



INTERNATIONAL INSTITUTE FOR THE UNIFICATION OF PRIVATE LAW  
INSTITUT INTERNATIONAL POUR L'UNIFICATION DU DROIT PRIVE

**UNIDROIT RESEARCH SCHOLARSHIP PROGRAMME\***

**Research reports by Scholars hosted at UNIDROIT in 2014**

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# Scholarship Interim Report

## For the International Institute for the Unification of Private Law “UNIDROIT”

Submitted by Ihab Arja

### **Introduction:**

This report is submitted to the International Institute for the Unification of Private Law “UNIDROIT” upon completion of the scholarship opportunity offered within the Research Programme for the period of 26<sup>th</sup> June-25<sup>th</sup> July, 2014.

This opportunity comes in relation to my research (thesis) titled ***“Security Interests and Remedies protecting Creditors under the Cape Town Convention & its Protocol on Matters Specific to Aircraft Equipment”- An Applied Study in the Jordanian Legal System***, in fulfillment of the requirements for the degree of MASTER OF LAW (LL.M.) in International Commercial Law by Yarmouk University – The Hashemite Kingdom of Jordan.

Additionally, as I work as a Legal Director - Aviation Jurist at the Jordan Civil Aviation Regulatory Commission (CARC) - the governmental entity responsible for regulating all the matters related to civil aviation sector in Jordan, the research will also be used for practical consideration for CARC’s proper legal application of the Convention and the Protocol, as Jordan is a Contracting State thereto.

### **Scope & purpose of the research:**

The research addresses the International Interests in aircraft and its equipments in accordance with the Convention on International Interests in Mobile Equipment 2001 (the “Cape Town Convention”) and its Protocol on Matters

Specific to Aircraft Equipment (the “Aircraft Protocol”), both ratified by the Hashemite Kingdom of Jordan in 2007 and entered into force therein in 2010. The study also addresses the legal remedies stipulated for protection of the secured creditors in the event of default or insolvency of the debtor, including consensual and judicial remedies.

The research is an applied study in the light of the Jordanian legal regime (a civil-law regime) that highlights amendments made, or shall be made, to the relevant Jordanian legislations and cases in which Jordanian law supplements the Convention where designates the applicable law in accordance with the rules of conflict of laws.

The main objective of the research is to define the relationship between the privileges provided to the secured creditor under an international interest in accordance with the Convention and the Protocol, and privileges provided to the same under a security interest in accordance with Jordanian legislations, and study its priority in application.

Therefore, the research answers a number of essential questions, embodied within the following, to achieve such purpose:

- What is the scope of application of provisions of the Convention and the Protocol and the relevant provisions of Jordanian legislations?
- To what extent do the Convention’s international interests affect the priorities of the secured creditors under the Jordanian law?
- Would the application of the Convention and the Protocol in Jordan collide with provisions of execution, attachment, priority of creditors, bankruptcy of merchants and liquidation of companies?
- Is there an actual necessity to amend the relevant Jordanian legislations to enable the application of provisions of the Convention and the Protocol without any conflict, or that the declarations made by Jordan are sufficient to achieve the alignment between them?

- Do the provisions of the Convention and the Protocol change the level of balance between the interests of the creditor and debtor in Jordanian law so overcome the creditor's interest?

### **Content of the research:**

The research studies number of essential topics, including;

- The concept of the international interest under the Convention and the Protocol, explaining types of contracts creating international interests (Security, Title Retention, Leasing and Sale contracts), and discusses the corresponding provisions within the Jordanian legislations regulating such contracts.
- Scope of application of the CTC and the Aircraft Protocol in regard to the formality and objectivity, categories of equipment covered, and the connecting factor.
- The registration system and all related matters thereto, including; the operation of the registry, approval to registration, date and duration of the registration, effects of registration, discharge and expiration of registration.
- Effects of the international interests against third parties, covering; priorities of interests and assignments and the effect of the debtor's insolvency on the international interest.
- Legal remedies available to the secured creditors on the aircraft in cases of the debtor's default; Consensual and Judicial remedies, or in case of the debtor's insolvency (Alternative "A" and Alternative "B")
- Remedies of deregistration export and physical transfer of the aircraft, and the provisions of the Irrevocable Deregistration and Export Request Authorization (IDERA).

The research also focuses thoroughly on the declarations made by Jordan at the time of ratification of the Convention and the Protocol, and the provisions that

develop concepts and rules unknown within the Jordanian legal system which may result priority of holders of registered international interests over the local creditors.

### **Conclusions and Recommendations:**

Upon completion of studying the aforementioned topics, the research stipulates a number of findings with regard to the provisions of the CTC and the Aircraft Protocol and the compatibility of the relevant Jordanian legislations with such provisions.

It concludes with number of recommendations and suggestions made by the researcher which are necessary to achieve the harmonization between the provisions of the CTC and the Aircraft Protocol and the relevant Jordanian legislations.

### **The importance of the research:**

The importance of the research lies in the fact that it addresses a Convention and a Protocol entered into force in Jordan recently, which results direct effects on the unsecured creditors, including the local Jordanian creditor. Moreover, some of the Convention and Protocol's provisions on the remedies available to secured creditor are not recognized by the Jordanian law.

This research, to the extent of the researcher's knowledge, is the first to study the Cape Town Convention and its Aircraft Protocol in the Arabic countries, which constitutes a new and pioneer addition to the Arabic legal scholarship, especially the Jordanian scholarship, since it is based on the descriptive and analytical method in connection with the Jordanian legal regime.

Air carriers, Air Operators, Investors, Banks, Regulatory bodies and Financing entities in the region shall benefit from this study in many aspects, such as when

drafting contracts to finance commercial aircraft sales and leases that include registry of international interest in accordance to CTC.

**Acknowledgement:**

I have greatly benefited from the period I spent at UNIDROIT's Library through the access to number of jurisprudential and legal references available at the library, which are not available in any Jordanian academic and legal institutions' library. This has enriched the diversity of references used in the research and made it possible to view various point of views in regard to study issues.

Finally, I would like to express my highest appreciation and thanks to UNIDROIT's staff who, graciously, made my stay comfortable and my task achievable.

It has been a positive and useful experience of great value to me. I am looking forward to any future cooperation with UNIDROIT.

**Ihab Arja**

# **A CRITIQUE OF AFRICAN STATES PARTICIPATION IN RETURN AND RESTITUTION OF CULTURAL PROPERTY UNDER THE 1970 UNESCO AND 1995 UNIDROIT CONVENTIONS\***

**BY**

**ADEWUMI, AFOLASADE A \*\***

## **INTRODUCTION**

Africa is the second largest continent after Asia. The cradle of humanity and modern humans was traced to Africa through fossils. The home of the world's first civilizations was discovered to be the Egyptian civilization in the Nile valley.<sup>1</sup> Archaeology in Africa today, is a vital intellectual component in fostering national identity and historical consciousness.<sup>2</sup>

In Western Africa, as the great 'scramble for Africa' began, the British and French antiquarians were very much interested in unearthing materials equivalent to pre historic materials unearthed in Europe. There were the ancient artifacts from Senegal and stone axes from Ghana. Ceramic works in Senegal, Mali, Niger, Ghana and Cameroon. In Nigeria there were the Benin bronzes, ancient arts of Ife, Iwo Eleru and Igbo - Ukwu art in the Eastern part of the country.

In Northern Nigeria, there existed the Nok statuettes. Esie stone sculptures also exist in Nigeria. The Horn of Africa comprising of Djibouti, Eritrea, Ethiopia, and Somalia, has the longest and possibly most diverse archaeological record in Africa.<sup>3</sup>

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\*This Report is a summary of my Ph.D Research that was completed at the International Institute for the Unification of Private Law (UNIDROIT) in Rome under the Research Scholarship Programme, btw October and November 2014, through the financial support from the United Kingdom Foundation. I sincerely appreciate the United Kingdom Foundation for the financial support and UNIDROIT for the opportunity of benefitting from the library resources. My sincere and profound gratitude goes to Ms Marina Schneider for painstakingly going through my work despite her very busy schedule and for constructively criticizing some portions of the work to make it better while also opening my eyes to areas I was not previously aware of. I also appreciate Ms Frederique Mestre for the warm welcome I received on my first day at the Institute; Ms Bettina Maxion for her great assistance in making use of the library; Ms Laura Tikanvaara and all other library staff and fellow interns for making my stay in Rome worthwhile.

\*\* A junior researcher and Ph.D student of Cultural Property Law in the Department of Public and International Law, Faculty of Law, University of Ibadan, Ibadan, Nigeria.

<sup>1</sup> The writings of the Victorian biologist Thomas Henry Huxley endorsed Charles Darwin's theories of evolution and natural selection published four years before his own work published in 1863 and titled *Man's Place in Nature*. Darwin himself speculated in 1871 in his *Descent of Man* that tropical Africa would prove to be the cradle of humankind. In 1924, *Australopithecus Africanus* was discovered by Raymond Dart and archaeologists established long Stone Age cultural sequences in eastern and southern Africa well before World War II. The late 1940's however heralded Africa's central role in human evolution; Vogel J.O., (ed.), *Encyclopaedia of Pre-Colonial Africa*, London: Sage Publications Ltd., 1997, p.51

<sup>2</sup>See Vogel J.O., *ibid*

<sup>3</sup>*Ibid*, p.75

In Southern and East Africa, countries as South Africa, Kenya, Uganda, Tanzania, Zambia, Malawi and part of Zimbabwe, Zaire have contributed immensely to the growth of archaeology.

Archaeology has played an influential role in formulating ideas about African history since the mid-nineteenth century. Africa's archaeological record extending from modern times back for nearly 2.5 million years, is the longest in the world due to the unique ability of archaeology to describe and explain human cultural change over an immensely large period of time. Archaeologists have a vital role to play in the study and interpretation of ancient Africa not only for specialist scholars but also for the whole world.<sup>4</sup> It is in this regard that Cultural Property and varied interest in it, is of paramount value to Africa as a conglomerate nation.

Brent is of the opinion that the displacement in African art took a large dimension in the 60s and 70s when the African countries were gaining independence from colonial rule.<sup>5</sup> The offer of hard currency to antiquity thieves fuelled the plundering. As far back as 1996, Drewal urged that drastic steps be taken to curb the activities of those plundering Africa's past, otherwise Africa will soon have a "landscape barren of cultural heritage."<sup>6</sup>

At the International plane, there exist two international instruments dealing with return and restitution of cultural property. One a public law instrument, the 1970 UNESCO Convention and the other a private law instrument, the 1995 UNIDROIT Convention. Despite these, the rape of Africa's cultural property continues unabated.

This situation led to the desire to undergo the research in this area to see what mechanisms and measures the international bodies have put in place to curb the scourge and how or what Africa has done by way of adopting the measures.

## **STUDY FOCUS / AIM**

This thesis is focused on bringing to limelight why Africa should participate maximally in the 1970 UNESCO and 1995 UNIDROIT Conventions on return and return restitution of cultural property by analyzing what Africa stands to benefit as a result of the Conventions.

## **OBJECTIVES OF THE STUDY**

The objectives of the research are:

- 1) To examine whether the two conventions have adequately made provisions for the main issues involved in the return and restitution of Cultural Property and if not, why?
- 2) To bring to limelight the benefits derivable from the combination of the two Conventions on the return and restitution of Cultural Property to source countries with particular reference to Africa.

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<sup>4</sup>*ibid.*, p.51

<sup>5</sup>Brent, M. (1996). A View Inside the Illicit Trade in African Antiquities. In *Plundering Africa's Past*, eds. Schmidt, P.R and McIntosh, R.J., 63–78. Bloomington and Indianapolis: Indiana University Press. Cited by Shyllon F., "Looting and Illicit Trafficking in Antiquities in Africa" in Manacorda S. & Chappell D (eds.) *Crime in the Art and Antiquities World... op.cit.* p.135 (hereinafter "Looting and Illicit Trafficking in Antiquities in Africa" ...)

<sup>6</sup>Drewal, H.J. (1996). Past as Prologues. In *Plundering Africa's Past*, (eds.) Schmidt, P.R. and McIntosh, R.J., 110–124. Bloomington and Indianapolis: Indiana University Press, cited in Shyllon F., *ibid*



- 3) To assess the extent to which African countries have participated in the 1970 UNESCO and 1995 UNIDROIT Conventions.
- 4) To examine the effectiveness of the 1995 UNIDROIT Convention in ensuring the return and restitution of Cultural Property to Africa and
- 5) To find a way forward to having more participation of African countries in the Conventions.

## RESEARCH QUESTIONS

In achieving the objectives of the thesis, the thesis raised and answered the following questions:

1. Why the clamour for return and restitution?
2. Why have both public and private law instruments on return and restitution of cultural property?
3. Are there mechanisms in place to actualize the provisions of these conventions?
4. How much impact have the conventions, the administrative and practical measures put in place by UNESCO and UNIDROIT had in Africa?
5. Why should return and restitution be a major concern for Africa?

In answering the above questions the thesis was structured into six chapters the first being the introduction that gave a background to the existence of the two conventions under study.

The second chapter discussed cultural property, its displacement and restoration. Here, Cultural Property in the context of this thesis refers to the term as defined by the 1970 UNESCO and 1995 UNIDROIT Conventions under review<sup>7</sup> thereby restricting the discussion to cultural property from a nationalistic angle<sup>8</sup> as opposed to cultural property from the international angle.<sup>9</sup> The internationalist view sees cultural property as the common heritage of mankind.<sup>10</sup> This view cannot have any bearing to the issue of return and restitution as cultural property found within a state's sovereignty cannot be regarded as *res nullius* (property belonging to no one), or *res communis* (property belonging to the whole world). Moreso, making cultural property universal contradicts the notion of 'return'.

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<sup>7</sup> 1970 UNESCO Convention, Article 1 and UNIDROIT Convention, 1995, Article 2

<sup>8</sup> Merryman J. H, 'Two Ways of Thinking about Cultural Property,' (1986) American Journal of International Law 80 at p. 831; Murphy J. D, Plunder and Preservation: Cultural Property Law and Practice in the People's Republic of China 2 –3, 155 (1995); Schmidt A. C, The Confuciusornis Sanctus: An Examination of Chinese Cultural Property Law and Policy in Action, (2000) 23 B. C. Int'l & Comp. L. Rev. 185, 192 – 198; Prott L. V and O'keefe P. J, National Legal Control of Illicit Traffic in Cultural Property, Paris, UNESCO (1983) p. 2

<sup>9</sup> Convention for the Protection of Cultural Property in the Event of Armed Conflict 1954, Article 1. The 1954 Convention coined the concept 'cultural property' and protects cultural property in armed conflicts. For materials on the implementation of the 1954 Convention and its Protocols see generally: Protecting Cultural Property in Armed Conflict, An Insight into the 1999 Second Protocol to the Hague Convention of 1954 for the Protection of Cultural Property in the Event of Armed Conflict. Woudenberg N. and Lijnzaad L. (eds.), Martinus Nijhoff Publishers, Leiden-Boston, 2010; Kila J., *Heritage under Siege*, Military Implementation of Cultural Property Protection Following the 1954 Hague Convention. 2012, Brill NV, Lesssiden.; Petrovic J., The Old Mostar and Increasing Respect for Cultural Property in Armed Conflict, Martinus Nijhoff Publishers, Leiden-Boston, 2013; O'Keefe R., *The Protection of Cultural Property in Armed Conflict*, Cambridge University Press, New York, 2006; Toman J., *Cultural Property in War: improvement in Protection*, Paris, UNESCO, 2009,

<sup>10</sup> This concept of culture as common heritage of mankind was proposed by Brazil and rejected at the Dumbarton Oaks Conference 1945 as an amendment to the UN Charter.

Cultural Property has symbolism and inspirational value which cannot be overemphasised. *Quatremère de Quincy*<sup>11</sup> has stated in ancient times that

*‘...monuments are connected diversely, extensively and in a highly significant manner with the history of the human intellect and its discoveries, errors and prejudices, and with the sources of all human knowledge. For discovering ancient customs, religious beliefs, laws and social institutions and for correcting, verifying and interpreting history, resolving its inconsistencies, making good its omissions and casting light on its obscurities, these monuments of antique art are an even greater source of inspiration than they are to the imitative arts. Thus philosophy, history, the science of languages, an understanding of the poets, a chronology of the world, scientific astronomy, and criticism are so many different parts of what is called the republic of the arts – all with an interest in the whole. Hence, where an artist may admire the genius who endows material with life, the scholar may discover a masterpiece of astronomy, a decision at a sad juncture in history, new scientific inductions, or parallels leading to a hitherto unknown truth. It is therefore in the interests of science, no less than art, that nothing should muddy, obstruct or dry up the source of this reproduction of the treasures of antiquity.’*

The Displacement of cultural property takes place as a result of trades between dealers in colonial times or occupation, wartime plunder, or appropriation or trafficking (theft or unauthorized export).<sup>12</sup> This distorts collective memory and peoples’ identities despite the constant efforts of the international community.<sup>13</sup>

This research made use of the word Restoration to cover terms such as reparation, repatriation, retrieval, return and restitution that have been used interchangeably by various writers over the years to refer to handing back of cultural property to its place of origin. These terms though often used interchangeably by writers have different legal connotations<sup>14</sup> in the sense that some issues are dealt with under public law while others are addressed under private law.<sup>15</sup> Different cases<sup>16</sup> have been used by writers in the attempt

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<sup>11</sup> *Quatremère de Quincy* A-C, Extracts from Letters to General Miranda 1796(Letter No. 2 p.20-21) in Prott L.V, *Witnesses to History* UNESCO Publishing, Paris 2009.p.19

<sup>12</sup> Cornu M. and Marc- Andre R., *New Developments in the Restitution of Cultural Property: Alternative Means of Dispute Resolution. IJCP (2010) 17: 1-31*

<sup>13</sup> Rivière F., Preface, Prott L.V.(Ed.) *Witnesses to History*.UNESCO Publishing, Paris 2009. p. xii

<sup>14</sup> Stamatoudi I., *Cultural Property Law and Restitution*, 2001, Edward Elgar Publishing, Inc. Massachusetts, p.14

<sup>15</sup> *Ibid* p 2

<sup>16</sup> Shinagawa bell case where Geneva repatriated to Shingawa in Japan, a gong that had been taken from a temple in Shingawa. For the full account See Bandle A.L., Contel R., Renold M. A., *Affaire Cloche de Shinagawa- Ville de Geneve et Japon* Platform Ar Themis (<http://unige.ch/art-adr>), Art-Law Centre, University of Geneva; *Union de l’Inde contre Credit Agricole Indosuez (Suisse) SA*, Supreme Court Decision, April 8, 2005: ATF 131 III 418. For a commentary on this case, see M.A. RENOLD, *An Important Swiss Decision Relating to the International Transfer of Cultural Goods: The Swiss Supreme Court’s Decision on the Giant Antique Mogul Gold Coins*, “International Journal of Cultural Property”, 2006, 13 (3), pp. 361-369; see also Contel, R., Chechi A., Renold M.A., *Affaire Pieces d’or geantes – Union de L’Inde contre Credit Agricole Indosuez SA*, Platform ArThemis (<http://unige.ch/art-adr>), Art-Law Centre, University of Geneva; Government of the Islamic Republic of Iran v. The Barakat Galleries Ltd. [2007] EWCA Civ. 1374. On this case, see A. Chechi – R. Contrel-M.-A. Renold, case Jiroft Collection-Iran v. The Barakat Galleries Ltd., Platform ArThemis (<http://unige.ch/art-adr>), Art-Law Centre, University of Geneva; D. Fincham,

to decide which of the terms should rightly be used for cases concluded within the scope of the Conventions under review because of their non retroactive nature and those concluded outside the scope of the conventions.<sup>17</sup>

Under the Conventions, only the terms return and restitution are used. Return would be based mainly on Article 7b of the UNESCO Convention and on chapter III of the UNIDROIT Convention which provides for the return of objects exported contrary to the laws of the country of origin, provided certain interests are damaged.<sup>18</sup> Restitution is based on Art. 7b of the UNESCO Convention and on Art. 3 of the UNIDROIT Convention.

Chapter 3 of the research examined the two conventions under review in a comparative manner and brought to limelight their complementarity which necessitates a combined use of both conventions for maximum results by states. The UNIDROIT Convention has been seen to be strongly promoted by the UNESCO Convention and as such complements the UNESCO Convention from a Private Law Perspective on its restitution mandate.

The UNIDROIT Convention is therefore seen to strengthen the provisions of the 1970 UNESCO Convention in areas that could hinder its implementation and supplements them by formulating minimum rules in terms of restitution and return of cultural objects. It guarantees the rules of private international law and of international procedure that allow the principles embodied in the 1970 UNESCO Convention to be applied.<sup>19</sup>

“Together the two Conventions,” as Lyndel Prott very well put it, “close many of the loopholes that had prevented courts from combating more forcefully the illegal trafficking of cultural objects.”<sup>20</sup>

Chapter 4 carries out a discussion of the legal, administrative and practical tools in place for implementing the provisions of conventions.

At the international level, there is a practice of having a body follow up on the effectiveness of instruments after drafting. The 1970 UNESCO Convention did not make provision for this kind of body and so for many years the Intergovernmental Committee,<sup>21</sup> though a separate body and not an organ of the 1970 Convention, had performed this role of following up on the implementation of the 1970 Convention

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Iran v. Barakat: Iran Wins Barakat Appeal, in PROTT, *Witnesses to History*, pp. 388-390; Attorney General of New Zealand v. Ortiz [1982] 3 QB 432, rev'd, [1984] A.C. 1, add'd, [1983] 2 All E.R. 93.

<sup>17</sup> Renold M., “International Tools: Return, Restitution and Beyond” in Manacorda S & Visconti A (*a cura di*) *Beni Culturali e sistema penale*, 2013, Milano, V&P Vita E Pensiero. p.127-137 at 128; Kowalski W.A., ‘Restitution’: *Art Treasures and War in Witnesses* in Prott L.V *Witnesses...* P.163; Barkan E., Making Amends: A New International Morality? *The Guilt of Nations: Restitution and Negotiating Historical Injustices* in Prott L.V *Witnesses...* P.78; Intergovernmental Committee for Promoting the Return of Cultural Property to its Countries of Origin or its Restitution in Case of Illicit Appropriation, UNESCO 1986 (Revised 1996).

<sup>18</sup> 1995 UNIDROIT Convention, Art. 5.3

<sup>19</sup> Questionnaire on the practical operation of the UNIDROIT Convention on Stolen or Illegally Exported Cultural Objects. Available at <http://www.unidroit.org/english/conventions/1995culturalproperty/1meet-120619/quest-e.pdf>

<sup>20</sup> Prott, L., *UNESCO Sources*, 72, September 1995 quoted from Shyllon F, The 16th Session of the UNESCO Intergovernmental Committee for Promoting the Return of Cultural Property to Its Countries of Origin or Its Restitution in Case of Illicit Appropriation, 21–23 September 2010 *International Journal of Cultural Property* (2011) 18:429–435

<sup>21</sup> UNESCO Intergovernmental Committee for Promoting the Return of Cultural Property to its Countries of Origin or its Restitution in Case of Illicit Appropriation. The body, is primarily a negotiating forum aimed at facilitating bilateral negotiations and agreements for the return or restitution of cultural property, particularly that resulting from colonization and military occupation to its countries of origin either when all the legal means have failed or where bilateral negotiations have proved unsuccessful.<sup>21</sup>

until recently when the Subsidiary Committee was formed as the monitoring body of the 1970 Convention.<sup>22</sup> Article 20 of the UNIDROIT Convention however makes provision for a follow up body for the convention which is the Special Committee to Review the Practical Operation of the 1995 UNIDROIT Convention on Stolen or Illegally Exported Cultural Objects.

To administratively achieve the goals of the UNESCO and UNIDROIT Conventions, UNESCO partners with other bodies in achieving its aim. In this regard, legal mechanisms, practical tools and ethical instruments have been developed by UNESCO, UNIDROIT and the partner institutions in order to contribute to the fight against displacement of cultural property. The partner institutions are The International Criminal Police Organization ICPO/ INTERPOL<sup>23</sup>; The World Customs Organization (WCO)<sup>24</sup>; United Nations Office on Drugs and Crime (UNODC)<sup>25</sup>; European Union<sup>26</sup>; The International Council of Museums (ICOM)<sup>27</sup> and The Art Market which though not exactly a partner institution, has been added to the list because of the role being played in recent times in the area of due diligence in assisting to stem the tide of illicit trafficking of cultural property.

The legal mechanisms are the UNESCO-UNIDROIT Model Provisions on State Ownership of Undiscovered Cultural Objects<sup>28</sup> and Bilateral Agreements - United States Import Control Mechanism.<sup>29</sup>

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<sup>22</sup> The Subsidiary Committee was elected by the Extraordinary meeting of the States Parties to the 1970 Convention which took place on 1st July 2013. Available at <http://www.unesco.org/new/en/culture/themes/illicit-trafficking-of-cultural-property/subsidiary-committee/1st-sc-session-2013/>

<sup>23</sup> The ICPO has been of tremendous help in the task of the return and restitution of cultural property. For further information see The International Criminal Police Organization ICPO/ INTERPOL. A paper presented by Romeo Sanga during the Regional Workshop on the 1970 UNESCO Convention on the Means of Prohibiting and Preventing the Illicit Import, Export and Transfer of Ownership of Cultural Property - held in Jomtien, Thailand, February 24-28, 1992

<sup>24</sup> The WCO is the only intergovernmental organisation which deals exclusively and systematically with the study of matters of customs technique. see Diagne A, [WCO] at a regional workshop on the 1970 UNESCO Convention on the Means of Prohibiting and Preventing the Illicit Import, Export and Transfer of Ownership of Cultural Property, held in Jomtien, Thailand, February 24 – 28, 1992; The WCO assisted UNESCO in the preparation of the 1970 Convention.

<sup>25</sup> UNODC has recognised that the actions of illicit traffickers in art and antiquities have many similarities to those engaged in other organised transnational criminal activities, including drugs and arms trafficking. As such, illicit trafficking in art and antiquities are activities which might be better targeted by collaborative law enforcement efforts using the powers already given by an international instrument like the UN Convention against Transnational Organised Crime, agreed in 2000 in Palermo, Italy. For more information See generally Manacorda S. & Chappell D., “From Cairo to Vienna and Beyond: Contemporary Perspectives on the Dialogue About Protecting Cultural Artefacts from Plunder”, in Manacorda S. & Chappell D (eds.) *Crime in the Art and Antiquities World, Illicit Trafficking in Cultural Property*, Springer, New York, 2011, p.1; UNODC mandates on illicit trafficking in cultural property, <https://www.unodc.org/unodc/en/organized-crime/trafficking-in-cultural-property-mandate.html>; Salvador Declaration, [https://www.unodc.org/documents/crime-congress/12th-Crime-Congress/Documents/Salvador\\_Declaration/Salvador\\_Declaration\\_E.pdf](https://www.unodc.org/documents/crime-congress/12th-Crime-Congress/Documents/Salvador_Declaration/Salvador_Declaration_E.pdf); [https://www.unodc.org/documents/organized-crime/UNODC\\_CCPCJ\\_EG.1\\_2012/A\\_RES\\_66\\_180\\_E.pdf](https://www.unodc.org/documents/organized-crime/UNODC_CCPCJ_EG.1_2012/A_RES_66_180_E.pdf); [https://www.unodc.org/documents/organized-crime/UNODC\\_CCPCJ\\_EG.1\\_2012/ECOSOC\\_Res\\_2010\\_19\\_E.pdf](https://www.unodc.org/documents/organized-crime/UNODC_CCPCJ_EG.1_2012/ECOSOC_Res_2010_19_E.pdf); [http://www.un.org/en/ga/search/view\\_doc.asp?symbol=A/RES/68/186](http://www.un.org/en/ga/search/view_doc.asp?symbol=A/RES/68/186); <https://www.unodc.org/unodc/en/organized-crime/trafficking-in-cultural-property-expert-group-2014.html>; Trafficking in cultural property: organized crime and the theft of our past. Available at <http://www.unodc.org/unodc/en/frontpage/2012/October/trafficking-in-cultural-property--organized-crime-and-the-theft-of-our-past.html>

<sup>26</sup> Directive 2001/38/EC of the European Parliament and of the Council of 5 June 2001 amending Council Directive 93/7/EEC on the return of cultural objects unlawfully removed from the territory of a Member State, in OJEU L187/43, 10.07.2001 proposes to complete the mechanism of restitution provided by the UNIDROIT Convention in the cases of goods that have been illicitly exported from one or more Member States.

<sup>27</sup> ICOM is devoted to the promotion and development of museums and the museum profession at an international level. It carries out part of UNESCO’s programme for museums and its secretariat incorporates the UNESCO-ICOM Museum Information Centre.

<sup>28</sup> The Model Provisions are intended to serve as a complement to the work of the organs responsible for their commission and the relevant partners and associates because they are aimed at facilitating the application of the 1970 UNESCO Convention and the 1995 UNIDROIT Convention. Each state is encouraged to implement it even though it is not a binding legal instrument.

<sup>29</sup> This is an international framework of cooperation aimed at reducing the incentive for pillage and unlawful trade in cultural objects

The Practical tools are Alternative Dispute Resolution Methods<sup>30</sup>; Object ID - The Inventory of Cultural Property Items<sup>31</sup>; UNESCO – WCO Model Export Certificate<sup>32</sup>; Basic Actions concerning Cultural Objects being offered for Sale over the Internet<sup>33</sup>; Basic checklist for national legislation by UNESCO<sup>34</sup>; Guidelines for proper implementation of national legislation<sup>35</sup>; Basic checklist of practical measures.<sup>36</sup>

The above shows that a lot of mechanisms have been put in place in ensuring that the provisions of the 1970 UNESCO Convention and the 1995 UNIDROIT Conventions are actualized. The formulation of national regulations and laws on the protection of cultural property is however not an end in itself but a means to an end. It is to enable the state parties successfully implement an international policy of control which does not get tangled in the web of national differences.

Chapter 5 after considering the wealth of Africa in cultural property as stated above, looks into the manner some African countries such as Egypt, Nigeria, Mali, Ghana and Zimbabwe have been deprived of their cultural property after colonization up till the recent times. The scenarios confirm the pattern of a network of thieves, smugglers, and middlemen connecting the authentic items from illicit excavations, churches, or museums, with the dealers in market countries. It is through a well-connected foreign dealer who ships the items abroad and sells them that they are laundered and placed in the legal market, for example, Belgium, Switzerland, or the Netherlands.<sup>37</sup>

In figuring out Africa's participation in the two Conventions, it has been deduced that fourteen years after the 1995 Convention came into existence, the five African countries who are signatories to the Convention are still signatories and have not taken any further step in the matter while Nigeria<sup>38</sup> and Gabon<sup>39</sup> have ratified the Convention.<sup>40</sup> The African representation of the UNIDROIT Convention can be regarded as 4%.

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<sup>30</sup> Several cases resolved through ADR exist on the ArThemis platform available at (<http://unige.ch/art-adr>), Art-Law Centre, University of Geneva.

<sup>31</sup> Years of research by UNESCO in collaboration with the museum community, international police and customs agencies, the art trade, insurance industry, and valuers of art and antiques led to the creation of Object ID as an international standard for describing cultural objects. Available at <http://archives.icom.museum/object-id/about.html>

<sup>32</sup> This model certificate has been recommended by UNESCO and the WCO in its entirety or in part, as the national export certificate specifically for cultural objects as opposed to the same export form currently in use for all other objects and cultural objects. UNESCO - WCO Model Export Certificate, <http://www.unesco.org/new/en/culture/themes/illicit-trafficking-of-cultural-property/legal-and-practical-instruments/unesco-wco-model-export-certificate/>

<sup>33</sup> INTERPOL, UNESCO and ICOM developing a list of Basic Actions to be followed by their member states to counter the Increasing Illicit Sale of Cultural Objects through the Internet. Basic Actions concerning Cultural Objects being offered for Sale over the Internet available at [http://www.unesco.org/new/fileadmin/MULTIMEDIA/HQ/CLT/pdf/basic-actions-cultural-objects-for-sale\\_en.pdf](http://www.unesco.org/new/fileadmin/MULTIMEDIA/HQ/CLT/pdf/basic-actions-cultural-objects-for-sale_en.pdf)

<sup>34</sup> Member states of UNESCO are expected to have respective national legislation that are made for the purpose of promoting return and restitution of cultural property. See Legal and Practical Measures Against Illicit Trafficking in Cultural Property, UNESCO HANDBOOK, *op.cit.*, p.5

<sup>35</sup> UNESCO expects that once states have followed the checklist in having a strong national legislation, they should take necessary steps in properly implementing the laws. See See Legal and Practical Measures Against Illicit Trafficking in Cultural Property, UNESCO HANDBOOK, *op.cit.*, p.7

<sup>36</sup> Majority of legal measures manifest as practical measures when implemented. UNESCO therefore expects states and other relevant entities to consider in addition to the legal measures, basic practical and protective measures. See UNESCO HANDBOOK, *op.cit.* p.14

<sup>37</sup> Gado, B. (2001). The Republic of Niger. In Brodie, N., Doole, J., Renfrew, C. (eds.). *Trade in Illicit Antiquities: The Destruction of the World's Cultural Heritage* (57–72). Oxford: Oxbow Books; Schmidt, P. R., McIntosh, R. J. (1996). *Plundering Africa's Past*. Bloomington: Indiana University Press. Both cited by Tijhuis A.J.G *loc.cit*

<sup>38</sup> Nigeria ratified the Convention on 10/12/2005 and it entered into force on 01/06/2006

<sup>39</sup> Gabon ratified the Convention on 12/05/2004 and it entered into force on 01/11/2004



At the first meeting of the Special Committee to Review the Practical Operation of the 1995 UNIDROIT Convention on Stolen or Illegally Exported Cultural Objects questionnaires were given to all persons present both states parties and non-state parties. Six African countries were in attendance.<sup>41</sup> Nigeria was there as a state party, Cote d'Ivoire as a signatory, Botswana, Cameroon, Ghana and Mauritius as other States present at the meeting. Questionnaires were distributed to all countries present both state parties and non-state parties. Nigeria being the only State Party present.

Nigeria joined the UNIDROIT Convention in 2007 and by 2012 stated in the questionnaire that efforts were being made towards domestication. Up till now, seven years after, the process has not been concluded.<sup>42</sup> No formal claims for restitution has ever been made by Nigeria and the country cannot estimate the percentage of items stolen each year. Nigeria has no provision on State ownership of cultural property. The provision on exportation in the local legislation<sup>43</sup> allows for exportation abuse<sup>44</sup> and as such needs to be brought in line with the Conventions. No bilateral treaty exists with any other state in respect of cultural property and the country cannot boast of more favourable rules than what the convention offers. The other African states in attendance though not yet parties to the UNIDROIT Convention are not better placed than Nigeria from their responses to the questionnaires.

From a cursory look at the answers given by African countries there present, it shows that a lot has to be done in the area of ensuring the implementation of the UNIDROIT Convention in Africa as there is nothing to show its relevance in African countries even after nineteen years of its being in force and as a self-executing Convention with its provisions written as rules and without reservations.

To determine the effectiveness of the 1970 UNESCO Convention, a survey of some of the legislation of African countries on cultural heritage was carried out. Thirty African countries are members of the 1970 Convention. The African representation of the 1970 Convention can be regarded as 50%. The 30 member countries<sup>45</sup> are Algeria, Angola, Burkina Faso, Cameroon, Central African Republic, Chad, Cote d'Ivoire, Democratic Republic of the Congo, Egypt, Equatorial Guinea, Gabon, Guinea, Lesotho, Libya, Madagascar, Mali, Mauritania, Mauritius, Morocco, Niger, Nigeria, Rwanda, Senegal, Seychelles, South Africa, Swaziland, Tunisia, United Republic of Tanzania, Zambia, and Zimbabwe. Ethiopia,<sup>46</sup> Ghana, and

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<sup>40</sup> STATUS/etat-UNIDROIT Convention on Stolen or Illegally Exported Cultural Objects (Rome, 1995) / convention d'unidroit sur les biens culturels volés ou illicitement exportés. Last updated, 21 February 2014, available at <http://www.unidroit.org/status-cp>

<sup>41</sup> Answers to the questionnaire relating to the practical operation of the 1995 UNIDROIT Convention. Available at <http://www.unidroit.org/english/conventions/1995culturalproperty/1meet-120619/list-answquest-ef.pdf>

<sup>42</sup> *ibid*

<sup>43</sup> NCMM Act, Section 25; The National Commission for Museum and Monuments (Export Permits) Regulations (L.N 62 of 1957), Section 2 (2)

<sup>44</sup> See Adewumi A.A, A Critique of the Nigerian Legal Framework for the Protection of Cultural Goods from Exportation Abuse. *Unilorin Journal of International and Comparative Law* (in press).

<sup>45</sup> See List of States Parties to the Convention in alphabetical order, [www.unesco.org/eri/la/convention.asp?KO=13039&language=E&order=alpha](http://www.unesco.org/eri/la/convention.asp?KO=13039&language=E&order=alpha), accessed 26 September 2013; see Shyllon F., Legislative and Administrative Implementation of 1970 UNESCO Convention by African States: The Failure to Grasp the Nettle, *International Journal of Cultural Property* (2014) 21:23–53 (hereinafter called Legislative and Administrative Implementation...*loc. cit.*) There are 55 countries on the continent of Africa. All are members of the AU except Morocco. Morocco withdrew from the Organization of African Unity (OAU), AU's predecessor, in 1984 following the recognition of Sahrawi Arab Democratic Republic declared by the Polisario Front by the majority of OAU members. Shyllon is aware that under UNESCO regional grouping, 48 sub-Saharan African countries comprise Group V (a), while seven, namely Algeria, Egypt, Libya, Mauritania, Morocco, Sudan, and Tunisia, are classified as Group V (b).

