7; Claimant's Exhibit, Nos 2 and 3.

6 Furthermore, TAILTWIST's Administrator in Insolvency, Dr Herbert Strict, confirmed the validity of the assignment on 17 October 2000: Respondent's Exhibit No 4.

7 Notice of Arbitration, No 12 states that 'When INVESTMENT was assigned the right to payment under the contract between BOBBINS and TAILTWIST, it was necessarily assigned the right to enforce its rights in the same manner as the assignor, TAILTWIST, would have had'.

8 Girsberger & Hausmaninger, 122–23.

9 The 'automatic transfer rule' provides that where a contractual right to receive payment has been validly assigned to a third party, security rights deriving from the original contract are automatically transferred with the assigned right: Girsberger & Hausmaninger, 122–23.

10 Claimant's Exhibit No 1; Notice of Arbitration, No 14; Statement of Defense, No 2.

(a) The arbitration clause was not automatically transferred because it is separable from the main contract

Under the doctrine of separability an arbitration clause is separable from the contract in which the clause is contained: 'there are in fact two separate contracts.'[11] One of the practical consequences of the doctrine is that the 'assignment of a right under the substantive contract could not by itself operate as a transfer of a right or obligation under the arbitration clause contained in that contract'.[12] Thus, the assignment of a right to receive payment under the main contract does not result in the transfer of the separable arbitration clause. In this way, rights arising under an arbitration clause must be distinguished from rights, such as mortgages, guarantees, or other rights securing payment, which are automatically transferred with any assignment of a right to receive payment.[13] Therefore, no arbitration agreement exists between BOBBINS and INVESTMENT because arbitration

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11 Redfern & Hunter, 154. This concept is also expressed as the 'autonomy of the arbitration clause'. See further David, 193: 'There is a clear tendency today, in a great number of countries, to consider that an arbitration clause is separable from the main contract in which it has been stipulated.' See also Berger, 119; Delaume, 301; Doak Bishop (2000), 8; Doak Bishop (1998), 1137; Herrera Petrus, 401; Garnett, Gabriel, Waincymer & Epstein, 37; Gross, 306; Huleatt-James & Could, 13; Lepri, 368–69; Rubino-Sammartano, 136. For cases and awards, see *Sidor v Linea Naviera de Cabotoje* 1999 US Dist LEXIS 12705 (SDNY 1999), 11; *Ferris v Plaister* (1994) 34 NSWLR 474,485–87; *Harbour Assurance Ltd v Kansa Ltd* [1992] 1 Lloyd's L Rep 81, 88; *Fung Sang Trading Ltd v Kai Sun Sea Products & Food Co Ltd* (unreported decision of Supreme Court of Hong Kong of 29 October 1991); *Prima Paint Corp v Flood & Conklin Mfg* 388 US 395 (US Sup Ct 1967), 403–04; Cass, of 17 September 1970, n 1525 in (1970) I Giust civ 1565; Cass, of 19 May 1989, n 2406 in (1989) I Giust civ 2605; ICC Arbitration Case No 5943 of 1996, 1016; ICC Arbitration Case No 5485 of 1989, 160. The principle of separability has been recognised in the Transnational Database Lex Mercatoria Principles, No XIV. 1, as well as in most national arbitration laws and institutional arbitration rules: Article 16 Model Law; Article 15(2) AAA Rules; Article 6(2) ICC Rules; Article 23.1 LCIA Rules; Section 30 *Arbitration Act* 1996 (UK); Article 19 PRC Arbitration Law 1994 (China) (translated by Jianlin & Yuwu); §1040(1) ZPO (Germany); Article 1697(2) Sixième Livre du Code Judiciaire (Belgium); Article 1053 Vierde Boek van het Wetboek van Burgerlijke Rechtsvordering (The Netherlands).

12 Veeder, 285. This principle has been endorsed in *Sojuznefteexport v Joc Oil* (1984) in 18 Y.B. 92, 99. For commentary on this case, see Doak Bishop (1998), 1138–1139. See also Runeland, 8. A similar principle is supported in Sweden: see Ulrichs & Akerman, 79.

13 INVESTMENT asserts that domestic law and Article 10 Receivables Convention (See Note 53 for discussion on the application of the Receivables Convention) support the application of the automatic transfer rule to an arbitration clause: Memorandum for Claimant, Université de Fribourg, 3. Article 10(1) Receivables Convention provides that 'A personal or property right securing payment of the assigned receivable is transferred to the assignee without a new act of transfer'. However, Article 10(1) Receivables Convention is intended to provide for the automatic transfer of security rights only: Bazinas (2001), 275–76; Bazinas (1998), 332. See Analytical Commentary on the draft Receivables Convention (A/CN.9/489), No 105; Report on Twenty-Sixth Session (A/CN9/434), No 140; Commentary to the draft Receivables Convention Part I (A/CN9/WGII/WP105), No 89. In the Working Party, it is clear that 'rights securing payment' is to be narrowly interpreted: Note by the Secretariat (A/CN9/WGII/WP96), Article 13[14], Remarks, No 2. An arbitration clause, which provides for a dispute resolution mechanism, is clearly not a security right and therefore the automatic transfer rule embodied in Article 10 Receivables Convention does not apply. Domestic legislation demonstrates that security rights are automatically transferred with the assignment of the right to receive payment. Eg, Article 170 Code des Obligations (Switzerland) states that 'The ancillary and preferential rights travel with the assigned claim, unless they are inseparably connected with the assignor' (translated by the authors of this memorandum). Article 1692 Code Civile (France) provides that 'The sale or assignment of a contractual right includes the accessory rights, such as guarantees, preferential rights and mortgages' (translated by the authors of this memorandum). § 401 BGB

rights are not automatically transferred with an assignment of a right to receive payment.

(b) The arbitration clause was limited to disputes arising between BOBBINS and TAILTWIST

(i) The automatic transfer rule does not apply if the parties have expressly consented to arbitrate only with each other

As INVESTMENT concedes, an arbitration clause will not be automatically transferred if the 'particular circumstances justify a different solution'.[14] One 'particular circumstance' justifying an exception to the application of the automatic transfer rule is presented when an arbitration clause 'is so worded as to make it clear that it binds only the original parties'.[15] This exception is based on the principle that the parties to an arbitration agreement may limit their consent to arbitrate so that they are bound to arbitrate only with each other.[16] An agreement to arbitrate constitutes a serious and significant forfeiture of the right to seek recourse in domestic courts, and this forfeiture must occur only if both parties to an arbitration agreement consented to refer a dispute arising between them to arbitration.[17] Therefore, a party cannot be

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(Germany) states that 'With the assigned claim, the rights of mortgage, ship mortgage or pledge which exist because of it, like the rights arising from a guarantee established for it, pass to the assignee' (translated by Forester, Goren & Ilgen, 64). Article 1263 Codice Civile (Italy) provides that 'By effect of the assignment, the claim is transferred to the assignee with any privileges…real…or personal…guarantees, and other accessories' (translated by Beltramo, Longo & Merryman).

14 Memorandum for the Claimant, Université de Fribourg, 3.

15 Mustill & Boyd, 138.

16 See also Gaillard & Savage, 434; Werner, 15–16; Reichsgericht: VII ZR 183/34 of 27 November 1934; Reichsgericht: VII ZR 321/08 of 8 December 1903; ICC Arbitration Case No 3281 of 1981. In *Bengiovi v Prudential-Bache Securities Inc* 1985 US Dist LEXIS 20391 (DDC 1985), a third party non-signatory was not entitled to rely on an arbitration agreement. The agreement made clear reference to the original co-contractors' names, and did not contain the third party's name. A second exception to the automatic transfer rule is where the contract has been entered into *intuitu personae*. A contract *intuitu personae* is an agreement which can only be performed by the original contracting parties, because the identity of the parties was a fundamental consideration in the contracting process. Such a contract may arise where there is a special relationship of trust between the two parties: *Canister Co v National Can Corporation* 71 F Supp 45 (DDel 1947), 47–48; *Meyer v Washington Times Co* 76 F 2d 988 (DDC 1935), 990; *Charles Devlin v The Mayor, Aldermen and Commonalty of the City of New York* 63 NY 8 (NY Ct App 1875), 16. Redfern & Hunter, 135. 'Arbitration is a consensual process based on an arbitration agreement': Hill, 503. See also Berger, 118; Coe, 55; De Boisseson, 68; Gaillard & Savage, 253; Holtzmann & Neuhaus, 260; Park (1998), 264; Park (1996), vA2; Poznanski, 71; Rosen, 599. For there to be an agreement between parties, there must be a 'meeting of the minds': Ripert, 598. Accordingly, a party cannot be required to arbitrate a dispute which that party has not agreed to submit to arbitration: *Three Valleys Municipal Water District v EF Hutton & Co* 925 F 2d 1136 (9th Cir 1991), 1142; *AT & T Technologies, Inc v Communications Workers of America* 475 US 643 (US Sup Ct 1986), 648; *Barrowclough v Kidder, Peabody & Co, Inc* 752 F 2d 923 (3d Cir 1985), 937–38; *United Steelworkers of America v Warrior & Gulf Navigation Co* 363 US 574 (US Sup Ct 1960), 582.

17 See *Fuller Promotions v Arlo Guthrie, Sutton Artist Corporation and Route 183 Productions, Inc* 565 F2d 259 (2d Cir 1977), 261; *Parsons and Whitiemore Overseas Co v Société Générale De L'Industrie De Papier* 508 F2d 969 (2d Cir 1974), 975; *Washington-Baltimore Newspaper Guild, Local 35 v The Washington Post Co* 442 F 2d 1234 (DDC 1971), 1238. See also Berger, 138; Fox, 283; Heuman, 49; Redfern & Hunter, 5.

compelled to arbitrate unless it consented to the involvement of the other participant in the arbitration; a party's consent to arbitrate *in general* is not sufficient.[18]

(ii) BOBBINS expressly consented to arbitrate only with TAILTWIST

BOBBINS argues that it consented to arbitrate only with TAILTWIST, and never consented to arbitrate with an assignee of TAILTWIST's rights under the contract of 1 September 1999.[19] In order to determine whether BOBBINS in fact consented to arbitrate with INVESTMENT, the arbitration clause in the contract must be interpreted in accordance with 'the same law, or rules of law, as the other provisions of the contract'.[20] The rules governing the contract of 1 September 1999 are contained in the United Nations Convention on Contracts for the International Sale of Goods (CISG). The CISG applies to the contract because, at the time of the conclusion of the contract, BOBBINS and TAILTWIST had their places of business in Equatoriana and Oceania respectively, both of which are 'Contracting States' within the meaning of Article 1(1)(a) CISG.[21]

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18 A party can only be compelled to arbitrate when it has consented to the involvement of the other participants in the arbitral process. It is for this reason that courts will not order joinder of parties in arbitral proceedings in the absence of consent: *The United Kingdom v The Boeing Company* 998 F 2d 68 (2d Cir 1993); *Weyerhauser Co v Western Seas Shipping Co* 743 F 2d 635 (9th Cir 1984); *Ore & Chemical Corp v Stinnes Interoil Inc* 606 F Supp 1510 (SDNY 1985); *Oxford Shipping Co Ltd v Nippon Yusen Kaisha* [1984] 3 All ER 835.

19 This does not mean that BOBBINS' consent to the assignment from TAILTWIST to INVESTMENT was necessary. A distinction must be drawn between consenting to the assignment and consenting, during the contractual negotiation process, to arbitrate with an assignee of TAILTWIST.

20 Redfern & Hunter, 157. See also Coe, 133–34; Holtzmann & Neuhaus, 259–60; Huleatt-James & Gould, 34; Piltz (2000), 556; *Kahn Lucas Lancaster, Inc v Lark International Ltd* 956 F Supp 1131 (SDNY 1997), 1134; F*ilanto, SpA v Chilewich International Corp* 789 F Supp 1229 (SDNY 1992), 1237; *David L Threlkeld & Cov Metallgesellschaft Ltd* 923 F 2d 245 (2nd Cir 1991), 249–50. In order to determine whether an assignee falls within the scope of an arbitration agreement, the intent of the parties to the original contract must be ascertained in accordance with general contractual principles: *Local 205, Community and Social Agency Employees' Union, District Council 1707 AFSCME, AFL-CIO v Day Care Council of New York, Inc* 992 F Supp 388 (SDNY 1998), 392; *W.J.Nolan & Co, Inc, William Nolan and Matthew Gershon v Midway Federal Credit Union* 913 F Supp 806 (SDNY 1996), 812; *Thomas S.McPheeters, III v McGinn, Smith and Company, Inc; Robert O.O'Farrell; and David Smith* 953 F 2d 771 (2d Cir 1992), 773; *Creative Securities Corp, et al, v Bear Stearns & Co, et al* 671 F Supp 961 (SDNY 1987), 965; *McAllister Brothers, Inc v A & S Transportation Co* 621 F 2d 519 (2d Cir 1980), 524. In accordance with general contractual principles, in order to ascertain whether a party is bound by a written arbitration agreement, 'the sole issue for determination is whether…there was the requisite "meeting of the minds" between the parties': *Sidor v Linea Naviera de Cabotaje* 1999 US Dist LEXIS 12705 (SDNY 1999), 13–14. See also *Deloitte Noraudit A/S v Deloitte Haskins & Sells, US and J Michael Cook* 9 F3d 1060 (2d Cir 1993), 1064; *Fisser v International Bank* 282 F 2d 231 (2d Cir 1960), 233. These authorities deal generally with non-signatories to arbitration agreements. INVESTMENT, as assignee, is a non-signatory to the arbitration agreement.

21 Article 1 (1)(a) CISG states that 'This Convention applies to contracts of sale of goods between parties whose places of business are in different States…when the States are Contracting States'. Both Oceania and Equatoriana are parties to the CISG (Notice of Arbitration, No 16) and have incorporated the CISG into their domestic law: Procedural Order No 2, Clarification No 2. Additionally, the contract itself provided that it was subject to the CISG 'and, in regard to any questions not governed by it, to the law of Oceania': Claimant's Exhibit No 1. Article 3(2) CISG states that the CISG 'does not apply to contracts in which the preponderant part of the obligations of the party who furnishes the goods consists in the supply of labour or other services'. This provision does not negate the applicability of the CISG to the contract of 1 September 1999. Services will constitute the 'preponderant part of the obligations' under Article 3(2) CISG if they constitute 'considerably more than 50% of the price': Schlechtriem (1986), 31. Honnold, 58–59, considers that services will be a preponderant part of the obligations if they constitute more than 15% of the price. See also ICC Arbitration Case No 7153 of 1992; Bonell & Liguori, 1; Ferrari (1995), 11; Gabriel, 18–19; Herber in Schlechtriem (1998), 39. The services

Thus, the arbitration clause in the contract must be interpreted in accordance with the CISG, and in particular, Article 8 CISG.[22] Article 8(1) CISG provides that 'statements made by and other conduct of a party are to be interpreted according to his intent where the other party knew or could not have been unaware what that intent was'. However, the subjective approach of Article 8(1) CISG requires proof of the actual intent of the parties.[23] Where, as in this case, there is insufficient evidence of the parties' subjective intent, Article 8(2) CISG provides that 'statements made by and other conduct of a party are to be interpreted according to the understanding that a reasonable person of the same kind as the other party would have had in the same circumstances'.[24] The clause itself stated that 'Any controversy or claim *between Tailtwist Corp* and *West Equatoriana Bobbins SA* arising out of or relating to this contract shall be determined by arbitration' [emphasis added].[25] This clause is almost identical to the American Arbitration Association 'standard clause',[26] differing in one significant respect: it makes *express* reference to the parties to whom the clause applies.[27] Viewed objectively, this deviation from the standard clause demonstrates the intent of BOBBINS and TAILTWIST to arbitrate only with each other. Indeed, under Article 8(2) CISG, a reasonable person in the position of BOBBINS or TAILTWIST would have interpreted this clause as specifically

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in the contract of 1 September 1999 account for $80,000 out of $9,300,000: Claimant's Exhibit No 1. This is less than 1% of the contract price and clearly is not the preponderant part of the obligations of TAILTWIST, the party who furnished the goods.