<sup>46</sup> Shyllon F, *loc.cit* states that "Ethiopia ratified the 1970 Convention, and the Decree was published in the National Gazette (Federal Negarit Gazeta, 28 October 2003, containing the proclamations number 373/2003 and 374/2003 of the ratifications of the 1954 Hague

Kenya are among the countries that are not States Parties. Linguistically, Francophone countries are better represented than Anglophone ones. Geographically, six out of seven North African countries are States Parties.<sup>47</sup> West Africa has a good representation, while Southern Africa is poorly represented.

African countries not parties to the UNESCO Convention such as Ethiopia<sup>48</sup>, Benin<sup>49</sup>, Botswana<sup>50</sup>, Lesotho<sup>51</sup>, Namibia<sup>52</sup>, Democratic Republic of the Congo (DRC)<sup>53</sup>, Kenya<sup>54</sup>, Malawi<sup>55</sup>, Swaziland<sup>56</sup> have their provisions on cultural property protection compared with countries that are state parties to the UNESCO convention such as Algeria<sup>57</sup>, Egypt<sup>58</sup>, Cote D'ivoire<sup>59</sup>, Democratic Republic of Congo<sup>60</sup>, Madagascar<sup>61</sup>, Mali<sup>62</sup>, Mauritania<sup>63</sup>, Nigeria<sup>64</sup>, South Africa<sup>65</sup>, Tanzania<sup>66</sup>, Zambia<sup>67</sup>, Zimbabwe<sup>68</sup>. The result shows that the State Parties to the UNESCO Convention were not better off than the countries that have not yet joined the convention in terms of legislation.

The survey shows that both states that have ratified the Conventions and States that have not ratified the Conventions are somehow operating on the same level as regards the subject matter of the Convention.

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*Convention and its First Protocol as well as of the 1970 UNESCO Convention). However, in the official UNESCO lists of States Parties to the Conventions, Ethiopia is missing. This means that the official instruments of ratification have never been deposited with the UNESCO Director General or the Director of the Office of International Affairs. Therefore, Ethiopia cannot be listed as a Party. I am grateful to Edouard Planché of UNESCO for drawing my attention to this situation."*

<sup>47</sup> Algeria, Egypt, Libya, Mauritania, Morocco, and Tunisia. Sudan is the only non-member.

<sup>48</sup> The Proclamation to Provide for Research and Conservation of Cultural Heritage 2000,

<sup>49</sup> Benin has the Order on the Protection of Cultural Property of 1 June 1968; Benin **also** has Law No. 20 of 2007 on the Protection of Cultural and Natural Heritage

<sup>50</sup> National Museum and Art Gallery Act of 1967; The Monuments and Relics Act 1970 as amended in 2001.

<sup>51</sup> Lesotho has the Historical Monuments, Relics, Fauna and Flora Act of 1967 and the National Heritage Resources Bill of 2011

<sup>52</sup> Namibia has the National Heritage Act 2004, National Art Gallery of Namibia Act 2007, National Arts Fund of Namibia Act 2005 and National Policy on Arts and Culture Act 2001

<sup>53</sup> Democratic Republic of Congo's Law 1971

<sup>54</sup> The National Museums and Heritage Act of 2006,

<sup>55</sup> Malawi has Museums Act 1989 and Monuments and Relics Act 1990

<sup>56</sup> Swaziland has the National Trust Commission Act 1971, as amended by the King's Order I Council of 1973 as the enactment protecting the State's cultural heritage.

<sup>57</sup> Algeria became a party to the 1970 Convention on 24 June 1974. The heritage legislation is Algeria's Ordinance No. 67-281 of 1967 relating to the excavation and protection of Natural and Historic Sites and Buildings.

<sup>58</sup> Egypt joined the 1970 Convention on the 5 April 1973. The heritage legislation is Egyptian Law on the Protection of Antiquities (1983), Law 117 as amended by Law No. 3 of 2010 Promulgating the Antiquities' Protection Law

<sup>59</sup> Cote d'Ivoire became a party to the 1970 Convention in 1990. The heritage legislation is The Law of 28 July 1987 relative to the protection of Ivorian cultural heritage.

<sup>60</sup> Democratic Republic of Congo's (DRC's) law concerning the protection of cultural property of 1971

<sup>61</sup> Madagascar joined the Convention in 1989. The heritage legislation is Madagascar's Order of 6 November 1982 on the Protection, Safekeeping and Preservation of National Heritage.

<sup>62</sup> In 1987 Mali ratified the 1970 Convention. The heritage legislation are Law No. 85-40 concerning the protection and promotion of the national cultural heritage which was passed on 26 July 1985. This was followed on 4 November 1985 by the enactment of the Decree No. 275 regulating archaeological excavations; Law No. 86-61 controlling traders in cultural objects was promulgated on 26 July 1986; On 19 September 1986 (Decree No. 999), was promulgated regulating the excavation and marketing of cultural objects;

<sup>63</sup> Mauritania joined the 1970 Convention on 27 April 1977. Mauritania promulgated the Law relating to the Preservation and Cultural Promotion of the National Prehistorical, Historical and Archaeological Heritage on 31 July 1972

<sup>64</sup> Nigeria became a party to the 1970 Convention on 24 January 1972 as its third member country. Up till now, close to nothing has been done to implement the Convention in Nigeria.<sup>64</sup> The current legislation for the protection of both moveable and immovable cultural heritage is the National Commission for Museums and Monuments Act 1979

<sup>65</sup> South Africa joined the Convention on 18 December 2003. The heritage legislation is The National Heritage Resources Act, 1999 of South Africa

<sup>66</sup> The Antiquities Act 1964 was modified by the Antiquities (Amendment) Act of 1979.

<sup>67</sup> Zambia joined the 1970 Convention on 21 June 1985. The heritage legislation is the National Heritage Conservation Commission Act of 1989

<sup>68</sup> Zimbabwe became a state party to the Convention on 30 May 2006. The heritage legislation is The National Museums and Monuments Act 1972 as amended in 2001

This may be attributed to the fact that the conventions have not been domesticated in the countries that have ratified the conventions. It can therefore be said that no African country as at today, has any legislation specifically aimed at implementing the provisions of the 1970 UNESCO and 1995 UNIDROIT Conventions. Some countries have, however, fortuitously passed laws that can be said to have partially implemented the provisions of the Conventions in some areas. This brings to light the fact that it can be optional for States to actually pass an implementing legislation for the Conventions once there are other avenues of implementing the provisions of the Conventions. For example, Kenya (a non-member) in Antiquities Act 1983 and Egypt (a member) under Egyptian Law 117 of 1983 both declared state ownership of cultural property. Madagascar in her legislation passed in 1982 which was seven years before joining the Convention states that the law is an attempt *totally or partially* to stop looting and illicit trafficking. Mauritania's legislation enacted in 1972, five years, before membership of the Convention talks about the imprescriptibility of cultural property, movable or immovable. In other words, the law recognizes that cultural objects are *res extra commercium*. However, the danger in using this approach,<sup>69</sup> of not passing an implementing legislation, is that if the relevant laws are not clearly spelt out anyone wishing to recover an object may have a difficult time establishing his case.<sup>70</sup>

The above makes the following queries apt: Is it now good enough for Africa to fold her arms and continue to watch the displacement of her cultural property go on unhindered while the efforts of UNESCO and partner institutions continue to have no efficacy over Africa? Should the rape of Africa continue unabated in a way that the future generations are denied of the priceless portion of the inheritance which should epitomize their enduring identity? I do not think so. This leads to the recommendations on the way forward out of this predicament.

## RECOMMENDATIONS

The recommendations will be in two parts. The first part will be recommendations to African countries while the second part will be recommendations to UNESCO and UNIDROIT, the international bodies concerned in this issue of return and restitution, as well as their partner institutions.

### Recommendations to African countries

*'Think globally, but act locally'.*<sup>71</sup>

Widespread lack of awareness of the problem and a lack of priority given to the issue is the major problem of African countries. Positive practical steps must be taken by African governments instead of waiting and expecting society to fix itself.

To feel the impact of the Conventions, African countries have a lot to do internally. The following are hereby recommended:

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<sup>69</sup>Similar to how the United States utilise her Stolen Property Act and Archaeological Resources Protection Act and other laws to combat illicit trafficking in cultural property. The United Kingdom has not passed a new legislation on cultural heritage generally since it became a member of the Convention but uses existing powers under other Acts and a new piece of legislation on criminal import of illicitly exported cultural objects known as Dealing in Cultural Objects (Offences) Act 2003.

<sup>70</sup>Shyllon F., Legislative and Administrative Implementation... p.12

<sup>71</sup> Becerril Ernesto, The Necessary Evolution of the Mexican Law under the New Paradigm of the 1972 UNESCO Convention in order to Strengthen the Fight against the Illicit Trafficking of Cultural Property. Jorge A.S (ed.) The 1970 Convention New Challenges, *Universidad Nacional Autonoma De Mexico*, Mexico, 2013. 45-55 at 54



## **At National Level**

### **1. Making cultural property Protection a priority issue:**

Effective combat of displacement of cultural property require resources in the form of money, trained manpower, facilities and logistics. Once the government of a country puts cultural property matters high on its scale of preference in allocation of resources, there will be adequate funds to operate in the sector internally.

### **2. Improvement of Status of Heritage Treaties/ Conventions**

In Africa, especially Nigeria, Cultural property should be removed from the category of treaties which may or may not need to be ratified under the Nigerian Treaties Act. This will ensure that agencies of government and executive authorities would not be emboldened to conclude agreements which might not serve the overall best interest of Nigeria as happened with the three Nok objects. However, it is suggest that the self-executing status that has been accorded under the Nigerian Constitution to the Conventions dealing with labour matters probably because they affect human dignity, should be accorded cultural heritage conventions as there can be no dignity without identity. This will go a long way in ensuring that the citizens are able to checkmate the fulfilment or otherwise by the government of her obligations under the Conventions.

### **3. Building coalition among municipal laws**

There is a need for all areas of municipal laws to be involved in protecting cultural property due to the peculiar nature of cultural property. All aspects of municipal laws like town planning laws, environmental laws, land use laws and so on should have provisions protecting cultural property.

### **4. Harmonisation of rules**

African states are hereby encouraged to adopt the UNESCO-UNIDROIT Model Provisions on harmonization of rules even though it is not a binding document because it provides for state ownership of cultural property as already exists in Egypt and Kenya.

**5. Training of law enforcement personnel-** knowing fully well that a list of procedures and best practices will help facilitate the work of police forces in the fight against the illicit trafficking of cultural property,<sup>72</sup> their training should be centered on how to identify, handle and store heritage objects. Other African countries should emulate South Africa's system of sophisticated training scheme for her heritage inspectors in this regard. For national cooperation, other African countries can emulate South Africa which has a National Forum for the Law Enforcement of Heritage related matters (NALEH) established to create a platform for a working relationship between law enforcement and heritage officials which comprise of South African Police Service, Customs, Interpol, South African Heritage Resources Agency, ICOM South Africa and the University of South Africa. This allows for the dissemination of information and the sharing of ideas regarding the protection of cultural property. Also, to ensure the quick identification of suspected objects, the telephone directory of experts in this field should be distributed to the police. Having a brochure on reporting procedures for illegal handling of cultural objects is equally a great idea highly useful for apprehending heritage criminals and probably expedite police processes.

**6. Use of Bilateral Agreements:** African States should enter into bilateral agreements with other states holding their prized cultural objects and also consider utilizing the **United States Import Control**

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<sup>72</sup> Working Meeting on "Model procedure for restitution of cultural objects on sale" 11 February 2014 - Room VIII, UNESCO Headquarters, Paris. Available at <http://www.unesco.org/new/en/culture/themes/illicit-trafficking-of-cultural-property/meetings/forums-seminars-and-information-meetings/working-meeting/#c1383040>

**Mechanism.** Sub-Saharan African countries like Burkina Faso, Cameroon, Chad, Cote d'Ivoire, Niger and Nigeria who like Mali are also on ICOM'S "Red List" should make use of this opportunity to enjoy the benefits of reducing the influx of its heritage items to the United States.

**7. Utilizing the Alternative Dispute Resolution Methods-** Arbitration, Mediation, Conciliation and Negotiation should be made use of by African states in recovering cultural objects more so when these alternative methods are not affected by the clogs in the wheels of litigation and lead to different outcomes which make for cordial relationships and compromise.

**8. Promoting public awareness through education-** No matter how well-crafted legislation is, its provisions cannot be fully actualized if the people, especially those at the grassroots, are not educated as to its importance. The people need to be sensitized through education and public awareness programs on the negative effects of displacement of cultural property and the need for their restoration. Such avenues to promote public awareness of the advantages that may be derived from the proper placement of cultural property include seminars, use of broadcasting houses, newspaper advertisement and enlightenment and so on. The local people can be educated as to the existence of law prohibiting looting of sites and their attention drawn to the need for protection in the interest of posterity. There must be extensive publicity on the damage caused by destruction of antiquities through dismembering and theft from collections with an explanation of the negative effects of displacement and why it must be prevented and stopped. Television programs and radio broadcasts can be a very successful tool in this area.<sup>73</sup> The general public should be sensitized too about the need to build up the old and ancient legal constraint on sale of cultural objects as existed in the olden days which has now been broken down due to westernization.

**9. Enhancing formal education on cultural property-** The study of history is being eroded from the curriculum of schools right from the primary to the tertiary levels in some African countries like Nigeria. It should be noted the schools are the best centers for education of the literate percentage of the populace. The curriculum of schools should be well adjusted to accommodate the values and benefits of cultural property.

**10. Organizing trainings and workshops-** Government at all levels, policy makers, religious organisations, governmental, non-governmental organisations, civil society leaders and young people must be actively educated through trainings and workshops on the need and importance of protecting and ensuring the return and restitution of cultural property and thereafter involved in the sensitization of the masses and those at the grassroots.

#### **11. Creation of local museums-**

The creation of local museums should be encouraged as affinity to the local people is the best guarantee for the protection of cultural material once it is secured by the people. Many of these irreplaceable objects come from the local and remote areas and these people are the best in terms of positioning to guard against their loss as they understand the meaning and significance of the objects most.

**12. Promulgation of proper legislation at the national level-** There is no gainsaying the fact that the present African laws are inadequate in protecting cultural objects. Many of these laws were adapted from European laws and as such do not reflect the African realities. African states should utilize the Basic checklist for national legislation by UNESCO in drafting up to date laws for protecting their cultural property.

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<sup>73</sup> O'Keefe P., *Trade in Antiquities, Reducing Destruction and Theft*, 1997, Archetype Publications Ltd and UNESCO, London and Paris. p.95

**13. Capacity building of museum professionals** - A lot still has to be done in the area of building capacity in museum professionals even though ICCROM (International Centre for the Study of the Preservation and Restoration of Cultural Property) programme *Prevention dans les Musees Africains (PREMA)*(1986-2000); *Ecole du Patrimoine Africain (EPA)*(1998); the Programme for Museums Development in Africa(PMDA)(2000) which in 2004 was renamed Center for Heritage Development in Africa (CHDA) are doing a great work in training, researching, conservation and development of movable and immovable cultural property. .

**14. Provision of adequate security of museums**- it is an open secret that our security measures around the museums in Africa, (with the exception of South Africa) is not tight at all. The situation depicted by the words of Shyllon<sup>74</sup> in 1996 as regards the status in Nigeria of museums, which is the same for many African countries, that: “*At the moment, national museums across the country lack critical security infrastructure namely, well trained security personnel, electronic burglary alarm systems and close circuit television monitoring systems*” still obtains.

African governments must ensure that the security condition of our museums is tightened. Close circuit television monitoring systems and electronic burglary alarm systems should be installed. While well trained security personnel should be made to man the museums.

**15. Entrenchment of uniform documentation of cultural objects** - African countries are enjoined to ensure that they have a uniform manner of documenting cultural objects and an adequate database of their heritage items which will go a long way in assisting the recovery, proper description and identification of cultural object if missing and the onward transmission of it to its country of origin. Making use of the object ID standard of ICOM is hereby promoted.

**16. Provision for adequate Compensation to Chance Finders of cultural objects:** African countries should reappraise their national laws to ensure that they contain provisions adequately compensating chance finders of cultural objects by either paying the economic or international market value of the object to the finder. This, it is presumed, will ensure that such finds are relinquished to the government instead of smuggling them out for better remuneration. A provision in this respect will go a long way in reducing the incidence of smuggling to the barest minimum, if not eliminating it totally.

**17. Effective Utilization of Intergovernmental Committee and facilities** - Bearing in mind the fact that the Intergovernmental Committee was established as a result of agitations by African States within UNESCO, one would expect that African States will maximally utilize whatever the Committee has to offer. Unfortunately, the reverse is the case. Little use of the Committee’s good offices in the recovery of their expropriated cultural property has however been made by African countries. Tanzania is the only African country that has filed a case in connection with her stolen Makonde mask. African countries are hereby encouraged to benefit from the work of the Committee moreso when it deals with cultural property expropriated before the coming into force of the 1970 Convention and 1995 Conventions. In this regard they should facilitate bilateral negotiations under the auspices of the intergovernmental committee.

**18. Export control Provisions**- The controversies arising from the wording of the export control provisions of both conventions has led to the bodies drafting *National Legal Control of Illicit Trafficking in Cultural Property*. African countries are hereby enjoined to comply with this document in securing their cultural property from undue exportation.

**19. Criminal Sanctions and Criminal Responsibility**- International law is currently moving towards a substantial strengthening of penal instruments that could in future lead to a notable

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<sup>74</sup> Shyllon F., Implementation...p. 24

intensification of criminal sanctions for illicit activities in the field of cultural property as discussed under UNODC. To move with this trend, the criminal law provisions of African states should be developed by identifying the objects to be protected and the constituent elements of the offences. Also, there should be an extension of *criminal responsibility* from physical persons to *juridical persons*. This will take care of a number of criminological features in this sector (strong group pressures on individual participants, porosity between licit and illicit markets), as well as some normative peculiarities (a high presence in the sector of deontological codes, supported by a possible attribution of liability to juridical persons

### **At Regional Level**

**20.** There should be a move towards harmonisation of laws through the African Union, (or initially through sub- regional groupings like ECOWAS, the Economic Community of West African States), as is being done in the European Union, for example, through the Council Regulation and Directive.<sup>75</sup> The Common wealth scheme for Protection of Cultural Heritage<sup>76</sup> within the commonwealth is not adequate in this regard as it is not obligatory like the European Union Directive.

### **Recommendations to the International Bodies**

Due to the realities facing the African countries as developing countries such as poverty, lack of infrastructure, manpower, awareness and technical know-how, the following are required of the international bodies behind the Conventions to ensure the effectiveness of the conventions:

#### **1. Establishing a Joint International Fund**

The international bodies should ensure that there is an international joint Fund to assist African countries and other source countries in effecting return and restitution of their cultural objects. Poor requesting states can't afford to pay compensation so all countries must be mandated to pay a certain amount regularly into this fund which will be strictly utilised for this purpose. Voluntary contributions from States and private institutions alone will not suffice as adopted under Recommendation 6 for the establishment of an International fund for training and education projects.<sup>77</sup> This joint fund advocated for, it is believed, will give efficacy to the UNIDROIT Convention as can be seen from the comments in the questionnaires answered by Cameroon, Ghana and Mauritius that financial aid is needed in participating in the convention.

In the same manner the UN Trust Fund created in 1989 has been assisting in reducing the financial burden of court proceedings on states in settling disputes through the International Court of Justice (ICJ), so also this fund advocated for will assist African States in the cost of legal proceedings, in exploiting the alternative dispute resolution claims and also in bringing claims before the Intergovernmental committee.

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<sup>75</sup> European Council Regulation on the Export of Cultural Goods (the "Council Regulation") of 9 December 1992, and the European Council Directive on the Return of Cultural Objects Unlawfully Removed from the Territory of a Member State (the "the Council Directive") of 15 March 1993.

<sup>76</sup> The Common wealth scheme for Protection of Cultural Heritage, 1993

<sup>77</sup> See IGC, Ninth Session, UNESCO Doc. 29/C/REP.12 and IGC Tent Session, UNESCO Doc.30/C/REP.4

## **2. Provision of infrastructure**

International bodies should assist the African countries in supplying materials and equipments needed to facilitate the duties these countries are to carry out under the Conventions. As the African countries join the conventions, the secretariats of UNESCO and UNIDROIT should ensure that assistance is given to immediately back up the theoretical decision of the countries with action. Presently, the most basic facilities for adequate registration and documentation in inventories required for laying claim to ownership of cultural objects are lacking in the majority of African museums. This has made it impossible for information to be passed on to INTERPOL and international channels immediately the theft of cultural objects is carried out. This point is also partly responsible for the answer given by the African countries in the questionnaire filled at the first meeting of the Special Committee to Review the Practical Operation of the 1995 UNIDROIT Convention on Stolen or Illegally Exported Cultural Objects to the effect that no claim has been reported or made under the 1995 UNIDROIT Convention.

## **3. Manpower supply**

It has been mentioned above that equipments and machines are needed to actualize the dreams of the UNESCO and UNIDROIT Convention and thus African countries must be assisted in this regard. It must be mentioned however that it is not enough to assist in ensuring equipments and machineries are in place, the necessary personnel to do the job must also be provided. It would be a good idea if specialists are sent in from ICOM and INTERPOL regularly to train and retrain officers and officials handling the equipments to ensure that things are working as expected in the African countries that are parties to the conventions.

## **4. Extensive follow up on State Parties activities**

Trainings alone is not sufficient to build capacity, so stakeholder reviews, meetings and mentored use of data on cultural objects inventoried are also necessary for maximum follow up of the activities going on in the territory of state parties in Africa due to the peculiarities of the continent as a result of colonization. For example since the first meeting of the Special Committee to Review the Practical Operation of the 1995 UNIDROIT Convention on Stolen or Illegally Exported Cultural Objects took place on 19<sup>th</sup> June 2012, it is not on record whether UNIDROIT has taken any steps to work on the points raised by these countries to the questionnaires issued out to them apart from posting them on their website. In line with this point, the proposition to amend Article 20 of the UNIDROIT Convention that provides for the convening of meeting to review the practical operation of the convention on the President's own initiative at regular intervals or at the at the request of five Contracting States is rather too vague. There should be a specific time frame for this considering the importance of the subject matter.

## **5. Scholarship facilities for Africans**

It is suggested that scholarship should be promoted as incentives for Africans to pursue education in disciplines in cultural heritage. Even though some nations could afford to sponsor their citizens, however because of lack of insight into the need for education in this regard, no

scholarship facility is provided. It is expected that if provision could be made by international bodies, there will be a break-through.

## **6. Endowment of professorial Chairs in African Universities**

There is need for provision to be made for experts to come into African Universities. It is suggested that if professorial chairs are endowed, there will be more dynamism in the quest for return and restitution of cultural property.

## **CONCLUSION**

The displacement of cultural property is an enduring and even increasing phenomenon. In the context of globalization dislocation of cultural objects constitutes an international phenomenon that threatens to loot, damage and destroy historic testimony and cultural identities.

UNESCO is not expecting that the past will be undone and every work of art returned to the place where it originated. UNESCO with its program on return and restitution of cultural property to its source countries, is equally not after hindering the trade of cultural artifacts, but rather aiming to ensure, together with the international community, that trade of cultural property be based on legitimate and legal grounds validated by all stakeholders. The main objective is to ensure that the heritage of all people can be appreciated in a balanced manner, in all its richness, with the ability to play a fundamental role as an instrument of sustainable cohesion between societies.

The UNIDROIT Convention has effective provision in place and it has achieved its objectives of putting in place minimal rules on private law. Without implementing these rules, the effectiveness of the Convention can never be achieved. The combined provisions of the 1970 UNESCO and 1995 UNIDROIT Conventions are adequate in ensuring Return and Restitution of Cultural Property. The problem we have is at the National level. The disparity in the National Laws of countries and the poor record keeping methods are germane to the loss of Cultural Property and serve as obstacles to return and restitution.

Lack of cultural conscience amongst the citizens and African nations leading to lack of funding the cultural section to be able to create awareness, prosecute cases and clamour for return and restitution is also a major hindrance. It is clear that the Conventions cannot act retroactively and as such are not fashioned after recovering all the treasures lost in colonial times but the Intergovernmental Committee should be well utilized by African states in this regard. The concern of the Conventions is how to guard jealously and preserve what exist today as the cultural patrimony of source countries to be handed down for the future generation to benefit from so as not to perpetuate the calamity of yesteryears. All hands should therefore be on deck in educating the populace on promoting what is left today as objects of our heritage. African law makers should enact laws or update what exists so as to be able to ensure that the facilities put in place on the international plane are given smooth sail at the national level. This is to prevent the adage that says "*what people learnt from history is that they fail to learn from history*" from holding sway in Africa and thus prevent the further denigration of Africa's past, no longer by the West but now by Africans through inaction, the first being colonization.

African states should take steps to ensure international cooperation by taking measures to stabilize frontiers and maintain control over works of art within their territory.

The social capital of Africa has to be strengthened, community based economic growth needs to be fostered, individuals need to be empowered in a bid to improve the living conditions of Africa as Africans pave way for her ingress into sustainable development through joining and fully implementing the provisions of the 1970 UNESCO and 1995 UNIDROIT Conventions.

The success of the Conventions as regards Africa depends on how much energy Africa is willing to put into it as the future of Africa now lies in the hands of Africans. Without any effort, the important, laudable and far-reaching facilities in place at the international level for ensuring return and restitution of cultural property will continue to be of little or no impact.

The query may be raised that what effect will joining the conventions have when not all market countries have joined? My answer to this is that when your house is in order by making sure all necessary measures as put in place by UNESCO and UNIDROIT have been taken to safeguard a nation's cultural objects, the market countries will have no illegal or stolen objects to acquire.

African countries should therefore work on a document that will allow for the operation on a day to day basis of the 1970 and 1995 Conventions with its provisions transmitted to all government sectors and not only to the Ministries of Justice and Foreign Trade but also to the religious, educational, agrarian and telecommunication sectors because the issue of displacement of cultural material indicts these sectors. The future of benefits derivable from these conventions in Africa is hinged on the commitment of local authorities, communities, religious institutions, priests, teachers amongst others.

I therefore conclude by joining in reiterating the urgent admonition that has been sounded repeatedly to the African states that have not joined the UNESCO Convention and the fifty three African nations that are yet to become States Parties to the UNIDROIT Convention to ratify<sup>78</sup> or accede to the Conventions as a mark of their determination to fight a major scourge of our time – dislocation in cultural property.<sup>79</sup>

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<sup>78</sup> Burkina Faso, Cote d'Ivoire, Guinea, Senegal and Zambia are signatories but have not yet ratified the UNIDROIT Convention.

<sup>79</sup> One of the recommendations of the Workshop on the Protection of African Heritage in Amsterdam urged Governments to accede to the UNESCO and UNIDROIT Conventions. Leyten H.M, "African Museum Directors Want Protection of their Cultural Heritage: Conference on Illicit Trade in Cultural Heritage, Amsterdam (22-24 October 1997)", 7 International Journal Cultural Property, 261 at 264-265 (1998); "Africom's Red List", ICOM News, Issue 2, 1998; cf. also ICOM website: [www.icom.org/redlist/](http://www.icom.org/redlist/); ICOM News, Issue 2, 1998. At the ICOM/UNESCO regional workshop on Illicit Traffic in Cultural Property in Arusha (Tanzania) in September 1993 and in Bamako (Mali) in October 1994, respectively, States not yet Parties to the 1970 UNESCO Convention were urged to join without delay. And at the UNESCO/ICOM Sub-Regional Workshop on Illicit Traffic in Cultural Property in Kinshasa (Zaire, now Democratic Republic of Congo) in June 1996, States which had not yet done so were urgently entreated to become Parties to the 1954 Hague Convention for the Protection of Cultural Property in the Event of Armed Conflict, to the 1970 UNESCO Convention and to the 1995 UNIDROIT Convention. For the texts of the Arusha Appeal, Bamako Appeal and the Kinshasa Declaration, see P. ASKERUD / E. CLÉMENT, Preventing the Illicit Traffic in Cultural Property: A Resource Handbook for the Implementation of the 1970 UNESCO Convention, UNESCO, Paris, 1997, Section 3:97-106. Especially worthy of mention however is Resolution A/RES/54/190 on the "Return or Restitution of Cultural Properties to the Countries of Origin" adopted on 17.XII.1999 by the General Assembly of the United Nations upon proposals by Cameroon, Chad, Djibouti, Egypt, Gabon, Guinea, Malawi, Mali, Morocco, Nigeria, Democratic Republic of Congo and Togo. Press Release GA/9699 – 7 March 2000, 122 available at <http://www.un.org/esa/documents/ares54.htm>. Also the text of the Resolution is reproduced in Uniform Law Review, 2000-2,p. 308; Shyllon F., The Recovery of Cultural Objects by African States through the UNESCO and UNIDROIT Conventions and the Role of Arbitration. Available at [http://portal.unesco.org/en/files/48671/13173107021V-2-0219\\_\\_-\\_\\_Prof.\\_Shyllon.pdf/V-2-0219++++Prof.+Shyllon.pdf](http://portal.unesco.org/en/files/48671/13173107021V-2-0219__-__Prof._Shyllon.pdf/V-2-0219++++Prof.+Shyllon.pdf)

**Report on a research at UNIDROIT**

**by Oksana Bilous**

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**Research topic:**

**«Unification and comparative analysis of the  
Contract Law in scopes of the UNIDROIT  
Principles»**

**Rome**

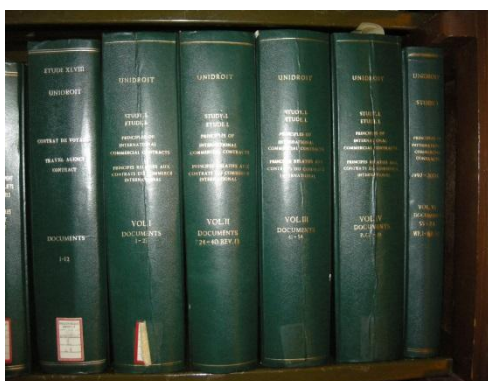
**February 3 – March 14**

**2014**

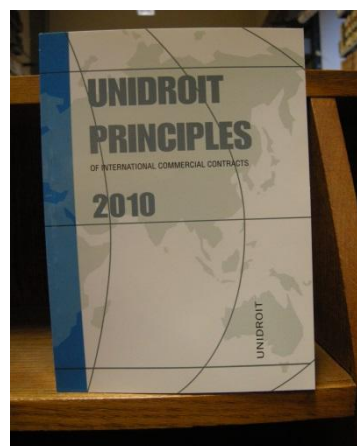


## ACKNOWLEDGMENTS

Many thanks to all Drafters of the UNIDROIT Principles,  
You transform the carbon into a diamond.



**CARBON**



**DIAMOND**

I started to study the UNIDROIT Principles of International Commercial Contracts on 2007 and now, when my research is almost complete I would like to do a statement that the UNIDROIT Principles deserve to be recognized by all nations as the General Contract Law Principles.

Before justifying my statement I have to refer at first to the philosophical issues from legal perspective.

I highlight three greatest legal ideas:

1. Division of the civil society and state (Hegel XVIII);
2. Recognition of human rights (UN 1948);
3. Adoption of General Contract Principles (UNIDROIT 1994).

From the moment of its appearance till now civil society turned into a global civil society, where all people got the ability to express themselves. Recognition of human rights gave people the opportunity to acquire different values on a basis of the rights they have. But You can't exercise your rights on the desert island. For self-realization people have to enter in relations. And most of those relations between people fall into the category of contract relations. That's why the existence of common contract principles is important.

And we actually have these principles! – the UNIDROIT Principles of International Commercial Contracts definitely should play the role of common contract principles. However, studying the UNIDROIT Principles for several years I've read an enormous amount of literature concerning the Principles and I have to admit that vast majority of scholars refer to the UNIDROIT Contract Principles<sup>1</sup> as to the source of the *lex mercatoria*, thus narrowing the sphere of application of

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<sup>1</sup> Prof. H. Kronke called the UNIDROIT Principles of International Commercial Contracts – the UNIDROIT Contract Principles at p. 451.

the Principles only to that extent that this is the instrument for solving disputes arising from international commercial transaction.

Of course in past international trade was the sphere of social life that needed the Principles in first turn. That's why the Principles were called «of international commercial contracts», but it doesn't mean that the Principles represent «international commercial law»<sup>2</sup>, they are general principles of contract law and they may regulate any contract: domestic or non-domestic, commercial or civil<sup>3</sup>. So, the UNIDROIT Principles are deserved to be recognized as General Contract Principles. Saying this in legal language – each state should allow applying the UNIDROIT Principles under its jurisdiction.

Two questions arise:

I. How one can prove that the UNIDROIT Principles really are the general contract law principles?

II. In case if it's so, how it's possible to implement this document into the national legal system(s) – the UNIDROIT Principles is not a treaty or a model law, there is no way of ratification?

#### I. Comparative analysis

The only possibility to find an answer for the first question – is to compare the UNIDROIT Principles with other Contract Law. For comparative analysis I choose four systems: French (the first Civil Code, based on Roman traditions), German (the first structured Civil Code, also based on Roman traditions), English (self in its kind, most recognized on the international level and influential one), US (the last in time, structured in Restatements, based on economical approaches towards legal solutions). Taking into account that all other national legal systems derived from the first three mentioned above, the comparative analysis only of these systems would give enough data to provide the truthful judgments.

After I did a comparative analysis I came to the following conclusions:

1. The UNIDROIT Principles represent the most coherent and complete system of rules than any other national contract law.
2. The UNIDROIT Principles offer the best solutions.
3. The UNIDROIT Principles involves the General Principles of Contract Law into the particular rules. In this way the Principles provide the legal policy while the national contact law only imposes the legal order.

1. The UNIDROIT Principles as a body of law cover all possible contract situations. None of national contract law has so many rules for such a variety of aspects of contract relations. Apart from usual rules, national systems also worked out some rare rules (*astreinte* in French Law), that is not possible to find in other systems. The drafters of the UNIDROIT Principles managed to gather all of those rules

<sup>2</sup> At the first stage of the preparatory work upon the Principles it was stated: «It should be avoided the law regulating international commercial transactions be described as «international commercial law» UNIDROIT Study L. Vol I – Doc. 1 at p.3.

<sup>3</sup> One may oppose me that the Principles don't provide the special protective measures towards consumers, but it is possible to apply the Principles together with national legislation which has the special rules concerning consumers. However, in my opinion there is no necessity for special consumer legislation unless the judges would apply the principle of good faith and fair dealing properly. Besides today the consumers themselves instead of benefits have detriments from that consumer legislation because e-commerce gave them an ability to buy via Internet, but the entrepreneurs don't accept the orders from physical individuals, they immediately cancel the access in the moment they realize that this is a physical individual who wants to buy a good. Developing this theme we would come to another important issue that needs its own research concerning international commercial law vs. international private law.

(art.7.2.4 *Judicial penalty*). But, the Principles is not only the collection of rules, they have well-structured system. UK common law for comparison has no structure at all and German law is overstructured (rules for obligations, general rules for contracts, special rules for contracts).

2. In those situations, where national contract law systems have completely opposite approaches the authors of the UNIDROIT Principles picked up the best solutions. It doesn't necessarily mean that authors of the Principles chose one approach and denied the opposite one. Sometimes they did this (art. 2.1.4 *Revocability of the offer*), but most of the times they worked out the third approach either based on combination of different approaches (arts. 6.1.2&6.1.3 *Performance in installments and partial performance*) or totally new one (arts.2.1.15, 2.1.16 *Negotiations*).

3. The most important idiosyncrasy of the UNIDROIT Principles is that the Principles are really the principles not the sole rules. The national contract law systems just declare the principles; the UNIDROIT Principles involve the principles into the particular rules. For instance the principle of **good faith and fair dealing** is present in arts. 1.8, 1.9(2); 2.1.4(2)(b), 2.1.15, 2.1.16, 2.1.18, 2.1.20; 2.2.4(2), 2.2.5(2), 2.2.7 та 2.2.10; 3.2.2, 3.2.5, 3.2.7; 4.1(2), 4.2(2), 4.6, 4.8; 5.1.2, 5.1.3; 5.2.5; 5.3.3 i 5.3.4; 6.1.3, 6.1.5, 6.1.16(2), 6.1.17(1); 6.2.3(3)(4); 7.1.2, 7.1.6, 7.1.7; 7.2.2(b)(c); 7.4.8, 7.4.13; 9.1.3, 9.1.4 and 9.1.10(1)<sup>4</sup>. It is hardly possible to count how many references where done to the principle of the **reasonability**. Among other general principles it is also important to mention:

- **freedom of contract**,
- *pacta sunt servanda* (binding character of contract),
- **protection of expectations**<sup>5</sup>,
- *culpa in contrahendo* (good faith in precontractual negotiations),
- *rebus sic stantibus* (duty to renegotiate contract in case of unexpected change of circumstances),
- **duty to cooperate** (help the other party to fulfil her obligation),
- **right for cure** (second chance to obligor in default to complete his performance),
- **policy against unfairness**<sup>6</sup>,
- **full and fair compensation**

and the last but the most important principle – is *favor contractus* principle.

*Favor contractus* means that all the problems in contract relations should be settled in such way which helps to save the contract and bring it to the successful fulfilment. This principle underlines the whole policy of the document. While national contract law just imposes the legislative order, the UNIDROIT Principles promote the idea of saving the contract and leading parties to that point when

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<sup>4</sup> UNIDROIT Principles of International Commercial Contracts 2010/ Rome: UNIDROIT, 2011 – 454 p. at p.19

<sup>5</sup> This principle was stated by Visser E. Gaps in the CISG: In General and with Specific Emphasis on the Interpretation of the Remedial Provisions of the Convention in the Light of the General Principles of the CISG // <http://www.cisg.law.pace.edu/cisg/biblio/visser.html>.

<sup>6</sup> This principle was stated by Wilhelmsson T. at page 244- International lex mercatoria and local consumer law: an impossible combination/Thomas Wilhelmsson // Revue européenne de droit de la consommation 1/2003– Wavvre:Larcier, 2003. - p. 342, - pp. 235-2526

each of them will gain what was expected at the beginning. That is why the UNIDROIT Principles are the real principles not just rules.

Judges may apply the UNIDROIT Principles when:

- 1) there is abuse of right;
- 2) the behavior goes beyond the scopes of the principle of good faith;
- 3) there is an obvious contradiction with normal and reasonable perception;

if these things don't infringe any particular rule of national legislation.

## II. Way of incorporation of the UNIDROIT Principles

The fact that the UNIDROIT Principles are the general principles of contract law, which arises from the content of the document doesn't give a clue how to apply the Principles in national jurisdictions. According to my suggestion<sup>7</sup> the countries should:

1. Amend the national contract law according to the UNIDROIT Principles;
2. Apply the Principles as general principles which the national law is based on.

Why it is not possible to achieve the necessary result by improving the national legislation, why it is still important to apply the UNIDROIT Principles in the national jurisdictions even after bringing up the national law to the UNIDROIT Principles standard? - Because

- 1) amendments would give literally the same rules, but it doesn't mean that judges would apply them similarly in all jurisdictions, there is a risk of different understanding of the rules<sup>8</sup>;
- 2) it is not possible to incorporate principles. You can bring into the law only the rules, not the principles. It is not possible to recopy the policy of the UNIDROIT Principles based on *favor contractus* idea. You can take a shell from the river but not the water it will flow away from your hand. It's not so evident. I realized this only when I started to draft amendments to Ukrainian Civil Code.

From the other hand why then it's necessary to amend the national contract law rules so they would be literally the same as the UNIDROIT Principles rules? At the Preamble of the UNIDROIT Principles it is said that «they may be used to interpret or supplement domestic law»<sup>9</sup>. At first perception there is no obstacle to apply the UNIDROIT Principles in national jurisdictions as it is stated at the Preamble without bringing any amendments to the national law. But the judicial practice shows that judges are not so willing to apply the UNIDROIT Principles<sup>10</sup>. Sometimes they apply the Principles in those cases which have foreign element but very rarely to the domestic cases<sup>11</sup>. For instance in Ukraine if the judge would find only the slight difference between the rule of Civil Code and the rule of the UNIDROIT Principles, even if both rules lead to the same solution, he would probably refuse to apply the UNIDROIT Principles and solve the case only upon the Civil Code. Uniform contract law rules should be work out only after that we would

<sup>7</sup> I suggest doing this in Ukraine which is Civil Law country based on German system.

<sup>8</sup> Zweigert and Kötz where the first to discover this problem – they called it the illusion of easiness of unification.

<sup>9</sup> UNIDROIT Principles of International Commercial Contracts 2010/ Rome: UNIDROIT, 2011 – 454 p.

<sup>10</sup> The fact that the UNIDROIT Principles

<sup>11</sup> As it is evident from <http://unilex.org/> database only several countries in the world have a constant practice of applying the UNIDROIT Principles to the domestic cases.

be able to proclaim the UNIDROIT Principles to be the general contract law principles on which all the rules all over the world are based<sup>12</sup>.

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As diamond has six angels, the UNIDROIT Principles has six possible ways of application<sup>13</sup>. But what has happened is that legal community percept the UNIDROIT Principle as *lex mercatoria*, thus only one angle of the diamond was putted into a light. By my research I just wanted to bring more light here so anyone can see that the UNIDROIT Principles deserve to be recognized as General Contract Law Principles.

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<sup>12</sup> The idea is the same as applying the UNIDROIT Principles together with CISG on the basis of art. 7 of CISG. But there is a total correspondence between two documents.

<sup>13</sup> Preamble to the UNIDROIT Principles states:

«These Principles set forth general rules for international commercial contracts.

They shall be applied when the parties have agreed that their contract be governed by them. (\*)

They may be applied when the parties have agreed that their contract be governed by general principles of law, the *lex mercatoria* or the like.

They may be applied when the parties have not chosen any law to govern their contract.

They may be used to interpret or supple-ment international uniform law instruments.

They may be used to interpret or supple-ment domestic law.

They may serve as a model for national and international legislators».

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مبادئ الاونيدروا , مصدر متجدد للاكس ماركاتوريا ومكانة قواعد القانون الاسلامي من هذه الجدلية

الدكتورة فاطمة بوراوي

تونس

## THE UNIDROIT PRINCIPLES AS A RENEWED SOURCE OF THE LEX MERCATORIA , AND THE ISLAMIC LAW AS A PART OF THIS DIALECTIC

Paper presented at the Conference on “ **The 2010 Unidroit Principles Of International Commercial Contracts in Light of International Conventions and National Laws: Launch of the Arabic Version of the 2010 Principles**” organized by Sultan Qaboos University in Muscat, Oman on 23 and 24 March 2014

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International Court  
نقطة البداية , ستكون هذا التعريف لللاكس ماركاتوريا في القرار التحكيمي الصادر عن  
of Arbitrage number 9875 00 01 1999 ICA

الذي جاء فيه , انها : "مجموعة القواعد القانونية و عادات التجارة الدولية التي وقع تكريسها شيئا فشيئا  
من مصادر مختلفة مثل عادات التجار او مواقف جمعياتهم المهنية او القرارات الصادرة عن المحاكم  
الدولية او المنظمات مثل الاونيدروا و المبادئ الصادرة عنها"

“ The rules of law and usage of international trade which have been gradually elaborated by different sources such as the operators of  
international trade themselves, their associations, the decisions of international arbitral tribunals and some institutions like UNDRIT<sup>1</sup> and  
its recently published Principles of international commercial contracts.”

اخترنا ان تكون نقطة البداية هذا القرار التحكيمي للعلاقة الواضحة التي قام بها بين اللاكس ماركاتوريا و  
مبادئ الاونيدروا و هذا ما سنؤكد من خلال هذه الدراسة.

هذا الموقف التحكيمي وقع تكريسه في عديد من القرارات اللاحقة التي استتبت في تكييف اللاكس  
ماركاتوريا كعادة من عادات التجارة الدولية تضم كل المبادئ و الانتاجات التطبيقية والممارسات  
والعادات التي تطبق في ميدان التجارة الدولية بين الفاعلين في الحقل التجاري والاقتصادي وترى  
مجموعة ما يسمى "بالتجار الدوليين" أن اللاكس ماركاتوريا أفضل حل لفض النزاعات والقضايا التي قد  
ترد بينهم في إطار معاملاتهم فهي أفضل من قانون وطني تكرر فيه وجهات نظر جهوية أو وطنية أو  
دينية ومتسم بثقافات تختلف بالطبع من بلد الى آخر.

سنترك هنا جانبا التطور التاريخي لمفهوم اللاكس ماركاتوريا وما حملته في طياتها من تعاريف ومعاني  
فأخرون قاموا بهذا العمل القيم ليتعدى ذلك إطار هذا البحث<sup>2</sup> ولكن من الأجدر التذكير أن قانون التجار  
كان منذ القدم قانونا فريدا من نوعه , يخص فئة معينة من المجتمع بعيدا عن كل التجاذبات الدينية  
المسيحية الكنيسية والملكية والسيادية.

يمكن وصفه بالقانون المنفرد بفئة ما<sup>3</sup> قانون اتسم باستناده على العادات وتقاليده التجارية المرتكزة أساسا و لا  
فقط على مبدأ حسن النية في المعاملات<sup>3</sup>.

قانون يختص به إذا التجار ويمارسه التجار تحكمه آليات خاصة ومحاكم خاصة كل ذلك في دائرة بعيدة  
كل البعد عما يخوضه الانسان العادي في ممارسته اليومية من قانون ومحاكم وآليات تحكمه

<sup>1</sup> [www.unidroit.org](http://www.unidroit.org) %§/

<sup>2</sup> G. Baron, Do the unidroit principles of International commercial contract form a new lex mercatoria? Arb.int.1999.115

<sup>3</sup> E.Locquin, où en est la lex mercatoria ? souverainetés étatiques et marches  
internationaux à la fin du 20 eme siecle 2000 .23

إذا نشأ قانون التجار كقانون فريد، خاص، خارق للعادة وبقي كذلك على مر السنين والعهود<sup>4</sup>. أما عن مبادئ الأونيدروا UNIDROIT<sup>5</sup> فهي ما يسمى في المصطلح القانوني المتعارف عليه بالقانون المرن أو soft law وذلك بالرجوع إلى مصدرها الخاص أولا ولطابعها الغير الالزامي ثانيا ولنا الرجوع إلى ذلك في وقت لاحق من خلال هذا التقديم.

من المتعارف عليه اليوم هو الجزم بأن مبادئ UNIDROIT تمثل شبه تقنين<sup>6</sup> quasi codification للأكس ماركاتوريا وذلك لعدد من الأسباب ونقط التشابه بين مبادئ الأونيدروا والأكس ماركاتورياو نحن في اطار هذا البحث نذهب الى اكثر من هذا اذ نرى ان مبادئ الأونيدروا مصدر شكلي متجدد للأكس ماركاتوريا.

نقطة الشبه الأولى تتمثل في الشكل وتتعلق بمصدرهما الخاص. فمبادئ UNIDROIT تتبع من مصدر خاص غير حكومي وهو معهد الأونيدروا : المعهد الدولي لتوحيد القانون الخاص<sup>7</sup>. ويمثل هذا العنصر نقطة اختلاف المبادئ عن بقية النصوص الدولية المتعلقة بتوحيد القانون مثل اتفاقية الأونيسترال في ميدان عقود البيع والقواعد الصيرفية و نظام الافلاس الدولي<sup>8</sup> ولكنه نقطة تقارب مبادئ الأونيدروا والأكس ماركاتوريا (المصدر الخاص الاحكومي) و لكنه في نفس الوقت و سنرى ذلك نقطة اختلاف فما بين المصدر المنظم المؤسساتي و المصدر العفوي التاريخي شان.

و النقطة الثانية متمثلة في الأصل وتتعلق بمضمون هذه المبادئ العامة UNIDROIT التي تمثل مجموعة قواعد تأليفية توحد ما هو متوافق ومتعارف عليه في ميدان التجارة الدولية وكذلك الشأن بالنسبة للأكس ماركاتوريا , غايتها تلبية حاجيات و مستلزمات التجار

و ستكون هتين النقطتين موضوع الجزء الاول من هذه الدراسة

بل أكثر من ذلك , ففي هذا الإطار لم تعد نهتم فقط بالتقارب بين مبادئ الأونيدروا والأكس ماركاتوريا فهذه نقطة غير خلافية , بل ما يهمنا هو الوصول إلى الإفصاح بأن مبادئ الأونيدروا هو مصدر متجدد للأكس ماركاتوريا أي مصدر شكلي للأكس ماركاتوريا بدون أي شك سيعقلن بصفة خاصة مسألة مصادر الأكس ماركاتوريا .

وبالتوافق على اعتبار مبادئ الأونيدروا مصدرا شكليا متجددا لقواعد الأكس ماركاتوريا يمكننا الجزم أيضا بأنه وبالنسبة للبلدان العربية المتأثرة مبادئها بالقواعد العامة للشريعة الاسلامية لا يوجد اي مانع وأي اشكال لمطابقة هذه القواعد لمبادئ الأونيدروا و للأكس ماركاتوريا و يمكن اذا للمبادئ العامة

<sup>4</sup> Rongeat-oudin la réception des principes UNIDROIT par la lex mercatoria , RDAI 2009 . 697

<sup>5</sup> Charpentier E , les principes UNIDROIT , une codification de la lex mercatoria ? les cahiers du droit 2005.193

<sup>6</sup> idem

<sup>7</sup> www.unidroit.org

<sup>8</sup> www.uncitral.org

لشريعة الاسلاميه الخاصه بالتجاره ان تحتل مكانتها في هذه المنظومه القانونيه الدوليه. لا ننسى التذكير أنه، وبالنسبه لما نسميه القانون الاسلامي في هذه الدراسه انه مجموعه القيم والمبادئ القانونيه التي استنبطها الفقهاء عبر التاريخ مثلت الركائز الاساسيه للقوانين العربيه الاسلاميه و التي تتكون مصادرها

من القران و السنه و الاجماع والاجتهاد un corpus juris arabe

ولعنا و من هذا المنبر يجدر بنا القول منذ البدايه انه و بحسب المنطوق الكوني للاحدودي لمبادئ الأونيدوا ,ان هذه الكونيه, لم تكن لتصل للأخذ بعين الاعتبار أيضا القواعد العامه الموجوده في الشريعه الإسلاميه بالنسبه للعقود التجاريه الدوليه, بالرغم من أنها تمثل مجموعه مبادئ لا حدوديه يمكن الاتفاق على عدم مخالفتها للقواعد العامه المكرسه في جميع الانظمه القانونيه مثل حسن النيه و الامانه و حريه التعاقد...و تمثل فرصه تقديم النسخه العربيه لمبادئ الأونيدوا احسن فرصه للحديث عن هذه الجدليه و التقارب.

ففي مبادئها العامه وقواعدها المستديمه أوجه تلاقي وتشابه بين مبادئ الأونيدوا ومبادئ الشريعه الاسلاميه نستنتجها في عديد الجوانب. و سيكون هذا موضوع الجزء الثاني من هذه الدراسه.

هذه الدراسه ستتطرق إذا الى جزئين

ففي الجزء الأول سنثبت أوجه التقارب بين اللآكس ماركاتوريا ومبادئ الأونيدوا أي كيف يمكن اعتبار مبادئ الأونيدوا مصدرا شكليا متجددا للآكس ماركاتوريا أو قانون التجار(1).

وفي الجزء الثاني سنعرض بصفه خاصه إلى مركز مبادئ الشريعه الإسلاميه والقوانين العربيه الاسلاميه من هذا الجدل اوكيف أن هذه المبادئ لا تتناقض مع المبادئ العامه للأونيدوا و الاكس ماركاتوريا وان قواعد الشريعه الإسلاميه والقوانين العربيه يمكن ان تكون مصدر استلهام للمبادئ العامه للأونيدوا و للآكس ماركاتوريا و سيتم التعرض إلى ذلك من خلال التطرق لبعض الامثله مثل الماليه الاسلاميه , الغبن او الظروف الطارئه (2).

## الجزء 1-مبادئ الأونيدوا , مصدرا متجددا للآكس ماركاتوريا

التقارب بين مبادئ UNIDROIT والآكس ماركاتوريا صحيح ويثبت على هذين المستويين

- أ-المستوى الشكلي : المتمثل في مصدر مبادئ الاونيدروا واللاكس ماركوتوريا الذي هو مصدر خاص و غير الزامي
- ب-والمستوى الأصلي المتمثل في موضوع هذه المبادئ او عنصر الغاية منها أو المبتغي أي أن كلاهما يهتمّ بوضع قواعد ملائمة للتجارة الدولية تمكن الفاعلين في هذا الميدان les opérateurs من الابتعاد عن كل المسائل الخلافية الموجودة في القوانين الوطنية الوضعية.
- ج- ولكن و بالرغم من هذا التقارب لا يجب ان ننسى في الختام التذكير بضرورة تنسيبه

### أ/على المستوى الشكلي

التقارب إذا بين مبادئ UNIDROIT واللاكس ماركاتوريا صحيح ويثبت على المستوى الشكلي المتمثل في مصدر مبادئ الاونيدروا واللاكس ماركوتوريا الذي هو مصدر خاص(1) و غير الزامي(2) و توحيدي (3)

### **1-مبادئ الاونيدروا , مصدر خاص لعقود التجارة الدولية**

بالطبع ككل نصّ صادر عن مصدر خاص غير حكومي، شكّل الحديث عن الطبيعة القانونية لمبادئ الأونيدروا موضوعا لا متناهيّا من النثر القانوني الهام<sup>9</sup> , هذا وبالخصوص انه لم يتولى أي بلد من البلدان المنتمية للمركز المصادقة أو التنصيص على هذه المبادئ أو إضفاء الصبغة الإلزامية لها.

ولكن وعلى الصعيد العملي كان لمبادئ الأونيدروا النجاح الكامل على المستوى القضائي والتحكيمي بالنسبة لعدد القضايا المستندة اليها وعلى الصعيد النظري، النجاح كان حليف المبادئ على مستوى عدد المقالات والأطروحات النظرية والعلمية القيمة المخصّصة لمبادئ الأونيدروا. تعدد القضايا والكتب والأطروحات والمقالات لا يحصى ولا يعدّ موضوعها مبادئ الأونيدروا فكون مصدر المبادئ مصدر خاص لا ينفي النجاح العملي والتطبيقي الهام لهذا النص الذي كيفه البعض بمجلة التجارة الدولية، مجلة كغيرها من المجالات القانونية أحرزت هذه الصفة لكونها معقلنة تأتي بقواعد عامة وتمثل مجموعة متناسقة وكاملة تعرضت لجميع أطوار و مراحل العقد من مفاوضة وتكوين وتنفيذ وجزاء عدم التنفيذ، .... وكذلك إلى العديد من المبادئ الأصولية في القانون التي تمثل نقطة وصل و التقاء جميع الأنظمة القانونية المختلفة وركيزة العلوم القانونية مثل مبدا حسن النية ومبدأ الوفاء بالعقد، ومبدأ سلطان الإدارة وحرية

<sup>9</sup> Fetze kamden , harmonisation,unification et uniformisation en droit des contrats, plaidoyer pour un discours affiné sur les moyens d'intégration juridique, rev drt unif 2008.707

التعاقد والقوة الملزمة للعقد وأمانة التعامل (1-5) وانتفاء الشكلية أو ما يسمى بالرضائية في العقود والقوة الملزمة للعقد (1-3) والعادات (1-9)...

و المصدر الخاص لمبادئ الأونيدرو لا يمنعنا من الجزم بانها تمثل مصدرا شكليا هاما للأكس ماركاتوريا و ذلك لسببين اثنين على الاقل . المصدر الخاص ضمان حياد (1-1) يرتقي الى مستوى التقنين (1-2)

### 1-1 المصدر الخاص ضمان حياد

السبب الأول أن مصدرها الخاص يمثل بالنسبة للكثير ضمان حيادها عن مختلف الحكومات – فبالنظر للجان العمل و هي الجهة التي أصدرت المبادئ، نلاحظ أن النية كانت متجهة نحو مشاركة أكبر الخبرات القانونية وأحسن الكفاءات العلمية في مجال القانون الخاص والقانون الدولي والقانون التجاري وقانون الأعمال والابتعاد عن التجاذبات السياسية والنوايا الحكومية.

فالمصدر الخاص إذا ضمان حياد و ضمان جودة ولا يمكن في أي حال من الأحوال أن يكون نقطة ضعف المبادئ، أو ابتعادها عن منصب مصدر من مصادر القانون الدولي.

### 1-2- مصدر خاص يرتقي الى مستوى التقنين

أما السبب الثاني فالمبادئ ترتقي إلى مستوى التقنيين والتدوين أي أنها تضبط قواعد عامة وموضوعية بالمعنى المتعارف للقواعد القانونية : مجموعة من القواعد الموضوعية , الاشخصية , المتناسقة , ضمن ما يشبه المجلة code أي أن مبادئ الأونيدرو بالرغم من مصدرها الخاص تأخذ شكل مجلة عقود التجارة الدولية وذلك بالرغم من عدم التنصيص حرفيا على كلمة المجلة لغياب عنصر الإلزامية للمبادئ<sup>10</sup> إذ أن الطابع الإلزامي هو لصيق بالعنصر الوطني أو الدولي أي عند حضور الدولة أو الدول كمصدر شكلي للقانون<sup>11</sup> و غيابه ينفي الطابع الإلزامي للقاعدة.

إذا تشكل مبادئ الأونيدرو بدون أي شك أنموذجا متناسقا ومتكاملا لمنظومة خاصة بالعقود التجارية الدولية وإن لم تسمى بمجلة. فطابعها هو التناسق والتكامل بين احكامها<sup>12</sup>. فالمنظومة منظومة متناسقة

<sup>10</sup> انظر مقدمة المبادئ 1994

<sup>11</sup> Principes du droit européen des contrats , Rouhette,, société de législation comparée , 2003

<sup>12</sup> E. Charpentier, précité

تتميز بوجود أحكام جد تقنية مثل مسألة النقود والآجال وأحكام أخرى أكثر منها فلسفية ونظرية ولكنها تمثل عند قراءتها بصفة جملة منظومة موحدة معقلنة متكاملة.

وتؤكد المادة 1-6 من المبادئ هذه الصيغة الشاملة للمبادئ عند التنصيص في الفقرة الثانية أن المسائل التي تدخل في نطاق تطبيق المبادئ ولا تحسمها صراحة يمكن أن تنظم كلما كان ذلك ممكنا وفقا للمبادئ العامة التي استلهمت منها".

## 2-مبادئ الاونيدروا . مصدر غير الزامي لعقود التجارة الدولية

عدم الزامية المبادئ عنصر قار ليس فيه داعي للشك اذ تنص مبادئ الاونيدروا صراحة في المادة 1-5 أنه "يجوز للأطراف استبعاد تطبيق هذه المبادئ أو مخالفتها أو تعديل أي حكم من أحكامها ما لم يرد في المبادئ نص مخالف" و لكن<sup>13</sup> و بعد سنوات من التطبيق والنجاح قررت اللجنة التنفيذية للاونيدروا إدخال فصل جديد في المادة 3.3.1 التي تنص على حالة العقد المخالف لنص أمر دولي كان وطني أو عبر حدودي وذلك مهما تعددت حالات المخالفة أكانت مخالفة في طور تنفيذ العقد، أو في سببه أو في فصوله.

ويفهم من القواعد الآمرة الواجبة التطبيق، القواعد المذكورة في الفصل 1.4 من مبادئ الأونيدروا الذي ينص على أنه "ليس من المبادئ ما يفيد تطبيق القواعد الآمرة سواء أكانت وطنية أو دولية أم فوق قومية، ما دامت تطبق إعمالا للقواعد الواجبة التطبيق في القانون الدولي الخاص.

Mandatory rules or the relevant rule of law private international

"Nothing in these principles shall restrict the application of mandatory rules whether of national, international or supranational origin which are applicable in accordance with the relevant rules of private international law"

فالمصدر الخاص لمبادئ الأونيدروا والطابع التشريعي لها لا يترك مجالا للشك في واجب احترام الأطراف للقواعد الآمرة أكانت وطنية، دولية أو لاوطنية والتي تكون واجبة التطبيق حسب مقتضيات القانون الدولي الخاص. وتذكر لجنة العمل أن مفهوم القواعد الآمرة المستعمل في هذا النص مفهوم عريض جدا يعنى به لا فقط القاعدة التي تصف نفسها بالآمرة بل وأيضا كل القواعد الآمرة التي يستنتج من تكييفها بأنها آمرة وإن لم تنص على ذلك صراحة، و الصيغة الآمرة تستنتج أيضا من مبادئ القواعد العامة للقانون و من مجمل المبادئ اللامنصوص عليها في قانون وطني معين و لكنها واجبة التطبيق بمقتضى النظام العام او الاخلاق الحميدة ... مثل منع الفساد والرشوة، ومنع التحريض على القتل واحترام النفس البشرية والمساواة بين الأجناس.....

<sup>13</sup> Gilles Cuniberti, le nouvel article 3.3.1 des principes UNIDROIT 2010 sur le contrat violant une règle impérative : un regard critique du point de vue du DIP, Rev. Dr. Unif V18 2013 pp490-508

إذا المفهوم المعمول به في الفصل 4-1 هو المفهوم الموسع لمذلول القواعد الآمرة , ولكن لصعوبة تحديدها بصفة مسبقة يذكر نفس الفصل ضرورة الرجوع إلى مقتضيات القانون الدولي الخاص ومنهجيته المعتمدة التي تختلف من نظام إلى آخر , كل يكرّس طريقة الوصول إلى معرفة ماهية القواعد الآمرة الواجب احترامها. وفي التعليق على ذات الفصل ذكرت لجنة العمل بعض الأمثلة التي تيسر هذا الفهم واستندت إلى اتفاقية روما 1980 في فصلها 147<sup>14</sup> أو الفصول 28-34-36 من القانون النموذجي للتحكيم التجاري الدولي unicitral الذي يكيّف هذه الفصول بكونها أمرة.

إذا ادخلت النسخة الجديدة للمبادئ فصلا جديدا وهو الفصل 1-3-3 الذي أريد به أحداث بعض التأثيرات الجديدة على القواعد الآمرة في حالة خضوع العقد لمبادئ الأونيدروا.

يأتي الفصل 1-3-3 لينص : " ان مخالفة قاعدة أمرة مهما كان مصدرها وطني أو دولي او ما فوق وطني حسب منطوق الفصل 4-1 ينتج عنه كل الآثار التي أوردتها القاعدة الآمرة ."

وهذا هو الجديد , فلم تنص النسخ السابقة للمبادئ لا في نسخة 2004 ولا في نسخة 1994 على حالات عدم مشروعية العقد أو مخالفة القواعد الآمرة وذلك , بحسب تفسير اللجنة , لصعوبة تعريف مفهوم النظام العام والقواعد الآمرة واختلاف التعاريف في القوانين الداخلية لمختلف البلدان وما ينتج عنه حتما من صعوبات توحيد النظام القانوني للمؤسسة .

ما يثير التساؤل هو العلاقة الجدلية بين مصدر خاص غير حكومي ' نص صادر عن مركز خاص علمي وكيفية تأثيره على قواعد أمرة وطنية أو دولية اي صادرة عن دولة ما أو مجموعة من الدول؟ كيف للخاص أن يؤثر على العام؟

وإن اتسم الفصل 4-1 من مبادئ الأونيدروا بما كيّفه الأستاذ Cuniberti بالرصانة التامة عند ترك الأولوية للقانون الأمر الحكومي او الفوق الحكومي على حساب مبادئ الأونيدروا , تتمثل صورة المادة 1-3-3 في الآتي : عندما يخالف العقد قواعد أمرة تنطبق حسب مقتضيات قواعد القانون الدولي الخاص أكانت هذه القواعد وطنية دولية أو ما فوق حكومية بحسب تأويل القاضي أو الحكم يجب التمييز بين وضعيتين: الوضعية الأولى: إن كانت مبادئ الأونيدروا مندمجة في العقد فتصبح جزءا لا يتجزأ من العقد و الوضعية الثانية في الحالة المخالفة اي عدم ادماج المبادئ في العقد.

### **الوضعية الأولى: إن كانت مبادئ الأونيدروا مندمجة في العقد**

وفي هذه الوضعية الأولى , حالة إدماج المبادئ في العقد والنتائج عن التنصيص الصريح من قبل الأطراف على ذلك في العقد ففي هذه الحالة يخضع العقد للقانون الذي سيحدد بحسب قاعدة تنازع الاختصاص الذي سيطبقها القاضي أو الحكم اذ لا تمثل المبادئ هنا قانون العقد بل بندا من بنوده.

<sup>14</sup>Article 7 de la Convention de Rome

ففي حالة إدماج مبادئ unidroit في العقد أي عندما تصبح المبادئ بندا من بنود العقد لا يرى الفقهاء كيف لها أن تؤثر على القواعد الآمرة إذ أن المبادئ لا تعتبر فقط في هذه الحالة كقانون ينطبق على العقد بل هي العقد ذاته، أي ان المسألة هنا ليست بمسألة تطبيق قانون.

فيجب التمييز هنا بين حالتين أيضا /ان كان النزاع من انظار المحاكم الوطنية او من انظار التحكيم.

### الحالة 1- النزاع من أنظار المحاكم الوطنية

يتحتم على القاضي المختص الرجوع إلى قواعد القانون الدولي الخاص المعمول بها في بلده وهذه القواعد تنص في معظمها على أن للأطراف حرية اختيار القانون المنطبق في العقد على شرط أن لا يخالف القواعد الآمرة المعمول بها في بلد النزاع. إذا يقع تطبيق القانون المنصوص عليه بحسب قاعدة تنازع الاختصاص التي تؤدي في أغلب الأحيان إلى تطبيق قانون وطني بما في ذلك قواعده الآمرة إذا في هذه الحالة تخضع المبادئ إلى أولوية القواعد الآمرة وتلغي إن خالفت إحدى هذه القواعد. ففي هذه الحالة لا يجوز لبند من بنود العقد (بما في ذلك مبادئ unidroit) أن يخالف القواعد الآمرة الوطنية وهذا هو المعقول والسائد وهذا ما نصت به المادة 1-1-3 و تعرف القواعد الآمرة هذه Loi de police بالقواعد الواجبة التطبيق نظرا لأهميتها بالنسبة للدولة التي أصدرتها وذلك مهما كان القانون المنطبق على العقد<sup>15</sup>. وهذا هو موقف المشرع الأوروبي في القرار عدد 2008/593 للمجلس الأوروبي في 17-06-2008 حول القانون المطبق في الالتزامات التعاقدية الذي رفض أن يطبق قانون غير وطني على العقد وإن كان هذا العقد دولي وهذا القانون الوطني يقع تطبيقه بحسب قواعد تنازع الاختصاص المتعارفة أي القانون المختار من قبل الأطراف أو في حالة سكوتهم القانون المعين من طرق قاعدة تنازع الاختصاص.

### الحالة 2 - النزاع من أنظار التحكيم

اذ ان للأطراف بالإضافة إلى التنصيص صراحة على تطبيق مبادئ unidroit حرية اللجوء الى التحكيم Arbitration clause ففي هذه الحالة<sup>16</sup> لا يرتبط الحكام بقانون وطني ما ويخول لهم تطبيق مبادئ الاونيدروا بصفة مستقلة أي بدون التطرق إلى قانون وطني إضافي يقيدهم وفي هذه الحالة ومبدئيا لا تنثير القواعد الآمرة للقانون الوطني اشكالا خاصا إذ أنها لا تطبق مبدئيا ولكن هذا لا يمنعنا من التذكير ببعض القواعد الخاصة بالتحكيم الدولي والتي اعتاد الحكام على احترامها في مجال احترام القواعد الآمرة

<sup>15</sup> Fouchard, Gaillard, Goldman , IC Arbitration, Klewer 1999

<sup>16</sup> Giardini A , mesure et méthode de l'application des principes dans l'arbitrage international, a new lex mercatoria ? organised by ICC 1994



- وهي أولا أن على الحكام التثبت عند التصريح بالحكم بأن القرار سيقع تنفيذه حتما في ذلك البلد الذي يستوجب فيه التنفيذ أي أن القرار التحكيمي لن يمس في أي حال من الأحوال بالقوانين الأمرة لبلد التنفيذ

- وهي ثانيا أن على الحكم أن يحترم ما كرسه النظام العام الاوطني واللاحدودي transnational public policy والإشكال الحقيقي المطروح في هذا الصدد يدور حول مفهوم التحكيم الدولي ودور الحكم الدولي هل هو بمثابة القاضي؟ عليه احترام القواعد الأمرة الواجبة التطبيق في البلد الذي يكون فيه مركزه؟ أم هل أن التحكيم الدولي منظومة جد مخالفة للقضاء العدلي ولا يرتبط بأهم قاعدة من القواعد الاجرائية؟ وهي احترام القواعد الامرة ما هو مفهوم النظام العام للاحدودي؟

النظريات تختلف والطرح لا ينتهي:

\*بين من يرى أن الحد من حرية الحكم في تطبيق القانون هو النظام العام كما يستنتج من النظريات المقارنة لما يسمى نظاما عاما في معظم البلدان<sup>17</sup>.

\*وشق آخر يرى أن النظام العام الدولي يجب أن يستنبط من بعض المعايير السابقة الوضع<sup>18</sup>; الاشكال هنا يتمثل في الاختلاف في هذه المعايير السابقة الوضع.

\*والشق الثالث يقضي ما يسمى القوانين الواجبة التطبيق Loi de police ويحبذ الرجوع فقط إلى مصطلح النظام العام بمفهوم القانون الدولي الذي هو بالطبع نظام عام أضيق من مفهوم النظام العام الداخلي.

ويعتقد الأمر في طور تنفيذ القرار التحكيمي أمام القضاء الحكومي ويدعو شق كبير من علماء القانون الحكم إلى التفتن الى أهمية تنفيذ القرار التحكيمي في بلدان التنفيذ وعلى أهمية إصدار حكم ينفذ في البلد الواجب التنفيذ فيه.

و لكن كيف لنا ان نفهم منطوق الفصل 1-1-3 في فقرته 2 الذي نصت صراحة أنه: "إن لم تنص القاعدة الأمرة صراحة على آثار مخالفتها يجوز للأطراف أن يدفعوا بكل وسائل عدم تنفيذ العقد التي من المعقول في ظروف الحال الاستناد إليها."

أما عن العلاقة الجدلية بين مبادئ unidroit والقانون الواجب التطبيق Loi de police

الإشكال المطروح متمثل في هذا السؤال هل أن القانون الواجب التطبيق من بين القوانين التي يجوز للأطراف المساس بها؟

Le régime de la loi de police est-il disponible ?

هل يجوز للأطراف الاتفاق على مخالفة القانون الواجب التطبيق؟

<sup>17</sup> Approche comparative de la recherche de la solution la plus communément admise par les ordres juridiques nationaux , P.Lalive, ordre public transnational ou réellement international et arbitrage international, rev arb 1986.329

<sup>18</sup> (P. Mayer: Mandatory rules of law in international arbitration 1986 – C2 P286)

طبعاً الاجابة لا يمكن أن تكون إلا بالنفي في صورة خرق واضح للقانون الواجب التطبيق أي في صورة الابتعاد الكلي عن مضمون هذا القانون.

ولكن ما هو الحال إن اتفق الأطراف لا على الابتعاد كلياً عن منطوق القانون الواجب التطبيق بل فقط على تحويل تنظيمه أي على جزاء مغاير للذي وقع التنصيص عليه.

هذا ما هو المطروح في الفقرة 2 من الفصل 1-3-3 جديد (نسخة 2010) إذا , كل الجدل سيدور حول التفرقة بين الآثار المنجرة على القانون الواجب التطبيق, هل هذه الآثار صريحة أم هل هي آثار ضمنية؟ وما هي الجدوى من هذا التمييز؟

لا تبرز أهمية الفصل 1-1-3 الجديد إلا في حالة عدم التنصيص الصريح على آثار جزاء مخالفة قاعدة أمرة أي في هذه الحالة الثانية عند وجود آثار ضمنية للقاعدة الأمرة, ويصعب العثور على هذا المعيار (ضمني/صريح) . صحيح أنه يمكن القول بأنه عندما لا تنص القاعدة على أثر واضح بصراحة أم على أثر فاعل ومباشر (effet spécifique) يكون الأثر, أثراً ضمناً.

ولكن يجب البحث على هذا الأثر الضمني في النظرية العامة للعقود والالتزامات وفي هذه الحالة فقط يمكن السماح للأطراف بحسب منطوق الفقرة 2 من 1-1-3 الاتفاق على تحويل آثار الجزاء.

ويؤكد الأستاذ<sup>19</sup> Cuniberti على المصدر المادي لهذا التمييز الوارد في الفصل 1-1-3 من مبادئ unidroit الذي هو القانون الأمريكي والقانون الأوروبي.

ففي حالة عدم التنصيص صراحة على جزاء مخالفة النص الأمر يجوز للقاضي في القانون الأمريكي<sup>20</sup> أن يفرض الجزاء الذي يراه مناسباً حسب عديد المعايير.

يضيف الأستاذ Cuniberti على أنه ومن الجدير إضافة معيار إثبات القانون الأجنبي المنطبق فإن كان من الهين اثبات أثر مخالفة القاعدة الأمرة في القانون الأجنبي ان كان هذا الأثر أثراً صريحاً وإن كان العكس فمن الصعب ذلك .

هذا الفصل يثير الكثير من التساؤلات فكيف للأطراف ان يقيموا بأنفسهم آثار ونتائج القواعد الأمرة؟ وكيف يمكن التمييز بين آثار القاعدة الأمرة المعقولة والآثار الغير معقولة؟

طبعاً لا يجوز للإرادة أن تتدخل في حالة التنصيص صراحة في القاعدة الأمرة على أثارها الأمرة فلا يجوز للأطراف الاتفاق مسبقاً على جزاء مخالفة نص أمر صريح يجازي بالبطان المطلق كالعقد اللامشروع.