22 According to Enderiein & Maskow, 61, 'Article 8 [CISG] governs the interpretation of statements and the otherwise legally relevant conduct of the parties'. See also Famsworth in Bianca & Bonell, 97–98; Honnold, 61; Schlechtriem in Schlechtriem (1998), 113; Secretariat Commentary in Official Records, 18; Landgericht Heilbronn: 3 KfH 653/93 of 15 September 1997; Oberlandesgericht Zweibrücken: 8 U 46/97 of 31 March 1998; Oberster Gerichtshof: 10 Ob 518/95 of 6 February 1996.

23 Enderiein & Maskow, 63; Famsworth in Bianca & Bonell, 98; Honnold, 118; Schlechtriem (1986), 39.

24 Article 8(1) CISG provides that a party's intent is to be determined subjectively: Enderiein & Maskow, 62–64; Honnold, 164; Karollus, 60. See also ICC Arbitration Case No 9187 of 1999; ICC Arbitration Case No 9117 of 1998. However, if the parties' intentions cannot be ascertained subjectively, Article 8(2) CISG provides for an objective test: August, 430; Fioravanti, 34; Gabriel, 30–31; Gillies & Moens, 12; Hascher in Arnaldez, Derains & Hascher, 598–99; Junge in Schlechtriem (1998), 71. Article 4.2 UNTDROIT Principles is analogous to Article 8(2) CISG: Bonell (1978), 430; Bonell (1997), 144; Ferri in Bonell & Bonelli, 130; Moens, Cohn & Peacock in Bonell (1999), 37–38. The record does not disclose BOBBINS' subjective intent whilst drafting and signing the arbitration clause, therefore Article 8(2) CISG must be applied in order to determine objectively BOBBINS' intent. The test is 'how a reasonable person in the same circumstances would have understood the declaration': Junge in Schlechtriem (2000), 141. See also Berlingieri, 329. When determining the objective intent of the parties, 'all relevant circumstances' may be taken into account: Article 8(3) CISG.

25 Claimant's Exhibit No 1.

26 The 'standard' American Arbitration Association clause accompanying the AAA Rules states that 'Any controversy or claim arising out of or relating to this contract shall be determined by arbitration in accordance with the International Arbitration Rules of the American Arbitration Association'. The Association further states that 'The parties may wish to consider adding (a) "the number of arbitrators shall be (one or three)"; (b) "The place of arbitration shall be (city and/or country)"; or (c) "the language(s) of the arbitration shall be…"'.

27 Further, none of the major permanent arbitral institutions (ICC, CIETAC, Stockholm Chamber of Commerce, WIPO, LCIA and AAA) recommend including the parties' names in their standard clauses: see Wheeler, 111–13.

and expressly applying only to the two parties named in the clause. The parties' consent was thus limited to disputes arising between them. Accordingly, INVESTMENT is effectively excluded from relying on the arbitration clause contained in the contract.[28]

Therefore, due to the limitation on the arbitration clause contained in the contract of 1 September 1999, BOBBINS consented only to arbitrate with TAILTWIST and consequently, no arbitration agreement exists between BOBBINS and INVESTMENT.

(c) The alleged arbitration agreement between BOBBINS and INVESTMENT is formally invalid

In order to be valid and enforceable, the alleged arbitration agreement between BOBBINS and INVESTMENT must comply with the mandatory formal validity requirements imposed by the law of Danubia, the seat of arbitration.[29] Danubia has adopted the UNCITRAL Model Law on International Commercial Arbitration (Model Law),[30] which applies to all international commercial arbitrations conducted in Danubia.[31] Further, the enforceability of foreign arbitral awards in Méditerranée and Equatoriana is governed by the United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards (New York Convention).[32] BOBBINS argues that the stringent formal validity requirements imposed by the Model Law and the New York Convention must not be circumvented on the basis of a purported application of the automatic transfer rule.

Under Article V(1)(a) New York Convention, domestic courts may refuse to recognise and enforce an arbitral award if the arbitration agreement does not comply with the law of the seat of arbitration.[33] Therefore, it is necessary that the alleged arbitration

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28 This limitation is supported by Article 15(1) Receivables Convention, which states that 'an assignment does not, without the consent of the debtor, affect the rights and obligations of the debtor, including the payment terms'. In this case, a transfer of the arbitration clause, despite the express wording of the clause, and in the absence of BOBBINS' consent, results in BOBBINS' rights and obligations being changed. Whereas BOBBINS was originally obliged to arbitrate only with TAILTWIST, a transfer of the arbitration clause would oblige BOBBINS to arbitrate with INVESTMENT. This change in obligations is thus contrary to the principle of debtor protection contained in Article 15(1) Receivables Convention. See Note by Secretariat (A/CN9/WGII/WP98), Article 7, Nos 1 and 2; Report on Twenty-Fourth Session (A/CN9/420), No 64; Report on Twenty-Sixth Session (A/CN9/434), No 87; Report on Twenty-Seventh Session (A/CN9/445), Article 7(1); Note by the Secretariat (A/CN9/WGII/WP93), Article 7, Nos 1 and 2; Note by the Secretariat (A/CN9/WGII/WP96), Article 7; Commentary to the Draft Receivables Convention Part II (A/CN9/WGII/WP106), No 29; Analytical Commentary on the Draft Receivables Convention (A/CN9/489), Nos 131–33.

29 Danubia is the seat of arbitration: Claimant's Exhibit No 1; Notice of Arbitration, No 14; Statement of Defense, No 2. Further, the letters of 5 June 2001 and 15 June 2001 from Eleni Lappa, ICDR Supervisor, recognised that the arbitration agreement provides that the arbitration will be held in Vindobona, Danubia.

30 Notice of Arbitration, No 18.

31 This dispute falls within the Model Law's definitions of 'international' (see Article 1(3)(a)), 'commercial' (see note to Article 1(1) Model Law) and 'arbitration' (see Article 2(a) Model Law).

32 Notice of Arbitration, No 19. Mediterraneo and Equatoriana, as the locations of INVESTMENT and BOBBINS respectively (Notice of Arbitration, Nos 1 and 2), are the countries in which any enforcement is likely to occur. In any event, Danubia and Oceania are also parties to the New York Convention (Notice of Arbitration, No 19).

33 See Poznanski, 87–88; Redfern & Hunter, 461.

agreement complies with the Model Law and, in particular, with the 'mandatory provisions' of the Model Law.[34] Article 7(1) Model Law states that 'An arbitration agreement may be in the form of an arbitration clause in a contract or in the form of a separate agreement'. This provision must be read in conjunction with Article 7(2) Model Law, which commentators consistently identify as one of the Model Law's mandatory provisions.[35] Article 7(2) Model Law states:

> 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.

A similar mandatory writing requirement is contained in Article II(2) New York Convention.[36] BOBBINS does not dispute that, under Article 7(2) Model Law and Article II(2) New York Convention, the contract of 1 September 1999 contained a valid arbitration agreement between BOBBINS and TAILTWIST.[37] However, BOBBINS disputes that any formally valid arbitration agreement was ever concluded between BOBBINS and INVESTMENT.[38] BOBBINS and INVESTMENT never signed any document containing an arbitration agreement; nor does the record disclose any 'exchange of letters, telex, telegrams or other means of telecommunication which provide a record of the agreement' between BOBBINS and INVESTMENT.[39] Further, there has been no 'exchange of statements of claim and defence in which the existence of an agreement

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34 The relevant provisions of the Model Law for the purposes of this dispute are contained in Articles 7 and 19 Model Law. Article 19(1) Model Law states that '*Subject to the provisions of this Law,* the parties are free to agree on the procedure to be followed by the arbitral tribunal in conducting the proceedings' [emphasis added]. Article 19(1) Model Law was described by the UNCITRAL Secretariat as 'the most important provision of the Model Law': Model Law Commentary (A/CN.9/ 264), No 1. In subjecting the procedure in the arbitral proceedings to the 'provisions' of the Model Law, Article 19(1) effectively limits the discretion of the Arbitral Tribunal to determine the conduct of the proceedings. In particular, the discretion of the Arbitral Tribunal is limited by the 'mandatory' provisions of the Model Law. 'Mandatory [provisions] cannot be derogated from by the contract': Hill, 491; Hoellering, 25.

35 The mandatory provisions were not enumerated in the Model Law because of 'drafting difficulties': Fourth Secretariat Note (A/CN.9/WG.II/WP.50), No 9; Holtzmarm & Neuhaus, 1119–20. However, commentators consistently identify Article 7(2) Model Law, which contains the 'in-writing' requirement, as a mandatory provision: Holtzmann & Neuhaus, 260; Redfem & Hunter, 141. See also Coe, 128; Gaillard & Savage, 374 (regarding the analogous provision in the New York Convention).

36 Article 7(2) Model Law was based on the writing requirement in Article 11(2) New York Convention: Kaplan (1996), 36. Indeed, 'any award that satisfied the requirements of Article 7 [Model Law] would be enforceable under the [New York] Convention': Holtzmann & Neuhaus, 262. See also Redfern & Hunter, 512. The principal purpose of the writing requirement in Article 11(2) New York Convention is to ensure that the parties are 'fully aware' of having chosen to arbitrate their disputes: Bortolotti, 449.

37 Statement of Defense, Nos 2–5.

38 Statement of Defense, No 3.

39 Article 7(2) Model Law requires a document in writing 'signed by the parties'. Although the accepted view is that the parties' signatures are not necessary, there must be sufficient written evidence of an agreement between the parties: Kaplan (1995), 24–25; Redfern & Hunter, 141. See also *Hissan Trading v Orkin Shipping* (unreported, CL 39, 8 September 1992), where a bill of lading was not signed by the parties. The Court held that, although there was evidence of written correspondence between the parties' solicitors prior to the commencement of proceedings, there was insufficient written evidence of an agreement to arbitrate under Article 7(2) Model Law. Similarly, under the New York Convention, there must be written evidence of an agreement to arbitrate: Redfern &

is alleged by one party and not denied by another.'[40] Finally, as there has never been any contractual relationship between BOBBINS and INVESTMENT,[41] there cannot be any reference in a contract concluded between BOBBINS and INVESTMENT to a document containing an arbitration clause.[42] Thus, any application of the automatic transfer rule to this arbitration clause would result in a formally invalid and unenforceable arbitration agreement between BOBBINS and INVESTMENT.

Further, INVESTMENT claims that, because the contract of 1 September 1999 included a clause expressly providing for the possibility of assignment,[43] BOBBINS impliedly intended that the arbitration clause be transferred as part of such an assignment.[44] However, given that the parties expressly consented to arbitrate only with each other, the mere *existence* of this clause does not provide evidence that BOBBINS or TAILTWIST intended to transfer the arbitration agreement as part of any assignment.[45] This is particularly the case because Article 7(2) Model Law was drafted to exclude an implied or tacit acceptance of an arbitration agreement or an alleged acceptance that did not reflect the fully informed consent of a party.[46]

Accordingly, there is no agreement between BOBBINS and INVESTMENT that satisfies the standard of formal validity articulated in Article 7(2) Model Law. Therefore, any alleged arbitration agreement between BOBBINS and

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Hunter, 142; van den Berg in Sood, 337. In *Zimmer v USA Europa SA v Cremascoli,* Cass 3 June 1935 n 3285 in (1984) Riv.dir.int.priv.proc. 73–76, the Italian Supreme Court decided that Article IT New York Convention does not require the existence of a written document signed by the parties. However, 'the parties consent to arbitration must be…unequivocally proven by written declarations made by both parties' (translated by the authors of this Memorandum). For a similar interpretation of the written requirements in Article II New York Convention see *Jauch & Huber GmbH v Soc de navigation transocéanique and Soc* SIAT Cass of 14 November 1981, n 6035, in Riv.dir.int.priv.pro. (1982), 821–29.

40 On the contrary, BOBBINS denied the existence of an arbitration agreement between BOBBINS and INVESTMENT in the Statement of Defense: Statement of Defense, Nos 2–5.

41 Statement of Defense, No 3.

42 The final sentence of Article 7(2) Model Law has been interpreted as referring, in a contract concluded between the parties to the arbitration agreement, to a document containing an arbitration clause. There is no such reference to an arbitration agreement in a contract concluded between BOBBINS and INVESTMENT. Thus, the requirements of Article 7(2) Model Law are not satisfied. See Holtzmann & Neuhaus, 263–64.

43 'If [TAILTWIST] should assign the right to the payments due from [BOBBINS], the latter agrees that it will not assert against the assignee any defense it may have against [TAILTWIST] arising out of defective performance of this contract, unless [TAILTWIST] does not in good faith attempt to remedy the deficiency': Claimant's Exhibit No 1; Statement of Defense, No 18.

44 Memorandum for the Claimant, Université de Fribourg, 4.

45 INVESTMENT claims that 'the fact that BOBBINS negotiated the non asserting of any defence clause against the assignee in case of an assignment, proves that *they had both considered an eventual future assignment,* and that BOBBINS should have inserted a clause of unassignability of the Arbitration agreement': Memorandum for the Claimant, Université de Fribourg, 4. BOBBINS and TAILTWIST could have provided that the arbitration clause would apply to assignees: for example, in *Cochran v Taylor* 273 nY 172 (NY Ct App 1937), 182, an option contained a clause stating that 'this agreement is binding upon the respective parties, personal representatives, heirs, and assigns'. This clause established the assignability of the option 'within the clear and expressed intent of the parties'. BOBBINS and TAILTWIST could have included a similarly worded clause to demonstrate that the arbitration agreement would apply to assignees.

46 Holtzmann & Neuhaus, 260; van den Berg, 171; *Frey, Milota, Seitelberger and Vesely v F Cuccaro e Figli.* Corte di Appello di Napoli of 13 December 1974. Moreover, in the drafting of Article 22 New York Convention, from which Article 7(2) Model Law derives, a proposal by the Dutch delegation that a 'confirmation in writing by one of the parties [which is kept] without contestation by the other party' be considered an arbitration agreement, was rejected: van den Berg, 196.

INVESTMENT is invalid and unenforceable. If, however, the Arbitral Tribunal determines that a valid and enforceable arbitration agreement *does* exist, BOBBINS presents arguments relating to INVESTMENT'S claim for payment of the two final installments under the contract of 1 September 1999.