<sup>19</sup> انظر نفس المقال

<sup>20</sup> 178 restatement USA, when a term is unenforceable on grounds of public policy

المسألة تطرح فقط في حالة وجود قواعد أمرة لم تنص صراحة على الجزاء بصفة أمرة أي تخول للأطراف الاتفاق على كيفية تطبيق جزاء عدم التنفيذ ويعطي الأستاذ Cuniberti في هذه الحالة مثلاً ورد في Uniform commercial code (719-2 U.S) الذي يخول للأطراف الاتفاق على جزاء عدم تنفيذ مقتضيات عقد البيع إلا في بعض الحالات<sup>21</sup>.

أما الفائدة الكبرى من المبادئ الأونيدروا والسبب الذي جعلنا نؤكد أنه يمكن وصفها بالمصدر المتجدد لللاكس ماركاتوريا هو حالة سكوت الأطراف على اختيار القانون المنطبق في العقد أو في العلاقة التجارية الدولية و هنا نتعرض للوضعية الثانية و هي وضعية عدم التنصيص على مبادئ الأونيدروا في العقد

### **الوضعية الثانية. عدم التنصيص على مبادئ الأونيدروا في العقد ولا على حالة تطبيق القانون**

من البديهي التصريح بالقول ان للأطراف الحرية المطلقة في اختيار القانون المنطبق على علاقاتهم التجارية الدولية وحرية اختيار مبادئ الأونيدروا كقانون تخضع له علاقاتهم التجارية تأتي في إطار ممارسة هذه الحرية.

و لكن عدم التنصيص على القانون المنطبق او على مبادئ الأونيدروا كقانون ينطبق على العقد لا يمثل حالة شاذة في مجال التجارة الدولية بل كثيراً ما لا تنتفطن الأطراف إلى أهمية اختيار القانون الواجب تطبيقه الا في في حالة حصول نزاع أو خلل و كأن القانون حالة مرضية.

تنص مقدمة المبادئ وفي التمهيد "ويمكن تطبيقها(المبادئ) عندما لا يختار الاطراف قانونا بعينه ليحكم عقدهم". وجب أن نميز هنا حالتين اثنتين كما فعلنا في السابق

الحالة الأولى: إن كان النزاع من انظار القضاء الوطني

الحالة الثانية إن كان النزاع من أنظار التحكيم الدولي

<sup>21</sup> [Consequential damages exclusions are hands down the most significant limitation of liability in a contract for the sale of goods. Potential liability for consequential damages in commercial contexts, usually in the form of the buyer's lost profits from the use or resale of the goods in its business, is enormous in comparison to the contract price of the goods. They can exceed, and most likely will exceed, the value of the goods by an unknown quantum, depending not so much on the actions and machinations of the seller as on the individual operating structure of the buyer and on the buyer's contracts and relationships with third parties

## النزاع من انظار القضاء الوطني

ففي الحالة الأولى كما أشرنا سابقا يتحتم الرجوع الى قواعد القانون الدولي الخاص وبحسب الحالات يتيح للقاضي اللجوء ام لا إلى قواعد غير وطنية أو ما فوق حدودية أولا ورأينا ذلك بالنسبة لاتفاقية روما التي ترفضه ونراه أيضا في عديد من مجالات القانون الدولي الخاص مثل المجلة التونسية في فصلها 62 الذي ينص " يخضع العقد للقانون الذي تعينه الأطراف وإذا لم تُحدّد الأطراف القانون المنطبق يعتمد قانون الدولة التي يوجد بها مقر الطرف الذي يكون إلتزامه مؤثرا في تكييف العقد أو مقر مؤسسته إذا كان العقد قد أبرم في نطاق نشاط مهني أو تجاري".

وفي هذه الحالة أي في حالة عدم اختيار الأطراف للقانون المنطبق في العقد و عندما لا تمثل مبادئ الاونيدورا جزءا منه , يصعب الرجوع اليها امام القضاء الوطني كقانون عقد. و قد يشكل عنصر عدم إلزاميتها مصدرا تخوّف وجدل إذ تنص المبادئ الاونيدورا صراحة في المادة 1-5 أنه "يجوز للأطراف استبعاد تطبيق هذه المبادئ أو مخالفتها أو تعديل أي حكم من أحكامها ما لم يرد في المبادئ نص مخالف" أي أنه وبصفة واضحة ليس للمبادئ أي طابع أمر إلا بالنسبة لعدد ضئيل من المواد التي تنص صراحة على طابعها الأمر مثلا في المادة 1-7 حسن النية أو المادة 19-3- في شروط صحة العقد أو 2-3-10 بالنسبة للتقادم<sup>22</sup>

ولكننا نجزم بأن هذا التخوف من عدم إلزامية مبادئ الاونيدورا هو تخوف في غير محله. إذ وإن كانت تنقص المبادئ عنصر الإلزامية لغياب التفويض الصريح من الأطراف إليها إلا أنه وفي الوقت الحاضر لا مجال سوى للشك في الطابع القانوني لها و ذلك لكل السباب المذكورة سابقا و التي ستذكر لاحقا.

## النزاع من انظار التحكيم

أما في الحالة الثانية أي إن كان النزاع من أنظار التحكيم، فحرية الحكم هنا أوسع و لا شك أن مجال تطبيق مبادئ اليونيدورا سيكون له الحظ الأوفر إذ يتمتع الحكام بحرية اختيار قواعد القانون التي يرونها مناسبة أو ملائمة كذلك الشأن بالنسبة لقواعد غرفة التجارة الدولية (1998) ICC (مادة 1-7) او المادة 24-1 من قواعد معهد تحكيم الغرفة التجارية بسنكهولم.

وإن كان اليوم من المتفق عليه فقها وقضاء أن للأكس ماركاتوريا الطابع الإلزامي عند اختيارها من طرف الحكام فإن هذه المسألة تتضاعف عند اللجوء إلى مبادئ الاونيدورا بالرجوع إلى طابعها المدون

<sup>22</sup> 1-7-1 يلتزم كل طرف بأن يتصرف وفقا لما يقتضيه حسن النية و ..... التعامل في التجارة الدولية.

3-19 " أحكام هذا الفصل أمره فيها عدا ما يتعلق منها بالقوة الملزمة مجرد الاتفاق أو عند توفر الاستحالة المبدئية أو الغلط".

10-3-2 " يجوز للأطراف تعديل مدة التقادم مع ذلك لا يجوز ..... تقصير المدة العامة للتقادم عن سنة واحدة، تقصير المدة القصوى للتقادم عن أربع سنوات، إطالة المدة القصوى للتقادم لأكثر من 15 سنة".

والمقنن. ذلك يعني , فإن كان الشك ممكنا أمام عدم تقنين اللاكس ماركاتوريا و عدم وجود مراجع مقننة ومكتوبة تلم بجميع هذه القواعد إلا أن هذا الشك لا مجال له بالنسبة لمبادئ الأونيدورا التي جاءت في قالب مجلة مكتوبة مقننة يمكن وبسهولة الرجوع إليها. وفي هذا المجال عرف بعض فقهاء القانون<sup>23</sup> المبادئ بأنها تقنين لقانون ثابت أو مستمر في ميدان القانون الدولي الخاص *une codification à droit constant du droit international applicable aux contrats du commerce international.* التقنين لقانون دولي خاص مستمر وثابت يعني أنه وقع تدوين ما هو ثابت و متعارف عليه في مجال التجارة الدولية في إطار مبادئ الأونيدورا التي يمكن اعتبارها تواصل لما هو سائد في ميدان التجارة الدولية، وليس انقطاعا أو تغييرا جوهريا بالنسبة للمبادئ العامة الثابتة في اللاكس ماركاتوريا<sup>24</sup>

### 3 – مبادئ الأونيدورا منظومة توحيدية

تنتج القيمة المضافة لمبادئ الأونيدورا من كونها مجلة توحيدية أي أنها مجلة حاولت توحيد مختلف الأنظمة القانونية السائدة لا في العالم في حقيقة الامر بل في العالم الغربي اي ما يسمى بالقانون الأنقلاومريكي والقانون الكوتينونتالي أي القاري اللاتيني او الروماني الجرمانى تاركة جانبا بقية الأنظمة القانونية الأخرى مثلا القانون الإسلامي أو الصيني أو الياباني. وفي مجال الانفتاح على الأنظمة القانونية الأخرى تمثل فرصة تقديم نسخة المبادئ 2010 باللغة العربية أحسن فرصة لتقريب وجهات النظر بين هذه الأنظمة القانونية و للحديث عن أوجه التلاقي بين هذه المبادئ ومبادئ النظام القانوني العربي الإسلامي واللاكس ماركاتوريا وهذا ما سيتم التطرق إليه في الجزء الثاني من هذه الدراسة من خلال بعض الأمثلة. اما الان فلنتطرق لوجه التشابه بين مبادئ الأونيدورا و الاكس ماركاتوريا على المستوى الاصلي.

#### ب- المستوى الاصلي:

التقارب بين مبادئ الأونيدورا و الاكس ماركاتوريا على مستوى الاصل يدور حول عدة معايير منها معيار الغاية (1) و نوعية القواعد اذ هي قواعد مادية (2)

<sup>23</sup> Elise Charpentier ; le Principes UNIDROIT , une codification de la lex mercatoria , les cahiers de droit 2005.46.195

<sup>24</sup> La loi française n°2000-321 du 12/04/2000 relative aux droits des citoyens dans leurs relations avec l'administration dispose « la codification se fait à droit constant sous réserve des modifications nécessaires pour améliorer la cohérence rédactionnelle des textes rassemblés , assurer le respect de la hiérarchie des normes et harmoniser l'état du droit

## 1-الغاية

تمثل مبادئ الاونيدروا عملا علميا متكاملا الغاية منه وضع القواعد الأجر والأمثل لعقود التجارة الدولية فالغاية واضحة في منطوق الفصل 1-6 من المبادئ إذ يذكر أنه " يراعى عند تفسير هذه المبادئ الطابع الدولي لها والغرض منها بما في ذلك الحاجة إلى تشجيع توحيد تطبيقها" ومن وراء ذلك الغاية الأسمى التي تتمثل في توحيد النظام القانوني للعقود الدولية بالابتعاد عن كل النقاط الخلافية في الأنظمة القانونية المختلفة والتركيز على أوجه التشابه والتلاقي بين هذه الأنظمة .

ويرتكز هذا التوحيد على ما يمثل في نظر الكثير أحسن حل قانوني بالنسبة للتجارة الدولية<sup>25</sup> أي ما يلئم حاجيات التجار ويواكب رغباتهم وهذا ما يؤكد الطابع المادي أو المباشر لقواعد الاونيدروا. إذ تتلاقى مبادئ الاونيدروا واللاكس ماركاتوريا في الغايات وهي غايات عملية بحتة بالنسبة للثانية تشكل بالنسبة للعلاقات التجارية الدولية احسن الحلول العملية المتوازنة لمواكبة سرعة نسقها والصبغة الدولية لها ومختلف الارضيات القانونية المتفارقة في بعض الأحيان تبعا للثقافات القانونية والعقليات والمجتمعات.

فتترك مبادئ الاونيدروا جانبا كل ما من شأنه خلق نقاط نزاعات في علاقات يغلب فيها الطابع الدولي وتوحد بين ما فيه أوجه التشابه والتلاقي ومع ما يتناسب والعلاقة التجارية الدولية.

و في كثير من القضايا نرى القضاة الوطنيين يستندون تلقائيا على اتفاقيات الاونيدروا في المجالات الخاصة التي لا توجد فيها قوانين تضبط المسائل المطروحة<sup>26</sup> لأنها تأتي بالحل الأكثر ملائمة للواقع , فكان ذلك موقف القضاء التونسي من اتفاقية UNIDROIT اوتوا حول الفاكترينغ لسنة 1988 1988/05/28<sup>27</sup>

## 2-نوعية القواعد

يمكن التذكير فقط في هذا الإطار أن الطابع المادي أو المباشر للمبادئ يخالف الطابع الغير المباشر أو اللامادي لقواعد تنازع القوانين The rules of conflict of law إذ أن المبادئ تأتي بالحل ولا تقتصر على تعيين القانون الواجب تطبيقه و هذا هو الحال بالنسبة لقواعد اللاكس ماركاتوريا. بل وأكثر من ذلك ففي مقدمة المبادئ يمكننا أن نقرأ ما يلي: "أن مبادئ الاونيدروا تعبر عن مفاهيم سائدة في كثير الأنظمة القانونية وإن تركز في جميعها (وطبعا ليست

<sup>25</sup> Béraudo , the UNIDROIT principles , a new lex mercatoria ? ICC publishing 1995.

<sup>26</sup> انظر مقالنا المنشور في مجلة القضاء و التشريع التونسية جانفي 2011 و انظر اطروحتنا الدكتوراه الفاكترينغ في القانون الداخلي و الدولي ة تونس 2003 ,

<sup>27</sup> Convention d'ottawa du 28 mai 1988 sur l'affacturage international, UNIDROIT

في جميعها كما ذكرنا إذ أنها تناسست منظومة القانون الإسلامي مثلاً وهي ذات أهمية بالغة الآن في أوساط الأعمال خاصة وتطور واكتساح المالية الإسلامية الأسواق الأوروبية والأمريكية) نظراً أن هذه المبادئ مقصود بها توفير منظومة قواعد معدة لتلبية احتياجات المعاملات التجارية الدولية فإنها نظمت أيضاً ماوقع اعتباره أفضل الحلول".

أكد المجلس التنفيذي لمعهد القانون الموحد في مقدمة المبادئ "أن هذه المبادئ مقصود بها توفير منظومة قواعد معدة لتلبية احتياجات المعاملات التجارية الدولية" وفي التمهيد يمكن أن نقرأ أنه يمكن تطبيق المبادئ عندما يتفق الأطراف على إخضاع عقدهم للمبادئ.

فتتلاقى طبعاً مبادئ الأونيدرو واللاكس ماركاتوريا في كثير من القواعد العامة من تلك التي تتعلق بمبدأ حسن النية والنزاهة في المعاملات...

وقد حصر بعض أساتذة القانون مبادئ اللاكس ماركاتوريا في قائمة على وجه الذكر تأتي في صدارتها قاعدة حسن النية في المعاملات التي تركزت في المواد الأولى من مبادئ الأونيدرو وبالقيمة الأولى من خلال الصيغة الأمرة التي حرر بها الفصل 7-1 "يلتزم كل طرف بأن يتصرف وفقاً لما تقتضيه حسن النية وأمانة التعامل في التجارة الدولية. لا يجوز للأطراف استبعاد هذا الالتزام أو تقييده."

أهمية هذا المبدأ "حسن النية في المعاملات" لا تستنتج فقط من الصيغة الأمرة للفصل 7-1 بل وإيضاً لإعادة التذكير بهذه القاعدة العامة الهامة في عديد من الفصول الأخرى نذكر منها الفصل 2.1.15 المتعلق بمنع التفاوض بسوء النية أو الفصل 2.1.16 المتعلق بالالتزام بالسرية أو الفصل 5.1.2 الذي ينص على "أن الالتزامات الضمنية تستخلص من حسن النية وأمانة التعامل."

كما تحتوي مبادئ اللاكس ماركاتوريا لمبدأ هام يتمثل في الحرية التعاقدية ومبدأ سلطان الإرادة وهذا ما نصت عليه أيضاً مبادئ الأونيدرو في مادتها 1.1. حرية التعاقد "يتمتع الأطراف بالحرية في إبرام العقد وفي تحديد مضمونه"

كما كرست مبادئ الأونيدرو العادات والممارسات كمصدر من مصادر القانون الدولي الخاص بالتجارة الدولية وأسندت للأعراف والعادات المركز الرئيسي بين مصادر القانون وكذلك فعلت اللاكس ماركاتوريا إذ نصت المادة 9.1 فقرة 2 "يلتزم الأطراف بأي عادة في مجال التجارة الدولية مادامت شائعة ومتبعة في مجال المعاملات المعنية ما لم يكن من غير المعقول تطبيقها."

وتوضح مبادئ الأونيدرو في بقية المواد دور المعاملات والعادات في تأويل و تطبيق الالتزامات التعاقدية وكذلك دورها في كامل أطوار العقد وذلك في عديد من المواد نذكر منها الفصل 3-4-6-1-2 أو

5-1-2

إذا على مستوى الأصل تمثل مبادئ الأونيدورا كما تمثل اللاكس ماركاتوريا جملة من القواعد الأصلية الهامة التي تضع حلاً لنزاع قائم ولا تكتفي بالتنصيص على القانون الواجب التطبيق، وهذا الحل يمثل حلاً لا وطنياً ولا متأثراً بثقافة ما أو ببلد ما بل هو حل لحدودي Transnational لا يمثل قانوناً وطنياً بذاته. المقارنة بين مبادئ الأونيدورا ومبادئ اللاكس ماركاتوريا المنشورة بمركز القانون الغير حدودي بكلونيا and bibliography ) center for transnational law , université de cologne, transnational data base TLBD ( the central transnational law digest و هو من الأوائل في العالم في ميدان اللاكس ماركاتوريا الذي وضع منصة للمعرفة وللتدوين في مجال قانون التجار a knowledge and codification platform تؤكد هذا التشابه.

ويرتكز المركز في تدوينه لهذه القائمة على ما يسمى فكرة Creeping Codification أي ما يسمى بالتدوين المستمر والغير مغلق ويعرف المركز هذه الفكرة بالقول

« The TLDB is based on the idea of the creeping codification of transnational law : an open list of the principles and rules of the lex mercatoria that is constantly updated but never completed »

إذا تركز فكرة هذا المركز في وضع قائمة مفتوحة غير مغلقة لاهم المبادئ والقواعد المتعارف عليها في القانون الدولي وخاصة في ميدان التجارة الدولية وهذه القائمة مفتوحة بالطبع إذ أنه من البديهي أن تكون متطورة مع زمنها وملائمة لكل التغيرات التي تقع يوماً بعد يوم في ميدان التجارة الدولية والتي من المفروض في هذا الميدان أن تقع.

وعند المقارنة بين هذه مبادئ UNIDROIT وهذه القائمة المفتوحة التي وضعها مركز TLDB لا يمكن إلا أن نصرح بهذا التشابه والتلاقي، فيمكن أن نقول بأن المادة 1 تنص على مبدأ حسن النية والنزاهة في المعاملات والمادة 2 على معيار المعقول good faith and fair dealing in international trade , standard of reasonableness

والمادة 4 على حرية التعاقد والقوة الملزمة للعقد والرضائية ولا يتسع المجال الآن للدراسة المقارنة الكاملة بين مبادئ أونيدورا والقائمة الغير الحصرية ل TLDB ولكنه من المعقول الجزم بهذا التقارب والتشابه. بالرغم من أننا سنقوم في الختام بتنسيب التقارب

### ج/ تنسيب التقارب بين مبادئ الأونيدورا واللاكس ماركاتوريا

بالرغم من عديد أوجه التلاقي والتشابه بين مبادئ الأونيدورا واللاكس ماركاتوريا إلا أن المصدرين وإن كانت مبادئ الأونيدورا تمثل إحدى المصادر الشكلية للاكس ماركاتوريا يختلفان في عديد من النقاط أبرزها منظومة وضع القواعد (1) والهدف من المبادئ (2) و وجود قواعد حدثية (3)



## 1- منظومة وضع القواعد

فإن كان وضع قواعد اللاكس ماركاتوريا وضع تلقائي، غير مصرّح به، غير معقلن، فقواعدها كرسست بفعل المعاملات المسترسلة التي تعاد بنفس الطريقة مرارا وتكرارا فوضع مبادئ الاونيدورا مبرمج وقع التفكير فيه إذ هو ثمرة نتاج علماء القانون والأخصائيون في مجالات قانون الدولي التجاري. جلسوا وفكروا وكتبوا واصدروا... كل هذا كان دقيقا ومبرمجا وإراديا فيبتعد كل البعد عن التلقائية التي تسود في نتاج قواعد اللاكس ماركاتوريا. نقطة الاختلاف بين مبادئ الاونيدورا ومبادئ اللاكس ماركاتوريا هي اذا المسألة الشكلية فبقدر ما يسهل التعرف على مبادئ الاونيدورا المقدمة بعديد اللغات و عديد النسخ بقدر ما يصعب تحديد ما تحتويه اللاكس ماركاتوريا من مبادئ أين نجدها ؟ أين كتبت ؟ كل هذه الأسئلة التي حيرت الفقه والفقه القانوني منذ عقود طويلة.

فهل نكتفي بقراءة المئات والآلاف من القرارات القضائية والتحكيمية للتعرف على مبادئ اللاكس ماركاتوريا أم هل يجب ان نتصفح مئات وآلاف الكتب الفقهية ؟ أو أن نحضر مئات اللقاءات السنوية الجامعة لأجدر وأسمى الخبرات القانونية حول اللاكس ماركاتوريا؟.

كيف يمكن أن نعرف ما نسميه الجامع في القانون أو Le dénominateur commun ؟

كان ولا يزال الجدل قائم حول اللاكس ماركاتوريا ولا نرى ختامه الان. ولكنه ومن المتأكد ان تكييف مبادئ الاونيدورا كمصدر شكلي لللاكس ماركاتوريا يمثل أحسن طريق وأيسره للوصول إلى هذه القواعد بل وأكثر من ذلك ففي نظرنا تمثل مبادئ الاونيدورا مصدر تجديد وتحديث لقواعد اللاكس ماركاتوريا ومصدر تقريبها لمراكز الاعمال والفاعلين في التجارة الدولية .

## 2- غاية القواعد

النقطة الخلافية الثانية بين مبادئ الأونيدورا واللاكس ماركاتوريا تتمثل في الهدف أو الغاية من قواعد الأونيدورا فهي أجمع وأوسع من غايات وأهداف اللاكس ماركاتوريا فهذه الأخيرة تعرف بكونها قانون التجار أو القانون الملائم للتجار إذ أنها تلبي حاجياتهم وأهدافهم وفي المقابل تعرف مبادئ الأونيدورا الغاية من وضعها وذلك بالتنصيص في التمهيد على أن هذه القواعد يمكن أن تستعمل كقانونا نموذجيا للمشرعين الوطنيين والدوليين ويمكن أيضا الاستناد عليها في تفسير أو تكميل القانون الوطني أو تكميل وثائق أخرى للقانون الدولي الموحد. إذا الغاية والهدف من مبادئ الأونيدورا كما نرى يتعدى ويتجاوز بكثير غايات وأهداف اللاكس ماركاتوريا التي تدور فقط حول تلبية حاجيات التجار ومعاملاتهم ولا تتطرق في حال من الأحوال إلى مواقف التشريعات

الوطنية و ليست بمصدر استلهم لهذه التشريعات , فاللاكس ماركاتوريا لا يمثل لا أداة تأويل ولا وسيلة تكميل أو غيرها للقوانين الوطنية.

### 3-قواعد حديثة جديدة

أما الاختلاف الجوهرى الثالث بين مبادئ الأونيدورا واللاكس ماركاتوريا يتمثل في القواعد الجديدة الغير متعارفة في جميع الأنظمة القانونية التي جاءت بها مبادئ الأونيدورا لأنها تمثل بالنسبة لهذه المؤسسة أحسن حل في وضعيات معينة كما هو الحال بالنسبة لما أتت به المبادئ من جديد أو من غير متعارف عليه في جميع الأنظمة القانونية. تدل قراءة التمهيد على هذا الاتجاه المكرس من قبل المجلس التنفيذي لأونيدورا ألا وهو إدخال بعض القواعد الجديدة الغير مكرسة في جميع الأنظمة والتي اعتبرها تضمن أفضل الحلول وإن لم يكن قنن بعد بوجه عام" و يطول الحديث عن قيمة المبادئ في جانبها الحداثي الذي لم يكرس ما هو متعامل عليه وما هو وارد بشكل متداول في اللاكس ماركاتوريا , فهل المعيار الزمني (ما هو متداول منذ وقت بعيد) أو المعيار الكمي ( ما هو متداول في جميع الأنظمة القانوني بشكل كثيف) هو الذي يعطي للمبدأ القيمة المفترضة ومنصب القاعدة العامة للتجارة الدولية أم هو معيار النجاعة ؟ أم هو معيار القيمة العلمية؟

يجب التذكير هنا بأن بعض القرارات التحكيمية الصادرة عن ICC نذكر منها القرار التحكيمي عدد 1997/8873 أو 1998 / 9029 bull ICC 1997/1998 ترفض تكييف مبادئ الأونيدورا كعادات عامة للتجارة الدولية و ذلك لحداثة الحلول المقترحة.

يحق لنا التساؤل وللإجابة سنحاول التركيز على بعض المؤسسات القانونية التي جاءت بها مبادئ الأونيدورا والتي لم تكن محل اجماع أو اتفاق الجميع. و من بين هذه المؤسسات ما يبين العلاقة الجدلية الممكنة بين مبادئ الاونيدورا و قواعد الشريعة الاسلامية<sup>28</sup>.

### الجزء الثاني. مكانة القانون الاسلامي في العلاقة الجدلية بين اللاكس ماركاتوريا و مبادئ الاونيدورا

<sup>28</sup> Donini V, regola morale e pragmatismo economico nel diritto islamico dei contratti, istituto per l'orienti , 2012

البعض من الفقهاء ينتقدون مبادئ الأونيدروا بالنسبة لمؤسستين على وجه الخصوص وهما مؤسسة الهارد شيب hardship او الظروف الطارئة ومؤسسة الغين (3-10) (2-6) gross disparity excessive advantage فهذا الجراء غير معمول به في جميع الأنظمة القانونية ولا يعاقب عليه في جل الاحيان , بينما كرسه القوانين المستمدة من القانون الاسلامي لانه يحترم مبدأ ضرورة التوازن التعاقدى (أ).

اما النقطة الثانية التي نستند عليها لاثبات مكانة القانون الاسلامي من العلاقة الجدلية بين مبادئ الاونيدروا و الاكس ماركاتوريا هي مثل المالية الاسلامية من هذا التساؤل الهام , هل ان مبادئ الاونيدروا مصدر كمالي او مستقل للقانون ؟ (ب)

#### أ- احترام التوازن التعاقدى, مبدأ ثابت في الشريعة الاسلامية وفي مبادئ الاونيدروا

احترام هذا المبدأ أدى اولا الى تكريس حلول قانونية مختلفة بين نظام و اخر (1) و ادى ثانيا الى التفرقة بين مبادئ الاونيدروا التي جاءت تكرر قواعد تاريخية حملتها الاكس ماركاتوريا و اخرى حديثة لا تكرر الاكس ماركاتوريا و انما متطابقة مع الشريعة الاسلامية (2)

#### 1-1- احترام التوازن التعاقدى بين مبادئ الاونيدروا و قواعد القانون الاسلامي عبر مثل الغبن

تأتي المادة 7-2-3<sup>29</sup> من مبادئ الاونيدروا وتؤكد أنه يجوز , "لأي طرف أن يتمسك ببطلان العقد أو أحد بنوده إذا تضمن العقد أو أحد بنوده ولدى إبرامه بدون مبرر مزية مفرطة للطرف الآخر". ويعتبر الافراط المتباين المفرط الافراط الغير المعقول بين قيمة الشيء المتعاقد عليه والتمن المدفوع من قبل الطرف الآخر، وهذا الإفراط من شأنه أن يخل بمبدأ التوازن المعقول المؤسس عليه العقد – لا يعاقب الاخلال بالتوازن فقط بل يعاقب الاخلال في حالة وجود افراط لا يمكن أن يقبله الانسان العاقل Reasonable person لأنه غير مشروع وغير مؤسس على سبب شرعي فالمزية advantage الباطلة هي مزية غير متوازنة ولكنها أيضا غير مشروعة an excessive advantage but also an unfair one

أما بالنسبة للقوانين العربية الاسلامية المستنبطة مبادئها من الشريعة الاسلامية فنظرية التوازن التعاقدى نظرية هامة جدا تؤسس لعدد المؤسسات القانونية في الشريعة الاسلامية ومنها نظرية منع الربا وفي كل

<sup>29</sup> في النسخة العربية لسنة 2004, المادة (3-10)

الحالات التي يفقد فيها العقد توازنه والتكافؤ بين الالتزامات أساس العقد المشروع يكون هذا العقد الا متوازنا عقدا باطلا<sup>30</sup>

ونظمت الشريعة الإسلامية الغبن في التعاقد، فأبطلت العقود الربوية، واعتدت بالغبن حين يقع من مال من يحتاج إلى الحماية، كالمحجور والوقف وبيت المال. وفي ذلك يتضح في الفقه اتجاهين

يرى أولهما عدم الاعتداد بالغبن إلا إذا صحبه تغريروا، تدليس

ويعتد الآخر بالغبن، ولو دون تغرير، إذا كان فاحشاً وصحبه غلط في القيمة

تتفق التشريعات العربية على عدم الاعتداد بالغبن المجرد، إلا إذا كان المغبون بحاجة إلى الحماية، التي يختلف مداها من تشريع لآخر، كما إذا وقع الغبن في بيع عقار القاصر، أو في عقد الشركة أو الوكالة أو القسمة، وكذا إذا لحق مال الدولة أو الوقف. وفيما عدا ذلك فليس للغبن تأثير في التصرفات القانونية إلا إذا صحبه أمر غير مشروع، كالتغريروا أو استغلال ضعف أحد المتعاقدين، وذلك على الوجه الآتي:

- ربط الغبن بالتغريروا: يسود هذا النظر في التشريعات التي تأثرت بالاتجاه الغالب في الفقه الإسلامي. وهي القانون المدني الأردني، وقانون المعاملات المدنية لدولة الإمارات العربية المتحدة والقانون المدني العراقي وغيرها.

اما عن نظرية التكافؤ بين الالتزامات *performan's equivalence* التي تؤسس نظرية العقود والالتزامات في القانون الاسلامي، إن أمكن لنا القول بوجود هذه النظرية، إذ كلنا نعرف أن القانون الاسلامي قانون لا تغلب فيه النظريات و لا الطابع التجريدي بل هو تطبيقي واقعي يستمد قواعده من الأمثلة التطبيقية، فيكون لتكافؤ الالتزامات البعد الحقيقي الواسع لتأطير كل الآثار الناجمة عن العقد وعن الالتزامات التقصيرية اللاتعاقدية كذلك مثلا الحال بالنسبة للمسؤولية إذ ما يستوجب من جبر الضرر الحاصل لقاء الفعل الضار هو بالخصوص ارجاع التوازن المنتهك ويكون إذا التعويض بحساب الضرر فقط ولا يجب أن يفوقه في كل الاحوال.

الحديث هنا ليس على نظرية التكافؤ أو التوازن بين الالتزامات بذاتها بقدر ما هو عن نقاط التلاقي بين مبادئ القانون الاسلامي ومبادئ الأونيدروا في مؤسسة منع المزية المفرطة أو غير المتوازنة و التي تركز في نظر الفقهاء أحسن تطبيق لنظرية العدالة التبادلية *commutative justice* و للمساواة بين المتعاقدين. يمكن في هذا الاطار الاستناد ايضا الى النصوص الحديثة في القانون الفرنسي التي اكدت مبدأ التوازن الواجب بين الالتزامات التعاقدية، الفصل 2-1-6-442 من المجلة التجارية الفرنسية الذي ينص على ان

<sup>30</sup> Chafik chehata , droit musulman, n 188

بنود العقد لا يجب ان تؤدي لخلق عدم توازن مؤثر بين التزامات المتعاقدين. وفي هذا الاطار , اصدرت

محكمة الاستئناف بباريس في 2013 قرارين هامين ذكرت فيهما<sup>31</sup> « le déséquilibre devient significatif par la

présence dans le contrat unique d'obligations injustifiées à la charge du fournisseur néfastes pour l'économie... »

هذا ما يعني ان المحكمة تؤكد انه من غير المشروع ان يؤثر بند من بنود العقد بصفة واضحة و جلية و غير مبررة على التزام طرف في العقد على حساب الاخر فيحدث انعكاسات سلبية على الاقتصاد , و تضيف المحكمة للدلاء بجملة من الامثلة لبنود تحدث عدم توازن جلي , مثل بند مراجعة الثمن عندما يمكن بصعوبة المزود من الزيادة في الثمن و يمكن في الوقت ذاته بسهولة المروج بتخفيض الثمن une

clause de révision de prix est source de déséquilibre significatif lorsque les stipulations contractuelles encadrent très strictement les demandes d'augmentation de tarif du fournisseur alors qu'elles permettent au distributeur d'obtenir beaucoup plus aisément une diminution de prix.

المثل الثاني الذي يؤكد حالة عدم توازن مفرط يتمثل في بند ارجاع الامبيعات clause retour des invendus التي

تنقل فقط كاهل المزود على حساب البائع la clause de retour des invendus imposant au fournisseur la totalité de la charge de la mévente d'un produit sans lui accorder aucune contrepartie

و كذلك الشأن بالنسبة لبند معدل الخدمات le taux de service المقترن بخطايا تفعل بالارادة المنفردة

للبائع فقط clause assortie d'un système de pénalités dont le déclenchement dépendrait de la volonté arbitraire du référencéur

نختم بالتاكيد على ضرورة التثبت من احترام التوازن بين الالتزامات التعاقدية وهو مبدا ثابت في جميع الانظمة القانونية الغربية و الاسلامية.

## 1-2- احترام التوازن التعاقدى بين مبادئ الاونيدروا و قواعد القانون الاسلامي عبر مثل الظروف

### الطارئة HARDSHIP

اما عن مؤسسة الظروف الطارئة او hardship تعتبر نظرية الظروف الطارئة من صميم الفقه الإسلامي فهي تقوم على أساس الضرورة والعدل ،والإحسان...

فان ولقد جاء في كتب الفقه الإسلامي الكثير من القواعد الكلية والمبادئ الفقهية التي تقوم على أساس نظرية الضرورة ويتفرع عن هذه النظرية جملة من القواعد تدخل ضمنها 'لا ضرر ولا ضرار' المشقة تجلب التيسير 'الضرر يزال' 'الضرورات تبيح المحظورات' 'الضرر الأشد يزال بالضرر الأخف' 'الضرر الخاص لدفع الضرر العام' 'درء المفاسد أولى من جلب المصالح' 'الضرورات تقدر بمقدارهما وغيرها من القواعد الكلية التي تجيز تغير العقود وتعديلها.

<sup>31</sup> CA PARIS 4/7/2013 jurisdata n°2013-015022 et 11/9/2013 jurisdata n°2013-019306 , le semaine juridique , ed entreprises et affaires 13/02/2014 n7 p 32

و تحتوي مبادئ Unidroit على قاعدة عامة تخص حالة تنفيذ العقود وهي قاعدة الفصل 6.2.1 الذي ينص "على أنه يجب على الأطراف الالتزام بكامل واجباتهم وإن كان هذا الالتزام أرهق بالنسبة لأحدهم ما عدا حالات hardship"

L'exécution en serait devenue plus onéreuse « Les parties sont tenues de remplir leurs obligations quand bien même sous réserve des dispositions suivante de hardship »

وتعرف مبادئ UNIDROIT حالة hardship في الفصل 6.2.2 كما يلي :

"وإن وقعت أحداث تخل إخلالا جوهريا بالتوازن المفروض في الالتزامات التعاقدية وإن كان هذا الإخلال يمس بقيمة الالتزام أو ثمنه وذلك سواء بالتخفيض أو بالتزريع... وكان لا يمكن توقعه..."

L'article 6.2.2 des principes UNIDROIT « lorsque surviennent des événements qui altèrent fondamentalement l'équilibre des prestations soit que le coût de l'exécution des obligations ait augmenté, soit que la valeur de la contreprestation ait diminuée... que la partie lésée n'a pu lors de la conclusion du contrat raisonnablement prendre de telles événements en considération... »

وفي حالة تحقق بند الوقاية hardship يفتح باب إعادة النظر في العقد والتفاوض من جديد بين الأطراف أو بواسطة القاضي حتى يتسنى الرجوع إلى تحقيق التوازن بينهم وهو ما يسمى بحسن النية المفترضة. لذا لا يجب أن يكون الاستناد على شرط الوقاية hardship وسيلة تأجيلية manoeuvre dilatoire فقط لتأجيل الوفاء بالالتزام أو لتعليقه لذا فرضت مبادئ UNIDROIT في الفصل 6.2.3 أن طلب إعادة النظر في العقد لا يخول وحده لأحد الأطراف تعليق التزاماته.