2 BOBBINS is not liable to make payment of $2,325,000 to INVESTMENT

INVESTMENT argues that:

1 *The notification sent by INVESTMENT to BOBBINS in German was effective under the Receivables Convention (Memorandum for the Claimant, Université de Fribourg, 8–11);*
2 *In any case, the notification sent by INVESTMENT to BOBBINS in English was effective because it arrived before payment was made by BOBBINS to TAILTWIST (Memorandum for the Claimant, Université de Fribourg, 11); and*
3 *The invalid payment instruction did not affect the validity of the notification of assignment (Memorandum for the Claimant, Université de Fribourg, 11–12).*

2.1 The Receivables Convention is the law applicable to the assignment and the notification of assignment

(a) The Receivables Convention is the law applicable to the assignment

BOBBINS acknowledges INVESTMENT'S claim that the law applicable to the contract of assignment concluded between TAILTWIST and INVESTMENT is the Convention on the Assignment of Receivables in International Trade (Receivables Convention).[47] Under Article 1(1)(a) Receivables Convention, the Convention applies to 'Assignments of international receivables and to international assignments of receivables…if, at the time of conclusion of the contract of assignment, the assignor is located in a Contracting State'.[48] According to Article 2(a) Receivables Convention,

47 Memorandum for the Claimant, Université de Fribourg, 2, 7. Note that Procedural Order No 2, Clarification No 1 states that 'Even though at the time of distribution of the Problem the text [was] in fact a Draft Convention, for the purposes of the Moot the Convention is in force…at all relevant times'.

48 This provision has the effect of ensuring both the 'broad applicability of the…Convention, and a sufficient level of certainty and predictability for all interested parties': Report on Twenty-Sixth Session (A/CN.9/434), No 20. The territorial scope of the application of the draft Convention has been the subject of detailed discussion in the Working Group: Report on Twenty-Fourth Session (A/CN.9/420), Nos 30 and 31; Report on Twenty-Fifth Session (A/CN.9/432), Nos 29–32; Report on Twenty-Seventh Session (A/CN.9/445), Nos 131–36. See also Bazinas (2001), 271; Sigman & Smith, 345; Smith, 478. The Working Group considered allowing the application of the draft Convention only when all three parties had their places of business in Contracting States. However, it was decided that this would 'unduly narrow the scope of the draft Convention': Report on Twenty-Sixth Session (A/CN.9/434), No 22. Furthermore, the place of business of the debtor should not be a factor in determining the applicability of the Convention. The debtor receives sufficient protection from the Convention: Report on Twenty-Sixth Session (A/CN.9/434), No 23. See also Ferrari (2000)(Melbourne Journal), 17.

'assignment' is defined as 'the transfer by agreement from one person ('assignor') to another person ('assignee') of all or part of or an undivided interest in the assignor's contractual right to payment of a monetary sum ('receivable') from a third person ('the debtor')'. Under Article 3 Receivables Convention, a receivable is 'international' if 'the assignor and the debtor are located in different States'; an assignment is 'international' if 'the assignor and the assignee are located in different States'.

TAILTWIST, the assignor, was located in Oceania,[49] a 'Contracting State' under Article 1(1)(a) Receivables Convention.[50] On 29 March 2000 TAILTWIST transferred to INVESTMENT its contractual right to receive payment from BOBBINS of $3,255,000 and hence this transaction fulfils the requirements of an 'assignment' under Article 2(a) Receivables Convention. INVESTMENT paid TAILTWIST the sum of $3,150,000 in exchange for the assignment.[51] Pursuant to Article 3 Receivables Convention, both the receivable and the assignment are international because at the time of the conclusion of the original contract TAILTWIST, BOBBINS and INVESTMENT, as the assignor, debtor and assignee respectively, were all located in different States.[52] Accordingly, the Receivables Convention is the law applicable to the assignment,

(b) The Receivables Convention is the law applicable to the validity and effectiveness of any purported notification of assignment

Article 29 Receivables Convention provides that 'The law governing the original contract determines…the relationship between the assignee and the debtor, the conditions under which the assignment can be invoked against the debtor and whether the debtor's obligations have been discharged'. The law governing the original contract between BOBBINS and TAILTWIST[53] is the CISG.[54] Additionally, the original contract expressly provided that it was subject to the CISG 'and, in regard to any questions not governed by it, to the law of Oceania'. [55] Thus the CISG and the law of Oceania govern the relationship between the assignee, INVESTMENT, and the debtor, BOBBINS.

For the purposes of determining whether INVESTMENT is entitled to payment of $2,325,000 from BOBBINS, the central issue is the notification of assignment provided by INVESTMENT to BOBBINS.[56] However, the CISG does not govern

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49 Notice of Arbitration, No 3.

50 Notice of Arbitration, No 17.

51 Respondent's Exhibit No 4.

52 Article 5(h) Receivables Convention states that 'A person is located in the State in which it has its place of business'. INVESTMENT is located in Mediterraneo (Notice of Arbitration, No 1); BOBBINS is located in Equatoriana (Notice of Arbitration, No 2) and TAILTWIST was located in Oceania (Notice of Arbitration, No 3). Furthermore, Article 1(3) Receivables Convention provides that 'This Convention does not affect the rights and obligations of the debtor [BOBBINS] unless…the law governing the original contract is the law of a Contracting State'. The law governing the original contract between TAILTWIST and BOBBINS is 'the United Nations Convention on Contracts for the International Sale of Goods [CISG] and, in regard to any questions not governed by it…the law of Oceania', which is a Contracting State: Claimant's Exhibit No 1. See also Notice of Arbitration, No 17.

53 Article 5(a) defines 'original contract' as 'the contract between the assignor and the debtor from which the assigned receivable arises'. The right to receive payment which was assigned to INVESTMENT arose from contract between TAILTWIST and BOBBINS.

54 Article 1(1)(a) CISG states that 'This Convention applies to contracts of sale of goods between parties whose places of business are in different States…when the States are Contracting States'. Both Oceania and Equatoriana are parties to the CISG (Notice of Arbitration, No 16) and have incorporated the CISG into domestic law (Procedural Order No 2, Clarification No 2).

55 Claimant's Exhibit No 1.

the question of assignment, and therefore the applicable law is the domestic law of Oceania, which has adopted the Receivables Convention and incorporated it into domestic law.[57] Thus, the Receivables Convention is the law applicable to the relationship between BOBBINS and INVESTMENT with regard to the payment of $2,325,000.

2.2 The purported notification of assignment written in German was invalid

On 5 April 2000, INVESTMENT sent BOBBINS a document written in German.[58] INVESTMENT claims that this document, signed for by BOBBINS on 10 April 2000,[59] constituted notification of the assignment of the right to receive payment.[60] More specifically, in its Memorandum for the Claimant, INVESTMENT argues that the notification fulfilled the requirements of Article 16(1) Receivables Convention,[61] which states that 'Notification of the assignment…is effective…if it is in a language that is reasonably expected to inform the debtor about its contents'.[62] Article 16(1) Receivables Convention is 'aimed at ensuring that the notification is designed to be understood by the debtor'.[63] Any purported notification must also comply with Article 5(d) Receivables Convention, which requires that the notification must be 'a communication in writing that reasonably identifies the assigned receivables and the assignee'.[64] Thus, having chosen to send notice written in German, INVESTMENT must demonstrate that it could have reasonably expected that the document would inform BOBBINS of the contents of the notice, and that the document reasonably identified the assigned receivables and the assignee,

(a) The purported notification is ineffective under Article 16(1) Receivables Convention

INVESTMENT argues that its use of German was sufficient under Article 16(1) Receivables Convention because 'German is a common language'.[65] This assertion provides no basis on which INVESTMENT may hold any reasonable expectation that a notification written

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56 This issue is expressed in Procedural Order No 3 as 'Whether the notice of assignment…was effective to obligate [BOBBINS] to pay the $2,325,000 to [INVESTMENT] rather than to [TAILTWTST]'. See also Procedural Order No 1, No 4; Notice of Arbitration, Nos 7 and 8; Statement of Defense, Nos 7–11.

57 Notice of Arbitration, No 17; Procedural Order No 2, Clarification No 2.

58 Claimant's Exhibit No 2.

59 Statement of Defense, No 7.

60 Memorandum for the Claimant, Université de Fribourg, 8–10. See also Notice of Arbitration, No 7.

61 INVESTMENT claims that 'the notification in German was sufficient to reach the requirement' of Article 16 Receivables Convention. Memorandum for the Claimant, Université de Fribourg, 10.

62 In discussing Article 16(1) Receivables Convention, Bazinas (2001), 280, notes that The test…refers not to whether the debtor was in fact informed but to the expectation of the person giving the notification'. See also Analytical Commentary on the draft Convention on Assignment of Receivables in International Trade (A/CN.9/489/Add.1), No 2.

63 Note by Secretariat (A/CN.9/WG.II/WP.98), Article 16, No 9.

64 Article 5(d) Receivables Convention states that 'Notification of the assignment' means a communication in writing that reasonably identifies the assigned receivables and the assignee'. The Working Group noted the close relationship between Article 16(1) Receivables Convention and Article 5(d) Receivables Convention: Report on the Twenty-Sixth Session (A/CN.9/434), No 167. See also Sigman & Smith, 350.

65 Memorandum for the Claimant, Université de Fribourg, 9.

in German would inform BOBBINS of the contents of the document. Indeed, under Article 16(1) Receivables Convention, 'the parties are encouraged to provide the notification…in the language out of which the receivables arise'.[66] The Receivables Convention provides no additional guidance as to whether a language fulfills the requirements of Article 16(1). However, domestic laws have identified the language spoken in the country of the addressee and the language in which the original contract was written as two useful criteria for determining the reasonableness of the use of a language.[67] As INVESTMENT was aware of the terms of the contract of 1 September 1999,[68] it must necessarily have been aware that the original contract was written in English.[69] INVESTMENT and TAILTWIST's contract of assignment, out of which the need for notification arose, was also written in English.[70] Further, INVESTMENT knew that BOBBINS was located in Equatoriana,[71] an English-speaking country.[72] Thus, INVESTMENT was notifying a company located in an English-speaking country of an assignment arising from a contract concluded in English between two companies based in English-speaking countries,[73] yet chose to send notification in German.[74] Therefore, INVESTMENT has no grounds on which it can establish a reasonable expectation that notice written in German could inform BOBBINS of the contents of the document.

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66 Smith, 482. This is reflected in the 'safe harbour' rule contained in the second sentence of Article 16(1) Receivables Convention: 'It is sufficient if notification of the assignment…is in the language of the original contract.'

67 Domestic laws impose varying criteria for determining whether the use of a particular language in legal communications is appropriate. Eg, under German domestic law, a statement in a language other than German is valid if it is in the language of the contract, the language of previous negotiations, or in the language of the addressee: Reinhart, 20. See also Beckmann, 79–80; Petzold in Jayme, 96; Piltz (2001), 11; Oberlandesgericht Frankfurt a M: 5 U 173/75 of 27 April 1976; Oberlandesgericht München: 24 U 93073 of 4 April 1974; Oberlandesgericht Bremen: 1 U 40/73 of 22 June 1973. A similar principle is applied under the CISG: Schlechtriem in Schlechtriem (1998), 169; Amtsgericht Kehl: 3 C 952/93 of 6 October 1995, in which general conditions in a different language to the rest of the contract were not incorporated into that contract because no translation was provided. Other nations, including France, Belgium and Portugal, have enacted legislation under which there is an obligation to use the language of that country even in international business transactions: Petzold in Jayme, 93.

68 INVESTMENT was aware of 'the terms of the contract between [TAILTWIST] and [BOBBINS]': Procedural Order No 2, Clarification No 20.

69 The original contract was written in English: Claimant's Exhibit No 1; Procedural Order No 2, Clarification No 9.

70 Procedural Order No 2, Clarification No 15.

71 INVESTMENT had addressed the purported notification of assignment to BOBBINS in Equatoriana: Claimant's Exhibit No 2.

72 Procedural Order No 2, Clarification No 8.

73 Procedural Order No 2, Clarification No 9; Notice of Arbitration, Nos 2 & 3; Procedural Order No 2, Clarification No 8.

74 In the Memorandum for the Claimant, INVESTMENT cites a decision of the Oberlandesgericht Hamm (11 U 206/93 of 8 February 1995) as authority for the proposition that notice may be given in a language other than that of the original contract or that of the assignee: Memorandum for the Claimant, Université de Fribourg, 9. More relevantly, however, the Court also stated that 'a reasonable person cannot be allowed to simply ignore a declaration of legal relevance only because it is not written in the language of the contract'. [Translated by the authors of this Memorandum.] INVESTMENT quotes 'the mere fact that a notice was given in a language which was not that of the contract or that of the addressee was *not an obstacle* for the notice to be effective': See Memorandum for the Claimant, Université de Fribourg, 9. The Court decided that a foreign language may be used if the addressee, under regular circumstances, is able to obtain knowledge of the content of the declaration or if, according to common usage, the addressee was expected to obtain that knowledge. Whether an addressee is expected to obtain such knowledge is to be determined by the conduct

Further, policy considerations also dictate that a document should not bind the recipient if it is written in a language that the sender should have known to be unreadable by the recipient. Article 16(1) Receivables Convention must be read in accordance with Article 7(1) Receivables Convention, which states that In the interpretation of this Convention, regard is to be had to its object and purpose as set forth in the preamble'. The preamble to the Receivables Convention specifically provides that one of the paramount aims of the Convention is the 'adequate protection of the interests of debtors in assignment of receivables'.[75] It would be contrary to the aim of debtor protection to force the debtor to bear the risk of the assignee sending notice in an unintelligible foreign language. Thus, INVESTMENT should have written the notification so that it could be understood by BOBBINS.[76] Despite the use of English in the original contract, in the contract of assignment, and in the countries of the debtor and the assignor,[77] INVESTMENT failed to meet this relatively simple expectation. In the circumstances of this case, therefore, the notice received by BOBBINS on 10 April 2000 failed to fulfill the requirements of Article 16(1) Receivables Convention.

(b) The purported notification was also ineffective under Article 5(d) Receivables Convention

In any case, the German notice also fails to meet the standard required by Article 5(d) Receivables Convention, which provides that any notice must reasonably identify 'the assigned receivables and the assignee'. The document does contain references to TAILTWIST, to INVESTMENT, to the date 1 September 1999 and to BOBBINS' remaining debt under the contract.[78] The notion of 'reasonable identification', however, requires more than mere *reference* to these facts. Indeed, while these references are discernible even to a person who cannot read German,[79] such skeletal details alone neither reasonably identify 'the assigned receivables and the assignee' under Article 5(d) Receivables Convention, nor lead to the inference that the document was a notification

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of a reasonable person with regard to customs and common usages in international trade. A reasonable person cannot be allowed to simply ignore a declaration of legal relevance [translated and summarised in English by the authors of this memorandum]. BOBBINS did not 'ignore' the document in German, and in fact exceeded the requirement imposed by the court by sending a request for clarification to INVESTMENT on 15 April 2000: Procedural Order No 2, Clarification No 28; Respondent's Exhibit No 1.

75 The principle of debtor protection is a 'main pillar' of the Receivables Convention: Bazinas (2001), 266, 278; Trager, 636. This principle is not only reflected in the Preamble and in Article 15, but also throughout the Receivables Convention. See Articles 1(3), 6,7,15(1) & (2), 18(1) & (2), 19(2) and 29. See also Bazinas (1998), 279 and Ferrari (2000) (Private Law), 195.

76 Note by Secretariat (A/CN.9/WG.II/WP.98), Article 16, No 9.

77 Claimant's Exhibit No 1; Procedural Order No 2, Clarification Nos 9 and 15. INVESTMENT also knew that BOBBINS was located in Equatoriana: Claimant's Exhibit No 2. The language spoken in Equatoriana is English: Procedural Order No 2, Clarification No 8.

78 Claimant's Exhibit No 2. INVESTMENT claims that these references, together with the fact that 'German is a common language,' suggest that a person who could not read German should have understood the document: Memorandum for the Claimant, Université de Fribourg, 9.

79 Memorandum for the Claimant, Université de Fribourg, 9, states that 'There is no need to know German to understand this information, and it should suffice to Simon Black to recognise that the notice treats of that contract and of an assignment'.

of assignment. This is because an assignment is a complex legal process,[80] and such a sophisticated inference may not be drawn from these minimal details divorced from any explanation of their meaning. Similarly, it is unreasonable for INVESTMENT to make the claim[81] that BOBBINS should have understood a document written in a foreign language to be a notification of assignment simply because BOBBINS had participated in assignments before and had provided for the possibility of an assignment in the contract of i September 1999.

2.3 The purported notification of assignment written In english was not received In time to prevent BOBBINS from making payment to TAILTWIST

On 15 April 2000, BOBBINS sent a facsimile to INVESTMENT seeking clarification of the document written in German.[82] On the morning of 19 April 2000, BOBBINS received a facsimile from INVESTMENT responding to BOBBINS' request for clarification.[83] This facsimile stated that the document written in German was a notification of assignment, apologised for the fact that the initial notification had been written in German, and enclosed a translation of the German document.[84] INVESTMENT claims that the facsimile sent to BOBBINS constituted an effective notification of the assignment.[85] However, BOBBINS argues that, for two reasons, the purported notification was ineffective. First, the purported notification was ineffective because it was not received by BOBBINS' Accounting Department before the payment of $2,325,000 was made to TAILTWIST. Secondly, in any case, the notification failed to provide a reasonable time for BOBBINS to request proof of the assignment.

(a) The notification was ineffective because it was not received by BOBBINS' Accounting Department before payment was made to TAILTWIST

INVESTMENT maintains that the notification of assignment became effective as soon as it entered BOBBINS' 'sphere of influence'.[86] Although Article 16(1) Receivables Convention states that a 'Notification of the assignment…is effective when received by the debtor', the concept of 'receipt' is not expressly defined in the Receivables Convention.[87] Accordingly, receipt must be interpreted in accordance with Article 7(2) Receivables Convention, which states that 'Questions concerning matters governed by this Convention that are not expressly settled in it are to be settled in conformity with the general principles on which it is based'. As set forth in the preamble to the Receivables Convention, these principles include the need 'to ensure adequate protection

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80 Zweigert & Kötz, 442–43.
81 Memorandum for the Claimant, Université de Fribourg, 9.
82 Respondent's Exhibit No 1.
83 Respondent's Exhibit No 2.
84 'The correspondence from us dated 5 April 2000 was a notice of assignment. [TAILTWIST] has assigned to us the right to receive the payments due to it under your contract with [TAILTWIST] dated 1 September 1999. I apologize for the fact that the notice of assignment sent to you was in German. A translation into English is attached': Respondent's Exhibit No 2.
85 Memorandum for the Claimant, Université de Fribourg, 11.
86 Memorandum for the Claimant, Université de Fribourg, 10.
87 Analytical Commentary on the draft Receivables Convention Addendum (A/CN.9/489/Add.1), No 2: 'When exactly a debtor is deemed to receive a notification is a matter left to law applicable outside the …Convention'.

of the interests of debtors in assignments of receivables'. Consequently, in order to protect the debtor's interests, a debtor should not be deemed, at law, to have received a notification until it is communicated to that part of the debtor's organisation authorised to act on the notification. Indeed, this principle is embodied in the law of domestic legal systems.[88] Otherwise, especially in situations where the debtor learns of the assignment for the first time in the notification of assignment, a debtor would immediately be bound by a notification from the moment of delivery to the debtor's organisation before there is an opportunity to act on the notification.

In this case, Mr Black, Vice-President of BOBBINS, had directed that the consultant's certification be sent 'directly from the consultant to the accounting department'.[89] Mr Black had also ordered the Accounting Department to make payment to TAILTWIST upon the arrival of the certification without seeking Mr Black's authorisation.[90] Hence, in effect, Mr Black had delegated his authority to the Accounting Department for the purposes of making this payment to TAILTWIST. The Accounting Department was thus that part of BOBBINS' organisation authorised to make payment, and any communication regarding a notification of assignment was effective only when delivered to the Accounting Department.

Upon his receipt of the purported notice of 19 April 2000, Mr Black sent a memorandum to BOBBINS' Accounting Department, communicating to it, as the relevant department in charge of the transaction, the details of the purported notification of assignment.[91] In sending this memorandum through the internal messenger service, Mr Black acted in accordance with BOBBINS' usual office procedure.[92] However, INVESTMENT claims that Mr Black's adherence to the usual office procedure was an unreasonable means of communicating with the Accounting Department.[93] While the issue of office communications is not addressed by the Receivables Convention,

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88 An analogous principle is contained in the US and German domestic jurisdictions. See § 1–201(27) of the United States Uniform Commercial Code (UCC), which states that 'Notice, knowledge or a notice or notification received by an organization is effective for a particular transaction from the time when it is brought to the attention of *the individual conducting that transaction,* and in any event from the time that it would have been brought to his attention if the organization had exercised due diligence' [emphasis added]. According to the Official UCC Commentary 'This is said to make it clear that 'reason to know, knowledge, or a notification, although "received" by a clerk in Department A of an organization, is effective for a transaction conducted in Department B only from the time when it was or should have been communicated to the individual conducting that transaction': cited in Kritzer, Detailed Analysis, 193. A similar principle is found in German law. Pursuant to §130 BGB, declarations usually only need to reach the 'sphere of the addressee' to be effective. However, §407(1) BGB provides an exception to this general rule. In the specific case of a notice of assignment, it is not sufficient that the notice reach the addressee's sphere of influence, it must actually be acknowledged by the relevant department in charge of the transaction.

89 Procedural Order No 2, Clarification No 31.

90 Procedural Order No 2, Clarification No 31.

91 Respondent's Exhibit No 3.

92 Procedural Order No 2, Clarification No 30.

93 Mr Black 'didn't act like a reasonable person': Memorandum for the Claimant, Université de Fribourg, 11.

94 In *Morgan Guaranty Trust Co of New York and Marine Midland Bank of New York v New England Merchants National Bank v TownBank and Trust Co* 438 F Supp 97 (DMass 1977), 104, considering the equivalent Massachusetts provision [Massachusetts General Laws Chapter 106 §1–201(27)], stated that 'A lag of a few hours in the transmission of information…does not constitute a lack

the right to adhere to usual office procedure is protected, and its use encouraged, in various domestic jurisdictions.[94] For example, under §1–201(27) US Uniform Commercial Code, 'An organization exercises due diligence if it maintains reasonable routines for communicating significant information'. Thus, in the circumstances of this case, INVESTMENT'S criticism of BOBBINS' usual office procedure is misplaced.

Accordingly, because the memorandum did not arrive at the Accounting Department until after payment had been irreversibly made to TAILTWIST's account, the notification simply arrived too late to be effective.

(b) INVESTMENT failed to provide a reasonable time in which to request proof of the assignment

If the Arbitral Tribunal determines that the notification did not need to arrive at the Accounting Department to be effective, the notification was nonetheless ineffective when it arrived at Mr Black's office on 19 April 2000.

(i) INVESTMENT was obliged to allow a reasonable time in which BOBBINS could request proof of the assignment

Article 17(7) Receivables Convention states that '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'. Furthermore, if a request for proof is made but no proof arrives prior to the time at which a payment must be made, Article 17(7) Receivables Convention provides that the debtor is 'discharged by paying…as if the notification from the assignee had not been received'.[95] Hence the debtor is discharged by paying the assignor if payment becomes due while the debtor is awaiting adequate proof.[96] Otherwise, if the debtor failed to pay the assignor, 'the debtor could be in default and become liable to [pay] damages and interest for late payment'.[97]

The necessary implication of Article 17(7) Receivables Convention is that notification of assignment must arrive at a time, sufficiently prior to payment becoming due, to enable the debtor to request and receive proof of the assignment within a reasonable

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of reasonable routines'. See also; *Haynes and Department of Family and Community Services* [1999] AATA 62, No 23: 'He submitted that adherence to the H & R Block office methodology… [was] a practical means of preventing a breakdown in order in the office.'; *Commercial Bank 'Hansacombank' v Republic National Bank of New York* 1999 Inc Dist LEXIS 1290 (SDNY 1999), 2; *The Queen v Steve Hannemann and Criminal Lawyer's Association* (2001) Ont Sup CJ LEXIS 509, 41; *Harty v Limerick County Council* [1999] IEHC 137, No 6; *Her Majesty R v Secretary of State for Home Department ex p Nyama* [1999] EWHC Admin 141 (HCJ QB 1999), No 363; *Her Majesty The Queen v Christopher Chiang* (1994) Ont Sup CJ LEXIS 1439, 12–13; *Re Day-Nite Carriers Ltd (In Liquidation)* [1975] 1 NZLR 172 (Sup Ct 1975), 180.

95 See Bazinas (2001), 277, 181, and Bazinas (1998), 339. The Working Group discussed this issue: Report on Twenty-Sixth Session (A/CN.9/434), No 186: 'In absence of adequate "proof" as to the status of the assignee, the debtor should be able to discharge its obligation by paying the assignor.' See also Remarks and Suggestions (A/CN.9/WG.II/WP.104), Article 19, No 2; Commentary to the draft Receivables Convention Part II (A/CN.9/WG.II/WP.106), No 48; Note by the Secretariat (A/CN.9/WG.II/WP.102), Article 18, No 4; Report on Twenty-Third Session (A/CN.9/486), Nos 28 & 29; Report on Thirty-First Session (A/CN.9/466), No 127; Proposal by United States of America (A/CN.9/WG.II/WP.100), Article 18, No 3.

96 Remarks and Suggestions (A/CN.9/WG.II/WP.104), Article 19, No 1.

97 Report on Thirty-First Session (A/CN.9/466), No 126.

time. Thus, in sending notification to the debtor, the assignee must allow a sufficiently long period of time, prior to payment being due, to provide an opportunity for a request to be made and answered. If that period is not sufficiently long, the debtor would be effectively denied its right to request proof under Article 17(7) Receivables Convention. The right to request proof of an assignment is of particular importance in a situation where, as in this case, the debtor is sent notification of assignment by an assignee with whom the debtor has had no previous business relationship.[98]

(ii) INVESTMENT did not allow BOBBINS a reasonable time in which to request and receive proof of the assignment

Prior to signing the contract of assignment of 29 March 2000, INVESTMENT knew 'in detail for what it was paying'.[99] Thus it may be inferred that INVESTMENT was aware that payment of the first of the remaining two installments owed by BOBBINS was due on 19 April 2000.[100] Despite this awareness, INVESTMENT failed to provide BOBBINS with notification of the assignment until the morning of 19 April 2000.[101] This notification allowed BOBBINS less than one business day before payment was due, a period of time in which it would be unreasonable to expect BOBBINS to request and receive proof of the assignment from INVESTMENT.[102]

Had INVESTMENT chosen to enclose *proof* of the assignment with the *notification* of assignment on 19 April 2000, there would have been no need for BOBBINS to request proof, and thus the notification would have been effective notwithstanding Article 17(7) Receivables Convention. While not expressly

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98 Trager, 636. BOBBINS 'neither has nor has ever had any business or contractual relationship with [INVESTMENT]': Statement of Defense, No 3. The Convention…recognises the need to protect the debtor in the case of a notification from a strange or dubious person': Bazinas (2001), 277. The debtor 'would be in a difficult position if faced with a notification from an unknown, foreign assignee': Report on Twenty-Third Session (A/CN.9/466), No 127. See also Analytical Commentary on the draft Receivables Convention Addendum (A/CN.9/489/Add.1), No 13.

99 Procedural Order No 2, Clarification No 20, confirms that INVESTMENT knew of the terms of the contract of 1 September 1999 and, further, that INVESTMENT 'would not have paid $3,150,000…if it had not known *in detail* for what it was paying' [emphasis added].

100 Note that under the contract of 1 September 1999, the payment timetable was '20% with order [on 1 September 1999]; 20% on completion of tests at our works; 25% on delivery to site; 25% on completion of commissioning on site; the balance after three months satisfactory performance': Claimant's Exhibit No 1. The right to receive the final two installments was assigned by TAILTWIST to INVESTMENT: Notice of Arbitration, No 7. While under this timetable, delivery was not due until 1 March 2000, TAILTWIST made delivery on 20 February 2000: Notice of Arbitration, No 6. Thus the installments were due earlier than may have been expected. However, as is stated in Procedural Order No 2, Clarification No 20, INVESTMENT knew 'in detail for what it was paying'. It may thus be inferred that INVESTMENT knew the dates on which it could expect payment from BOBBINS.

101 This is the date on which the notification in English arrived: Respondent's Exhibit No 2; Claimant's Exhibit No 3.

102 The exact time period between INVESTMENT'S notification to BOBBINS and the time that payment was made is not known. The facsimile containing the notification was received on the morning of 19 April 2000: Statement of Defense, No 7. The unreasonableness of the time period is emphasised by the fact that INVESTMENT had taken four days to respond to BOBBINS' facsimile inquiry of 15 April 2000: Respondent's Exhibit Nos 1 and 2; Statement of Defense, No 7.

103 Report on Twenty-Sixth Session (A/CN.9/434), No 169: 'establishing such a general condition of effectiveness would make the assignment process excessively cumbersome'.

104 Statement of Defense, No 3.

required under the Receivables Convention,[103] it would have been reasonable for INVESTMENT to enclose such proof with the notification, particularly given that INVESTMENT was sending notification as a means of demanding a substantial payment from a company with which it had never had any business or contractual relationship prior to the assignment.[104] However, because such proof was not enclosed with the notification, the notification was ineffective, and BOBBINS has thus discharged its obligation by making payment to TAILTWIST.

2.4 Both purported notifications were formally invalid due to a change in the country of payment

Any purported notification of assignment must be formally valid under Article 15(2)(b) Receivables Convention. This Article provides that a payment instruction may not 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'. For the purposes of interpreting this provision, it is apparent that in instances in which a payment instruction is made simultaneously and concurrently within a notification of assignment, that instruction is deemed to be part of the notification of assignment itself.[105] Thus, any formal invalidity in *one part* of the notification of assignment must consequently render the *entire* notification of assignment formally invalid.

In this case, the purported notifications of assignment which were received by BOBBINS on 10 April 2000 and on 19 April 2000 included a paragraph in which the country in which payment was to be made was changed from Oceania, where TAILTWIST was located, to Mediterraneo, where INVESTMENT was located.[106] This change constitutes a violation of Article 15(2)(b) Receivables Convention, and the principle of debtor protection, for which purpose this Article was included in the Convention.[107] Thus a significant part of each of the two purported notifications of assignment was not formally valid, and as such the notifications of

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105 The Working Group discussed this point. There are instances in the commentary to the Receivables Convention in which a notification of assignment is said to 'contain' a payment instruction: See Commentary to the draft Receivables Convention Part I (A/CN.9/WG.II/WP.105), No 55; Report on Twenty-Third Session (A/CN.9/486), No 13; Report on Twenty-Sixth Session (A/CN.9/434), No 92; Note by the Secretariat (A/CN.9/WG.II/WP.93), Article 7[4], No 2; Analytical Commentary on the draft Receivables Convention (A/CN.9/489), No 64. See also Bazinas (1998), 340.