« La demande ne donne pas par elle-même à la partie lésée le droit de suspendre l'exécution de ces obligations »

لم تأخذ كل القوانين بهذه النظرية و منها القانون الفرنسي او التونسي , فمبدأ حياد القاضي وعدم تدخله في العقد الذي نسميه أيضا بمبدأ عدم المساس بالعقود principe de l'intangibilité des contrats هو من ثوابت التشريع الفرنسي والتونسي. الأسباب كثيرة ويطول شرحها الآن هي معروفة تتمحور خاصة في النظرة الذاتية الفائقة للعقد عمل إرادي لا يمكن لغير إرادة الأطراف التدخل فيه. وتتمثل الأسباب أيضا في الموقف السلبي تجاه السلطة القضائية التي ليس لها حق التدخل في وضعيات قانونية إرادية دون المساس بجوهر نظرية التعاقد ألا وهي نظرية الحماية القانونية الواجبة لكل وضعية قانونية l'impératif de la sécurité juridique وأكثر من هذا كله يمثل مبدأ Pacta Sunt Servenda حد تدخل القاضي الذي لا يمكنه التدخل في العقد دون المساس لهذا المبدأ الجوهري، فإذا راجع القاضي العقد أخل بشريعة الطرفين ومس بقاعدة أساسية وهي

احترام إرادة الأطراف. ولكن وبالرغم من هذه الثوابت النظرية نرى سوى في فقه القضاء التونسي أو فقه القضاء الفرنسي تحركا متزايدا نحو الاخذ بهذه النظرية<sup>32</sup>

## 2- احترام التوازن التعاقدى بين مبادئ الاونيدروا و الاكس ماركاتوريا

بالنسبة للمؤسسات أو المبادئ التي لم يقع تكريسها في اللاكس ماركاتوريا أو التي هي ليست بمحل اجماع يجدر لنا القول بأن مبادئ الاونيدروا أسست لنظام قانوني جديد فريد من نوعه يذهب إلى أكثر مما توافق عليه التجار عبر السنين، ويمثل من هذه الناحية مصدرا متجددا وحديثا للقانون المعمول به في ميدان التجارة الدولية.

أما بالنسبة للصنف الاول من مبادئ الاونيدروا التي تكرر قواعد اللاكس ماركاتوريا كما هي متعارف عليها ومتفق عليها من الجميع و منذ القدم فيمكننا الجزم بان هنالك اتفاق حول الطبيعة الالزامية لهذه المبادئ وتكريسها لنوع من المجلة الدولية للعقود التجارية الدولية فجاءت الهيئات التحكيمية والمؤسسات الحكومية تؤكد ذلك ولا نرى إلا في قليل من الاحيان بعض المواقف التي ترتفع بصوت يخالف ذلك (انظر مثلا القرار التحكيمي عدد 9479 / 1999 ICC الذي يذكر في الحكم , الطابع الغير المتكامل للمبادئ بوصفها لا تمثل في نهاية الامر مجلة متناسقة )

فمعظم الحكام والمؤسسات التحكيمية تقر بالطابع القانوني للمبادئ وتؤكد أنها تكرر نوعا من مجلة العقود التجارية الدولية وذلك لأنها تمثل ما وقع قبوله وتكريسه من قبل الجميع ومنذ سنوات.

les principes UNIDROIT sont une source fiable de de droit international en ce qu'ils réaffirment "ICC paris 9797 du 8/7/2000

les principes directeurs universellement acceptés et au cœur des notions fondamentales que les arbitres appliquent généralement

تؤكد معظم القرارات التحكيمية الصبغة القانونية والتدوينية لمبادئ الاونيدروا والبعض يضيفها بكونها قاعدة قانونية على معنى الفصل 1-17 من قانون التحكيم للغرفة التجارية الدولية بباريس الذي يخول للحكم في حالة عدم اختيار القانون من قبل الأطراف اعتماد القانون الانسب او الاجدر

the most appropriate law of the contract

و اما في المقابل و بالنسبة للصنف الثاني من مبادئ الاونيدروا كما سبقا ان ذكرنا ( اي المبادئ الحداثية ) , تتعالى بعض الأصوات لتؤكد عدم توصل المبادئ لمركز القواعد القانونية العامة

<sup>32</sup> حسن النية معيار تنفيذ العقد

John hopkins university-دراسة مقارنة بين القانون التونسي والفرنسي ومبادئ الاونيدروا , انظر مقالنا في هذا الصدد , منشورات université turin . fevrier 2013.

خاصة بالنسبة للمؤسسات التي لم تكن موضوع اتفاق مسبق من قبل جميع الانظمة القانونية والتي هي وإلى الوقت الحاضر موضوع جدل (مؤسسة الظروف الطارئة مثلا او المزية المفرطة...) بعض القرارات التحكيمية الأخرى ICC 1997/8873/00.07.1997 تنقص من قيمة المبادئ كمصدر متجدد للاكس ماركاتوريا بالاستناد إلى الطابع غير الأمر للمبادئ 00-00-2000. ICC 10021 ولكن و بالنسبة لنا هذا الطابع التكميلي أو التفسيري لا يحول عائقا لاعتبار المبادئ كمصدر للقانون وذلك للأسباب التي وقع شرحها فيما قبل و كذلك الحال بالنسبة لبقية المبادئ العامة للقانون الدولي المتمثلة في الاكس ماركاتوريا.

بعض القرارات التحكيمية ترى أنه من الغير السهل اعتبار مبادئ الاونيدروا في الجانب التي تأتي به بقواعد جديدة وخلافة كمصدر للاكس ماركاتوريا فرفض بعض الحكام تطبيق المبادئ لحدثة الحلول وغير الاتفاق عليها في جميع البلدان.

نقرأ مثلا في القرار التحكيمي عدد 9029<sup>33</sup> ICC

« In other words , although the UNIDROIT principles constitutes a set of rules theoretically appropriate to prefigure of the future lex mercatoria, should they be brought into line with international commercial practise, at present there is no necessary connection between the individual principles and the rules of the lex mercatoria, so that the recourse to the priniples is not purely and simply the same as recourse to an actually existing international commercial usage »

تعلق هذا القرار بفصلين أحدثا جدلا قانونيا وفقهما وهما الفصل 10-13 المتعلق بالمزية المفرطة و الفصل 6.2.2 المتعلق بالظروف الطارئة.

تأكد المحكمة في هذا الصدد " the appeal to the UNIDROIT principles as regards gross disparity and hardship was not valid. It having been made clear that the UNIDROIT principles are not part of normative sources of production and they are designed to constitute an uniform model for regulating the negociation of contractual relations whatever their connection with the lex mercatoria and with international commercial usage in particular and it is also clear that the UNIDROIT principles are only partly valid and in many ways an innovative "

مثلت مسألة حماية الطرف الضعيف في العقد محل جدل ونقاش بين أساتذة القانون في مختلف الأنظمة القانونية ونقط الاختلاف بين دوائر الاعمال و التجار في العالم، فلا تنظر القوانين الوضعية لهذه المسألة بنفس القدر من الأهمية ولا تقدم حولا متشابهة.

تمثل اذا المواد الحداثيّة والتجديدية لمبادئ الاونيدروا نقطة اختلاف المبادئ والاكس ماركاتوريا إذ ان هذه الاخيرة تمثل تعبير قانوني تاريخي مستمر لعادات وسلوك ثابت دائم بينما تمثل الاولى في بعض موادها مصدر خلق متجدد لقواعد جديدة حداثيّة في مجال التجارة الدولية لا تحظى باتفاق جميع الانظمة القانونية وضعها مركز الاونيدروا كذلك لتصوره انها الاجدى والافضل من

<sup>33</sup><http://www.uniles.nfa/>



بين الحلول الفريدة من نوعها في ميدان العقود التجارية الدولية ونراها هنا جليا متطابقة مع ما اتت به قواعد الشريعة الاسلامية.

#### ب- مبادئ الاونيدروا مصدر مستقل او كمالي؟ و موقع القانون الاسلامي من هذا الجدول؟

سنتعرض لهذه العلاقة الجدلية من خلال مسألة المالية الاسلامية أولا (1) ثم من خلال دراسة بعض الامثلة الفقه قضائية (2)

#### مسألة المالية الاسلامية1-

عند مناقشة أطروحة هل أن اتفاقية روما المتعلقة بالعلاقات التعاقدية على المستوى الاوروبي تنطبق بشكل جيد على موضوع المالية الاسلامية والقانون الصيرفي الاسلامي , تطرق السيد كليان بالز<sup>34</sup> لهذا الجدال القانوني الهام. هل أن النظرة الكونية للاكس ماركاتوريا أو قانون التجار تخالف وتعكس النظرة الجهوية الضيقة لتوحيد القانون على المستوى الاوروبي؟ ونحن سنضيف في هذا الاطار , هل أن النظرة الكونية للاكس ماركاتوريا أو قانون التجار تخالف وتعكس النظرة التي ينظر اليها القانون الاسلامي؟ أم أنه «يتماشى اليوم مع النظريات الحديثة السائدة من توحيد قانون التجارة الدولية او على الاقل تنسيقه

uniform law

standardization and harmonization

حاول الاستاذ بالز الإجابة على هذا الاشكال الهام عبر طرح موضوع المالية الاسلامية لأنها في الوقت الحاضر لم تعد مكتنفة فقط في حدود البلدان الاسلامية<sup>35</sup> بل تجاوزتها لاكتساح أسواق جديدة أوروبية وأمريكية تجاوزت العامل الديني الأولي . فالعاصمة الانغليزية<sup>36</sup> مثلا تمثل اكبر ساحات المالية الاسلامية<sup>37</sup>.

<sup>34</sup> Kilian Balz, islamic law as governing law under the Rome convention ,uniform law review 2001- 1- 37

<sup>35</sup> <http://www.fsa.ulaval.ca/labval/Finance%20Islamique%20et%20Capital-Risque.pdf>

<sup>36</sup> لندن - 30 - 10 - 2013 -- أعلنت الحكومة البريطانية عن تشكيل مجموعة عمل دولية للتمويل والاستثمار الاسلامي تهدف الى تعزيز مكانة الخدمات المالية الإسلامية في العالم خلال الاعوام الخمسة المقبلة

<sup>37</sup> حجم الاموال المدارة في المصارف والمؤسسات المالية الاسلامية بلغ نحو تريليون <http://www.zawya.com/ar/story/> دولار حول العالم، ما يكشف ان الصيرفة الاسلامية باتت تأخذ حيزا كبيرا من قطاع الصيرفة العالمية , ديسمبر 2013

ويمثل موضوع المالية الإسلامية<sup>38</sup> أحسن موضوع حديثي عصري يمكن أن تتجادل فيه نظريات الكونية والجهوية للقانون المنطبق على العلاقات التعاقدية بين نظرات جهوية دينية وأخرى كونية تستند على أطروحات قانون التجار<sup>39</sup>.

Universalist lex mercatoria .versus regionalist unification of law

يتعقد الأمر بالنسبة لتوحيد القانون المنطبق على العلاقات التعاقدية والصيرفية خاصة عندما يضاف العامل الديني على العامل الجهوي وهذا هو الحال مثلا بالنسبة للقانون الاسلامي، يرى الاستاذ بالز انه يجب الابتعاد على القانون الوطني وإن كان جهويا توحيدا (مثل القانون الاروبي) للتفكير في قانون لا وطنيا لا حدوديا لتنظيم ميدان المالية الإسلامية في العالم وهذا النظام القانوني الذي لا ينبع من مشروع وطني أو مجموعة من المشرعين الوطنيين يمكن ان يكون متمثلا في مبادئ الاونيدروا المتعلقة بالعقود التجارية الدولية و تكون هذه المبادئ ممثلة لمصدر متجدد للاكس ماركاتوريا أو القانون الملئم للتجار. بالطبع وبتطبيق القاعدة الغير مختلف في مضمونها التي هي مبدأ الإرادة وحرية الأطراف في اختيار القانون المنظم لهذه العلاقات loi d'autonomie the principal of party autonomy , يمكن للأطراف اختيار القانون الاسلامي كقانون منظم للعقد مثلا

وهذا ما ركزته جميع الاتفاقات والنصوص الدولية مثل اتفاقية روما للقانون المنظم للعلاقات التعاقدية او (3-1) او القانون المثالي الأونسسيترال (1-28) المنظم للتحكيم الدولي.

الاشكال يتمثل في أن القانون الاسلامي يمثل قانونا غير وطنيا ولا حدوديا The a-national order of islamic Law و لكن هل من الممكن اللجوء إلى قانون لا وطني في الظرف الأوروبي الحالي أي حسب منطوق اتفاقية روما للعلاقات التعاقدية؟ هل من الممكن اعتماد قانون غير وطني مثل القانون الاسلامي ؟ أو قانون التجار؟ الاكس ماركاتوريا؟ او مبادئ الاونيدروا ؟ بالنسبة للموضوع المالية الإسلامية ؟

الحل أنه من الكلاسيكي التمييز بين وضعين كما ذكرنا سابقا, ان كان النزاع من اختصاص المحاكم الوطنية national courts؟ أو ان كان النزاع من اختصاص المحاكم؟

ففي الحالة الاولى يصعب ذلك لكل الاسباب التي وقع ذكرها سابقا , اما بالنسبة للحالة الثانية فلا جدال أن التحكيم يقبل بهذا الاختيار اللاحدودي أي القانون الغير وضعي او الاوطني. فالحكام يقبلون باختيار الاطراف للقوانين اللالوضعية مثل قانون التجار أو حتى مثل القانون الاجدر أو الأصلح للعلاقة التعاقدية الذي propre law of th equality يمكن أن يكون لحدوديا ويستند الحكام أيضا إلى المبادئ العامة للقانون كجزء لا يتجزأ من قانون التجار او اللاكس ماركاتوريا، فالحرية هنا تامة في ميدان التحكيم الدولي.

هناك نحو 350 بنكا ومؤسسة مالية اسلامية حول العالم تقدم نحو 40 منتجا اسلاميا في كل المجالات المالية، تستحوذ اوربا على نحو 38 15% منها بـ50 مؤسسة وبنك تقدم الخدمات المالية الإسلامية عبر نوافذ خصصت لهذا الهدف، ويستفيد من خدماتها في اوربا لوحدها نحو 18.2013 مليون مسلم يعيشون هناك

<sup>39</sup> <http://www.islamicbankingmagazine.org/>

فما هو الحال إن اختار الأطراف لا المبادئ العامة للأكس ماركاتوريا بل المبادئ العامة للقانون الاسلامي ؟

بخصوص المنظومة الخاصة بالمالية الاسلامية فيمكن الجزم في الوقت الحاضر بوجود نوع من المبادئ الا متخالف في شأنها تمثل نوعا من السنتدار STANDARD أو القواعد المبدئية وضعتها الجمعية الدولية للبنوك الاسلامية ( the international association of Islamic Banks ) متمثلة فيما يسمى المثال<sup>40</sup> البنكي الاسلامي A model islamic banking act<sup>41</sup>

فلا مجال للشك أن الحكام سيطبقون هذه المبادئ العامة للحدودية TRANSNATIONAL

ولكن ما هو الحل إن كان النزاع من أنظار المحاكم الوطنية National Courts ؟

فمن المتعارف عليه أن القضاة يرفضون اللجوء إلى القواعد القانونية للحدودية أو اللاوطنية a non-state law لانهم مفوضون من قبل السلطات الوطنية للقيام بمهمتهم التي هي وظيفة شأن عام. وهذا هن المبدأ بالنسبة لاتفاقية روما إذ أن القانون المقصود في الفصل 1-3 هو القانون الوطني دون سواه.

يقيد هذا الفصل من اتفاقية روما القضاة في اختيار القانون الاجدر او الاكثر ملائمة مع العقد the proper law of the contract كقانون وطني دون سواه إذا يمكن اقصاء قواعد التشريع الاسلامي و كذلك قواعد الاكس ماركاتوريا في حالة عدم اختيار القانون من قبل الاطراف و لكن هذا لا يمنع الأطراف من اختيار هذه

المبادئ كقانون مادي ينظم علاقاتهم law .an agreement on the level of substantive / ou droit matériel ;

لا يمكن للقضاة اذا اللجوء من تلقاء أنفسهم إلى هذه المبادئ ولكن إن وقع اختيارها من قبل الأطراف فلا مانع في ذلك و تكون هذه القواعد العامة مصدرا ماديا صالحا لتنظيم العلاقات التعاقدية بين الأطراف وذلك تطبيقا لمبدأ سلطان الإرادة وحرية الأطراف في اختيار الأجدر بوضعيتهم.

الاشكال إذا يطرح إن لم يحدد الأطراف القانون المنطبق؟

فالحل هنا حسب منطوق الفصل 41 من اتفاقية روما يتمثل في اختيار القانون الوطني الاكثر تعلقا أو

الأوثق صلة بالعقد the contract shall be governed by the law of the country which is the most closely connected

ويعني ذلك أنه وفي حالة عدم اختيار الأطراف القانون المادي المنطبق لا يجوز الرجوع إلى مبادئ القانون الاسلامي أو مبادئ الاكس ماركاتوريا كمنظومة لاحودية ولا وطنية

<sup>40</sup> [http://www.bnm.gov.my/documents/act/en\\_ib\\_act.pdf](http://www.bnm.gov.my/documents/act/en_ib_act.pdf) exp

<sup>41</sup> Because Islam forbids simply lending out money at interest, Islamic rules on transactions (known as *Fiqh al-Muamalat*) have been created to prevent it. The basic principle of Islamic banking is based on risk-sharing which is a component of trade rather than risk-transfer which is seen in conventional banking. Islamic banking introduces concepts such as **profit sharing** (*Mudharabah*), **safekeeping** (*Wadiyah*), **joint venture** (*Musharakah*), **cost plus** (*Murabahah*), and **leasing** (*Ijar*).

وهذا من الغريب، فمن المتعارف عليه أن هذه المبادئ العامة الخاصة بالتجار هي الأساس بالنسبة لقواعد العقود الدولية التجارية إذ انها بذلك تتيح الابتعاد على كل ماهو لا متوافق عليه أو شديد التطرف في القوانين الوضعية المختلفة.

إذا نختم فنقول انه من الضروري الأخذ بقواعد الشريعة الإسلامية المنظمة للمالية الإسلامية كجزء لا يتجزأ من قانون التجار الدولي لان الاخذ بمختلف النظريات القانونية في التجارة الدولية أحسن حل للوصول الى ملائمة اكثر لتطلعات التجار وحاجياتهم. فحاجياتهم مختلفة بحسب طلباتهم ومواقعهم و توحيد القانون لا يعني غياب عنصر الخصوصية الثقافية الناتجة عن دين أو تاريخ.

ويقارن الاستاذ بالز<sup>42</sup> تأويل اللاكس ماركاتوريا بالرجوع إلى قواعد القانون الروماني كمصدر تاريخي لقانون التجار ويقول أنه من الممكن طبعا وبالنسبة للطرف الخاص بالمالية الإسلامية الرجوع إلى قواعد الشريعة الإسلامية وهي قواعد غير وطنية ولاحدودية كجزء من اللاكس ماركاتوريا الخاصة بالتجار المهتمين بالمالية الإسلامية.

النظرة فريدة من نوعها وشديدة الأهمية بالنسبة للباحثين في مجال توحيد القانون إذ تعني أن توحيد القانون لا يكون على حساب نكران الخصوصية المطلوبة بالنسبة لبعض العمليات القانونية الفريدة مثل عقود المرابحة الخاصة بالتشريع الإسلامي وتطبيق الأطراف للاكس ماركاتوريا في هذا المجال يعني أيضا الأخذ بعين الاعتبار القانون الإسلامي كقانون لاوطني وغير حدودي. وعند الرجوع الى مبادئ المالية الإسلامية , لا نرى أي مبدأ يمكنه أن يعارض القواعد المعمول بها في الاكس ماركاتوريا أو مبادئ الاونيدروا. وهذه المبادئ التي يحصرها الفقهاء في أربعة<sup>43</sup> هي تحريم التعامل بالفائدة أو الربا<sup>44</sup> , و المعايير الاخلاقية و القيم المعنوية و الاجتماعية ثم المسؤولية عن المخاطر التجارية<sup>45</sup>.

<sup>42</sup> انظر نفس المقال

<sup>43</sup><http://www.albaraka.com/>

"تُستمد مبادئ التمويل الإسلامي من القرآن الكريم والذي يؤمن المسلمون بأنه كلمات الله سبحانه وتعالى الحقّة كما أوحى بها للبي محمد (ص). ويمكن تلخيص هذه المبادئ الإسلامية للتمويل في أربعة مفاهيم كما يلي. 1- التحريم الكامل للربا , إن أول وأهم مفهوم هو التحريم الكامل للفائدة أخذًا وعطاءً، وهذا ما هو معروف بلفظ الربا. المال وحده لا يستطيع تحقيق أرباح، وعندما يتفشى الربا في اقتصاد بأكمله فإن ذلك يعرض رفاه كل فرد يعيش في ذلك المجتمع للخطر. عندما يبدي المستثمرون اهتماما أكبر بمعدلات أسعار الفائدة والعائد المضمون أكثر من اهتمامهم بكيفية استخدام الأموال، فإن النتائج لا يمكن إلا أن تكون سلبية. 2- المعايير الأخلاقية، المبدأ الثاني يتعلق بالمعايير الأخلاقية. عندما يقوم المسلم باستثمار أمواله في شيء ما فإن واجبه الديني يحتم عليه التأكد من أن ما يقوم بالاستثمار فيه هو أمر جيد ومفيد. ولهذا السبب، فإن الاستثمار الإسلامي يتطلب إجراء دراسة جادة عن المشروع الذي سيتم الاستثمار فيه وسياساته والمنتجات التي سوف ينتجها والخدمات التي سيقدمها وتأثير هذه جميعها على المجتمع والبيئة. وبعبارة أخرى، يجب على المسلم أن يلقي نظرة متمنعة على العمل الذي سيكون على وشك المشاركة فيه.. في جميع جوانب النظام المالي، وضع الإسلام بعض القواعد وبعض الأنظمة فيما يتعلق بالكيفية التي ينبغي على المسلمين اتباعها فيما يتعلق بالمشاركة في هذه الأنشطة، فعلى سبيل المثال وفيما يتعلق بتداول الأسهم أو التعامل في سوق الأوراق المالية، فإن الإسلام ينص على التمعن في أنشطة هذه الشركات للتأكد من كون هذه الأنشطة تتوافق مع أحكام الشريعة الإسلامية أم لا. 3- القيم الأخلاقية والاجتماعية، المبدأ الثالث يتعلق بالقيم الأخلاقية والاجتماعية. يدعو القرآن الكريم جميع أتباعه إلى رعاية الفقراء والمعوزين ومساعدتهم. وعلى هذا، يتوقع من المؤسسات المالية الإسلامية أن توفر خدمات خاصة للمحتاجين من الناس، وهذا لا يقتصر على مجرد الهبات والتبرعات الخيرية بل اتخذ أيضا طابعا مؤسسيا في العمل المصرفي الإسلامي في شكل قروض بدون أرباح أو عمولات وهو ما يعرف بالقرض الحسن.. جزء من أعمال المصرف الإسلامي هو القيام ببعض المشاريع الاجتماعية والتي تشكل أعمال البر ودعم الجمعيات الخيرية جزءا منه، كما تقدم المصارف الإسلامية قروضا بدون فائدة. فعلى سبيل المثال، إذا كان أحد الأفراد يحتاج إلى الذهاب إلى المستشفى للعلاج أو دخول الجامعة فإن المصرف الإسلامي يقدم له ما يعرف باسم

## 2- مبادئ الاونيدروا مصدر ملحق أو كمالي لقانون التجارة الدولية , أمثلة فقه قضائية؟

الجدل الفقهي يدور حول مسألة صعبة الحل في الواقع وهي الاتية هل تمثل مبادئ الاونيدروا مصدر مستقل لقانون التجارة الدولية ؟ أو هل هي مصدر ملحق أو كمالي يعني أن بتطبيقها يقع تطبيق اللاكس ماركاتوريا؟ بعبارة أخرى هل هي مصدر مستقل بذاته؟ أو مصدر ثانوي تطبق إن وقع الرجوع إلى اللاكس ماركاتوريا؟ فقط هذه الحالة على أساس القاعدة القانونية المعروفة : الفرع يتبع الأصل؟. لا يمكن الإجابة على هذا السؤال إلا إذا قمنا بإحصائيات دقيقة لعدد من القرارات التحكيمية والقضائية التي طبقت مبادئ الاونيدروا أما بشكل منفرد أي كمصدر أصلي أو كمصدر ثانوي فرعي أي عند تعرضها للاكس ماركاتوريا.

وهذا بالطبع من الصعب القيام به وذلك لعدد من الأسباب من أهمها السرية المتعارف عليها في ميدان الأعمال وصعوبة التوصل إلى القرارات والأحكام.

ونقرأ في هذا الصدد القرار التحكيمي عدد 11 575 الصادر ن ICC في 2003

"In a dispute the Arbitral Tribunal decided to apply the UNIDROIT Principles rather than other anational principles and rules in view of the fact that they are much more precise than the Lex mercatoria and other similiary « vague and heteroclitic » principles and rules".

يجب الرجوع في هذا الصدد إلى التفرقة السابقة الذكر بين العقود التي حدّد بها أصحابها الرجوع إلى مبادئ الاونيدروا وبقية العقود وكذلك التفرقة بين إذا ما كان النزاع من أنظار المحاكم الوطنية أو المحاكم التحكيمية.

القرض الحسن، ويمنح هذا القرض الحسن عادة لمدة سنة واحدة ولا يتقاضى المصرف الإسلامي أي شيء عن ذلك...4-- المسؤولية عن المخاطر التجارية، المبدأ الرابع والأخير يتعلق بالمفهوم الشامل للعدالة والإنصاف، وهي فكرة وجوب أن تشارك جميع الأطراف المعنية على حد سواء في المخاطر والربح من أي مسعى أو عمل. لكي يكون مستحقاً لأي عائد، يجب على مقدم التمويل تحمل مخاطر هذا العمل أو النشاط التجاري أو تقديم بعض الخدمات الأخرى مثل توفير الأصول، وإلا فإن مقدم التمويل، من وجهة نظر الشريعة الإسلامية، ليس فقط طفيلي اقتصادي بل آثم أيضاً. وهذا المبدأ مستمد من الحديث النبوي الشريف "الخراج بالضمان". ومعني هذا هو أن المرء يصبح مستحقاً للربح فقط عندما يتحمل مسؤولية مخاطر الخسارة. عن طريق ربط الربح مع احتمال الخسارة يميز القانون الإسلامي الربح الشرعي عن جميع الأشكال الأخرى للمكاسب. للتأكد من اتباع هذه المبادئ، يجب أن يكون لكل مؤسسة إسلامية مجلس استشاري يعرف باسم هيئة الرقابة الشرعية، ويجوز أن تشمل هيئة الرقابة الشرعية أعضاء من المصرفيين أو القانونيين أو علماء دين ما داموا قد تلقوا تدريباً مناسباً في فقه المعاملات بصفة خاصة."

الربا في اللغة هي الزيادة على الشيء، وفيما يتعلق بالتمويل فإن تعريف الربا في الشريعة الإسلامية هو "آية زيادة في الدين مشروطة في 44  
العقد أو حسب العرف المعتاد " -مُنذر حقف \_ المعهد الإسلامي للبحوث والتدريب - البنك الإسلامي للتنمية

45 <http://www.albaraka.com/>

تجدر الملاحظة هنا وأنه بالرجوع إلى موقع unilex<sup>46</sup> المختص بجمع القرارات والأحكام حول تطبيق مبادئ الاونيدروا والاتفاقية الدولية حول عقود البيع CISG<sup>47</sup> وبالرجوع إلى القرارات التي تخص تطبيق المبادئ كتعبير عن اللاكس ماركاتوريا نجد عديد من القرارات تحكيمية

Principles as an expression of the lex mercatoria referred to in the contract 30-4-2001 – Ad hoc arbitration ( san José Codo Rica)<sup>48</sup>

هذا لا يمنع من الافصاح بالقول أنه وبالنسبة لجل الحكام, تعتبر مبادئ الاونيدروا جزء لا يتجزأ من اللاكس ماركاتوريا , ففي حالة تنصيب الأطراف في العقد على تطبيق قواعد الاكس ماركاتوريا يرجع الحكم إلى مبادئ الاونيدروا بصفة تلقائية لأنها جزء لا يتجزأ من اللاكس ماركاتوريا وكان هذا الحال في عديد من القرارات التحكيمية الصادرة عن ICC ويمكننا أن نقرأ في القرار التحكيمي

ICC sent. N° 8540 du 4109/1996

" In determining the content of these general principles we feel entirely justified in referring to the UNIDROIT principles which we consider a useful source of establishing general rules for international commercial contracts ».

وتذكر المحكمة في قرار صادر في 2001 ( عدد 10422 ) باللغة الفرنسية في نسخته الأصلية في حالة عدم اختيار القانون المنطبق على العقد ووفقا للفصل 1-17 من التنظيم الخاص ب ICC يطبق الحكم القانون الانسب, وفي هذه الحالة, رأى الحكام ان ارادة الاطراف اتجهت نحو تطبيق قانون محايد بعيد عن مختلف القوانين الوطنية

« Le tribunal arbitral appliquera par conséquent les règles et les principes généralement reconnus dans le commerce international ( lex mercatoria ) et notamment les principes UNIDROIT dans la mesure où ils apparaissent comme une transposition fidèle des règles reconnues comme applicables aux contrats internationaux par les commerçants engagés dans le commerce international »<sup>49</sup>

في ختام هذه الدراسة لا يسعنا الا ان نعبر عن شديد ثقتنا بأن يحتل النظام القانوني الاسلامي المكانة التي له ان يرتقي اليها في هذه الديناميكية الكونية المتمثلة في تنسيق و توحيد قانون التجارة الدولية وان يحتل منصبه بين الاكس ماركاتوريا و مبادئ الاونيدروا لكل اوجه التقارب المبينة سابقا و التي ستعطي لعملية توحيد قانون التجارة الدولية , الشمولية و الكونية المرتقبة.

<sup>46</sup> UNILEX / WWW.unilex .info (on CISG and UNIDROIT principles International case law and bibliography

<sup>47</sup> CISG : United Nations convention on contracts for the international sale of Goods).

<sup>48</sup> 2002	ICC	11018
2003	ICC	12040
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<sup>49</sup> Tranelex.uni.koel.DOCID 210422

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# Intellectual Property Rights and Contract Farming

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1. Methodological note: In agriculture field, many kinds of intellectual property maybe concerned, such as patent, plant new variety, trademark, trade secret, and regulations on plant genetic resource. To focus the research aim, the establishing conditions for intellectual property rights, including the application procedures and substantial requirements are briefly mentioned. Researches are mainly based on the precondition that some kind of intellectual property rights are already got by the right holders. There are many types of agreements made in agriculture industry; two are of particular important in the context of arranging rights in intellectual property. The first type of agreement is the so-called technology license. The parties to these agreements include large multinational corporations, small plant biotechnology companies, universities, government agencies, and farmers or growers. The subject matter of these agreements often involves molecular genetic technology and licenses to this technology, often protected by patents. Farmers typically buy the biotechnology seed which is accompanied with a technology license that gives the farmer the right to use the patented technology in the context of producing a single crop from the purchased.<sup>2</sup> The second type of agreement that is prevalent in the agricultural industry involves that transfer of rights to seeds from

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<sup>2</sup> Mark.D.Janis, Herbert H.Jervis and Richard Peet, Intellectual Property Law of Plants, Oxford University Press 2014, p.435.

plant and seed breeders to the ultimate end-users, the individual farmer or grower, which is more legally complex and controversial, so emphasised in the research.

## **I. Patent**

### **1. Patent protection on international conventions**

2. A patent is a set of exclusive rights granted by a sovereign state to an inventor or assignee for a limited period of time in exchange for detailed public disclosure of an invention. An invention is a solution to a specific technological problem and is a product or a process. The grant, which lasts for years according to domestic law from the date of filing the application, protects the inventor's right to exclude others from asexually reproducing, selling, or using the plant so reproduced.
3. Patent is a very useful means to protect agricultural invention and recognized in several conventions. Paris Convention on the Protection of Industrial Property, article 1 provide that " Industrial property shall be understood in the broadest sense and shall apply not only to industry and commerce proper, but likewise to agricultural and extractive industries and to all manufactured or natural products, for example, wines, grain, tobacco leaf, fruit, cattle, minerals, mineral waters, beer, flowers, and flour."
4. TRIPS 27.3 " Members may also exclude from patentability:(a) diagnostic, therapeutic and surgical methods for the treatment of humans or animals; (b)plants and animals other than micro-organisms, and essentially biological processes for the production of plants or animals other than non-biological and microbiological processes. However, Members shall provide for the protection of plant varieties either by patents or by an effective sui generis system or by any combination thereof." In particular, the first paragraph of Article 27 calls on WTO members to provide patent protection for both products and processes, and forbids discrimination among different fields of technology, including agriculture. Therefore, this provision allows the patenting of plants and plant varieties as well as their genetic components. WTO members also agreed that plants, animals and all essentially biological process for their protection may be excluded from patentability. However, if they do so, they shall provide for the protection of plant varieties either by patent or by effective sui generis system or by any combination thereof. Under Article 27.3(b)of TRIPs Agreement, countries are free to choose their own effective sui generis system for the protection of new plant varieties. When a WTO member excludes plants from patentability, the obligation to provide an effective sui generis system for the protection of plant varieties cannot be waived on the basis of Article 8.1.<sup>1</sup> Therefore, there are three possible TRIPs-compliant forms of intellectual property protection for plant varieties: patent, sui generis protection, or any combination thereof.
5. According to Article 28 of the TRIPs Agreement, a patent shall confer on its owner the right to prevent others from making, using, offering for sale, selling or importing the patented products. Patent owners shall also have the right to assign, or transfer by succession, on patent and to conclude licensing contracts. Members may provide limited exceptions to the rights conferred by a patent, provided that such exceptions do not unreasonably conflict with a normal exploitation of the patent and do not unreasonably prejudice the legitimate interest of the patent owner, taking

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<sup>1</sup> Queen Mary Intellectual Property Research Institute (2004), "The Relationship between Intellectual Property Rights and Food Security", DG Trade of the European Commission, at pp.9-10.

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account of legitimate interest of third parties. The term of protection available shall not end before the expiration of a period of twenty years counted from the filing date.

## **2. *Representative on domestic laws***

6. Under the European Patent Convention (EPC), to which most European countries are contracting states, plant varieties are excluded from patentability. However, the exclusion is interpreted narrowly, and patents can be obtained with claims embracing one or more plant varieties, provided that the invention is not technically restricted to a plant variety. For example, a patent can validly be granted with a claim to a transgenic plant, which encompasses many plant varieties within the scope of the claim. In contrast, a claim that is specifically directed to one or more particular plant varieties is not allowable. Patents on plant breeding methods: In Europe, "essentially biological processes for the production of plants" are excluded from patentability. This is interpreted to exclude from patentability any method involving sexual crossing and selection of plants, regardless of the degree of human intervention in the breeding process, unless the crossing and selection steps include an additional technical step that introduces or modifies a genetic trait in the plant.<sup>1</sup>
7. In US, the 1930 Plant Patent Act was the first system to be specifically designed for the protection of plants. The plant patentee has the right to exclude everyone else from asexually reproducing the plant or using, offering for sale and selling plants asexually derived from the patented variety. Patents to plants which are stable and reproduced by asexual reproduction, and not a potato or other edible tuber reproduced plant, are provided for by Title 35 United States Code, Section 161 which states: Whoever invents or discovers and asexually reproduces any distinct and new variety of plant, including cultivated sports, mutants, hybrids, and newly found seedlings, other than a tuber propagated plant or a plant found in an uncultivated state, may obtain a patent therefore, subject to the conditions and requirements of title. (Amended September 3, 1954, 68 Stat. 1190).

## **3. *Examples of patent terms in contract***

8. If a patent is authorized to the right holder, he has several exclusive rights on that patent, so when conclude contract with farmers, patents are always express in contract. The following are some examples of patent terms of contract.
9. Monsanto Company is a publicly traded American multinational agrochemical and agricultural biotechnology corporation, who have many patents on agricultural industry. Monsanto Technology Agreement provides "the licensed grower agrees "to use the seed containing Monsanto gene technologies for planting a commercial crop only in a single season" and "to not save any crop produced from this seed for replanting, or supply saved seed to anyone for replanting." Monsanto's restriction on seed growers include (1)requiring growers to use only seed containing Monsanto's biotechnology for planting a single crop("exclusivity provision"); (2)prohibiting transfer or re-use of seed containing the biotechnology for replanting ("no replant policy");(3)prohibiting research or experimentation ("no research

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<sup>1</sup><http://www.mewburn.com/patents/life-sciences-biotech/industrial-agricultural-biotech/plant-variety-rights-and-patents-for-plant-related-inventions>. (accessed 7 July 2008).

policy”); and (4) requiring payment of a “technology fee”.<sup>1</sup> In addition to signing the technology agreement, farmers are responsible for following the structures and procedures laid out in the contract’s supplementary 31 page publication, Monsanto’s Technology Use Guide. Between these two documents, specific conditions subject farmers to invasions of privacy and property that have led to an undermined number of patent infringement allegations.<sup>2</sup>

10. [ PATENTS AND TRADEMARKS] The Buyer expressly assumes all risks of patent, trademark or plant variety rights infringement by reason of its use or sale of the Seeds, either alone or in conjunction with other materials. The Buyer shall immediately inform the Seller of any claims or legal proceedings involving the Buyer and regarding the patents or trademarks of the Seeds delivered, and shall indemnify the Seller from any such claims or legal proceedings. The Buyer agrees to discuss and agree with Seller on the defence strategy that shall be used against such a claim or in legal proceedings.<sup>3</sup>
11. GMO contracts also ban growers from saving seed produced by their GMO crops. This forces them to buy new seed every season, unlike traditional crops that can be replanted freely. The contracts provide for severe penalties if growers save their seed. This can be particularly harsh in the case of growers who never see the contract, but are bound merely by opening a bag of seed, as they may save their seed and incur penalties inadvertently.<sup>4</sup>

#### **4. Infringement**

12. Since the mid-1990s, Monsanto indicates that it has filed suit against 145 individual U.S. farmers for patent infringement and/or breach of contract in connection with its genetically engineered seed but has proceeded through trial against only eleven farmers, all of which it won. In 2006 *Monsanto Co.v Scruggs* by the US Court of Appeal for the Federal Circuit, the court held that “no replant policy simply prevents purchasers of seeds from using the patented biotechnology when that biotechnology makes a copy itself. This restriction therefore is valid exercise of its rights under the patent law. The no research policy is a field of use restriction and also within the protection of the patent laws. ” 2013 *Bowman v. Monsanto Co.* is a United States Supreme Court patent decision in which the Court unanimously affirmed the Federal Circuit and held that patent exhaustion does not permit a farmer to reproduce patented seeds through planting and harvesting without the patent owner's permission.
13. In conclusion, when plant germplasm falls within the scope of patent claims, the legitimate experimental use of genetic material is restricted and a licence from the patent owner is required. A patent shall confer on its owner the right to prevent others from making, using, offering for sale, selling or importing the patented products. Although the strict provisions outlined in Monsanto’s technology agreement are often not read by farmers who sign them- much less understood by

<sup>1</sup> *Monsanto Co.v Scruggs*, et al, 459 F.3d 1328 (Fed. Cir.2006).at p3. Also, Monsanto's patents and license agreement again upheld. <http://business.highbeam.com/437330/article-1G1-191907143/monsanto-patents-and-license-agreement-again-upheld> (accessed 7 July 2008).