106 Notice of Arbitration, Nos 1 and 3; Claimant's Exhibit Nos 2 and 3; Procedural Order No 2, Clarification No 12.

107 Article 15 Receivables Convention is entitled 'Principle of debtor protection'. 'In order to highlight the importance of the need to protect the debtor in a prominent manner, the Working Group decided to include a reference in the preamble and a general statement of this principle of paramount importance for the draft Convention in draft article 17 [current article 15]': Commentary to the draft Receivables Convention Part II (A/CN.9/WG.II/WP.106), No 29. See also Analytical Commentary on the draft Receivables Convention (A/CN.9/489), No 131; Report on Twenty-Sixth Session (A/CN.9/434), No 87; Report on Twenty-Seventh Session (A/CN.9/445), No 195; Note by the Secretariat (A/CN.9/WG.II/WP.93), Article 7, No 1; Note by the Secretariat (A/CN.9/WG.II/WP.96), Article 7, Remarks; Note by Secretariat (A/CN.9/WG.II/WP.98), Article 7, No 2.

108 While the invalidity of the payment instruction may have been corrected by INVESTMENT on 5 July 2000 (Respondent's Exhibit No 5), this does not retrospectively affect the validity of the purported notifications of assignment as received by BOBBINS on 10 April 2000 and 19 April 2000.

109 Article 17(1) Receivables Convention provides that 'Until the debtor receives notification of the assignment, the debtor is entitled to be discharged by paying in accordance with the original contract'.

assignment themselves must be considered to have been invalid and ineffective.[108] As such, there was no notification of assignment, and thus BOBBINS' obligation to pay $2,325,000 was discharged by making payment to TAILTWIST.[109]

3 *BOBBINS is entitled to declare a reduction of $930,000 in the contract price*

INVESTMENT argues that:

1 *BOBBINS is prevented from asserting defences against INVESTMENT (Memorandum for the Claimant, Université de Fribourg, 19–21); and*

2 *BOBBINS may not declare a reduction in the price by $930,000 under Article 50 CISG (Memorandum for Claimant, Université de Fribourg, 12–19).*

3.1 The CISG is the law applicable to payment of the final Instalment of $930,000

BOBBINS agrees with INVESTMENT'S contention that the CISG is the law applicable to determining whether BOBBINS is liable to make payment of the final instalment of $930,000 to INVESTMENT.[110] Under Article 29 Receivables Convention, the law governing the original contract governs the relationship between the assignee and the debtor.[111] The original contract 'is governed by the [CISG] and, in regard to any questions not governed by it, by the law of Oceania'.[112] As BOBBINS' reliance on the defective performance of the contract by TAILTWIST and its resulting declaration to reduce the contract price are issues governed by the CISG, the CISG is the law applicable to the relationship between BOBBINS and INVESTMENT with regard to the payment of $930,000.

3.2 The waiver of defence clause does not prevent BOBBINS from asserting defences against INVESTMENT

BOBBINS argues that it does not have to pay the final installment of $930,000

110 Memorandum for the Claimant, Université de Fribourg, 13: 'the alleged misperformance in the contract…must be governed by the CISG.'

111 Article 29 Receivables Convention states that The law governing the original contract determines… the relationship between the assignee and the debtor…and whether the debtor's obligations have been discharged'.

112 Claimant's Exhibit No 1.

113 Claimant's Exhibit No 5.

114 Procedural Order No 2, Clarification No 39; Claimant's Exhibit No 5.

115 Procedural Order No 2, Clarification No 42. In order for a lack of conformity to exist under the CISG, 'The seller must deliver goods which are of the…quality…required by the contract': Article 35(1) CISG. There were specifications in the annexes to the contract of 1 September 1999 describing the level of performance required of the equipment under the contract. If the Arbitration reaches a stage of detailed fact-finding after the conclusion of this stage of the Arbitral proceedings, BOBBINS is prepared to present evidence as to the deficiencies in the performance of the equipment. However, this Memorandum and the Oral Hearings will only determine whether BOBBINS has the legal right to declare a price reduction under Article 50 CISG, based on an application of Articles 39, 40 and 44 CISG: Procedural Order No 3. Therefore, it is assumed that there is a lack of conformity under Article 35(1) CISG.

116 Procedural Order No 2, Clarification No 45.

to INVESTMENT because of a lack of conformity in the performance of the equipment provided by TAILTWIST. BOBBINS has been unable 'to operate the equipment in a satisfactory manner'[113] with the result that 'full production was never achieved'.[114] In accordance with Procedural Order No 2, it can be assumed that 'there are deficiencies in the performance of the TAILTWIST equipment'.[115] BOBBINS has determined that these deficiencies reduce the value of the equipment by $930,000.[116] At this stage of the Arbitral Proceedings, INVESTMENT has not disputed that the deficiencies constitute a lack of conformity in the performance of the equipment.[117] While it is not clear whether the lack of conformity was caused by 'difficulties with the equipment itself or in the inadequate training given to [BOBBINS'] personnel',[118] the result was 'the same in either case'.[119] Consequently, BOBBINS wrote to TAILTWIST's Administrator in Insolvency on 10 January 2001 to inform the Administrator of the lack of conformity in the performance of the equipment and to declare a reduction in the price by $930,000 under Article 50 CISG.[120]

However, according to INVESTMENT, BOBBINS is prevented from asserting this lack of conformity against INVESTMENT because TAILTWIST

117 Memorandum for the Claimant, Université de Fribourg, 14. However INVESTMENT may choose to do so at a later stage of the Arbitral Proceedings: Procedural Order No 3.

118 Claimant's Exhibit No 5.

119 Claimant's Exhibit No 5.

120 Claimant's Exhibit No 5.

121 Memorandum for the Claimant, Université de Fribourg, 20: 'the clause is valid and…BOBBINS is precluded from asserting any defences against TAILTWIST's assignee, ie, INVESTMENT.' The clause in the contract of 1 September 1999 stated: 'If [TAILTWIST] should assign the right to the payments due from [BOBBINS], the latter agrees that it will not assert against the assignee any defense it may have against [TAILTWIST] arising out of defective performance of this contract, unless [TAILTWIST] does not in good faith attempt to remedy the deficiency.': Claimant's Exhibit No 1.

122 The contract of 1 September 1999 expressly provides that the law applicable to the contract is the CISG, and 'in regard to any questions not governed by it…the law of Oceania.': Claimant's Exhibit No 1. The CISG does not govern the validity of a waiver of defence clause, therefore, the law of Oceania is the applicable law to this clause. Oceania has ratified the Receivables Convention: Procedural Order No 2, Clarification No 2. Article 18(1) Receivables Convention provides that, where an assignee has made a claim, a debtor may raise against an assignee all defences and set-off rights arising from the original contract as if the assignment had not been made. Article 18(1) Receivables Convention is qualified by Article 19(1) Receivables Convention. Article 19(1) provides that 'The debtor may agree with the assignor in a writing signed by the debtor not to raise against the assignee the defences…that it could raise pursuant to article 18'. BOBBINS agreed in its contract with TAILTWIST of 1 September 1999 that it would not assert against an assignee of TAILTWIST 'any defense it may have against [TAILTWIST] arising out of the defective performance of this contract, unless [TAILTWIST] does not in good faith attempt to remedy the deficiency': Claimant's Exhibit No 1. The Working Group emphasised the importance of ensuring the validity of such an agreement, since it allows the assignor to increase the value of receivables and the debtor to obtain more credit or better payment terms. See Bazinas (2001), 282; Bazinas (1998), 342; Commentary to the draft Receivables Convention Part II (A/CN.9/WG.II/WP.106), Nos 55 and 56. The Working Group decided not to specify the point of time at which an agreement not to assert defences should be made. However, during the drafting of Article 19 Receivables Convention, the Working Group pointed out that in most cases an agreement not to assert defences is made at the time of conclusion of the original contract. See Commentary to the draft Receivables Convention Part II (A/CN.9/WG.II/WP.106), Nos 55 & 56; Report on Twenty-Fourth Session (A/CN.9/420), No 138. The contract concluded between BOBBINS and TAILTWIST contained a specific waiver clause, inserted into the written document, signed by both BOBBINS and TAILTWTST. The clause is therefore valid under Article 19(1) Receivables Convention.

123 Claimant's Exhibit No 1.

and BOBBINS included a waiver of defence clause in the contract of 1 September 1999.[121] BOBBINS does not dispute the existence or validity of the waiver of defence clause,[122] which stated that 'If [TAILTWIST] should assign the right to the payments due from [BOBBINS], the latter agrees that it will not assert against the assignee any defense it may have against [TAILTWIST] arising out of defective performance of this contract, unless [TAILTWIST] does not in good faith attempt to remedy the deficiency'.[123] BOBBINS has no reason to suggest that TAILTWIST ever failed to act *in good faith*. However, BOBBINS argues that INVESTMENT may not rely on this clause because TAILTWIST simply *never attempted* to remedy the lack of conformity in the performance of the equipment.

(a) The lack of conformity in the performance of the equipment became apparent at the end of June 2000

On 18 April 2000, BOBBINS' consultant certified that the installation and commissioning tests of the equipment had been successfully completed.[124] However, the consultant's certification 'did not…imply that the equipment was in full working order. That was to be determined by a three month period of satisfactory operation'.[125] Upon the expiration of the three month period on 10 August 2000, BOBBINS was obliged to pay the final installment of $930,000.[126] However, by the end of June 2000, BOBBINS 'reached the conclusion that [it] would not be able to make whatever adjustments might be necessary to achieve the desired level of production'.[127] As a result, the equipment never reached full capacity.[128] Therefore, the lack of conformity in the performance of the equipment became apparent by the end of June 2000.[129]

(b) TAILTWIST did not attempt to remedy the lack of conformity in the performance of the equipment because of its insolvency

TAILTWIST entered insolvency proceedings on 20 April 2000.[130] After 16 June 2000, when TAILTWIST was liquidated and its business activities terminated, 'the only activities

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124 Statement of Defense, No 9; Claimant's Exhibit No 5.
125 Claimant's Exhibit No 5; Statement of Defense, No 13.
126 Statement of Defense, No 12, states that 'According to the contract with [TAILTWIST] two periods began upon the certification of successful installation and commissioning tests on 18 April 2000. The first was a period of three weeks during which [TAILTWIST] personnel would remain to train [BOBBINS'] personnel in the correct operation, adjustment and maintenance of the machinery and a further three month period of satisfactory performance of the [TAILTWIST] equipment, at the end of which [BOBBINS] was required to pay the final balance of $930,000 of the contract price'. The three-week training period began on the 10 May 2000, three weeks after the completion of the installation and commissioning tests on 18 April 2000. Therefore, the three-month period of satisfactory performance ended on 10 August 2000, three months after the 10 May 2000. See also Claimant's Exhibit No 1; Statement of Defense, No 20.
127 Procedural Order No 2, Clarification No 39.
128 Claimant's Exhibit No 5; Procedural Order No 2, Clarification No 39.
129 Thus any notice given in accordance with Article 39(1) CISG would have been given within a 'reasonable time' from this date. The record does not disclose any information as to whether an examination has been performed in accordance with Article 38 CISG.
130 Statement of Defense, No 13; Claimant's Exhibit No 4.
131 Statement of Defense, No 19.
132 Claimant's Exhibit No 4.
133 Claimant's Exhibit No 1.
134 See Section 3.2(a) of this memorandum.

carried on in respect of [TAILTWIST] were in connection with the liquidation'.[131] As a result, from 16 June 2000, BOBBINS has 'not been able to call upon [TAILTWIST] for assistance'.[132] Under the contract of 1 September 1999, BOBBINS is prevented from asserting defences against an assignee of TAILTWIST for defective performance of the contract 'unless [TAILTWIST] does not in good faith attempt to remedy the deficiency'.[133] As has been established above,[134] the lack of conformity in the performance of the equipment became apparent at the end of June 2000. However, given that after 16 June 2000 TAILTWIST was no longer conducting any business activities, it was not possible for TAILTWIST, or its Administrator in Insolvency, to make *any* attempt to remedy the lack of conformity. Accordingly, because TAILTWIST simply did not attempt to remedy the lack of conformity in the performance of the equipment, the waiver of defence clause does not prevent BOBBINS from relying upon the lack of conformity as a defence, and asserting this defence against INVESTMENT.

3.3 BOBBINS may reduce the price by $930,000 under Article 50 CISG

INVESTMENT maintains that 'The sum of $930,000…is owed to INVESTMENT by BOBBINS'.[135] BOBBINS, however, has relied on the lack of conformity in the performance of the equipment to declare a reduction of $930,000 in the contract price under Article 50 CISG.[136] This Article states that 'If the goods do not conform with the contract…the buyer may reduce the price in the same proportion as the value that the goods actually delivered had at the time of delivery bears to the value that conforming goods would have had at that time'.[137]

Generally, in order to declare a price reduction under Article 50 CISG, the buyer must fulfill the requirement of Article 39(1) CISG by giving 'notice to the seller specifying the nature of the lack of conformity within a reasonable time after he has discovered it or ought to have discovered it'.[138] INVESTMENT argues that neither the letter sent by BOBBINS to TAILTWIST's Administrator in Insolvency on 10 January 2001, nor complaints made by BOBBINS' personnel to the TAILTWIST employees during the training period, amounted 'to a notification in accordance with Article 39(1) CISG'.[139]

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135 Memorandum for the Claimant, Université de Fribourg, 12.

136 Claimant's Exhibit No 5.

137 In accordance with Procedural Order No 3, at this stage of the Arbitral Proceedings, there is no need to determine whether the lack of conformity '*in fact justified* a reduction in the price and, consequently, whether the amount of reduction was appropriate' [emphasis added].

138 Schwenzer in Schlechtriem (1998), 313: 'The notice must be addressed to the seller [emphasis added].' See also Schlechtriem (1986), 70: 'the notice is effective upon dispatch (Article 27 [CISG]), but it must be sent by a means of communication appropriate to the circumstances and generally designed to reach the addressee.' For a similar opinion, see Frattini (Article 39), 178. Reasonable time depends on the circumstances of the case: Berlingieri, 331; Cabella Pisu, 362; Callegari, 983; Cottino, 161; Frattini (Article 39), 179; Honnold, 336; Piltz (1996), 2771; Veneziano, 515.

139 Memorandum for the Claimant, Université de Fribourg, 15. See generally Memorandum for the Claimant, Université de Fribourg, 15–17.

140 Statement of Defense, Nos 21,22 & 24. BOBBINS never gave notice of the lack of conformity: Notice of Arbitration, No 10 and Procedural Order No 1, No 5 and Procedural Order No 3, in which reference is made to 'the failure to give notice of the alleged deficiencies'. Article 39(1) CISG states 'The buyer loses the right to rely on a lack of conformity of the goods if he does not give notice to the seller specifying the nature of the lack of conformity within a reasonable time after he has discovered it or ought to have discovered it'.

While BOBBINS acknowledged in its Statement of Defense that it has not given notice of the lack of conformity in accordance with Article 39(1) CISG,[140] BOBBINS nevertheless maintains that it is entitled to declare a reduction in price under Article 50 CISG for two reasons. First, under Article 44 CISG, BOBBINS has a reasonable excuse for its failure to give notice. Secondly, in any case, under Article 40 CISG, BOBBINS is not required to give notice of the lack of conformity to TAILTWIST because TAILTWIST 'knew or could not have been unaware' of facts relating to the lack of conformity in the performance of the equipment.

(a) BOBBINS has a reasonable excuse for its failure to give notice of the lack of conformity to TAILTWIST

Article 44 CISG allows a buyer who has failed to give notice of a lack of conformity under Article 39(1) CISG the right to declare a price reduction if the buyer has a 'reasonable excuse for his failure to give the required notice'.[141] INVESTMENT claims that BOBBINS has no reasonable excuse for its failure to give notice.[142] However, a buyer will be excused under Article 44 CISG in circumstances where it would be unduly harsh and unfair to deprive the buyer of all remedies, especially as it is the seller who has not conformed to the contract.[143] In determining whether a buyer has a reasonable excuse for failing to give notice under Article 39(1) CISG, regard is to be had to all the relevant circumstances of the case,[144] and to the protection of the buyer's rights.[145]

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141 Article 44 CISG states that 'Notwithstanding the provisions of paragraph (1) of Article 39 and paragraph (1) of article 43, the buyer may reduce the price in accordance with article 50 or claim damages, except for loss of profit, if he has a reasonable excuse for his failure to give the required notice'.

142 Memorandum for the Claimant, Université de Fribourg, 18–19.

143 Enderlein & Maskow, 172, commenting on the reasons for the adoption of Article 44 CISG, notes that 'The loss of all rights by the buyer as a consequence of the failure to give notice seemed to some to be too harsh a punishment because it was the seller who committed the breach of contract'. See also Cottino, 159; Sono in Bianca & Bonnell, 326; Ziegel & Samson, Section II. Article 44 CISG was originally included to assuage concerns of developing countries that Article 39 CISG was too harsh: Kritzer, (Highlights), 18. However, Article 44 CISG will equally apply to merchants from developed countries: Schlechtriem (1991), 26–27.

144 Huber in Schlechtriem (1998), 348–50: 'A buyer's conduct…is excusable if in the circumstances it deserves to be accorded a degree of leniency.' See also Cuffaro, 202; Kennedy, 339. A proposed amendment to the draft CISG demonstrates that Article 44 CISG was not intended to be applied narrowly. Proposed amendment to draft Article 44 CISG: 'the buyer may reduce the price in accordance with Article 46 or claim damages…if he could not reasonably be expected to give the required notice because of a circumstance beyond his control or another good ground.': Official Records, 171. The notion of 'fairness' must be considered when determining whether or not there is an 'excuse' under Article 44 CISG: Kuoppala, 4.7.2. See further Enderlein & Maskow, 172. A buyer's conduct, although not in itself correct and in accordance with the rules, is excusable if in the circumstances of the specific case it deserves to be accorded a degree of understanding and leniency.

145 Huber in Schlechtriem (1998), 348.

146 'The notices required under this article may serve various purposes: (i) When the seller learns that the buyer is dissatisfied with the goods, the seller is afforded the opportunity to substitute conforming goods or otherwise to "cure" the defect; (ii) On receiving such a notice the seller has the opportunity to preserve evidence of the quality of the goods': Yearbook IV, 48. In this case, notice would not have served the purpose of allowing TAILTWIST to gather evidence, because it was insolvent and no longer conducting business activities (Statement of Defense, No 19). See also Callegari, 983; Enderlein & Maskow, 159–60; Frattini (Article 39), 178; Schwenzer in Schlechtriem (1998), 312; Sono in Bianca & Bonnell, 309.

147 Statement of Defense, No 19.

The relevant circumstances in this case include a consideration of whether the purposes of Article 39(1) CISG would have been achieved had notice been given. Under Article 39(1) CISG, the principal purpose of giving notice of a lack of conformity is to allow the seller to examine the goods and, if appropriate, to remedy the lack of conformity by repairing the goods or by providing substitute goods.[146] On 16 June 2000, all further business activities of TAILTWIST were terminated and the company entered into liquidation.[147] From that point onward, the only activities being undertaken by TAILTWIST and its Administrator in Insolvency were those in connection with the liquidation.[148] TAILTWIST was thus not in a position to examine the goods nor to remedy the lack of conformity. Therefore, because TAILTWIST was no longer in operation when the lack of conformity became apparent at the end of June 2000,[149] the main purpose of Article 39(1) CISG would not have been achieved by giving notice to TAILTWIST.[150] In such circumstances, it would be unfair and unreasonable to deprive BOBBINS of all remedies against TAILTWIST, especially given that it is TAILTWIST who has failed to fulfill its contractual obligations by providing equipment which does not operate at its promised capacity.[151] Hence, BOBBINS' failure to give notice should be excused under Article 44 CISG, and BOBBINS should not be prevented from declaring a price reduction under Article 50 CISG.

(b) TAILTWIST could not have been unaware of facts relating to the lack of conformity under Article 40 CISG [new argument]

If the Arbitral Tribunal determines that, despite the reasons outlined above, BOBBINS has no reasonable excuse for its failure to give notice, BOBBINS is nevertheless entitled to declare a price reduction. Under Article 40 CISG, the seller is not entitled to rely on the failure of the buyer to give notice of a lack of conformity 'if the lack of conformity relates to facts of which [the seller] knew or could not have been unaware and which he did not disclose to the buyer'. For Article 40 CISG to apply, it is not

148 Statement of Defense, No 19.

149 See Section 3.2(a) of this memorandum.

150 At the time that BOBBINS became aware of the non-conformity, TAILTWIST was effectively unoperational: Procedural Order No 2, Clarification No 39. Therefore there was no 'utility in giving notice': Procedural Order No 2, Clarification No 40. Further, BOBBINS did not receive correspondence from TAILTWIST's Insolvency Administrator until 17 October 2000: Respondents Exhibit No 4. The Insolvency Administrator received and sent correspondence from an address which was different from that of TAILTWIST: Compare Notice of Arbitration, No 3, and Respondent's Exhibit No 4. Consequently, when the non-conformity became apparent on 30 June 2000, it was unclear to whom notice should be sent.

151 For the same reasons, the purposes of Article 39(1) CISG would not have been achieved by giving notice to INVESTMENT. Further, INVESTMENT, as a bank (Notice of Arbitration, No 1) and not the seller, would not have been in a position to facilitate any possible examination of, or remedy of, the lack of conformity.

152 Sono in Bianca & Bonell, 314: 'It is not necessary for the seller to know the exact extent of the non-conformity. It would be sufficient if the seller knew of the facts the nature of which would ordinarily result in non-conformity.' See also Mo, 103: '["facts relating to non-conformity"] includes information which may or may not directly evidence the existence of non-conformity, but which may imply the existence of, or lead to the discovery of non-conformity.' See Frattini (Article 40), 184; Schlechtriem (1998), 322; Wautelet in Van Houtte, Wautelet & Erauw, 186. See also Oberlandesgericht Karlsruhe: 1 U 280/96 of 25 June 1997; Bundesgerichtshof: VIII ZR 123/88 of 5 January 1989.

153 See Ferrari (1995), 113; Frattini (Article 40), 184; Magnus in Honsell, 438; Resch, 478; Schlechtriem (1986), 69; Wautelet in Van Houtte, Wautelet & Erauw, 186; Witz, 16. See Oberlandesgericht München: 7 U 4427/97 of 11 March 1998; Bundesgerichtshof: VIII ZR 123/99 of 5 January 1989. Other commentators consider 'simple negligence' to be sufficient: Enderlein & Maskow, 164.

necessary that the seller knew or could not have been unaware of the *exact nature* of the lack of conformity. It is sufficient that the seller knew or could not have been unaware of facts which would *ordinarily result* in such a lack of conformity, or which would *imply the existence* of a lack of conformity.[152] Under Article 40 CISG, the standard of 'could not have been unaware' is satisfied if the seller is grossly negligent in failing to recognise obvious facts that relate to a lack of conformity.[153]

In order to interpret the terms of the contract of 1 September 1999, it is necessary to ascertain the intent of the parties in accordance with Article 8 CISG.[154] Article 8(1) CISG provides that 'statements made by and other conduct of a party are to be interpreted according to his intent where the other party knew or could not have been unaware of what that intent was'. According to Article 8(3) CISG, 'In determining the intent of a party…due consideration is to be given to all the relevant circumstances of the case including the negotiations'. [155] Consequently, oral statements made during the negotiations provide evidence of the subjective intent of a party.[156] The contract of 1 September 1999 lists the training of BOBBINS' personnel 'for three weeks on site', and prices it at $80,000.[157] The purpose of the training was to instruct BOBBINS in the 'correct operation, adjustment and maintenance of the machinery'.[158] In negotiations prior to the signing of the contract, 'TAILTWIST had said that the training would be conducted by four of their personnel…[and] that the cost would be $20,000 per person for the three week period'.[159] TAILTWIST's intention in pricing the training at $80,000 in the contract is thus evident in the oral commitment that it made to BOBBINS, promising to provide four personnel, at $20,000 per person, for three weeks.[160] Consequently, when TAILTWIST recalled two of these four personnel upon the commencement of its insolvency proceedings on 20 April 2000,[161] TAILTWIST could not have been unaware that the training it provided after that date was only half that which it had promised under the contract.

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154 See Note 24.

155 Article 8(3) CISG: 'In determining the intent of a party or the understanding a reasonable person would have had, due consideration is to be given to all the relevant circumstances of the case including the negotiations, any practices which the parties have established between themselves, usages and any subsequent conduct of the parties.'

156 Bianca, 148; Enderlein & Maskow, 62. See also Yearbook DC, 63.

157 Claimant's Exhibit No 1.

158 Claimant's Exhibit No 1.

159 Procedural Order No 2, Clarification No 35.

160 Claimant's Exhibit No 1; Procedural Order No 2, Clarification No 35.

161 Statement of Defense, No 14.

162 Statement of Defense, No 14.

163 Procedural Order No 2, Clarification No 39. It is not clear whether these complaints were in relation to the recall of the two employees, or whether they concerned the training provided by the two remaining employees. BOBBINS states that 'the two remaining Tailtwist employees would have had a difficult time at best to conduct the training that was called for under the contract for which four persons had been anticipated. Under the circumstances they were obviously upset and concerned about their own future. As a result, they were not able to give even the amount and quality of training that they otherwise might have given': Statement of Defense, No 14.

164 See *Beijing Light Automobile Co Ltd v Connell Limited Partnership,* Stockholm Chamber of Commerce, Arbitration Award of 5 June 1998. See also *Oberlandesgericht Düsseldorf:* 17 U 82/92 of 8 January 1993. Enderlein & Maskow, 164: 'What is being referred to [in Article 40] is not only the knowledge of the seller personally, but also of his employees.'; Magnus in Honsell, 439; Resch, 478; Schwenzer in Schlechtriem (1998), 322; Wautelet in Van Houtte, Erauw & Wautelet, 186. This

Additionally, following the recall on 20 April 2000 of two of the four personnel performing the training,[162] BOBBINS made 'various statements' to the remaining two employees complaining that the training being provided was 'not sufficient'.[163] Under Article 40 CISG, the knowledge of statements made to employees or agents is considered to be the knowledge of the employer or principal.[164] Hence TAILTWIST is deemed to have known of the complaints made to its employees concerning the inadequacy of the training provided. Consequently, TAILTWIST could not have been unaware that BOBBINS was receiving inadequate training from the TAILTWIST employees.

Therefore, TAILTWIST could not have been unaware that, as a result of the inadequate training, BOBBINS would be unable to operate, adjust and maintain the equipment correctly.[165] The necessary result of this inability would be that BOBBINS would be unable to operate the equipment at its full capacity. Therefore, under Article 40 CISG, TAILTWIST could not have been unaware of facts which related to a lack of conformity in the performance of the equipment.[166] TAILTWIST is unable to rely on the failure of BOBBINS to give notice of the lack of conformity, and hence BOBBINS may declare a reduction in the price under Article 50 CISG without giving notice.

4 *INVESTMENT should bear the costs of arbitration and BOBBINS' legal costs [new argument]*

In accordance with Procedural Order No 3, this memorandum need not address the *calculation* or *apportionment* of the costs of arbitration.[167] It is a general principle of international commercial arbitration, however, that costs are borne by the unsuccessful party,[168] and thus an award by the Arbitral Tribunal in favour of BOBBINS should be followed by a decision that INVESTMENT bears the costs of arbitration and BOBBINS' legal costs.

BOBBINS commends the arguments in this memorandum to the Arbitral Tribunal in order to achieve a just resolution of this dispute.

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is also supported by Transnational database, Lex Mercatoria Principle No II.5. For domestic law see *Magco of Maryland, Inc v John Mills Barr, Commissioner of Department of Labor and Industry* 33 Va App 78 (Va Ct App 2000); *Beach Petroleum NL and Another v Johnson and Others* (1993) 115 ALR 411; *Benjamin Center, Individually and as a Shareholder of Hampton Affiliates, Inc, Appellant, v Hampton Affiliates, Inc, et al, Respondents, et al, Defendants* 66 nY2d 782 (NY Ct App 1985).

165 Claimant's Exhibit No 1.

166 A buyer cannot rely on Article 40 CISG if the seller disclosed to the buyer its knowledge of facts relating to a lack of conformity: Schwenzer in Schlechtriem (1998), 322. The record gives no indication of any such disclosure by TAILTWIST to BOBBINS.

167 Procedural Order No 3 states that 'The memoranda…should not consider the following issues… Any calculation or apportionment of the costs of the arbitration'. Any allocation of costs would be a procedural matter determined by reference to Article 31 AAA Rules, which states 'The tribunal may apportion such costs among the parties if it determines that such apportionment is reasonable, taking into account the circumstances of the case'.

168 Derains & Schwartz, 342; Gaillard & Savage, 686. See also *Arbitration Act* 1996 (UK), s 61(2); Article 28(4) LCIA Rules; Article 40 UNCITRAL Arbitration Rules; *Channel Island Ferries Ltd v Cenargo Navigation Ltd* [1994] 2 Lloyd's L Rep 161; ICC Arbitration Case No 7585 of 1992.

Book Reviews

Edited by Garrick Professor Gabriël A Moens and Dr Rodolphe Biffot, *The Convergence of Legal Systems in the 21st Century: An Australian Approach,* Copyright Publishing Company Pty Ltd, 2002, ISBN 1 876344 09 1

The modern study and practice of comparative law is to a large extent recognised as having begun in 1900 at the International Congress of Comparative Law held in Paris. This was the beginning of a series of such conferences—which are now quadrennial—with the 16th Congress of the International Academy of Comparative Law being held just over a century later, in July 2002, at the University of Queensland (hosted by the Australian Institute of Foreign and Comparative Law, located in the TC Beirne School of Law). In conjunction with the conference, the principal organisers brought out this edited compilation of articles compiled by leading Australian legal experts.

In 1900, the conference *Zeitgeist* was an optimistic faith in progress, a strong desire for mastery of one's fate, and the forging of a common destiny. The founders talked of a common law of mankind, a world law created by the comparative legal method. In 2002, the conference theme was *Convergence of Legal Systems in the 21st Century,* and this compilation deals with the Australian approach to this concept.

After a brief introduction by the editors, the book is sub-divided into collections of articles on the topics of six of the main conference sessions: *E-commerce, Constitutional Law, Legal Philosophy and Theory, Criminal Law, Commercial Law* and *Dispute Resolution*. While no book of practicable length could be comprehensive in its choice of topics, this is an excellent selection in covering most of the main areas of legal knowledge, including those where current developments are most active. There is no doubt that the book is and will remain a very valuable research tool.