<sup>2</sup> The Center for Food Safety, *Monsanto vs. U.S. Farmers*, 2005, p.17.

<sup>3</sup> Seed Sales T&C United Oilseeds Marketing Ltd William Road, Devizes, Wiltshire, SN10 3US, UK

<sup>4</sup> <http://faircontracts.org/issues/farming>. (accessed 7 July 2008).

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them. To date, the complicated and unreasonable terms of Monsanto's technology agreement have not yet to be effectively challenged in court. <sup>1</sup>

## **II. Plant new variety rights**

### ***1. Plant new variety rights on international conventions***

14. The International Union for the Protections of New Varieties of Plants (UPOV) is an intergovernmental organization and not a 'treaty' as such. Countries are not obliged to join UPOV as a result of their affiliation with any other organization or the ratification of any specific treaty. Membership is purely voluntary. The UPOV Convention has been revised three times, however not all member countries are bound by the latest convention (1991). Approximately 26 countries remain bound by the 1978 Convention, while Spain and Belgium are bound by the original Convention (1961). <sup>2</sup> The core content of UPOV convention is plant breeders' rights.
15. Plant breeders' rights (PBR), also known as plant variety rights (PVR), are rights granted to the breeder of a new variety of plant that give the breeder exclusive control over the propagating material (including seed, cuttings, divisions, tissue culture) and harvested material (cut flowers, fruit, foliage) of a new variety for a number of years. Plant New Variety rights protection confers the right to exclude others from: producing or reproducing, propagating, offering for sale, selling or other marketing, exporting, importing or stocking for any of the above purposes the protected variety. Plant breeders' rights contain exemptions from infringement that are not recognized under patent law.
16. Before 1991, UPOV provided three limitations on plant breeders' monopoly rights. First, other breeders could freely use UPOV-protected varieties for research purposes. Second, farmers could reuse the seed for the following year's harvest under certain condition. Third, plant breeders were forced to choose to protect their plant varieties with either a Plant Breeders' Rights or a patent. The 1991 UPOV made reversions especially limited the exemptions. According to Article 15.1 of the 1991 UPOV Act, neither the authorization of the right-holder nor the payment of royalties is required when acts involving the use of protected varieties are "done for the purpose of breeding other varieties." Acts done "privately and for noncommercial purposes" or "for experimental purposes" are also exempted. Two major implications can be identified. On the one hand, the plant breeders' exemption is preserved intact. However, the authorization of the breeder of the "original" variety as well as some economic compensation is required when a new "essentially derived" variety is commercialized. The 1991 UPOV Act limits the farmer's privilege to save seeds for replanting, and requires farmers to limit the amount of saved-seeds or to pay an equitable remuneration to the right-holder. <sup>3</sup> In addition, the informal sale and offer for sale of protected varieties is outside the scope of such privilege, because plant breeder's right may only be limited "to permit farmers to use for propagating, on their own holdings, the products of the harvest

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<sup>1</sup> The Center for Food Safety, *Monsanto vs. U.S. Farmers*, 2005, p.17.

<sup>2</sup> The International Union for the Protections of New Varieties of Plants, <http://www.upov.int/portal/index.html.en> (accessed 7 July 2008).

<sup>3</sup> The farmer's privilege is allowed at the option of UPOV member states "within reasonable limits and subject to the safeguarding of the legitimate interests of the breeder'." Article 15 of the 1991 UPOV Act.

obtained by planting, on their own holdings, the protected varieties.”<sup>1</sup> The important thing to mention is that farmers’ exemption is mandatory in 1978 convention, but optional in 1991 convention, which means the decision to include an exemption is dependent on each member’s national legislation. Also, according to 1991 UPOV, in order to qualify for these exclusive rights, a variety must be new, distinct, uniform and stable. It permits member states to protect the same plant variety with both a breeder’s right and a patent.

## **2. Representative domestic laws**

17. The EU, three legislations delineate the legal framework that applied to the protection of plant-related innovations: the 1973 European Patent Convention, Directive 98/44/EC on the Legal Protection of Biotechnological Inventions, and Council Regulation 2100/94/CE on Community Plant Variety Rights. The Community protection of plant varieties (CPVR) enables applicants, on the basis of one application, to be granted a single intellectual property right which is operative throughout all countries that are members of the European Union. A CPVR can only be transferred or ceased within the EU Community on a uniform basis. That is, a CPVR can only be valid (or cancelled) across all EU countries, not selected individual countries. In Europe, plant varieties can be protected either nationally or at European Community level. The Community Plant Variety Right (CPVR) is a plant variety right valid throughout the European Community. The following acts relating to the plant variety require authorisation by the holder of the CPVR: production or reproduction (multiplication), conditioning for the purpose of propagation, offering for sale, selling or other marketing, exporting from the European Community, importing to the European Community, stocking for any of the above purposes. To conclude, in Europe, the Directive extends the “farm saved seed exemption” of Article 14 of EC Regulation 2100/94 beyond the scope of application of such Regulation. In particular, Article 11.1 of Biotechnology Directives states that the sale or commercialization of plant-propagating materials for agricultural use “implies authorization for farmer to use the product of his harvest for propagation or multiplication by him on his own farm”. To extent and conditions of this derogation correspond to those established in Article 14 Regulation 2100/94. In particular, farmers can only replant seeds of the following agricultural species: fodder plants, cereals, potatoes, oil and fibre plants. No quantitative restrictions are established. However, only small farmers are exempted from paying an equitable remuneration to the right-holder, while farmers who grow an area bigger than the area needed to produce 92 tons of cereals must pay a royalty “sensibly lower” than the one normally charged by the title-holder. In addition, the Regulation requires that farmers provide relevant information to plant breeders’ rights holders. A farmer who fails to meet this obligation upon request may forfeit the seed-saving exemption and be exposed to infringement liability.<sup>2</sup>
18. In US, in 1970, the Plant Variety Protection Act was enacted to provide plant breeders with intellectual protection for “sexually propagated or tuber propagated plant varieties.” Plant varieties are eligible for protection when they are new, distinct, uniform and stable. The PVP certificate holder has the right to exclude

<sup>1</sup> Article 15.2 of the 1991 UPOV Act.

<sup>2</sup> Case C-305/00, Christian Schulin v Saatgut- Treuhandverwaltungsgesellschaft mbH, 2003, E.C.L.I-3525.

others from selling, offering for sale, reproducing, importing, exporting, propagating and conditioning for the purpose of propagating the protected varieties.<sup>1</sup> The PVPA includes an explicit statutory safe harbor provision shielding from infringement “any act done privately and for noncommercial purpose.” This exemption overlaps substantially with the breeders’ exemption, means the use and reproduction of a protected variety for plant breeding or other bona fide research. PVP rights are also limited by a statutory “saved-seed” exemption, which allows farmers who grow protected varieties (obtained through authorized sources) to save the resulting seed for the production of a subsequent crop “for use on the farm”.<sup>2</sup> The PVPA contains an exhaustion of rights provision that immunizes most domestic activities undertaken in connection with a variety that was the subject of an authorized sale. Under the relevant provisions, of a protected variety is “sold or otherwise marketed with the consent of the PVP owner in the US, then any act concerning propagating material of any kind, or harvested material, including entire plants and parts of plants of the protected varieties is not an infringement.”<sup>3</sup> The provision also imposes some qualifications. An alleged infringer cannot claim the benefit of the exhaustion provision if the activity at issue “involves further propagation of the variety.” Likewise, exhaustion of rights does not immunize an alleged infringer for activities that involve exports of “material of the variety that enables the propagation of the variety, into a country that does not protect varieties of the plant genus or species to which the variety belongs, unless the exported material is for final consumption purposes.” The unauthorized sale of protected varieties for reproductive purposes by unauthorized sellers, a practice commonly referred to as brown-bagging, is prohibited by federal law. It's commonly called "brown bagging" because the seed is packaged in plain, brown bags. Brown-bagging seed is considered by some as a way to circumvent the legal process of seed sales and the payment of royalties or research fees to the variety owner. The seed saving exemption as currently codified in US law remains more generous than its counterparts in many other UPOV-based regimes. The US seed-saving exemption does not require the seed-saving farmer to pay a fee to the PVP owner for the saved seed, while other jurisdictions (such as Europe, under the Community Plant Variety regime) do require payment.<sup>4</sup>

19. The Brazilian plant breeder’s rights law includes a seed-saving exemption. Brazil enacted a plant breeders’ rights law in 1997, in the form of the Federal Law on Plant Varieties. The statute exempts any person who: stores and plants seeds on his premises or on the premises of third parties of which he has possession; or uses or sells as food or raw material the product of his planting, except for the purposes of reproduction; or being a small rural producer, multiplies seed, for donation or exchange in dealings exclusively with other small rural producers, under programs of financing or support for small rural producers conducted by public bodies or nongovernmental agencies, authorized by Government.<sup>5</sup> The Brazilian seed-saving exemption expressly does not apply to the cultivation of sugar cane. Instead, cultivation of sugar cane, even for the farmer’s own use, requires a license, unless

<sup>1</sup> 7 US Section 2402(a) and 7 USC Section 2401 (a).

<sup>2</sup> 7 U.S.C. article 2543.

<sup>3</sup> 7 U.S.C. article 2541(d).

<sup>4</sup> Mark D. Janis, Herbert H. Jarvis, and Richard Peet, *Intellectual Property Law of Plants*, Oxford 2014, p.116.

<sup>5</sup> the Federal Law on Plant Varieties, Art.10.

a license fee would impair the economic and financial balance of producer's farm, or unless the farmer is not a large producer.

20. China became a UPOV member in 1999, adheres to the 1978 Act. The governing law on plant variety protection in China is the Regulations of People's Republic of China on the Protection of New Variety of Plants (Oct.1999). Chinese plant variety law includes a limited seed-saving exemption. It provides that there is no liability under the plant variety protection regime for "the use of propagating purposes by farmers, on their own holdings, of the propagating material of the protected variety harvested on their own holdings".<sup>1</sup> The exemption does not impose any requirement for the seed-saving farmer to pay a royalty, but it also does not permit the sale of saved seed.
21. Japan is a UPOV member and a signatory of the 1991 Act. The statute governing the plant variety protection in Japan is the Plant Variety Protection and Seed Act, Law No. 83 of 1998. Japanese plant breeders' rights are subject to a range of statutory exemptions and limitations. The Japanese statute includes a save-seed exemption that does not require the farmer to pay compensation to the rights holder. Under the exemption, farmers who use harvested material of a registered variety "as propagating material for the next production cycle" are exempt from plant breeder's rights liability. However, the use must be on the farmer's own holdings, and there appears to be no authorization for brown-bag sales. Moreover, the saved -seed exemption is merely a default rule that must give way if the farmer has made a contractual arrangement, and the exemption does not apply to vegetatively propagated varieties.<sup>2</sup>
22. A sui generis system in India. Some developing countries want to acknowledge the rights of farmers arising from their contribution to crop conservation and development and the sharing of their knowledge on adaptive traits. They also want to encourage farmer-to-farmer exchange of new crop/plant varieties that are adapted to the local growing conditions. As a result, some developing countries have chosen a sui generis system of plant protection. Under the Indian Protection of Plant Varieties and Farmers' Rights Act 2001, the regime for plant protection is similar to that set out by UPOV and the requirements for protection are novelty, distinctness, uniformity and stability. Under Article 39(iv) the farmer is entitled to save use, sow, resow, exchange, share or sell his farm produce including seed of a protected variety. However he is unable to sell seed that has is branded with the Breeders name.<sup>3</sup> In this way the breeder has control of the commercial marketplace without threatening the famers' ability to practice his livelihood. The Indian Act also contains provisions for "benefit sharing" whereby the local communities are acknowledged as contributors of land races and farmer varieties in the breeding of "new" plant varieties. The provision in it is these extra provisions granting rights to both breeders and farmers which makes the Indian system a sui generis method of protection. Plant variety rights in India are granted subject to a variety of limitations, including, among others, a farmer's privilege, provides that "a farmer

<sup>1</sup> the Regulations of People's Republic of China on the Protection of New Variety of Plants, Art.10(ii).

<sup>2</sup> the Plant Variety Protection and Seed Act, Art.21(3).

<sup>3</sup> "Branded seed" means any seed put in a package or any other container and labeled in a manner indicating that such seed is of a variety protected under this Act. (The Protection of Plant varieties and Farmers' Rights Act 2001, article 39).



shall be deemed to be entitled to save, use, sow, resow, exchange, share or sell his farm produce including seed of a variety protected under this Act in the same manner as he was entitled before the coming into force of this Act.” This appears to be an expansive farmer’s privilege in that it permits not merely reuse, but also exchanging, sharing, and, most importantly, selling. “Brown bag” sales are presumably authorized as a consequence of this language. The provision includes additional language that prohibits farmers from reselling “branded” seed, meaning “any seed put in a package or any other container and labeled in a manner indicating that such seed is of a variety protected under this Act.”<sup>1</sup>

### **3. Examples of plant new variety rights terms in contract**

23. The marking provision permits PVP certificate holders to give notice to the public that the variety is protected by affixing a label to the variety (or to a container of seed of variety), the label stating “U.S. Protected Variety” or similar words.<sup>2</sup> However, the provision also permits breeders to label their varieties (or associated containers) with either the words “Unauthorized Propagation Prohibited” or “Unauthorized Seed Multiplication Prohibited” before any PVP certificate issues. If a variety is distributed with the owner’s authorization and is received by the infringer without such a marking, the PVP owner cannot recover damages in an infringement action against the infringer unless there is evidence that the infringer had actual notice or knowledge that propagation is prohibited or that the variety is a protected variety. If the infringer had such actual notice, the PVP owner may recover damages accruing after the receipt of notice.<sup>3</sup> It is the PVP owner’s burden to prove either that a proper marking was including or that the infringer had actual notice.

### **4. Infringement**

24. In the US, the saved-seed exemption allows farmers to engage in “bona fide” sales of saved-seed for other than reproductive purpose. Early disputes concerned the scope of the exemption under the PVPA, culminating in the Asgrow litigation and the 1994 amendments to the PVPA. The current exemption, unlike the pre-1994 exemption, forbids farmers from selling saved seed for reproductive purpose.
25. *Asgrow Seed Co. v. Winterboer*, 513 U.S. 179 (1995) Supreme Court of the United States. The Plant Variety Protection Act of 1970, 7 U. S. C. § 2321 et seq., protects owners of novel seed varieties against unauthorized sales of their seed for replanting purposes. An exemption, however, allows farmers to make some sales of protected variety seed to other farmers. This case raises the question whether there is a limit to the quantity of protected seed that a farmer can sell under this exemption. By reason of its proviso the first sentence of § 2543 allows seed that has been preserved for reproductive purposes (“saved seed”) to be sold for such purposes. The Winterboers invoked the saved-seed exemption, arguing that it permitted them to sell unlimited amount of saved seed for replanting, as long as the sales were between farmers. Asgrow argued that the saved seed exemption only permitted sales up to an amount that the seller would need in order to replant his or

<sup>1</sup> Protection of Plant Varieties and Farmers’ Rights Act, Art. 39 (1)(iv).

<sup>2</sup> 7 U.S.C. Art. 2567.

<sup>3</sup> BASF Agrochemical Prods., 2006 WL 2088163, at 4.

her own fields. The structure of the sentence is such, however, that this authorization does not extend to saved seed that was grown for the very purpose of sale ("marketing") for replanting—because in that case, § 2541(3) would be violated, and the above discussed exception to the exemption would apply. As a practical matter, since § 2541(1) prohibits all unauthorized transfer of title to, or possession of, the protected variety, this means that the only seed that can be sold under the proviso is seed that has been saved by the farmer to replant his own acreage. Thus, if a farmer saves seeds to replant his acreage, but for some reason changes his plans, he may instead sell those seeds for replanting under the terms set forth in the proviso (or of course sell them for non reproductive purposes under the crop exemption). In 1994, Congress amended § 2543, narrowing the exemption so that it did not apply to farmers who sell PVP-protected seed to others for replanting.<sup>1</sup> Under the current exemption: except to the extent that such action may constitute an infringement under subsections (3) and (4) of § 2541 (a), it shall not infringe any right hereunder for a person to save seed produced by the person from seed obtained, or descended from seed obtained, by authority of the owner of the variety for seeding purposes and use such saved seed in the production of a crop for use on the farm of the person, or for sale as provided in this section. A bona fide sale for other than reproductive purposes, made in channels usual for such other purposes, of seed produced on a farm either from seed obtained by authority of the owner for seeding purpose or from seed produced by descent on such farm from seed obtained by authority of the owner for seeding purposes shall not constitute an infringement. A purchaser who diverts seed from such channels to seeding purposes shall be deemed to have notice under § 2567 that the actions of the purchaser constitute an infringement.

26. A farmer who had been accused of saving seed in breach of a contractual restriction attempted unsuccessfully to invoke the PVPA false marking provision.<sup>2</sup> The farmer, Showmaker, had purchased Garst non-GMO soybean seed from Advanta. The seed was not protected under the PVPA (or the utility patent statute), but the seed bags did include a tag stating that "the soybean seed in this bag contains genetics developed, licensed or owned by seller, that "all rights to make, produce or sell seed products derived from this seed reside solely with seller," and that the buyer was "strictly prohibited from saving or selling, for seed purposes, any grain products from this seed." Showmaker sued, claiming, among other things, that the language on the bag tag amounted to a false marking in violation of the PVPA false marking provision. This district court dismissed the claim under Rule 12(b)(6), and the Federal circuit affirmed. Advanta's bag tag had not referenced any PVPA applications or certificates, and did not use the term "Unauthorized seed Multiplication Prohibited." The language that the tag did use "in no way conveys PVPA protection nor uses any term confusing similar to 'these terms of art, and therefore the district court have been correct to dismiss the case, the Federal Circuit Concluded.
27. To sum up, in contract farming the most controversy issue in plant variety right is farmers saved seeds. The two versions of UPOV convention differs much. In 1978 UPOV, farmer saved seeds exemption is mandatory for members, but in 1991 UPOV, it is optional, which arise distinct among domestic legislations and practice. In the

1 Plant Variety Protection Act Amendment of 1994, Pub.L. 103-349, 108 Stat. 3136, 3142.

2 Showmaker v. Advanta USA, Inc., 411 F.3d 1366 (Fed. Cir. 2005).

whole world, different nations have various rules on conditions and limitations of farmer saved seeds. Firstly, on the matter of farmer selling the saved seeds, many jurisdictions are generally prohibit, such as US, EU, and China, but farmers selling the saved-seeds are allowed in India on some conditions. Secondly, US, China and Japan do not require the farmer to pay compensation to the rights holder, but EU countries require sensibly lower fees paid to the plant breeder, also EU require farmers provide relevant information to the plant breeder, which is not a common practice in other countries. Thirdly, about whether farmer saved seeds can be excluded in contract, Japanese laws explicitly recognize the effective of this contractual arrangement; also exclusion clause is supported by also several cases in US courts. Fourthly, on what plants species farmer can saved seeds is regulated by domestic laws, some countries adopt negative list, such as Brazil, others adopted positive list which allow farmer can save seeds on specific species such as European. The farmer save seed is rather controversy, when deciding whether farmer abuse his rights, the core legal concepts, such as "for non-commercial use", "privately", "for use on farm" "selling" and "transfer" are at the court's power of discretions according to facts.

### **III. Trade Secret**

#### ***1. Trade secret on international conventions***

28. The precise language by which a trade secret is defined varies by jurisdiction (as do the particular types of information that are subject to trade secret protection). However, there are three factors that, although subject to differing interpretations, are common to all such definitions: a trade secret is information that (i) Is not generally known to the public; (ii) Confers some sort of economic benefit on its holder (where this benefit must derive specifically from its not being publicly known, not just from the value of the information itself); (iii) Is the subject of reasonable efforts to maintain its secrecy. These three aspects are also incorporated in the TRIPS Agreement in Article 39 TRIPs does not use the term "trade secret", however, it is addressed as follows: natural and legal persons shall have the possibility of preventing information lawfully within their control from being disclosed to, acquired by, or used by others without their consent in a manner contrary to honest commercial practices so long as such information meet the above requirement. Undisclosed information is also protected by member states of the Paris Convention for the Protection of Industrial Property.<sup>1</sup>
29. The threshold for qualifying for protection under trade secret is putatively lower than that of the PVPA and certainly lower than that of patent law. Trade secret law's requirement or secrecy need not meet patent law's requirement of "novelty" or "inventive step". Most significantly, the law of trade secret offers no protection against reverse engineering. A trade secret law, generally speaking, does not offer protection against discovery by fair and honest means. Later innovators may freely exploit independent invention, accidental disclosure, or so-called reverse

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<sup>1</sup> Article 10bis of the Paris Convention (1967)

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engineering, which is by starting with the known product and working backward to divine the process which aided in its development or manufactures.<sup>1</sup>

## **2. Representative domestic laws**

30. Various countries have laws that protect "trade secrets," "confidential information," "know-how", "industrial secrets", "commercial secrets " and the like. Trade secret may include research and development information, such as the genetic composition of inbred seeds, breeding records, breeding codes, production codes, product and manufacturing characteristics, testing and evaluating procedures, supplier names, and germplasm sources. Trade secrets may also include marketing information, such as customer lists, sales strategies, or financial information. Trade secret protection of varietal plants is more difficult because true-to-type plants can be grown from the progeny of seed sold to customers. Perhaps, a restricted sale of variety in the form of a trade secret could be fashioned to prevent saving of seed.<sup>2</sup>
31. The US common law with regard to trade secrets was first summarized in the Restatement (First) of Torts in 1939. Plant and plant genetic resources, if maintained in appropriate secrecy, maybe protected by trade secret law. In the United States, trade secret law is determined by individual states, not by Congress.
32. The laws of the EU member countries are far from harmonized when it comes to handling the protection of such trade secrets. In late November 2013, the European Commission proposed a draft Directive on the protection of undisclosed know-how and business information (trade secrets) against their unlawful acquisition, use and disclosure. The proposal aims to align national legislation across Member States so that trade secrets holders will be able to defend their rights in court and have access to sufficient and comparable redress across the EU.

## **3. Examples of trade secret terms in contract**

33. There are confidentiality terms in agriculture contracts, such as "the Farmer shall not, during the term of this Agreement and within two years after its expiration, disclose any proprietary or confidential information relating to this Contract without the prior written consent of the Buyer."<sup>3</sup>
34. Confidentiality(The parties shall treat all aspects of this transaction and all other transactions including financial and other information made available by one to the other in the course of negotiations leading to this Agreement as strictly confidential and shall: (a) not use any such information for any purpose not connected with the completion of the transactions (b) consult on any announcement or public statement in respect of any of the transactions).
35. [Limited License for Patents and Trade Secrets]: The High Olete soybeans obtained by grower under this Agreement contain valuable trade secrets pertaining High Olete quality traits that are proprietary to OPTMUM (the Olete Trade Secret). In addition, certain patents are pending with respect to High Olete soybeans (the Pending Olete patents). OPTIMUM hereby grants a license to the Grower, subject to the Restriction (as defined below), to use the Olete Trade Secret and any pending

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1 See generally Pamela Samuelson & Suzanne Scotchmer, The Law and Economics of Reverse Engineering, 111 YALE.L.J. 1575 (2002).

2 Mark.D.Janis, Herbert H.Jervis and Richard Peet, Intellectual Property Law of Plants, Oxford University Press 2014, p.468.

3 Tabella full contract, p 176.

the Olete patents that issue prior to the expiration of this license to the extent necessary to grow High Olete soybeans as provided in this Agreement. The license shall automatically terminate upon the earlier delivery of the OPTIUM GRAIN to the ELEVATOR and August 31, 1999. The license grants hereunder is subject to the following restrictions: 1. Grower may not use any OPTIUM SOYBEAN or material directly or indirectly derived therefrom for breeding, research, seed production, reverse engineering or analysis of the genetic makeup thereof; 2. GROWER may not sell, transfer, give or supply, directly or indirectly, and OPTIUM SOYBEAN or material directly or indirectly derived therefrom unless GROWER gives notice to the recipient of the terms and conditions of the Agreement and agrees to bound by such terms and conditions; 3 GROWER may not sell, transfer, give or supply, directly or indirectly, any OPTIUM SOYBEAN, any if its seed components, or any material directly or indirectly derived therefrom (other than the OPTIUM SOYBEAN) to any party for any purpose; and/or 4. GROWER may not use the OPTIUM SOYBEAN, the OPTIUM GRAIN or any material directly or indirectly derived therefrom for any purpose other than to grow and deliver the OPTIUM GRAIN as expressly provided in this Agreement including, but not limited to, export outside the US except by sale to OPTIUM or OPTIUM's designee.<sup>1</sup>

#### **4. Infringement**

- <sup>36.</sup> A United States court has recognized that "Genetic message" of inbred plant varietal lines may be protected by trade secret subject to the provision that reasonable effort has been taken to preserve the secrecy of the genetic information.<sup>2</sup> In this case, the court held that the genetic information present in certain corn seeds developed by the plaintiff and used by the defendant as its own were trade secrets. The violation of contractual terms explicitly barring a seed purchaser from using seed for downstream breeding should readily support a trade secret claim. Courts have held that trade secret protection under state law is not preempted by the federal patent statute. The Supreme Court states in *Kewanee Oil Co. v. Bicron Corp.* that trade secrets and patents serve similar purpose. <sup>3</sup> The issue of whether trade secret protection for plants was preempted by the Federal Plant variety and Protection Act has been raised in litigation. The Eighth Circuit has held that the PVPA does not preempt trade secret claims. <sup>4</sup>
37. Breach concerning duty to inform or report/confidentiality/trade secret. In cases where confidential information may be exchanged between the parties, some contracts expressly provide for confidentiality clauses.<sup>5</sup> Even when they do so, it is not always clear which information is confidential and whether it can be transferred to qualified third parties (e.g. input providers). Clearly critical, though lacking a specific provision, is the transfer of confidential information to contractor's (potential) competitors, which may amount to fundamental breach. Indeed, even

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1 Optimum Quality Grains, L.L.C. Agreement to Grow Optimum Soybeans and Limited License for Patent and Trade Secret.

2 Pioneer Hi-Bred Int'l Inc.v. Holden Found. Seeds, Inc., 35 F.3d 1226, 1236 (8th Cir.1994).

3 *Kewanee Oil*, 416 U.S. 487.

4 *Holden*, 1987 WL 341211, at 43.

5 See, for example, the Cameroun model contract for the production of manioc (FAO database n. 18): "Article 13: Obligation de confidentialit  Les deux parties sont tenues   l'obligation de discr tion. Elles s'engagent pour elles et pour toute personne travaillant pour leurs comptes   tenir confidentielle toute informations obtenues, fournies et/ou trait es, toute communication de renseignement, document ou objet quelconque et   ne faire aucune communication sur le contenu de ce contrat aux tiers sans l'accord des parties contractantes".

before calling for the application of contractual remedies (e.g. damages or contract termination), disclosure of confidential information may represent a major threat to the trust within the relationship between parties, possibly leading to its final break-down.<sup>1</sup>

38. The process of growing out a bag of hybrid seed and identifying the inbred plants is referred to as "chasing selfs". The exploitation of chasing selfs to isolate the inbred parent lines of a hybrid variety may constitute either an instance of permitted reverse engineering or an infringement of a trade secret. No court has directly states that chasing selfs is improper means. In the Holden Litigation, the court did not have rule on whether chasing selfs was proper or not.<sup>2</sup> If the use of chasing selfs "is deemed to be an act of uncovering the trade secret through legitimate, publicly available means, it may fit within the scope of permissible reverse engineering". On the other hand, if this technique is "characterized as taking advantage of a mistaken or accidental disclosure of the secret, where all reasonable precautions against disclosure were taken, then trade secret protection might be preserved." Bag tag licenses may be used to put purchasers on notice that chasing selfs is improper.<sup>3</sup> The bag tag may state that the seed company's hybrid parent lines are trade secret, and that any parental seed in the bag cannot be used without incurring liability for misappropriation.

## IV. Overlap of rights

### ***1. Patent, plant breeder' rights and trade secret***

39. Since plant varieties can be replicated through sexual and asexual reproduction, or both, transfer of intellectual property rights in plant inventions presents unique challenges. Many plant varieties such as fruit trees and horticultural plants are typically reproduced asexually. In the US, asexually reproduced plant varieties are commonly protected by plant patent, but also can be protected by utility patent. In the US, sexually reproduced plants are protected by utility patent or PVPA certificate. In case of asexually reproduced varieties, breeders typically license plant propagators to reproduce and sell plant patent, or less commonly, utility patent-protected varieties. In case of sexually reproduced varieties, the breeder may sell seed directly to farmers, or license a third party to sell seed produced by the breeder.
40. In comparison with the patent system, sui generis plant variety protection presents similarities as well as elements that remarkably differ. Under the UPOV Convention, the object of exclusive rights in plant varieties is the propagating material.<sup>4</sup> Thus, plant variety do not cover within their subject matter technical process for the production of protected varieties, while patents may afford such protection. In addition, specific genes or combinations of genes of protected varieties are outside the scope of protection, remaining available for further research and breeding.

<sup>1</sup> Fabrizio Cafaggi, Draft Chapter IV-Remedies for Breach, p.66.

<sup>2</sup> Holden, 1987WL 341 211, at.12.

<sup>3</sup> See Roger A. Mc Ewen, Legal Issues Related to the Use and Ownership of Genetically Modified Organisms, 43 WASHBURN L.J. 611, 639 (2004).

<sup>4</sup> article 1(vi) of 1991UPOV.

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41. There is tension over the relationship between patent rights and plant breeder's rights. There has been litigation in Australia, the United States, and Canada over the overlap between such rights. Each of these cases was decided on the principle that patents and plant breeders' rights were overlapping and not mutually exclusive. Thus, the exemptions from infringement of plant breeders' rights, such as the saved seed exemption, do not create corresponding exemptions from infringement of the patents covering the same plants. Likewise, acts that infringe the plant breeders' rights, such as exportation of the variety, would not necessarily infringe a patent on the variety, which only allows the patent owner to prohibit making, using or selling the patented invention.
42. As regards the nature and characteristics of rights granted under the two systems, the comparison between Article 28 of the TRIPs Agreement and Article 14 of the 1991 UPOV Act demonstrates that a close correspondence exists between them. In fact, according to Article 28 of the TRIPs Agreement, a patent shall confer on its owner the right to prevent others from making, using, offering for sale, selling or importing the patented products.<sup>1</sup> Likewise, under UPOV-like legislation, the holder of a plant variety protection certificate has the right to exclude others from producing or reproducing, conditioning for the purpose propagation, offering for sale, selling, exporting, importing and stocking propagating material of the protected variety for any of the above mentioned purposes.<sup>2</sup> These rights may also cover the harvested material that is obtained through the unauthorized use of propagating material, when the title holder has had no reasonable opportunity to exercise his rights in relation to the propagating material itself.<sup>3</sup> Another aspect that differs from patent law is that PVP systems normally envisage the existence of agricultural exemption. 1991 UPOV Act limits the farmer's privilege to save-seeds for replanting, and requires farmers to limit the amount of saved seeds or to pay an equitable remuneration to the right-holder. In addition, the informal sale and offer for sale of protected varieties is outside the scope of such privilege, because plant breeders' rights may only be limited "to permit farmers to use for propagating, on their own holdings, the product of the harvest obtained by planting, on their own holdings, the protected varieties."<sup>4</sup>
43. The requirements for protection under UPOV are easier to meet than those that apply to patents. This is because plant breeder's rights are specially crafted to accommodate the peculiar needs of plant breeding. Therefore, the criteria of distinctness, uniformity and stability are generally adapted to the mode of reproduction of the variety and are more flexible than patentability requirements.
44. In US, it is possible to obtain protection for the same plant under both a utility patent and a plant patent at the same time, provided that the requirements for patentability for both types of patents are fulfilled. In North America, recent case law has recognized the need to ensure full protection to patent holders against the privileges enjoyed by plant breeders and farmers under concurrent forms of sui generis plant variety protection. Therefore, when plant germplasm falls within the scope of patent claims, the legitimate experimental use of such genetic material is

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<sup>1</sup> Article 28.1 of the TRIPs.

<sup>2</sup> Article 14(1) of the 1991 UPOV Convention.

<sup>3</sup> Article 14(2) of the 1991 UPOV Convention.

<sup>4</sup> article 15 the 1991 UPOV Convention.

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restricted and a license from the patent owner may be required. Likewise, when protected seeds are replanted a royalty has to be paid to the patent holder.

45. In some countries (including the United States, Australia and Europe) plants can be covered by patent claims provided that the patent applications are able to meet all of the necessary standards and requirements that exist in that country for patentability. Under the Trade-Related Aspects of Intellectual Property Agreement which binds World Trade Organization members, member countries that choose not to provide such mechanisms for plants under their national patent system must provide an alternative way in which an entity may claim that it has a legal right to intellectual property. In the U.S. and Australia individual plant varieties are patentable. In Europe, individual plant varieties per se are not patentable, however, a plant which is characterized by a particular gene (as opposed to its whole genome) is not included in the definition of a plant variety and is therefore patentable.<sup>1</sup>
46. The European system also articulated in such a way that 1998 Biotechnology Directive takes over the farmers' exemption from the EC Regulation on Community Plant Variety Rights. Therefore, farmers can enjoy the freedom to save and replant seeds under identically conditions regardless of whether such seeds are protected by plant variety rights or patent. On the contrary, the interpretation of US plant-related IP laws relies on the principle of independence between different IPR systems. The consequence is that an action prohibited under a protection scheme (e.g. the patent system) cannot be permitted only because it is expressly allowed under a different protection scheme. (e.g. a sui generis PVP system).<sup>2</sup>
47. Some seed companies draft contract terms concerning intellectual property right in a very wide way, which covers all the above mentioned intellectual property rights, such as in Limited License for Patents and Trade Secrets clause. Under this term, the contractual materials could be protected by patent, plant varieties, also trade secret law. The wide scope of protection including the right to exclude others from asexually reproducing, selling, or using the plant so reproduced according to patent law, exclude the farmer to export the seed according to the plant variety rights, and not to disclose certain information according to trade secret laws. This wide range of protection made farmer can only buy branded seeds owned by big seeds companies.
48. It is very common that the contract between the seed seller and purchaser contains post-sale contract restrictions. The farmer and purchaser of seeds require title to the grain or product grown from the seeds in order to sell it in the channels of trade. As a consequence, a "bag tag" agreement contains post-sale contract restrictions, which will be discussed subsequently.

## **2. Are "bag-tag" licenses enforceable?**

49. Plant breeders routinely require purchasers of PVPA-protected seed to waive their statutory rights under the PVPA's crop and research exemptions through "seed-wrap" or "bag-tag" licenses printed on or attached to a bag of seed. This is an instance of using contract as a means of privately securing rights akin to those ordinarily conferred through intellectual property legislation or, as may be true in

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<sup>1</sup> [http://www.patentlens.net/daisy/bios/1234#types\\_of\\_claims](http://www.patentlens.net/daisy/bios/1234#types_of_claims). (accessed 7 July 2008).

<sup>2</sup> Claudio Chiarolla, Intellectual property, Agriculture and Global Food Security: The Privatization of Crop Diversity. Edward Elgar Publishing Limited, 2011, p.109.



the context of PVPA-protected seed, restoring the breeder's control over plant genetic information. Seed-wrap licenses routinely prohibit the "resale of seed or supply of saved seed to anyone, including the purchaser, for planting"; "the use of the product, or the parental lines used in producing the product, for use in development or breeding"; and "use of any parental seed that might be unintentionally contained ...for purposes ...other than production of forage, or grain for feeding or processing." These provisions, if valid, would effectively strip a purchaser of PVPA protected seed of rights shielded under the statute's crop and research exemptions. Plant breeders may impose seed-wrap contracts even in the absence of plant variety protection; it is possible to establish these license agreements based on trade secret or utility patent protection for the plant varieties at issue. The scope of protection available under the PVPA falls roughly between the protective levels of trade secret and patent. If seed-wrap contracts are valid when based on trade secret or patent, they should be valid a fortiori when the underlying genetic information is protected under the PVPA.