In their introduction, the editors justify the choice of theme on the basis of it being appropriate, at the commencement of a new century, to reflect on the similarities of the major legal systems of the world. They also furnish a very useful short guide to the contents of all the articles included. Although all authors are Australian, only a few articles relate to matters of current or recent controversy in Australia: notably Lynne Barnes' article on 'Sentencing', which in large measure relates to the issues raised by particular provisions for mandatory sentencing in Western Australia and the Northern Territory of Australia, which have since been repealed following changes of government. The only flaw in this otherwise comprehensive discussion is that it completely ignores the wide range of mandatory sentences imposed for matters such as motoring offences. The article also discusses the issues and difficulties raised by guideline judgment legislation in New South Wales, and mentions the recent imposition of minimum sentences at federal level to combat 'people smuggling' in the wake of the late 2001 crisis precipitated by the *MV Tampa* episode. It also touches upon the underlying constitutional issues of separation of powers between the legislature and judiciary.

In the other articles grouped under heading of 'Criminal Law', Richard Refshauge furnishes an excellent account of the history and practice of prosecutorial discretion in Australia, making very interesting comparisons with the United Kingdom, and the other three articles involve constitutional and international issues. Carolyn Evans has provided a very comprehensive account of the law bearing on the criminal liability of ministers, governors and governors-general in Australia, identifying such murky issues as the uncertainty over whether customary international law applies in Australia. The article contributed by Alexis Goh and Steven Freeland is complementary in that it discusses the International Criminal Court established on 1 July 2002. It also explicitly mentions the tension between national sovereignty and international law, which underlies most of the acute current legal and political controversies. Professor David Lanham has supplied a comprehensive account of the use of Australian criminal law and its international offshoots in fighting corruption.

Also in the fields of constitutional and international law, John Trone is an acknowledged expert on all aspects of the constitutional treaty making powers of the Government and Parliament of the Commonwealth of Australia. He has brought his very considerable expertise to bear in formulating a comprehensive analysis of constitutions and treaty on contractual rights and freedoms. Simon Evans and Stephen Donoghue have contributed a veritable tome on the issue of standing in constitutional cases, including a discussion of the justiciability of such matters as seeking to restrain a double dissolution of Parliament.

Jenni Whelan and Christine Fougere discuss 'The Proscription of Hate Speech in Australia'. It is a well documented history of the law in this area, but explicitly one-sided in unashamedly advocating greater restrictions on free expression. There is no consideration of arguments for greater freedom of communication Of course, no article can currently answer the question to what extent, if at all, the implied constitutional protection of freedom of political communication will invalidate such proscriptions. Professor Richard Bartlett discusses comprehensively The Status of Indigenous People in Australia' and its history during the period of European settlement. He is very critical of the attitudes of settlers and Governments, as he is in many of his other writings.

In a much less controversial—but probably far more important—area of the lives of most people and businesses, Alexander Reilly has carefully analysed the financial and budgetary arrangements in the Australian Federation, providing much very useful statistical information in the process. Figures are given for the last year before the introduction of the Goods and Services Tax as part of a major taxation reform on 1 July 2001, as well as for later periods, providing a very interesting comparison. He has identified problems arising for the pronounced vertical fiscal imbalance, such as the consequent reluctance of States to privatise utilities.

The consequences of privatisation are also ably discussed by Martin Klapper, in the context of administrative law, in the 'Legal Philosophy and Theory' section, where Iain Stewart makes many exceedingly interesting and well argued and supported observations in discussing The Structure of the Australian Legal System'. Public finance and privatisation are also relevant in Keturah Whitford's incisive discussion of issues relating to 'Insolvency of Public Entities in Australia'. Finally, in this section, Klaus A Ziegert discusses 'Australian Families and their Law', analysing the changes in both Australian family law and comparative law itself over the 20th century.

Business and economic issues are very well covered, with articles in the 'Commercial Law' section on 'Liability for Defective Products' (Professor Peter Gillies); 'Present and Future of Real and Personal Securities' (Anne Wallace); 'Limits and Control of Competition with a View to International Harmonisation' (Paul Latimer); 'Rights of Minority Shareholders' (Keith Fletcher); and 'Collective Agreements and Individual Contracts of Employment' (Andrew Frazer).

Also, the section on 'Dispute Resolution' comprises an analysis of developments in *Mediation in Australia* by Professor Tania Sourdin, and dispute resolution in sport by Saul Fridman and Chris Davies. Apart from this, commercial issues are well represented. In 'E-commerce', Annelies Moens and John Selby discuss the current issues of electronic transactions and privacy legislation, and interactive gambling. Clive Turner, a leading authority on intellectual property, provides an account of the effect of the recent copyright legislation dealing with digital issues, notable for its conciseness and clarity.

Alun A Preece

By GE Dal Pont (Foreword by The Hon Justice Kevin Lindgren), *Law of Agency,* Butterworths, Sydney, 2001, ISBN 0 409 31655 5

This is a superb new book on the law of agency in Australia. It fills what hitherto has been, apart from some excellent but shorter treatments of the same topic, a noticeable gap in Australian commercial law publications. It is comprehensive, based, as its author indicates in the Preface, on 'the reading of all 20th century Australian agency cases, as well as a significant proportion of English, Canadian and New Zealand cases of the same period. Frequent reference and citation [being made] to English case law from the 19th century and earlier'. This 'and earlier' will be welcome to those legal practitioners and judicial officers who, in the search for good expositions of fundamental principle, seek beyond the usual historicist focus upon the 19th century. The latter is rather like the all too ready identification of Victoriana with the truly 'antique'. As in equity, many of the genuinely 'classic' judicial statements on the law of agency were first made in the 18th century, or even earlier.

If the overemphasis on 19th century decisions is perhaps an understandable tendency of the lawyers of nations like Australia, which came of age and also to self-government during that century, the book is not guilty of this. Instead, Dal Pont's mode of proceeding is the sound one of providing a very clear and concise exposition of the law, using a careful balance of the most up-to-date contemporary, the earlier modern and the pre-modern case law. Whilst arrangement of the text into manageable numbered paragraphs is by no means new, the author has followed the commendable path taken in Australian legal writing by works such as Meagher, Gummow & Lehane's *Equity: Doctrines and Remedies* and by (then Professor) Justice PD Finn, of the Federal Court of Australia, and others. This endeavour is to state briefly the essence of the principle animating the law or rule, referring to relevant case law and indicating the nature of exceptions and qualifications; and being alert to the best—including even venerable—expositions of a principle, but without unduly dwelling on the *merely* historical discussion of its development.

The book is structured in 26 chapters, arranged into eight parts under the headings as follows: an introductory discussion on the 'Context' [of the law of agency]; 'Creation of Agency'; 'Agent's Authority'; 'Agent's Duties'; 'Agent's Rights'; 'Principal's Relationship with Third Parties'; 'Agent's Relationship with Third Parties'; and lastly, 'Termination of Agency', including an additional chapter on the *'Revocation of Powers of Attorney'*. All chapters are equipped with detailed footnotes referring to case law, statutory provisions, relevant legal texts and learned articles. The whole work is characterised by a wide sweep of view, extending across not only the Australian and English cases (although naturally these predominate), but also taking in Canada and New Zealand. The parts on creation and termination of agency are straightforward, direct and brisk. The former is notable for its admirable setting of the law of agency into context, by means of discussions on 'Definition', 'Comparisons to Other Legal Relationships', and the question of 'Capacity'; likewise Part III on 'Express and Implied Authority and Non-Delegation'.

The three succeeding parts: on 'Agents' Duties' and 'Rights' and on the 'Principal's Relationship to Third Parties', make up the bulk of the book. These parts each contain a detailed exposition of the state of the law in contemporary Australia, illustrated by detailed references to (and quotation of key extracts from) the case law, both leading and incidental. A notable feature of the author's treatment is the strength of his discussion of the role of equitable principles and remedies in relation to agency, seen particularly in Chapter 12 on 'Duties in Equity'. Another notable feature, welcome to Australian practitioners, is the discussion of Secret Commissions Legislation in the Australian States and Territories. Practitioners, and especially advocates, will find the author's discussion of the agent's standard of care, and the question of the extent to which Counsel can, or cannot, be regarded as an 'agent' of the client, of interest. In this regard, the author refers, *inter alia,* to the judgment of Fullagar J in *Hansen v Marco Engineering (Aust) Pty Ltd* [1948] VR 198, (at 203).

Dal Pont acknowledges in the Preface that the law of agency is never static, and he points to some very recent major Australian decisions whose effect could not be taken into account in this first edition, but which will fall to be dealt with in the second edition. These include the decision given by the Federal Court of Australia in November 2000 in *NMFM Property Pty Ltd v Citibank Ltd (No 10)* [2000] FCA 1558. Some kind of concluding chapter on 'possible directions and emerging developments' might have rounded off the work, but many of those aspects are quite adequately indicated in the relevant chapters. It may well be that our (very busy and productive) author will have the opportunity to add something along those lines to the second edition. The book's production is in the familiar format of Butterworth's legal textbooks series, and its notably high standard is a credit to the publisher.

The author, Dal Pont, teaches in the Faculty of Law in the University of Tasmania at Hobart. In 1996, his book, *Lawyers' Professional Responsibility in Australia and New Zealand,* performed a similar and very welcome service for Antipodean lawyers and legal scholars to that of the present book. That book amounted to the first truly comprehensive, very well organised and thematic treatment of its subject, containing a wealth of references to relevant and up-to-date case law, statutory materials and legal professional bodies' guidelines. It can be expected that this new book on the

Law of Agency in Australia will be equally well received, and likewise, referred to often by judges and much consulted by practitioners.

Speaking at the recent launch of the *Oxford University Companion to the High Court of Australia,* a project celebrating both that Court's upcoming centenary 1903–2002 and also, incidentally, the centenary of Australia's Federation in 1901, Chief Justice of Australia, Hon Murray Gleeson AC noted the pressing need in Australia, as elsewhere, for much more 'bridge-building' between legal practice and the academic study of law. These two fields are not strictly exclusive and autonomous, despite what some, upon each side of that particular divide, would have us all believe. Weisbrot reminded us in his *Australian Lawyers* (1990) p 123 of Max Weber's wry observation, as early as 1905, on the tendency of some forms of law teaching in modern times towards the 'emancipation *[sic]* of legal thinking from the everyday needs of the public'. That was then, and still is, a very curious and, indeed, disturbing development.

It is sound, well informed and well rounded legal scholarship like that found in the present work which will make permanent and positive contributions to the rule of law in civil society and to the public good. Dal Pont has proved himself an excellent bridge-builder, using durable materials and a solid structural sense to give us a legal work over which the needful traffic of ordinary commercial activities can be safely guided. It is not usual to comment on book dedications. However, in this case it seems to me that the manner and occasion thereof illustrates something of the author's solid grounding in the realities of justice and of community, which appears to inform and balance his discussion on the law of agency. Like Sir Isaac Isaacs (a great Australian expositor of principles in equity), Dal Pont has reflected there a heartfelt filial piety for his late mother: *Sapeva poco della lege, ma conosceva delle cose piu importanti* (she knew little of the law, but she knew about the most important things). This is a welcome and eminently useful addition to the bookshelf of the commercial lawyer.

Douglas Hassall

By Yuwa Wei, Investing in China: The Law and Practice of Joint Ventures, Federation Press, Sydney, 2000, ISBN 1 86287 345 3

Investing in China intends to study the legal, business and cultural considerations for foreign, and particularly Australian, investment in China. Wei, the author, argues that the most effective business structure for investment in China is the joint venture, and supports this argument by an analysis of the taxation, management, marketing and financial consequences in an historical, cultural and legal setting. However, she also carefully incorporates the possibility of variant purposes of foreign investment, and evaluates different types of business structures pursuant to these same criteria. Therefore, she has also provided a useful guidebook for anyone interested in investing in China.

In her second chapter, Wei outlines China's economic reform programme and its emergence into a market-driven economy. She emphasises China's strategic importance,

both political and economic. She also discusses the most viable regions for investment. In discussing the policies and practices of China in relation to foreign investment, she highlights the desirability of China as an investment venue. In addition, she indicates that China is an important target of Australian foreign investment due to its proximity and economic potential. However, previous investments have generally been underperforming. The author identifies the reasons for this as lack of understanding of Chinese consumers of distribution and retail structure, operational inefficiency and inappropriate choice of business structure.

The major part of the book is aimed at discussing the relevant concerns in choosing a business structure. Wei identifies these structures as equity and contractual joint ventures, wholly foreign owned enterprises, branches of foreign businesses in China, and other types of investment vehicles such as technology transfers and compensation trades. In future editions it is suggested that she should incorporate a more detailed analysis of the cultural and social aspects of China, which she emphasises as the main pitfall for investors.

This reviewer found certain chapters to be of particular interest. In Chapter 3, Wei discusses the Chinese legal system and legal framework for foreign investment. Here she is concerned to highlight China's growing stability, the development of the rule of law and the safety of investing in China. In Chapter 4, she discusses China's protection of intellectual property, again emphasising China's stability and legal security. Chapter 9 discusses China's dispute resolution procedures, these being mediation, arbitration and the legal process, explaining China's court system. In this forum, the author also discusses the role of international law, and conflict of laws to which the parties to a dispute must submit or may choose to submit.

Finally, the book is concerned with investigating the relevant concerns of a foreign investor: business structure, taxation consequences, management and marketing and the deployment of profits and capital. In this respect, the title is a misnomer. Wei does not investigate the law and practice only of joint ventures, but the law and practice of foreign investment. Joint ventures are merely the most efficient and predominant structure of foreign investment in China.

In Chapters 5–8, the author addresses matters of concern to investors. In discussing business structure, she highlights China's encouragement of joint ventures. However, she usefully identifies the advantages and disadvantages of each investment structure in overall terms. The joint venture in China has a different status to that of a joint venture in Australia; in particular, it can be a legal entity and therefore it can have limited liability. In other chapters, she discusses the advantages and disadvantages for each business structure in specific terms, relating to taxation benefits and consequences, issues of control and laws relating to repatriation and remittance of profits.

Wei has thus written a useful guidebook for investors interested in China. Her main concern is to highlight China's desirability as a destination for investment, but also to indicate the necessity of considering different cultural, social and legal systems in evaluating investment choices. Her work is easy to read and she provides a very useful table in her conclusion, which reiterates, in summary form, the conclusions she has reached about each of the business structures.

Federation Press should be congratulated on the publication of this useful text. It is especially important that Australian legal publishers continue to focus on Asian law.

Oanh Thi Tran

Edited by Lilian Edwards and Charlotte Waeldend, *Law & the Internet: A Framework for Electronic Commerce,* Hart Publishing, Portland, Oregon, 2000, ISBN 1 84113 141 5

This second edition follows up on the first edition: *Law & the Internet: Regulating Cyberspace* (1997), which was a collection of essays aimed at demystifying the Internet and analysing its impact on the legal profession. This is a rapidly evolving area of law, and the second edition is almost entirely revamped.

The book starts with *The Internet: An Introduction for Lawyers,* written by Andrew Terrett and Iain Monaghan. This chapter has been substantially rewritten since the first edition. The authors offer a detailed description of the physical and virtual layers of the Internet, and introduce the techno-jargon that computers and the Internet seem to attract. It also offers an overview of the legislative issues and trends that are arising in the area of ecommerce and the Internet, although the in-depth analysis is left for later chapters to explore.

Part 1 of the book addresses ecommerce issues, with four essays related to business on the web. The first essay considers some of the legal ramifications of entering into contracts electronically over the web. The author, Andrew D Murray, develops the law of contract to encompass this new communication medium, and considers factors such as contract formation, the postal acceptance rule and e-mail acceptances, and incorporation of express and implied terms. Particular attention is paid to cross-border transactions and the question of where the contract is formed, and of what law is applicable.