50. Major seed producers typically include express license restrictions on seed bags (called "bag tag" or "seed-wrap" licenses), or require growers to sign a "technology agreement" when purchasing seed. A representative Pioneer bag tag license, for example, provides, in relevant part, that "if the tag indicates this product or the parental lines used in producing this product are protected under one or more US patents, Purchaser agrees that it is granted a limited license thereunder only to produce forage, or grain for feeding or processing. Resale of this seed or supply of saved seed to anyone, including Purchaser, for planting is strictly prohibited under this license." Similarly, a Monsanto technology agreement appearing on bags of Roundup Ready soybeans in the late 1990s expressly providing that seeds must be used "for planting a commercial crop only in a single season" and directing farmers not to "save any crop produced from this seed for replanting, or supply saved seeds to anyone for replanting."
51. Although there has not been a large amount of litigation concerning the enforceability of bag tag agreements per se, much can be learned from those cases which have been decided, as well as court cases involving analogous schemes, such as computer software license, frequently referred to as shrink-wrap licenses. With any bag tag agreement, there is risk that a court may determine that the terms are not part of the agreement. Depending on which court is doing the analysis, there are different statutes and legal precedent which might apply. Based on review of the existing case law it is clear there are precautions a seller can take to enhance the likelihood that a court will consider the bag tag agreement as part of the parties' agreement. Importantly, the terms on the label should be prominent and conspicuous, and designed to come to the attention of any reasonable purchaser. The label should clearly and unambiguously convey the limited right. The label should provide that agreement to the license terms is required. The label should provide that the purchaser has the right to accept the license or return the product for a refund within a time period. Finally, the buyer should have some actual or constructive knowledge of the contents of the bag tag agreement terms before the products arrive, or, at a minimum, the buyer should not have some contrary notion of what those terms will say.<sup>1</sup>

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<sup>1</sup> Mark D. Janis, Herbert H. Jervis and Richard Peet, *Intellectual Property Law of Plants*, Oxford University Press 2014, p. 447.

- 
52. Giving a buyer notice of bag tag agreement terms prior to the purchase makes it both more fair that the terms be incorporated into the agreement and more likely that the court will find that the parties actually agreed to the additional terms. Both actual and constructive notice are looked upon favourably, though of course actual notice, being more explicit, is more ideal. Actual notice would require the seller give the buyer information regarding the bag tag agreement terms prior to delivery of the product, such as by giving the buyer a copy of the bag tag agreement or discussing the agreement with the buyer.
  53. Regardless of the applicable jurisdiction there are specific steps a seller can take to help bolster the validity and enforceability of the seller's bag tag agreement. The terms should be prominent and conspicuous, and designed to come to the attention of any reasonable purchaser. The label should clearly and unambiguously convey the limited right. The label should provide that agreement to the terms is required, and that the purchaser has the right to accept the agreement or return the product for a refund within a time period of at least thirty days. Lastly, the Buyer should have some actual or constructive knowledge of the contents of the bag tag agreement terms before the product arrives, or, at a minimum, the buyer should not have some contrary notion of what those terms will say.<sup>1</sup>
  54. Post-sale license restrictions may be held unenforceable if (1) the license restrictions broaden the scope of the patent beyond the reasonable scope of the granted claims; and (2) under a rule of reason the anti-competitive effects of the broaden outweigh the pro-competitive effects of the patent grant.<sup>2</sup> In this context, field-of-use restrictions in license agreements are generally upheld as enforceable.<sup>3</sup> On the other hand, post-expiration royalty provisions are viewed as per se anti-competitive because they unduly broaden patent scope in an anti-competitive fashion.<sup>4</sup> Bag tag license restrictions have been challenged as anti-competitive but US courts have generally found the license terms to be enforceable.<sup>5</sup>
  55. To sum up, even "bag tag" licenses may include unfair content to little farmers, but it is hard to deny its validity. The terms could be challenged on different cause of actions, such as breach of competition law, not a part of a contract because of insufficient notice, or other reasons. But it is extremely difficult to small farmer to justify his claim by denying validity of terms concerning intellectual property. .

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<sup>1</sup> Mark.D.Janis, Herbert H.Jervis and Richard Peet, *Intellectual Property Law of Plants*, Oxford University Press 2014, p.446.

<sup>2</sup> *Mallinckrodt, Inc.v. Medipart, Inc.*, 976 F.2d 700 (Fed. Cir. 1992).

<sup>3</sup> *Pioneer Hi-Bred*, 283 F.Supp.2d at 1045.

<sup>4</sup> *Virginia Panel Crop.v. MAC Panel Co.*, 133 F.3d 860, 869 (Fed. Cir.1997), cert. denied, 525 U.S.815 (1998).

<sup>5</sup> *Pioneer Hi-Bred*, 283 F.Supp. 2d at 1042.

**Study Report**  
**Submitted to UNIDROIT**

**THE FINANCIAL LEASE IN THE UNIDROIT  
INSTRUMENTS, THE UCC, AND THE  
CAMBODIAN LEGISLATION**

**--from a Perspective of Comparative Study**

**BY HOK Siem**

**As a result of the research at UNIDROIT from April to May 2014**

**Rome**

**May 21, 2014**

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**HOK Siem**

## ABOUT THE RESEARCH

The concept of financial lease is very interesting topic to me since I used to write my master dissertation on the Legal Protection against Market Manipulation in the Securities Market which also relates to the financial sector. According to my researches that I have been conducted for six weeks, I found out lots authors who also interested in discussing on the issues of the complex financial leasing transaction within their books, journals and articles. It was also considered as a hot topic for the UNIDROIT legislative activities due to the needs of the uniform legislation for managing the operation of financial lease both at the domestic and international level. Since there are many issues regarding to the financial leasing activities and with the limited time in doing my research at the UNIDROIT, thus this paper can not well deeply discuss on every important points of the topic by just study on some important parts and focus on the finding some possible solutions to improve Cambodian legislation on the financial lease.

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## EXECUTIVE SUMMARY

Financial Lease usually exists in countries that have sophisticated and efficient secured financing systems. Indeed, this is not the only reason for the continually increase in the use of financial lease that has occurred in many countries. There are also other reasons for growth in this type of secure financing in the economical perspective. For instance, because of its flexibility, leasing has been used as a tool to encourage through taxation laws the acquisition of new capital goods and by the facilitating on the modernization of the manufacturing capacity of the country.

The concept of financial lease was stated in the instrument of the UNIDROIT since 1988 through the promulgation of the Convention on International Financial Leasing as follow by the adoption of her Model Law on Leasing in 2008. Due to the complex transaction of the financial leasing operations, the UNIDROIT considered it as one of the important topics for conducting the legislative activities. UNIDROIT tries to reach her goal by providing the unification on the private international laws to the all states members.

While the concept was recognized by the United States (US) from the end of 1950s and later she played the leading role in the field which pushed the US legislators to adopt the laws and regulations on the matter. As a result, the US adopted the Uniform Commercial Code whose Article 2A is used to govern the financial leasing operation and the article is influenced by the UNIDROIT Convention since she wants to form the uniform code among her states.

The first law on financial lease in Cambodia was promulgated in 2009 and followed by other relevant regulations. However, there are still the gaps that caused by the emerging legislation and require for further improvement on it. In addition, there are also many problems that are created by such kind of complex transaction, to which involved by the tripartite relationship. The uncertainty of legal treatment from one jurisdiction to another usually happens at domestic level which requires an instrument that set out of the application law to ensure and promote the interstate transaction such as a cross-border leasing which is also the concern to Cambodia. Therefore, the author of the article decided to conduct the study on these three legal systems on the financial lease and then make a comparison on them in order to find the feasible suggestions to the Cambodian legislation.

## INTRODUCTION

UNIDROIT Model Law on Leasing was adopted on November 13, 2008. The model law has been designed to make a lot of developing countries engaged in the international commercial transaction to a market economy easier by taking the model law as the basis of the adoption of their domestic laws based on the development of leasing within their jurisdictions<sup>1</sup>. Since the model law is based on the 1988 Ottawa Convention, Convention on International Financial Leasing, in which used to govern the financial leasing transaction based on its two main purposes include: the governing the growth of a nascent leasing industry and removing certain legal impediments to the international financial leasing of equipment, while maintaining a fair balance of interests between the different parties<sup>2</sup>.

Furthermore, the regulation is considered as an interesting topic since there are lots of both international institutions and countries have participated in the joint sessions until the draft model law was adopted in 2008. However, the topic still continues for further discussion and study for conducting the useful commentary on the model law in order to make it becomes more effective while the issues around the financial lease do not only relate to the complex transaction<sup>3</sup> of an internal commerce within a state, but also the interstate commerce. The drafters of the UNIDROIT instruments on the financial lease at all time are informed of the necessary of clarifying the legal status of leasing at the national level in order for it to be able to aware its full potential at the international level<sup>4</sup>. It is also for the purpose of forming of the uniform law in order to settle with the problems that arise in many legal systems from the absent of domestic laws and regulations for dealing and governing the interstate commerce<sup>5</sup>. Since the uncertainty of legal treatment from one jurisdiction to another usually happens at domestic level which requires an instrument that set out of the application law to ensure and promote the interstate transaction such as a cross-border leasing<sup>6</sup>. As was mentioned earlier, the growth of leasing keeps increasing through out the world which requires each country to aware of the urgent need of a new capital equipment like the use of cross-border leasing.

In particular, the United States plays as the leading role in the development of world leasing industry has also faced the problems in lacking of the domestic laws<sup>7</sup>. This causes the US experts to call for the adoption by their government since they realized about the difficulties that non-uniform state law created for interstate commerce<sup>8</sup>. It is worth noting that the provisions of Article 2A of the Uniform Commercial Code (UCC) were directly inspired by the Ottawa Convention<sup>9</sup>. In the US, the Article 2A of UCC was a response to these problems after the unsuccessful of the Uniform Sale Act, adopted in 1906<sup>10</sup>. So, it will be a good example by choosing the US as the country which had an experience of facing legal obstacles on financial leasing operations and found possible solution by forming the UCC under the inspiration from the UNIDROIT instruments. It will also good for the comparison with the current situation in Cambodia which relates to the management of financial leasing for finding a possible lesson.

Although, Cambodia is not the member of the UNIDROIT as well as its legal instruments especially regarding to the financial leasing provisions, but whether or not the UNIDROIT instruments have influenced on the Cambodian legislation. It is still the question which will be answered in the article. Through the economic development within the country, the concept of financial

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<sup>1</sup> See Lena Peters, International Institute for the Unification of Private Law (UNIDROIT): Leasing (Study LIX), 2011, 38

<sup>2</sup> Ibid., 37.

<sup>3</sup> See Martin J. Stanford, The uniform commercial code law journal: International Financial Leasing: The Status of the UNIDROIT Convention and an Analysis of its Provisions, (vol.32:182, West Group Publication: 1999), stated: "Complex Transaction refers to a transaction which involves the interaction of two contracts, a leasing agreement and supply agreement".

<sup>4</sup> Ibid., 190.

<sup>5</sup> Ibid., 202 & 203.

<sup>6</sup> Ibid., 204 & 205.

<sup>7</sup> Ibid., 205.

<sup>8</sup> See Harry M. Flechtner, CISG vs. Regional Sales Law Unification: The US Experience with the UCC and the CISG: Some Insights for the Proposed CESL, 2012, 6.

<sup>9</sup> Stanford (1999), 205.

<sup>10</sup> Flechtner (2012), 6.

lease was classified as an important concern which encouraged the adoption of some remarkable laws and regulations in order to govern and develop such activities. Particularly, the 2009 Law on Financial Lease is adopted in order to govern only the financial lease of movable property which refers to all properties, plants, and equipments except land and building within the territory of the Kingdom of Cambodia<sup>11</sup>. Added to the main law, some regulations orderly adopted for the purpose of promoting the banking and financial system development. On the other hand, there are still some legal obstacles which challenge the financial lease operations within Cambodia as well as the external operation with other states in accordance with the evolution of the economy. For instance, the lack of definite and uniform legislation to govern such specific activities like the cross-border leasing is also regarded as the obstacles. It means that Cambodia still needs further improvement relate to the implementation of the financial lease operation.

This leads to the discussion on the concept of financial lease in this article by dividing into four main parts. Firstly, the article will discuss about the basic concept of financial leasing under the UNIDROIT instruments. Secondly, the paper will take a look into the financial lease within the UCC of the US since it was inspired by the UNIDROIT convention. Then a discussion on the current situation of the financial lease in Cambodia will be elaborated. Following that it is a comparative study between these three legal systems in order to find the common features and differences of financial leasing. Finally, the article will discuss on the result of the comparative study as well as the current legal obstacles in Cambodia for finding the possible suggestion on the improvement of Cambodian legislation on the financial lease.

## **I. THE FINANCIAL LEASE UNDER THE UNIDROIT INSTRUMENTS**

### **1. The Historical Background of Financial Lease**

The growth of leasing is through the works and activities of the International Finance Corporation (I.F.C) since 1977 until now which have taken into two forms<sup>12</sup>. First, the IFC has worked on the improvement of national financial market regarding to the initiation of leasing as a substitute source of industrial agricultural and commercial enterprise's financial equipment<sup>13</sup>. Second, it is also focus on the encouragement of the competition and efficiency within the financial sector through the performance of financial companies in order to determine the validity of leasing within financial and economic scopes<sup>14</sup>. Indeed, a 'financial lease' is according to this widely adopted categorization a tri-partite relationship between the<sup>15</sup>: lessor and lessee, who are the parties to a lease contract; and lessor and supplier, who are the parties to a sale contract. There are four stages<sup>16</sup> to consider during the discussion on the concept of financial lease such as:

- The lessee selects the supplier (manufacturer or distributor of the goods) and the equipment according to its requirements;
- The lessee thereafter enters into a lease contract with the lessor (a specialized leasing company or other financial institution) for that piece of equipment from the supplier;
- The lessor enters into a sale contract with supplier acquiring delivers the equipment to the lessee;
- The supplier delivers the equipment to the lessee.

It is necessary to categorize the type of transaction of the financial lease since in certain jurisdiction the lessee's end-of-lease term options and/or obligations are critical<sup>17</sup>.

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<sup>11</sup> Cambodian Law on Financial Leasing (2009), Article 3.

<sup>12</sup> Stanford (1999), 185.

<sup>13</sup> Ibid.

<sup>14</sup> Ibid.

<sup>15</sup> Ibid., 333.

<sup>16</sup> Ibid.

<sup>17</sup> Ibid.



As a result, it made UNIDROIT conduct the preparation of Uniform Rules with two reasons. First, the raising of potential of leasing as an investment tool at both the national and the cross-border levels through the capital investment that needs for many parts of the world by concerning on the economic reason<sup>18</sup>. Second, the often vast differences in the legal treatment of leasing from one jurisdiction to another and the general failure of legislators to adopt a consistent attitude to the resolution of this problem which were happened at both domestic and cross-border level by foiling leasing's efforts<sup>19</sup>. For instance, the absence of privities of contract between lessee and supplier was happened in many legal systems and was regarded as a problem for those countries. To respond on the problem, the Convention according treats the lessee as a third party beneficiary of duties undertaken by the supplier under the supply agreement<sup>20</sup>.

To date, five instruments on leasing have been elaborated under the auspices of UNIDROIT<sup>21</sup>. Two important instruments under the UNIDROIT framework for dealing with the financial lease are the UNIDROIT Convention on International Financial Leasing (Ottawa, 28 May 1988) and the UNIDROIT Model Law on Leasing (2008)<sup>22</sup>.

## **2. The UNIDROIT Convention on International Financial Leasing (Ottawa, 28 May 1988)**

### *2.1 General Concept of Financial Lease*

The convention was promulgated on 28 May 1988 with its purposes are: first of all is to take out a legal impediments to international financial leasing, while maintaining a fair balance of interests between different parties to the transaction and, secondly, thus to enhance more chances for international financial leasing<sup>23</sup>. The scope of application of this convention was consciously limited to what is known as 'financial lease', which is a separate legal instrument for removing the existing legal uncertainty that hampered the realization of the full potential of financial leasing at cross border level<sup>24</sup>. The application of the Convention also covers to those sub-leasing arrangements common in international financial leasing transactions provided that the sub-lease is a financial leasing transaction otherwise subject to the Convention through the clarification that the supplier involves in the same equipment is the person from whom the first lessor acquired the equipment<sup>25</sup>. Thus, the application is also extended to leveraged leasing transactions, whereas involves the title to the equipment, tax indemnification benefit associated with ownership and large amount of capital in the transaction<sup>26</sup>.

Furthermore, two important factors are considered as crucial important in the convention while discussing on the financial lease<sup>27</sup>. The pivotal role played in the transaction by the lessee who selects the equipment and supplier on its own with a concomitant reduction in the role of the lessor is considered as the first factor<sup>28</sup>. Secondly, the period of economic amortization of the equipment is the term of the leasing agreement between the lessee and lessor, whence the essentially financial nature of the transaction for the lessor. The rentals payment of lessee for its rights to use of the equipment as would be the case with a typical

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<sup>18</sup> Karen B. Brown, International Congress on Comparative Law, Herbert Kronke. Financial Leasing and Its Unification by UNIDROIT, 2012, 322.

<sup>19</sup> Brown, (2012), 322.

<sup>20</sup> Stanford (1999), 205.

<sup>21</sup> Brown, (2012), 322: provided that five instruments are the UNIDROIT Convention on International Financial Leasing (Ottawa, 28 May 1988); the Convention on International Interests in Mobile Equipment (Cape Town, 16 November 2001); the Protocol to the Convention on International Interests in Mobile Equipment on Matters Specific to Aircraft Equipment (Cape Town, 16 November 2001); the Protocol to the Convention on International Interests in Mobile Equipment on Matters Specific to Railway Rolling Stock (Luxembourg, 23 February 2007); and the Model Law on Leasing (Rome, 13 November 2008).

<sup>22</sup> The UNIDROIT Official Website, Instruments: Leasing\_Convention, Retrived on May 5, 2014 from <http://www.unidroit.org/instruments/leasing/convention-leasing>

<sup>23</sup> Stanford (1999), 190.

<sup>24</sup> Peters (2011), 37.

<sup>25</sup> UNIDROIT Convention on International Financial Leasing (Ottawa Convention, 1988), Article 2.

<sup>26</sup> Ottawa Convention, 1988, Article 14.

<sup>27</sup> Stanford (1999), 192-193.

<sup>28</sup> Ibid.

bailment. However, it also causes the guarantees for lessor on the amortization of its capital investment<sup>29</sup>. This Convention applies to financial leasing transactions in relation to all equipments save that which is to be used primarily for the lessee's personal, family or household purposes<sup>30</sup>. In addition, the convention has defined the financial leasing transaction in order to provide further detail of the financial leasing concept.

The financial leasing transaction referred to a transaction which consists of the following characteristics namely (i) the lessee specifies the equipment and selects the supplier without relying primarily on the skill and judgment of the lessor; (ii) the equipment is acquired by the lessor in connection with a leasing agreement which, to the knowledge of the supplier, either has been made or is to be made between the lessor and the lessee; and (iii) the rentals payable under the leasing agreement are calculated so as to take into account in particular the amortization of the whole or a substantial part of the cost of the equipment<sup>31</sup>.

The legal systems of the convention are included duties imposed upon the lessor; duties incumbent on the lessee; rights of the lessee against the supplier; position of the lessor in relation to third parties; and the extent to which the parties may exclude the application of the convention or derogate from its provisions<sup>32</sup>. In practice, the conflict usually would arise as between the lessor and third parties would be in cases where the lessee had gone bankrupt<sup>33</sup>. So, the convention responds with the problem through the creation of a registration system as the only truly effective ways of providing notice to third parties of the lessor's title. Furthermore, the convention only to deal with the issue of enforceability of the lessor's real rights in the equipment in relation with an unsecured creditors and the trustee in bankruptcy of the lessee<sup>34</sup>. In order to understand on these provisions of financial lease that were stated in the convention, it is necessary to discuss on the rights and duties of the parties, remedies and the cross-border provision in the next following sections.

## *2.2 Rights and Duties of the Parties under the Financial Leasing Agreement*

### **2.2.1 Lessor**

The position of the lessor in relation to third parties is usually caused the problem which makes the authors of the UNIDROIT Convention focus on the best suitable way for dealing with the protection of the lessor's title to the equipment in one side and the protection of third parties dealing with the lessee on the other side. The real rights of lessor in the equipment are valid against the lessee's trustee in bankruptcy and creditors. The trustee in bankruptcy includes a liquidator, administrator or other person appointed to administer the lessee's estate for the benefit of the general body of creditors<sup>35</sup>. However, it is not affect on any creditor who have a consensual or non-consensual lien or security interest in the equipment arising otherwise than by virtue of an execution as well as any right of arrest, detention or disposition conferred specifically in relation to ships or aircraft under the law applicable by virtue of the rules of private international law<sup>36</sup>. Furthermore, the lessor is not liable to the lessee in respect of the equipment save except in case that the lessee has suffered loss in accordance with its reliance on the lessor's skill and judgment and intervention<sup>37</sup>.

On the other hand, the lessor is obligated to the following duties:

- Lessor is liable to the lessee for non-delivery, late delivery or a non-conforming tender;

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<sup>29</sup> Ibid.

<sup>30</sup> Ottawa Convention (1988), Article 1(4).

<sup>31</sup> Ottawa Convention (1988), Article 1(2).

<sup>32</sup> Stanford (1999), 192-193.

<sup>33</sup> Stanford (1999), 192-193.

<sup>34</sup> Ibid.

<sup>35</sup> Ottawa Convention (1988), Article 7(1).

<sup>36</sup> Ottawa Convention (1988), Article 7(5).

<sup>37</sup> Ottawa Convention (1988), Article 8(1).

- Lessor has to provide the warrant for a quiet possession and make sure that no disturb to the lessee;
- Lessor is not liable the third parties death, personal injury or damage to the property caused by the equipment.

### **2.2.2 Lessee**

The lessee has a right to exercise and hold the equipment in accordance with what have stated in the lease contract as well as the rights that derived from the supply agreement under this Convention<sup>38</sup>. Indeed, the lessee has right to reject equipment or terminate the lease contract when the equipment is not delivered or lately delivered<sup>39</sup>. In practice, the lessee may transfer his right to the use of the equipment or any other rights to third parties unless get the consent from the lessor<sup>40</sup>.

#### **Duties of the lessee:**

- Duty to take proper care of the equipment by using in a proper use based on its term and condition<sup>41</sup>;
- Duty to compensate the lessor in the event of its default: the lessor's remedies are divided into two types, those that it may exercise in the event of any default by the lessee and those that it may not exercise where the lessee's default is substantial. Right of the Lessee against the Supplier. The independent direct right of action of the lessee against the supplier instituted by Article 10(1) is one of the principal novelties of the UNIDROIT Convention in relation to pre-existing national law<sup>42</sup>.

### **2.2.3 Supplier**

The duties of supplier are owed to the lessor in accordance with the supply agreement unless the lessee was a party to the agreement or the equipment was supplied directly to the lessee. It shall be noticed that the supplier is not liable on the same damage to lessor and lessee. Moreover, the supply agreement are not terminated or rescinded unless the lessor agrees on it<sup>43</sup>.

## **2.3 Provisions for Governing Cross-border Leasing**

This convention applies when the lessor and the lessee have their places of business in different States and (a) those States in which the supplier has its place of business are Contracting State; or (b) both the supply agreement and the leasing agreement are governed by the law of a Contracting State<sup>44</sup>. Whenever the contracting states has two or more territorial units in which has different legal system and it is difficult to determine which law is applicable on their relation, they first shall declare their intention at the time of signature, ratification, acceptance, approval or accession that this Convention is applicable to their territorial units<sup>45</sup>. However, due to the freedom of contract which stated about the ability of the parties to exclude the UNIDROIT Convention or derogate from its Terms: in line with the generally accepted rule deprive the parties of their freedom to choose alternative rules to govern their agreements and the parties are free to exclude the application of the UNIDROIT Convention altogether. On the other, as to avoid the risk of two parties seeking to exclude its application to the detriment of the third party, such exclusion requires the agreement of all three parties.

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<sup>38</sup> Ottawa Convention (1988), Art 11.

<sup>39</sup> Ottawa Convention (1988), Art 12(1)(a).

<sup>40</sup> Ottawa Convention (1988), Art 14.

<sup>41</sup> Ottawa Convention (1988), Art 9.

<sup>42</sup> Ottawa Convention (1988), Art 13(2).

<sup>43</sup> Ottawa Convention (1988), Art 10.

<sup>44</sup> Ottawa Convention (1988), Article 3(1).

<sup>45</sup> Ottawa Convention (1988), Article 3(1).

### 3. The UNIDROIT Model Law on Leasing (2008)

#### 3.1 General Concept of Financial Lease

As a response to the requirements of the developing countries and countries in economic transition in the willing to reform their domestic leasing laws, it caused the preparation of a model law on leasing by the Governing Council<sup>46</sup>. Indeed, the UNIDROIT Convention was designed to deal with international financial leasing transactions and not to be a model for domestic law as well as to harmonize legal framework of leasing for national legislators in order to increase the trade flow among the countries. Not many developing states have effective legal structures for secured financing. States which inherited or have adopted civil codes are likely to have unsophisticated secured financing regimes, since traditionally the civil law did not recognize non possessory secured financing devices.

It is necessary to remove uncertainty as to the meaning of another term: “financial leasing transaction”. In the balance of this paper, the term “financial leasing transaction” is used to refer to a special tri-partite relationship between supplier, the lessor and the lessee. A financial leasing transaction involves two separate, but related, contracts. The first contract is a supply contract, concerning term, approved by the lessee so far as they concern the lessee’s interest, between the lessor and a supplier of property who is named by the lessee and who aware that the property is to be leased to the lessee. The ownership of property is transferred to the lessor under this contract. When selecting supplier and the property, the lessee is not relying primarily on the skill or judgment of lessor. The second contract refers to the transaction between the lessor and lessee under a financial leasing transaction is usually a financial lease. However, the Model Law differs from the Ottawa Convention since the model law focus on the leasing in general while the leasing more specifically govern the international financial leasing. According to the Article 2 of the Model Law on Leasing has stated:

Financial Lease means a lease, with or without an option to purchase all or part of the asset that includes the following characteristics:

- (a) The lessee specifies the asset and selects the supplier;
- (b) The lessor acquires the asset in connection with a lease and the supplier has knowledge of that fact; and
- (c) The rentals or other funds payable under the lease take into account or do not take into account the amortization of the whole or a substantial part of the investment of the lessor.

The financial lease is involved when the transaction to which the lessee is required to pay what is the equivalent of the lessor’s capital investment plus a credit charge at the commercial rate at the time of agreement as well as if the right to possession of the property for all or a partial of its useful life is belonged to the lessee. But, if it is less than the useful life, the financial leases also can be happened in that transaction. In addition, even the lessee can purchase the property at the price lower than the market value which he or she will exercise the option and acquire legal title to the property, the transaction is regarded as the financial lease too<sup>47</sup>. Due to the model law, the word ‘asset’ refers to all kind of property which were used in the craft, trade or business of the lessee, including the immovable properties such as future assets, capital assets, specially manufactured assets, equipment, plants, and living and unborn animals without cover the money or investment security<sup>48</sup>. While the agreement between lessor and supplier<sup>49</sup> in which the lessor acquires the asset for lease under a financial lease is considered as a supply agreement<sup>50</sup>.

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<sup>46</sup> Peters (2011), 38.

<sup>47</sup> Uniform Law Review, Ronald C.C. Cuming, Model Rules for Lease Financing: A Possible Complement to the UNIDROIT Convention on International Financial Leasing, (UNIDROIT, 1998), 372.

<sup>48</sup> Ottawa Convention (1988), Art., 2.

<sup>49</sup> Ottawa Convention (1988), Art., 2: provided that “the supplier refers to a person from whom a lessor acquires the asset under the financial lease”.

<sup>50</sup> Ottawa Convention (1988), Art., 2.

It shall be noticed that the model law does not cover to a lease whose functions relate to a security right and the lease or supply agreement of large aircraft equipment unless three parties agreed in the written agreement<sup>51</sup>. In order to understand about the concept of the financial lease under the model law, it is necessary to closely look into the duties and rights of the contracting parties under the instrument.

### *3.2 Rights and Duties of the Parties under the Financial Leasing Agreement*

The rights and duties of tripartite in the financial leasing agreement under the model law do not state clearly as what have mentioned in the Ottawa Convention; however, the scope of these rights and duties are very similar under these two instruments. Since the paper already discussed on the rights and duties of the contracting parties in the abovementioned section, so in the part will focus only the main rights and duties which are stated in the model law. The duties of both lessor and lessee are independent and irrevocable when the asset has been delivered<sup>52</sup>. Furthermore, the rights and duties of lessor can be transferred unless the lessee provides the consent on the transferring<sup>53</sup>.

It seems that the model law focuses much on the duties of the lessor and lessee rather than their rights by specified about lessor's warranties on the quiet possession, acceptability and fitness for purpose<sup>54</sup> as well as the duties under the supply agreement<sup>55</sup>. Follow with the duty of lessee to the supplier if he or she directly involves in that agreement, the duty for maintain the caring on the equipment and the duty return the asset back to the lessor when come to the end of the contract period.

The supplier is obligated to the lessor or lessee in accordance with the supply agreement; however, the supplier is not liable for the same damage to both lessor and lessee<sup>56</sup>. The provision also stated in the Ottawa Convention and both instruments are set for the same purpose is to make the certainty and avoid the confusion on the duties of supplier since the tripartite transaction is more complex than other transaction.

It shall be noticed that the lessor and lessee are free to determine the content of their lease agreement which shows the concept of freedom of contract stated in the model law.

### *3.3 Remedies of Financial Lease*

The model has mentioned about the remedies to govern on the financial leasing agreement which the lessee can demand the asset from the supplier when the asset does not deliver both all or partial. In addition, the lessee can refer to other remedies that were stated by the law. Therefore, it requires the other law to cover on the remedies for settle the disputes which caused by the financial leasing agreement. The point is differed from the provision that stated in the article 12 of the Ottawa Convention, the lessee has rights to reject and termination the leasing agreement if its asset was delivered lately or did not deliver. On the other hand, the model law just stated about the damage of asset without fault of the lessee or lessor before the asset is delivered to the lessee, the remedies is the lessee can demand the inspection and either accept the asset with due compensation form the supplier for the loss in value or seek such other remedies as are provided by law.

Although, the model law is taken by many states to put into the consideration of their national legislators, there still have the confusion on its provision since the model law governs on both general lease and financial lease. As a result, some states take all the provisions both general lease and financial lease if they do not have their own legislation yet. While other will take only the financial leasing concept if they already had the provision governs the general lease.

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<sup>51</sup> Ottawa Convention (1988), Art., 3.

<sup>52</sup> Ottawa Convention (1988), Art., 10.

<sup>53</sup> Ottawa Convention (1988), Art., 15.

<sup>54</sup> Ottawa Convention (1988), Art., 16 & 17.

<sup>55</sup> Ottawa Convention (1988), Art., 7.

<sup>56</sup> Ottawa Convention (1988), Art., 7.

## II. THE FINANCIAL LEASE IN THE UCC

### 1. The Introduction to the Uniform Commercial Code (UCC) of the US

#### *1.1 The Experience of US on Financial Lease*

The US is regarded as the main actor who involved in the financial lease transaction for long time ago. According to the experiences, the country has faced many challenges too especially regarding to the legal obstacles which push the legislators to concern on the adoption of laws and regulations for governing this activity. An interesting case in the US which can show the notion of financial lease in the US history, is the railroad companies pushing ahead with new routes intended to focus their financial resources on the provision of track and facilities, gaining their rolling stock on leases initially known as 'car trusts' and later was known as 'equipment trusts'<sup>57</sup>. From the end of the 1950s and with the advent of the 1960s, the leasing was accepted by large industrial companies, public utilities, national banks and governments as well as the creation of the first independent leasing companies<sup>58</sup>, playing a role analogous to that of banks and financial institutions albeit with the significant difference that they set out to buy and then lease equipment to their clients rather than simply loaning them the necessary funds to buy it<sup>59</sup>.

#### *1.2 The Introduction to the UCC of the US*

The reason why the article selects to study about the US law on financial lease is because the influence of the UNIDROIT instruments to that state law. Indeed, Article 2 of UCC which was inspired by the Ottawa convention has the fundamental goal is to reduce the transactions costs imposed on cross-border leasing by non-uniform law in the jurisdictions whose law may potentially apply. Through the US historical background, there are disputes happen in the relation of contracting parties and usually on the choice of law that requires the decision for determining which law will govern in a dispute. The difficulties of non-uniform state law created for interstate commerce<sup>60</sup>. Furthermore, the US has found the idea for cross-border leasing as a curious topic in accordance with the range of its obstacles such as: tax regulations, administrative requirements, protection of consumer, difficulty in delivery, and language and culture. The trader is required to adapt to the different national leasing laws that may apply in cross-border dealing causes cross-border trade more complex and costly compared to domestic leasing, both for business-to-consumer and business-to-business transactions<sup>61</sup>.

The UCC is a prominent example of a multi-jurisdictional commercial code heralded in America as the greatest harmonization of private law in the country's history. Some Articles have fully independent sub-articles, such as Article 2 (sale of goods) and Article 2A (lease of goods); Article 4 (bank deposits and collections) and Article 4A (funds transfers), cover vast areas of commercial law including the above-mentioned sale and lease of goods and bank and wire transfers, along with negotiable instruments. It began drafting in 1942 and after a decade of work the UCC was established in 1952. It was not until the mid-1960s that it became the law of all the US states<sup>62</sup>. From the time that the code was adopted until now, there are lots revisions and at least one time for each article is amended. The Florida Legislature's most recent foray into the U.C.C. was last session's enactment of two revisions especially the Article 2A of the code that governing the leasing. Some important point has been revised especially relate to the financial lease, therefore the next section will discuss on the concept of financial lease under the UCC.

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<sup>57</sup> The uniform commercial code law journal, vol.32:182 1999, 184.

<sup>58</sup> The US Leasing Corporation was founded in San Francisco in 1952 and exported to both Europe and the Far East.

<sup>59</sup> The uniform commercial code law journal, vol.32:182 1999, 184.

<sup>60</sup> Flechtner (2012), 5-6.

<sup>61</sup> Flechtner (2012), 7.

<sup>62</sup> Flechtner (2012), 32.

## 2. The Basic Concepts of Financial Lease in the US

### 2.1 General Concept of Financial Lease

Article 2A has a number of special rules for finance leases that recognize the limited role of the finance lessor in the transaction and applies to transactions involving billions of dollars annually, consumer's rental of automobiles equipment, on the other hand, and to leases of such items as commercial aircraft and the industrial machinery<sup>63</sup>. There are several reasons for codifying the law with respect to leases of goods. An analysis of the case law as it applies to leases of goods suggests at least three significant issues to be resolved by codification. First, what is a lease? Second, will the lessor be deemed to have made warranties to the lessee? Third, what remedies are available to the lessor upon the lessee's default?<sup>64</sup> This idea is not apply on the general lease but also the financial lease.

Most leasing occurs when a lessor in possession of goods grants use of the goods to a lessee for consideration. At times, though, the lessor does not own the goods that the lessee wishes to rent. The lessee typically wants to arrange for the goods directly with a supplier; the lessor essentially just finances the purchase of the goods, though it does take title plus a residuary interest in the goods themselves. This transaction is analogous to a purchase money security agreement: the lessor here is in the same position as the bank or other third-party creditor in the purchase money situation. Here, too, the lessor is usually a financial institution. Financial Leases refers to a certain leasing transactions substitute the supplier of the goods for the lessor as the party responsible to the lessee with respect to warranties and the like<sup>65</sup>. The definition of financial lease was developed to describe these transactions. Financial Lease means<sup>66</sup> a lease with respect to which:

- i. The lessor does not select, manufacture, or supply the goods;
- ii. The lessor acquires the goods or the right to possession and use of the goods in connection with the lease; and
- iii. One of the following occurs:
  - the lessee receives a copy of the contract by which the lessor acquired the goods or the right to possession and use of the goods before signing the lease contract;
  - the lessee's approval of the contract by which the lessor acquired the goods or the right to possession and use of the goods is a condition to effectiveness of the lease contract;
  - the lessee, before signing the lease contract, receives an accurate and complete statement designating the promises and warranties, and any disclaimers of warranties, limitations or modifications or remedies, or liquidated damages, including those of a third party, such as the manufacturer of goods, provided to the lessor by the person supplying the goods in connection with or as part of the contract by which the lessor acquired the goods or the right to possession and use of the goods; or
  - if the lease is not a consumer lease, the lessor, before the lessee signs the lease contract, informs the lessee in writing (a) of the identity of the person supplying the goods to the lessor, unless the lessee has selected that person and directed the lessor to acquire the goods or the right to possession and use of the goods from that person, (b) that the lessee is entitled under this Article to the promises and warranties, including those of any third party, provided to the lessor by the person supplying the goods in connection with or as part of the contract by which the lessor acquired the goods or the right to possession and use of the goods, and (c) that the lessee may communicate with the person supplying the goods to the lessor and receive an accurate and complete statement of those promises and warranties, including any disclaimers and limitations of them or of remedies.