The remaining three chapters in Part 1 consider data privacy and security. Martin Hogg analyses the British Government's Electronic Communications Act 2000 and its application to cryptography, encryption and electronic signatures. Saul Miller follows this with a discussion about electronic payment, and raises some of the statutory provisions regulating use of credit cards. These are then compared with debit cards and with the Mondex Digital Cash system, with the legal protections for consumers being analysed. Andrew Charlesworth sums up Part 1 with a consideration of 'Data Privacy in Cyberspace', looking at privacy provisions particularly in the EU and the USA. The pace of development in this area of law is demonstrated by the need for an addendum to the chapter citing developments since it was written.

Part 2 of the book is devoted to 'Intellectual Property on the Internet'. William Black starts with a description of the 'Domain Name System (DNS)' and the way this system is managed. Charlotte Waelde follows on from this with two chapters discussing the commercial significance of the domain name and the overlap with trade marks and trading names. The Trade Marks Act 1994 (UK) provides the statutory background for the discussion of trade marks and the use of domain names. Again, this is an area that the author notes is continually changing and developing, and her second chapter considers forthcoming issues in trade mark disputes, focussing on some recent cases from the USA.

Chapter 9 of the book is written by Hector L MacQueen, and is a discussion of 'Copyright and the Internet'. This very topical issue considers copyright of commercial interests on the Internet, including music (CDs and MP3s), videos and libraries. The

author examines the legal provisions relating to information on the Internet, and the law that is developing to protect the intellectual property while also allowing reasonable reproduction by libraries, educational institutions and museums. The final chapter in Part 2 is by Paul Torremans, and analyses Internet disputes about copyright and choice of jurisdiction in terms of private international law.

Part 3 of the book relates to 'Content Liability'. Lilian Edwards opens with three chapters: the first on' Defamation and the Internet', with a particular focus on the liability of Internet service providers. Her second chapter analyses 'Pornography and the Internet', and the legislative measures being taken to regulate the pornographic content of Cyberspace, while still allowing free speech and civil liberties. Her third chapter looks at junk electronic mail, and considers the need for the legal regulation of this medium. Paul Carlyle finishes with a discussion of 'Legal Regulation of Telecommunications', and the impact this is having on the provision of Internet services.

Since the contributors are all based in the UK, the book is largely based on law derived from the UK. However, the editors do note that the USA still sets the benchmarks for ecommerce in the world, and as such, there is reference to laws and cases from that jurisdiction. There is also reference to law from the European Union countries, and Australia, where Lilian Edwards completed a sabbatical in 1999.

The book is easy to read, and despite the numerous authors, has been well edited with the result that it flows smoothly through the various topics. While each chapter could be developed into an entire text on each subject, the book provides a worthwhile overview of this developing area of law throughout the world. The statement of law in the second edition is much more developed than in the first, and with the speed of change in this area of law, it won't be long before publication of the third edition is warranted.

Peter Walsh

By Mads Bryde Andersen, *IT-Retten,* Forlaget It-Retten, Copenhagen, 2001, ISBN 87-988580-0-9

This book is one of the most complete presentations of the Danish IT law ever made. Dr jur Mads Bryde Andersen has been a Professor at Law at the University of Copenhagen since 1991, and he is one of the leading scholars in the area of IT law in the Danish legal professioon Professor Andersen is also involved in several IT law institutions both in Denmark and abroad.

IT-Retten is a thorough examination of legislation and case law regarding IT law issues in Denmark. The book's 936 pages have been divided into four main parts. The first part is an introduction to IT law, with a general explanation of the common problems within this modern law discipline. Besides a description of the historical development of the computer and IT law, and problems in regard to evidence and jurisprudence, a very useful explanatory chapter on the technical aspects of computers

and how they work has been included in Part 1. In Part 2, Dr Andersen goes through the various intellectual property rights and the consequences that the introduction of information technology has had on these legal disciplines. Part 3 is probably of least relevance for non-Danish readers. Here, the focus is on the marketing and treatment/processing of personal information. The last part of the book discusses the legal problems that can occur when a contract regarding information technology products is entered into, or when a contract is entered into by the use of information technology.

IT-Retten also contains a very useful dictionary on the technological terms used in information technology, and in the spirit of technology that this book describes, it is available for private use on www.it-retten.dk.

As with all the other books written by Professor Mads Bryde Andersen, *IT-Retten* is easy to read. He makes use of simple but very precise language, which allows the reader to focus on the important issue, IT law, which is very well described in the book.

One very user friendly aspect, which is especially expressed apparent in the second part of the book, is the way Dr Andersen first presents the general rules of a subject, for example, copyright law (Chapter 6), and then explains the unique characteristics of this branch of law in regard to information technology. The fact that Professor Andersen, in his discussion of the requirements for a copyright protectable computer program, also examines whether or not programming macros and hyperlinks are computer programs, shows exactly how thorough and complex this book is.

Due to the numerous discussions in *IT-Retten,* the book is a good starting point for any research regarding information technology law in Denmark, as well as the rest of Scandinavia.

The rapidly increasing use of the Internet has made it more important for legal systems and lawyers all over the world to find more uniform approaches to legislation regarding information technology in order to ensure the rights of the parties involved in this business. Two main issues are contract law and intellectual property law. Professor Andersen has taken up the challenge by presenting foreign law and then comparing it with the Danish approach.

Usually the interest of legal literature is within the jurisdiction which the literature presents. However, Professor Mads Bryde Andersen's *IT-Retten* is the exception that proves the rule. Due to the fact that he is constantly comparing the Danish legislation and case law with foreign jurisdiction, and due to the fact that most Danish legislation governing information technology is an implementation of European Union directives, *IT-Retten* is of high interest to most lawyers and legal scholars working with information technology law on a regular basis. Hopefully, this excellent book will be translated into English so that non-Danish speaking readers will have the opportunity to enjoy this extremely relevant and interesting presentation.

Henrik Norsk Hoffmann

By Peter Gillies, *Business Law,* Federation Press, Sydney, 2001, ISBN 186 287 378X

What a relief! Here is a legal book which is clear in language and structure, breaks down complex legal matters and covers basic legal principles: the best proof that law need not be expressed in some ancient English language with strange grammatical and semantic constructions hard to explain even for the professionals. Peter Gillies fulfils his objective, as stated in his introduction to the first edition, 1988, 'to improve the clarity of legal writing and to structure material in a logical way'.

The first four chapters give a broad overview of the Australian legal system: in the historical context, with its origin in the English system; and, within the Australian Constitution, the different sources of law (common law, equity, statute law) as well as the court/tribunal system. As a German lawyer, I found that this chapter gave me a useful introduction to the Australian legal system.

One important aspect of this book is the depth of analysis of contract law (Chapters 7–25). This can only be welcomed, as contract law is the basis of everyday dealings as well as business agreements. Basic requirements for the formation, terms and termination of a contract and, on the other hand, vitiating factors and remedies for breach of contract are fully discussed. In his discussion of contract law, Gillies refers to the leading cases and integrates useful quotations from decisions into the text. The reader who needs more information can utilise the text to undertake further research.

Later chapters refer to important aspects of business law. Chapters 26–29 examine agency, partnership and property law (real, personal and intellectual). The discussion of intellectual property is up-to-date in incorporating an analysis of the Copyright Amendment (Digital Agenda) Act 2000 (Cth). The topics of trust, succession and bailment deal with matters that are relevant in business. The remaining chapters deal fully with specific legislation that is important for business: the Trade Practices Act 1974 (Cth) and the Fair Trading Acts which concern consumer protection (Chapter 33), as well as regulating restrictive trade practices (Chapter 39). A useful table at the end of Chapter 33 refers to the provisions of the Trade Practices Act 1974 (Cth) and the corresponding provisions in the Fair Trading Acts.

Business Law is also a practical reference for 'Credit Law' (Chapter 34) and 'Insurance Law' (Chapter 35). Chapter 36, 'Bills of Exchange', and Chapter 37, 'Banks and Cheques', offer a useful guide to the use of bills of exchange and cheques. Chapter 38, 'Bankruptcy', has a good discussion of the process of invoking the bankruptcy jurisdiction, and includes a useful discussion of non-bankruptcy remedies, for example, arrangement with creditors.

Gillies has updated the chapter on company law (Chapter 40) to include the changes brought in by the Corporate Law Economic Reform Program Act 1999.

The final two chapters, 'Employment' (Chapter 41) and 'Debt Collection' (Chapter 42), are written by Tony Smith. They are equally clearly structured, containing easy-to-understand flow charts and tables. Debt collection was newly added to this edition and provides a lot of practical guidance for the procedure of recovery of debts.

The most compelling feature of this book is that it is well written and easy to understand. Each chapter contains a useful introduction that places the topic in

context and often shows the development of the legal principles. The book includes a comprehensive table of statutes and cases. The index is excellent. *Business Law* is an ideal reference book about basic legal principles that relate to business and are also relevant to legal practice. The publishers should consider publishing this important work in hardcover, as it forms an important part of the libraries of many practitioners who use the work as a first reference.

Sabina Langenham

By Raymond Jack, Ali Malek and David Quest, *Documentary Credits—The Law and Practice of Documentary Credits Including Standby Credits and Demand Guarantees,* Butterworths, UK, 2001

This third edition, eight years after the previous one, introduces two new authors and substantial re-writing in the areas of fraud, electronic credits, originality, standby credits, and conflicts of law.

The terms 'documentary credits' and 'letters of credit' are both in current use and no distinction need be made between them. 'Standby letter of credits' have a different function and a chapter is devoted to them. The International Chamber of Commerce (ICC) Uniform Customs and Practice (UCP) set the international banking standards. Documentary credits facilitate international transactions providing a promise by a bank of immediate or future payment against the presentation of document to the bank or its agent, most commonly in the sale of goods.

The authors point out that the UCP are accepted by banks in over 160 countries, including Commonwealth countries, making their application to credits almost universal.

With the incorporation by banks of the UCP into the contracts in connection with credits, a code can provide uniformity in the rights and obligations to which those contracts give rise. The authors urge the courts to adhere to the code, where incorporated, providing it is not in conflict with an express provision, and in conflict with common law precedents prior to the 1993 revision.

Although this book covers the English law, it makes greater use of Commonwealth and US materials. This overseas material is particularly important in considering an area of law where the principles are common to many jurisdictions.

The authors again highlight the remarkable statistic that over half of all documents presented are discrepant on first presentation. To assist students and practitioners, the ICC's Position Papers 1 to 4, the UCP (1993 Revision) and the ICC Uniform Rules for Demand Guarantees are appended. To assist students to familiarise themselves with the documents commonly used, Lloyds TSB Bank plc has allowed publication of their specimen forms in the appendices.

The authors postulate that as a consequence of the risks associated with the acceptance of commercial documents, standby credits, demand guarantees and performance bonds have become increasingly popular. This edition devotes considerable space to the major development in this area: the introduction of a

new set of rules, International Standby Practices 1998 (ISP98). They believe that as the ICC endorses ISP98 it is to supplant the use of the UCP for standbys.

Unlike commercial credits, where the bank pays against a bill of lading or other transport document evidencing shipment of goods, the purpose of a standby credit or independent guarantee is usually to give security against the applicant's breach of contract, not to enforce performance. Thus, in *Bachmann Pty Ltd v BHP Power New Zealand Ltd,* Booking JA stated on 11 September 1998, Supreme Court of Victoria Court of Appeal (unreported):

> International trade is facilitated by traditional credits, which provide a mechanism for performance of contracts of sale. Standby credits are a safeguard which comes into play where there is a suggestion that contracts (whose subject-matter can vary widely) have been broken.

For example, the seller/beneficiary will call on a commercial credit whenever the goods are shipped, but an employer/beneficiary will (or should) call on a standby credit or independent guarantee only if he believes that the contractor/applicant is in breach.

The other batch of instruments, variously called demand guarantees, performance bonds, etc, is fully explained under the general term 'independent guarantees'. The House of Lords considered performance bonds in *Trafalgar House v General Surety Co* (1996), but the confusing terminology in use may still lead to difficulties in construing particular instruments.

The work is comprehensive in bringing the profession up to date with electronic credits. As a documentary credit is a written record and a not physical good, it appears eminently suitable for implementation in electronic form. However, as it is only one element in the international sale transaction, an electronic credit must be part of an overall system for electronic trade. Mindful of the security risks of the interception, accidental corruption, forgery, or deliberate modification of messages en route, the authors believe that with a reliable system of authentication, electronic messages potentially provide a much more secure method of communication.

Whilst the regular use of such instruments as part of international trade is still a little way off, the authors deal with initiatives under development and examine the legal problems which will be encountered with electronic documents. They advise on the impact of the Electronic Communications Act 2000.

The extensive revision on fraud and injunctions takes account of recent cases on the right or obligation of the bank to refuse payment where there is evidence of fraud. Fraud is an exception to the principle of autonomy which requires the credit to be treated as a transaction independent from the underlying contract between applicant and beneficiary, and unaffected by disputes on that contract. It is also an exception to the rule that a bank deals in documents alone, and is obliged to pay against documents which are conformant on their face without regard to their accuracy or genuineness. The foundation stone of English law in this area is a United States case, *Sztejn v Henry Schroder Banking Corp* (1941). This is authority that the court may interfere to prevent a bank paying against

documents, and that the same fraud would entitle the bank of its own motion to refuse to pay. Important new decisions covered in the text include *Themehelp v West* (1996) and *Czarnikow-Rionda Sugar Trading Inc v Standard Bank London* (1999) on injunctions, and *Banco Santander SA v Banque Paribas* (2000) on discounting of deferred credits. The authors note that the Commonwealth authorities have made an important contribution to the development of the law in this area.

As documentary credit disputes almost always have an international element to them, the chapter on 'Conflicts of Law and Illegality' looks in greater detail at jurisdictional and choice of law issues, including the Brussels and Rome Conventions.

Since the previous edition, the area of greatest controversy has been the debate over original and copy documents, sparked by the decision of the Court of Appeal in *Glencore v Bank of China* (1996), and fanned by that in *Kredietbank Antwerp v Midland Bank* (1999). This decision represented a loosening of the rule of strict compliance which the authors suggest goes too far. Whilst the ICC issued a policy statement intended as a 'clarification' of Article 20 (ambiguity as to the issuers of documents) of the UCP, the authors are convincing in their view that it is difficult to reconcile with either of the two court decisions. The English law will have to clarify this 'unsatisfactory' matter, prior to the next edition.

Lindsey Alford JD

Book Notices

RECOLLECTIONS OF A BLEEDING HEART (A PORTRAIT OF PAUL KEATING PM)

by Don Watson

Knopf (Random House, Australia), 2001

ISBN 0 409 31655 5

This is a biography of Paul Keating, who was the Australian Prime Minister from late 1991 until 1996. His speech writer wrote this book. For those with an interest in international trade law issues, the book contains useful background material on APEC (the Asia-Pacific Economic Co-operation Forum).

SOURCES OF BIBLIOGRAPHIC INFORMATION ON PAST LAWYERS

by Guy Holborn

British and Irish Association of Law Librarians, 1999

ISBN 0 9502081 2 4

This book, which is written by the Librarian at Lincolns' Inn, is an excellent resource reference for those who are interested in undertaking research on lawyers from England and Wales.