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<sup>63</sup> American Law Institute, Uniform Commercial Code: Official Text and Comments (2013-2014 Ed.), 2013, 177.

<sup>64</sup> American Law Institute (2013), 178.

<sup>65</sup> The Uniform Commercial Code of the US (1952), Article 2A (209).

<sup>66</sup> American Law Institute (2013), 182-183.

For a transaction to be qualified as the financial lease it shall first be qualified as a lease. The financial lease refers to the product of a three party transaction in which the supplier manufactures or supplies the goods pursuant to the lessee's specification, may be even pursuant to a purchase order, sales agreement or lease agreement between the supplier and the lessee. After the prospective financial lease is negotiated, a purchase order, sales agreement, or lease agreement is entered into by the lessor, agreement or lease is assigned by the lessee to the lessor, and the lessor and the lessee then enter into a lease or a sublease of goods. Due to the limited function usually performed by the lessor, or the lessee refers almost entirely to the supplier for representations, covenants and warranties. If a manufacturer's warranty carries through, the lessee may also focus to that. Yet, this definition does not restrict the lessor's function solely to the supply of funds; if the lessor undertakes or performs other functions, express warranties, covenants and the common law will protect the lessee. If a transaction does not qualify as a financial lease, the parties may achieve the same result by an agreement; no negative implications are to be drawn if the transaction does not qualify. Further, absent the application of special rules (fraud, duress, and the like), a lease that qualifies as a financial lease and is assigned by the lessor or the lessee to a third party does not lose its status as a financial lease under this Article. Finally, this Article creates no special rule where the lessor is an affiliate of the supplier; whether the transaction qualifies as a financial lease will be determined by the facts of each case.

Under the UCC the word 'goods' was used to replace the word 'equipment' in the UNIDROIT instruments and it refers to all things that are movable at the time of identification to the lease contract, or are fixtures but the terms does not cover some specific things such as: money, documents, instruments, accounts, chattel paper, general intangibles, or minerals or the like, including oil and gas, before extraction. The term also covers the unborn young of animals<sup>67</sup>.

In order to have further understanding on the definition of financial lease, it is better to look into the analysis of fact finding through the example, assume that B has bought goods from C pursuant to a sales contract. After delivery to and acceptance of the goods by B, B negotiates to lease the goods to A, on terms and conditions that, we assume, will qualify the transaction as a lease. In documenting the sale and lease, B assigns the original sales contract between B, as buyer, and C, as seller, to A. A review of these facts leads to the conclusion that the lease from A to B qualifies as a financial lease, as all three conditions of the definition are satisfied as below:

- (i) is satisfied as A, the lessor, had nothing to do with the selection, manufacture, or supply of the equipment.
- (ii) is satisfied as A, the lessor, bought the equipment at the same time that A leased the equipment to B, which certainly is in connection with the lease.
- (iii) A is satisfied as A entered into the sales contract with B at the same time that A leased the equipment back to B. B, the lessee, will have received a copy of the sales contract in a timely fashion.

## *2.2 Rights and Duties of the Parties under the Financial Lease*

According to the UCC, the promise of lessee under financial lease contract became irrevocable and independent in accordance with the acceptance of goods by the lessee. Moreover, it is effective and enforceable to all the parties of the contract as well as against the third parties. If any party would like to terminate, revise, cancel or any other changes to the promise, it requires the consent from the other party<sup>68</sup>. This provision shows the rights of lessee which can enjoy under the formation of financial lease contract.

Since the supplier is obligated and liable to the lessor through the supply agreement which shall provides the warranties whether express or imply to the lessor as well as the third party, lessee, due to the financial leasing agreement<sup>69</sup>. As the lessee generally relies almost entirely upon the supplier for warranties with respect to the goods, requires that one of the following occur:

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<sup>67</sup> The UCC (1950), Art 2A (103).

<sup>68</sup> The Uniform Commercial Code of the US (1952), Article 2A (407).

<sup>69</sup> The Uniform Commercial Code of the US (1952), Article 2A (209).



- The lessee receive a copy of the supply contract before signing the lease contract;
- The lessee's approval of the supply contract is a condition to the effectiveness of the lease contract;
- The lessee receive a statement describing the promises and warranties and any limitations relevant to the lessee before signing the lease contract;

Before signing the lease contract and except in a consumer lease, the lessee need to get a writing identifying the supplier and the rights of the lessee under Section 2A-209, and also requires the advising that the lessee a statement of promises and warranties is available from the supplier. The provision also applies to the financial lease. Thus, the transaction may still qualify as a finance lease in case that the lessee agreed on the supply contract before the lease contract is effective and such approval was a condition to the effectiveness of the lease contract and even where oral supply orders or computer placed supply orders are compelled by custom and usage. Anyway, if the lessor does not want to show the entire supply contract to the lessee, including price information, the lease may be provided with a separate statement of the terms of the supply contract relevant to the lessee, promises between the supplier and the lessor that does not affect the lessee need not be included. The risk of loss is passed to the lessee which is difference from the general lease contract<sup>70</sup>. For further rights and duties of tripartite will discuss in the remedies section of the paper.

### 2.3 Remedies of Financial Lease

Termination happens when either party pursuant to a power created by agreement or law puts an end to the leasing contract otherwise than for default. The lessee has rights to apply the following remedies when the lessor fails to deliver goods in complies with the financial leasing agreement or repudiates the agreement<sup>71</sup>:

- To cancel the leasing agreement or reject to accept the goods;
- To recover the rent and security as has been paid;
- To exercise any other rights or pursue other remedies which stated in the leasing agreement;
- To recover the damages that caused by the lessor's default, including the liquidated damage, incidental and consequential damage, or other types of damages;
- To reject the goods when the goods that was delivered by the lessor does not conform to the leasing agreement; however, the lessee shall provide the notification about the rejection and a reasonable care and time to the lessor or supplier. The lessor or supplier who was rejected has the time to cure the default and make it to be conformed to the provision that was stated in the contract after receive the notification of rejection from the lessee;
- To ask for the specific performance from the lessor if the goods is regarded as the unique type of goods.

However, the default can happen not just only by the lessor, but also by the lessee to which allow the lessor to enjoy some specific rights as below<sup>72</sup>:

- To cancel the leasing agreement between them;
- To proceed respecting goods which is not identified to the lease agreement;
- To withdraw the delivery of the goods or get back the possession of the previously delivered goods;

<sup>70</sup> The Uniform Commercial Code of the US (1952), Article 2A (219).

<sup>71</sup> The Uniform Commercial Code of the US (1952), Article 2A (508).

<sup>72</sup> The Uniform Commercial Code of the US (1952), Article 2A (523).

- To recover the damages and dispose the goods;
- To exercise any other rights or pursue any other remedies which are mentioned in the financial leasing agreement.

### III. THE FINANCIAL LEASE IN THE CAMBODIAN LEGISLATION

#### 1. The Notion of Financial Lease in Cambodia

##### *1.1 The Background of Financial Lease*

The Royal Government of Cambodia has been putting many efforts on updating laws and regulations and introducing the new legislation in the field of finance and banking, trade and investment in order to develop the business and investment climate as well as to comply with WTO regulations and keep its promises made upon the accession to WTO. The major laws and regulations enacted or issued in such fields since 2007. As a result, a draft law on financial leases was adopted by the National Assembly in 2009 that officials say will help businesses and enterprises obtain long-term sources of capital from banks or lease companies in the wake of the global economic crisis.

According to the banks in Cambodia dare not grant long-term (five- or 10-year) loans to businesses through their worried about losing their money which is considered as an impediment for entrepreneurs to expand businesses and small-and-medium enterprises (SMEs). To solve this kind of issue, **H.E. Mr. Chea Chanto**, governor of the National Bank of Cambodia (NBC), told the Assembly. "The draft law on financial leases will enable businesses and SMEs in Cambodia to obtain a long-term source of capital from the banking and financial system with limited collateral." In addition, he also shared his idea on the explanation of the definition of financial leases that refers to the leases of assets and properties over the long term, between a lessor (a licensed bank or lease company) and a lessee (a developer, manufacturer or other customer). He added that financial leases could include properties such as machinery and all kinds of equipment, but excluded land and buildings<sup>73</sup>.

The growth of the banking sector in Cambodia also regarded as the reason why Cambodia needs to improve her legal system to govern this sector especially in relation with the financial lease. As the banking sector's growth continues to accelerate and increase in sophistication, new banking products and services also develop. Leasing and hire purchase products have been increasingly prevalently used mainly for consumer goods financing. We can clearly see the development of Cambodian legal system on the financial lease by looking into the major relevant law and regulations that are already adopted by the Cambodian legislative branches through the proposal on those draft laws by the executive branch.

##### *1.2 Regulatory Frameworks for Financial Lease*

###### **1.2.1 The Law on Financial Lease (2009)**

The Law on Finance Lease was promulgated in June 20, 2009. The Law is adopted for the purpose to provide a framework for the development of the banking and financial system in Cambodia to allow participants, both Lessor and Lessee, to engage in equal, safe and effective financial lease activities<sup>74</sup>. The Law achieves this by setting out the rights and duties of parties that are involved in financial lease operations and providing mechanisms to protect those rights. The scope of this Law will extend only to the financial lease of moveable property in the Kingdom of Cambodia<sup>75</sup>.

<sup>73</sup> Phnom Penh Post, National Assembly Passes Financial Lease Law, (2009), retrieved on May 8, 2014 from

<file:///D:/Research%20at%20UNIDROIT%20from%20April%2015-May%2023,%202014/Cambodian%20Documents/Related/National%20Assembly%20passes%20financial%20lease%20law,%20Business,%20Phnom%20Penh%20Post.htm>

<sup>74</sup> Law on Financial Lease (2009), Art., 1 & 2.

<sup>75</sup> Law on Financial Lease (2009), Art., 3.

The law is consisted of 38 Articles and 8 Chapters prescribing General Provisions, Financial Lease Agreement, Rights and Obligations of the Lessors, Rights and Obligations of the Lessees, Supervisory Authority and Regulatory Power, Sanctions, Transitional Provisions, and Final Provisions. The governing power is provided to the National Bank of Cambodia (NBC) which is classified as a governing body for issuing, suspending or revoking the operating licenses of financial leases as well as to issue the necessary regulations in order to implement this law<sup>76</sup>. A company which deals in finance leases is required to apply for a license from the NBC within 12 months from the effective date of the law. Only banks and financial institutions licensed by the NBC are allowed to conduct financial lease transactions<sup>77</sup>.

**1.2.2 The Prakas No. B.7.011.241 (NBC) dated December 27, 2011 on Financial Lease Business. (L/R/Bank/Khm&Eng/2012) (Royal Gazette, Year 12, No. 10, dated February 08, 2012)**

The governor of NBC issued a Prakas on the financial leasing business on December 27, 2011. The purpose of this Prakas is to set up, promote and develop the financial leasing industry by providing guidance for financial leasing business operators in Cambodia<sup>78</sup>. A bank can offer leasing services as part of its banking operations as defined in Article 2.1 of the Law on Banking and Financial Institutions (1999) and Article 34 of the Law on Financial Leases (2009). These provisions also apply to Commercial banks, Specialized Banks and Microfinance institutions.

According to the Prakas, a financial lease refers to a lease for an initial non-cancelable term of a year or more, in which the lessee specifies movable property and selects the supplier without relying primarily on the skill and judgment of the lessor<sup>79</sup>. Further, the movable property must be acquired by the lessor by means of a financial lease agreement for leasing to the lessee. The Prakas also outlines conditions that the leasing institutions must comply with in order to offer financial leasing services. Bank must obtain approval from the NBC by demonstrating compliance with the requirements defined in Article 4 of the Prakas. Other institutions intending to provide or providing financial lease products must apply for a license from the NBC. Specific requirements for the application for license will be determined in another Prakas<sup>80</sup>.

**1.2.3 The Prakas No. B.7.011.242 (NBC) dated December 27, 2011 on Licensing of Financial Lease Companies. (L/R/Bank/Khm&Eng/2012) (Royal Gazette, Year 12, No. 10, dated February 08, 2012)**

The Governor of NBC issued a Prakas on the licensing of financial lease companies on December 27, 2011. According to this Prakas, financial lease companies are defined as institutions solely engaged in the financial lease business with a minimum registered paid up capital of 200, 000, 000 Riel<sup>81</sup>.

Any natural or legal person who offers financial leasing services must hold a license issued by the NBC in order to comply with the Prakas. The Prakas provides the details information of the required documentation for the license application as well as the costs and fees involved in this process which were stated in the Article 4 of the Prakas. The validity of the license term is for 5 years from the approval date and renewable by filing a request<sup>82</sup>. The Prakas also states about rules concerning capital deposit and reporting obligations<sup>83</sup>. It also consists of the provisions relate to the shareholding structure and governance of financial leasing companies as well as sanctions for non-compliance, which include from restrictions on operation and fines<sup>84</sup>. Finally, the

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<sup>76</sup> Law on Financial Lease (2009), Art., 33.

<sup>77</sup> PricewaterhouseCoopers, Cambodia News Brief: A periodic summary of new rulings & other legal documents relating to legal, tax and investment developments in Cambodia, 2009, 1.

<sup>78</sup> The Prakas No. B.7.011.241 (NBC) dated December 27, 2011 on Financial Lease Business, Article 1.

<sup>79</sup> The Prakas No. B.7.011.241 (NBC) dated December 27, 2011 on Financial Lease Business, Article 2.

<sup>80</sup> BNG Legal, Primary Law Update: Banking, 2012, 2, retrieved on May 7, 2014 from <http://bnlegal.com/index.php/category/monthly-law-update/2012/>

<sup>81</sup> The Prakas No. B.7.011.242 (NBC) dated December 27, 2011 on Licensing of Financial Lease Companies, Article 3.

<sup>82</sup> The Prakas No. B.7.011.242 (NBC) dated December 27, 2011 on Licensing of Financial Lease Companies, Article 8.

<sup>83</sup> The Prakas No. B.7.011.242 (NBC) dated December 27, 2011 on Licensing of Financial Lease Companies, Article 10.

<sup>84</sup> The Prakas No. B.7.011.242 (NBC) dated December 27, 2011 on Licensing of Financial Lease Companies, Article 13 & 14.

Prakas also stated about a six-month grace period for any person or company engaged in the financial lease business without a license to apply for a license from the NBC<sup>85</sup>.

## 2. Basic Concepts of Financial Lease in Cambodia

### 2.1 General Concept of Financial Lease

Under the Cambodian financial legal system, the general lease is stated in the Civil Code 2007 and the financial leasing transaction is governed by the Law on Financial Lease (2009). For example, Definition of perpetual leases: “Perpetual lease” refers to a long-term lease of immovable for a term of not less than 15 years<sup>86</sup>. A perpetual lease shall not be valid unless it is established by writing. A perpetual lease that is not in writing shall be deemed to be a lease without a prescribed period, and may be terminated at any time by either party unilaterally in accordance with Article 615(Notice of cancellation of lease without fixed term)<sup>87</sup>. While the provisions on tax are provided in other law, law on Financial Management (2010) stated about the tax at the rate 0.1% will apply to immovable property. The immovable property was defined by this law as include land, houses, buildings and other constructions that are built on that land.

On the other hand, the law on financial lease has provided distinguish between the definition of lease and financial lease. Lease refers to a transaction that a lessor enter into an agreement with a lessee, the lessee is received the right to possession and use of movable property for a certain period as getting back a periodic lease payments<sup>88</sup>. While the word ‘financial lease’ was also defined by the same article as the following:

Financial lease is a lease for an initial non-cancelable term of a year or more, in which

- i. The lessee specifies movable property and selects the supplier without relying primarily on the skill and judgment of the lessor; and
- ii. The movable property is acquired by the lessor in connection with a financial lease agreement for leasing to the lessee

Provided, however, that a subsequent lease of previously leased movable property is from the same lessor, such lease can still qualify as a financial lease.

A lease may be a financial lease without regard to:

- i. Whether or not the periodic lease payments are calculated so as to take into account in particular the amortization of the whole or a substantial part of the cost of the movable property, or
- ii. Whether or not the lessee has or subsequently acquires the option to buy the movable property or to hold it on lease for a further period<sup>89</sup>.

As other legal system, there are two agreements which involved in the financial lease namely, supply agreement, is an agreement by which the lessor acquires possession and use of the movable property to be leased to the lessee. Another agreement is a financial lease agreement refers to an agreement, in which the lessor purchases movable property selected by the lessee from a supplier, and leases this movable property to the lessee and authorizes the lessee to periodically pay the lease payment. The agreement has to make in written form and signed by the Lessor and the Lessee and together with the setting of the terms and conditions of the parties with respect to the leased movable property<sup>90</sup>. An agreement can be regarded as a Financial Lease Agreement only if it provides the following key points<sup>91</sup>: (a) a description of the leased movable property; (b) the amount, periodicity and term of the Lease Payments; (c) a commencement date of the Financial Lease; and (d) the signature of the Lessor and the Lessee.

A Financial Lease Agreement may provide for a Security Deposit, Advance Lease Payments, or both. Under the agreement, the lessee requires to accept the use of movable property within a period of at least one year. At the end of the agreement, the lessee

<sup>85</sup> The Prakas No. B.7.011.242 (NBC) dated December 27, 2011 on Licensing of Financial Lease Companies, Article 18.

<sup>86</sup> Cambodian Civil Code (2007), Article 244.

<sup>87</sup> Cambodian Civil Code (2007), Art., 245.

<sup>88</sup> Law on Financial Lease (2009), Art., 4.

<sup>89</sup> Law on Financial Lease (2009), Art., 4.

<sup>90</sup> Law on Financial Lease (2009), Article 5.

<sup>91</sup> Law on Financial Lease (2009), Article 5.

may or may not buy up that movable property<sup>92</sup>. The lessor can provide financing to lessee to use the movable property without grant the ownership of such movable property to the lessee.

## *2.2 Rights and Duties of the Parties under the Financial Lease*

### **2.2.1 Lessor**

The ownership of the leased movable property still belong to the lessor except for ownership transferred to the lessee or other parties during and after the term of the financial lease<sup>93</sup>. The lessor is obligated to pay import tax and other tax obligations in accordance with law, and their registration cost of the leased movable property except where the Financial Lease Agreement provides otherwise<sup>94</sup>. The lessor has to warrant the quiet use and possession of the leased movable property to the lessee, who shall be free from interference by the lessor during the implementation of the Financial Lease providing that the Lessee is not in breach of the Lease Agreement<sup>95</sup>.

On the other hand, the lessor also granted some specific rights under the application of the law. First, the lessor is not liable to any damages that caused by third parties or the movable property unless the damage is caused by his or her default<sup>96</sup>. The lessor also has rights to request the lessee to compensate for the damages or the loss of the movable property during the financial lease term which were regarded as the lessee's default. For detail of the rights are stated in the Article 17 of the law on financial lease. The movable property is not the property of the lessee, so if the lessee becomes insolvent and enters insolvency proceedings, the lessor has the right to confiscate the lease movable property and seek payment in the liquidation process by the court<sup>97</sup>.

### **2.2.2 Lessee**

If the leased movable property is delivered in a timely manner and conforms to the supply agreement, the lessee is obligated to accept it. While the lessee has the right to reject the movable property, demand from the supplier the immediate cure of its defect or defects, or to cancel the Lease Agreement if it does not deliver. However, the Lessee shall have no right to terminate, rescind or modify the Supply Agreement without the consent of the Lessor<sup>98</sup>. Furthermore, the lessee has to pay lease payment and the agreement will become irrevocable or absolute after the acceptance by the lessee<sup>99</sup>. The duties of care and use the movable property in comply with the rules, measures and regulations are also the obligations of the lessee<sup>100</sup>. The lessee has the right to make a sublease on the movable property only if receive the prior consent from the lessor<sup>101</sup>. The lessee will receive the rights from the supply agreement since the supplier also owed to the lessee if the lessee is the party to the supply agreement or the movable property is derived directly to the lessee<sup>102</sup>.

## *2.3 Supervisory Body on the Financial Leasing Transaction*

The National Bank of Cambodia shall act as the guardian authority of the leasing institutions and was granted the supervisory powers such as<sup>103</sup>:

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<sup>92</sup> Law on Financial Lease (2009), Article 10.

<sup>93</sup> Law on Financial Lease (2009), Article 11.

<sup>94</sup> Law on Financial Lease (2009), Article 12.

<sup>95</sup> Law on Financial Lease (2009), Article 14.

<sup>96</sup> Law on Financial Lease (2009), Article 15 & 16.

<sup>97</sup> Law on Financial Lease (2009), Article 20.

<sup>98</sup> Law on Financial Lease (2009), Article 23.

<sup>99</sup> Law on Financial Lease (2009), Article 25.

<sup>100</sup> Law on Financial Lease (2009), Article 26.

<sup>101</sup> Law on Financial Lease (2009), Article 32.

<sup>102</sup> Law on Financial Lease (2009), Article 31.

<sup>103</sup> Law on Financial Lease (2009), Article 33.

- To issue, suspend and revoke license on the financial leasing operations business by setting clearly about the process and procedure of the licensing;
- To make the regulations and implement the existing law and regulations;
- To oversee and examine on the financial lease institutions;
- To put the sanction to the financial lease institution which failed to heed with the warning or not comply with the injunction, the NBC will impose the disciplinary sanctions<sup>104</sup>.

In order to operate financial lease business in Cambodia, the financial lease institutions must have the licenses that approved by the NBC<sup>105</sup>.

#### **IV. THE COMPARATIVE STUDY AND FEASIBLE SUGGESTIONS TO THE CAMBODIAN LEGISLATION ON FINANCIAL LEASE**

##### **1. The Comparative Study of Financial Lease in UNIDROIT Instruments, the UCC and the Cambodian Legislation**

As aforementioned, the concept of financial lease was regarded as an important topic in both Cambodia and the US as well as under the UNIDROIT instruments. Therefore, it is necessary to conduct a comparative study on these three legal systems for finding the common features and the differences of each provision which can contribute a good lesson for Cambodia to improve her own existing legislation on financial lease.

##### *1.1 The Common Features*

Begin to compare among these instruments, the first common feature was found out is the similar purpose of them. All of them share the common purpose is to govern the complex transaction which involve tripartite relationship namely the lessor, lessee and supplier within the agreement. The most important purpose of these legislation is to maintain and ensure the protection as well balance the interest of all parties to the contract. Furthermore, the basic rights and duties of each contracting party are also stated in the similar way in abovementioned legislation such as:

- The lessor's immunity on the damage to person or property which caused by the equipment or movable property;
- The duties of lessor in providing the warranties to the lessee during the term of the financial leasing agreement; for example, the warranty on the quiet possession;
- The lessee can make a sublease unless get the approval and prior consent from the lessor;
- The duties of care and use the equipment or movable property in comply with its term and condition by the lessee;
- The notification of the lessee's rejection shall give to the lessor and leave a reasonable time for the lessor to cure it;
- The lessee has to pay the lease payment and bear the risk of loss;
- The remedies which are used to apply when the default happen and caused by the lessor or lessee;

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<sup>104</sup> Law on Financial Lease (2009), Article 35: "has stated about the disciplinary sanctions which includes caution, reprimand, prohibition on the execution of certain operation and any other limitations on the carrying on of business, temporary suspension of one or more of the executives; with or without appointment of a provisional administrator, compulsory resignation of one or more of the executives; with or without appointment of a provisional administrations, and withdrawal of the license and liquidation".

<sup>105</sup> Law on Financial Lease (2009), Article 34.

- The benefits and obligations of a supplier's promise can be to the lessor or lessee which is depend on the provision and the parties to the supply agreement and the supplier shall not liable to the lessor and lessee for the same damage.

In addition, between Article 2A of the UCC and the UNIDROIT Model Law on Leasing, the common purpose of these two instruments is mentioned about the provisions which govern on both general lease and financial lease. On the other hand, the Cambodian Law on Financial Lease and the Ottawa Convention are more specifically cover only the financial lease as seen in the title of these two instruments. Last but not least, the common feature among these legislation also include the general principle of contract is whenever any breach or default happen, these laws and regulations will try to bring all the parties to the contract back to the same situation before the contract take place. Finally, all these legal systems are shared the same objective by increasing and pushing the growth of leasing in the world in order to develop the world economy, finance and banking. As a result, it will also contribute to each own economic and financial system development in each country as well as in the cross-border leasing which is the main objective of the UNIDROIT instruments on financial lease.

### *1.2 The differences*

Although, these abovementioned instruments share many common features, but they still consist of some notable differences which will discuss in the section. The discussion on the differences will provide the good lesson for the development of Cambodian current laws and regulations on financial lease. Start from the definition of the key term is 'financial lease' which already discussed in the previous part of the paper, by a close looks into these instruments shows the differences between the definition in Cambodian law, UNIDROIT instruments and the UCC. Both definitions of financial lease that stated in the Cambodian law and the UNIDROIT Convention are similar while under the UCC seems to be more detail and specific on each activity which is considered as the financial lease. Second, the objective of the financial leasing agreement also was used in different term and scope such as:

- Cambodian law on financial lease, the objective refers to the movable property, including all properties; plants; and equipments except land and building;
- The UCC, the objective refers to goods which means all things that are movable at the time of identification to the lease contract, or are fixtures but the terms does not cover some specific things such as: money, documents, instruments, accounts, chattel paper, general intangibles, or minerals or the like, including oil and gas, before extraction. The term also covers the unborn young of animals;
- The UNIDROIT instruments, the objective refers to equipment which covers plant, capital goods or other equipment under the UNIDROIT Convention. While the Model law used the word 'asset', refers to al property used in craft, trade or business of the lessee, including immovable, capital assets, equipment, future assets, specially manufactured assets, plants and living and unborn animals; however, did not include the money or investment securities.

Moreover, the legal effect of these legal instruments are also differences since the Cambodian law and the UCC have the legal effect at the national level (their own territories), while the UNIDROIT Convention's legal effect is at the international level and for the model law is just a soft law, but it is used to improve the domestic legislation. Last but not least, the real rights of lessor which are used to against with lessee's bankruptcy and creditor have mentioned only in the Cambodian law and UNIDROIT instruments and does not exist in the UCC. In conclusion, it can be seen that both Cambodian law and the UCC's provisions seems more specific and detail compare to the UNIDROIT instrument because both legislation are used to governed only domestic financial leasing transaction within their own territories, while the UNIDROIT convention and model law have to be an unified among all state members which should be the uniform law and can govern the national, cross-border leasing and international financial leasing transactions.

## **2. Feasible Suggestions to the Cambodian Legislation on Financial Lease**

### *2.1 The Challenges of Financial Lease in Cambodia*

#### **2.1.1 What are the Challenges on the Current Legislation?**

The Cambodian legal system remains somewhat opaque and not fully formed and, therefore, reliable legal outcomes are not always guaranteed in local forums. It is important for international investors in Cambodia to take note of a number of legal issues when planning a deployment of capital to the Kingdom. There are only some reasons why the Cambodian legal frameworks are not conducive to the development of leasing since Cambodia already adopted the definite law on financial lease. Contradictions may exist between various elements of a Cambodia's legislative framework that prevent leasing from working effectively especially regarding to the fiscal issues which seems not clearly discuss in the law on financial lease. It is unclear whether lessors hold title to leased assets or not since no any provision talk about this matter. Definitions and legal implications of finance leases need to be specified in the legislation. Rules on these issues should be clear a written with users in mind.

#### **2.1.2 What are the Provisions for Governing the International Financial Leasing or Cross-border Leasing?**

It is a fact that the most successful efforts in the field of the unification of law have often occurred in those area where uniform law serves the dual functions of providing a uniform international legal framework for international manifestations of a particular type of commercial activity and filling a legal vacuum regarding such activity at the domestic level. The first concern that the type of leasing which has since gone on to enjoy worldwide success by reason of its ability to provide flexible financing terms and important cash flow benefits for small and medium-sized businesses, particularly in developing countries and countries with transition economies, for which financial lease will often represent the only source of funds permitting the acquisition of those categories of high-value capital equipment essential for them to modernize their means of production and thus to create vital new pockets of national wealth.

Indeed, the Cambodian legislation do not have the provisions for managing and governing the cross-border leasing and international financial leasing which still requires the legislators to concern on the issue. This legislation will not only solve the problem of transnational leasing transaction but also help to improve the financial system in the country through the increasing of foreign investment. This lead to the question whether or not Cambodia should ratify or sign on the international regulations which is considered as the uniform law like the UNIDROIT convention or model law? As to answer with the question, how to deal with the conflict of law or jurisdiction when the transaction is the interstate or transnational leasing?

### *2.2 The Possible Suggestions to the Cambodian Legislation on Financial Lease*

Although, Cambodia recently already had the definite law on financial lease, but still faced some aforementioned obstacles which need to find a possible solution and mechanism for settling it. The possible suggestions to Cambodian legislation on financial lease can be taken from the lessons that were received from the comparative study, international experiences and other countries' experience like the US even both countries have different legal system. For instance, the US, the argument ran for a long time that leases could be adequately dealt with either under the bailment law or financial lease law. The granting to the lessee in the leasing agreement of an option to purchase the leased equipment is seen by some legal systems which essentially in the Civil Law jurisdictions. The development of international commercial law that was started under his leadership of the institute can be used as the tool for the next step in the development of modern leasing law.

The following are the key elements of effective leasing legislation which should be the possible suggestions to the Cambodian legislation on financial lease:

- A clear and detail definition of what financial lease is because the financial leasing contract is flexible, to which allow the contracting parties can set up the broad scope of it and sometimes cause the problem if without the clear limitation on it;



- An appropriate balance of rights and responsibilities among parties of a lease should be clearly and definitely specified in the laws and regulations in order to avoid the misinterpretation on those provisions;
- Fast and efficient repossession procedures should be specify in order to push the transaction goes smoothly;
- There should be a concern on the adoption the provision for governing the cross-border leasing as well as the international financial leasing. It is not only to govern but also to settle the conflict of law during the dispute happen in the cross-border transaction;
- It may be also a good solution for Cambodia to consider on becoming the member of the international instruments that used to govern the international financial leasing. Particularly, the UNIDROIT convention on international financial leasing and model law on leasing. This may leads to the improvement on the current Cambodian legislation and helps to settle the legal obstacles too.

Particularly, it can be seen from the UNIDROIT Model Law on Leasing which were considered by some states as their lessons as following:

- It is generally well recognized by stakeholders who regard it as simple, clear and acceptable within the local legal frameworks and practices, to which the model law has taken the basic concepts and common purpose from the UNIDROIT Convention on International Financial Leasing and put more efforts for making it more effective;
- It focuses on both general lease and financial lease, can be easily redrafted to focus on one type of lease only which can allow the national legislator used to adopt or improve their own legislation through the provision with the benefit of the comparison between the general lease and financial lease;
- The definition of a financial lease due to a tripartite agreement, to which the supplier is a party to that the arrangement needs to be thoroughly explained with particular emphasis on why, in a financial lease, the asset must be purchased by the lessor from the supplier in connection with a lease.

It can be the solution for settling on the cross-border leasing by providing ratification on the UNIDROIT Convention on International Financial Leasing 1988 as well as the Model Law on Leasing. Cambodia has an experience as the member of the UNIDROIT Convention on Stolen or Illegally Exported Cultural Objects 1995 through the ratification in 2002. There are also many common features among these instruments.

## CONCLUSION

Cambodia is still a developing country which has to build the strong economy through not only the domestic trade or commercial activities but also international foreign investment, transnational commerce and other international trade. As aforementioned, the concept of financial lease was regarded as a curious topic in accordance with the development of economic within the country. Although, Cambodia has concentrated on the development of the sector since 2009; however, there are still facing some difficulties and legal obstacles especially relate to the legal framework for governing the interstate leasing transaction. Not only Cambodia but also a raising number of countries which encounter these issues have looked to financial lease as a method to address the lack or inadequacy of legal infrastructures at the international level. Some states already accepted and received the inspiration from the international instruments which used to govern the financial lease. It has been discussed in the article, the US's experience on the unification of her own legislation on the financial lease among her states, Article 2A of the UCC is inspired by the UNIDROIT Convention on International Financial Leasing (1988). It is linked to the previous question that

already picked up in the introduction of the paper, whether or not the UNIDROIT instruments have influenced on the Cambodian legislation since she is not the member of the international organization or its financial leasing instruments yet.

As a result from the comparative study, it can be seen that the provisions were stated in the Cambodian law on financial lease are very similar to the provisions of the UNIDROIT Instruments and where the provisions of Article 2A of the UCC are more detail. Furthermore, it already discussed in the last section of the paper on the legal obstacles and possible suggestions to the recent Cambodian legal system by the author of the article. To conclude that Cambodia should improve on the existing provisions which used to manage and control the financial leasing operation such as to set up more definite and clear definition of the financial lease, to adopt the law and regulation for governing the cross-border leasing and international financial leasing as well as to be able in settling the conflict of laws or jurisdictions, and to consider on becoming the member of the UNIDROIT instruments by providing the ratification on the UNIDROIT Convention and taking the model law on leasing as the model for improving the recent laws and regulations.

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## **Research Scholarships Programme Report**

International Institute for the Unification of Private Law

**UNIDROIT**

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### ABSTRACT

My research at UNIDROIT Library examines the interactions between international private law and international commercial arbitration and in particular the role of Arbitration in the evolution of a transnational commercial legal order. During my eight weeks of research period I focused on reading and strengthening my theoretical understanding about the new law merchant, i.e., *Lex Mercatoria*, its sources, content and the methodology. After analysing the opposite positions regarding the existence of *lex mercatoria* I have come to the conclusion that the modern law merchant has a significant role to play in the pragmatic considerations of international commercial players even when the majority of legal scholars think that it is merely an abstract idea. Having identified the fact that international arbitration regime plays a significant role in the revival of the *lex mercatoria*, I concentrated on how the UNIDROIT Principles of International Commercial Contracts can be best served as a solution to the choice of law problems in international commercial arbitration.

### Acknowledgements

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Last, but not least by any means, I am thankful to my employer, National Law University Jodhpur for granting me a sabbatical leave to undergo this advanced learning process at UNIDROIT. I am pleased to report that my research period at UNIDROIT Library has helped strengthening my theoretical understanding and enabled me to make substantial progress in my research relating to the interface between International commercial arbitration and Private International Law. In my initial proposal, I have outlined this topic with a special reference to Indian jurisprudence. However, after my preliminary reading of the materials relating to Principles of International Commercial Contracts, I shifted my focus into the role of UNIDROIT principles in answering the complex conflicts of law questions faced by the actors in International commercial transactions.

### SUMMARY

It is said that the concept of *lex mercatoria* cannot be discussed in isolation. In other words, this phenomenon becomes alive only within the framework of international commercial arbitration. The role of international commercial arbitration in cementing international commercial relationships is undisputed. However, a more important question is what role the International arbitration regime can play in rejuvenating the transnational commercial law or vice versa. Recently, international private law community has been witnessing a discourse to the effect that the legitimacy of a-national arbitration is founded on the modern law merchant. However, I am of the opinion that the contemporary development in *lex mercatoria* has been toned up because of the contributions from the international commercial arbitration regime. This argument is primarily due to three reasons.

First, National parliaments have been updating the arbitration statutes in line with the international standards of arbitration law and practice. Most of which allows the parties to select 'Rules of law', instead of Law in governing their international contracts. This directly or indirectly permits the parties to explore the options available in the *lex mercatoria* system. Secondly, International arbitrators in the absence of an express designation of governing law made by the parties may apply transnational rules and they are allowed to arrive at this through a comparative law methodology. The authority of an arbitral tribunal to determine the *lex contractus* as empowered by the parties has not been restricted to national legal systems including any private international law rules. International arbitral practice and publicly available awards shows that the experienced tribunals follow an appropriate conflict of laws methodology which is different from the traditional conflict of laws generally adopted by national courts. In fact, many of the modern arbitration statutes provide for a *Voie Directe* approach in determining the applicable substantive law; and, finally, national courts have been showing a positive attitude to the awards that are decided on the basis of *lex mercatoria*, during the challenge procedure or at the enforcement stage. The underlying pro-enforcement bias of the New York Convention fortifies the likelihood of national courts respecting arbitral awards based on transnational commercial principles.

At this point, it is important to mention that while most of the modern arbitration statutes and institutional rules allow the parties and arbitrators to apply transnational commercial rules,

the availability of such autonomous rules still remains a vexed problem in conflicts of law jurisprudence. I believe, the UNIDROIT Principles provide a pragmatic answer to the international business community because of its a-national character. More importantly, available awards and the court decisions based on those awards evince the significance of these Principles as an ideal vehicle for transnationalisation of international commercial law.

In closing, I once again, wish to express my sincere gratitude to the International Institute for the Unification of Private Law (UNIDROIT) for its generous support. I am truly appreciative of this scholarship.

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## **UNIDROIT Principles and Lex Contractus: Revisiting the convergence of International Commercial Arbitration and Modern Lex Mercatoria**

### **I. Introduction**

International commercial arbitration, no doubt, has made spectacular progress since the last quarter of the 20<sup>th</sup> century and did not lose its momentum even during the global economic crisis. The inevitability of this dispute resolution mechanism in today's scenario is evidenced by the growing number of nation states becoming contracting parties to the NYC, the global framework for the recognition and enforcement of Arbitration agreements and awards. National governments are in fact competing in the promotion of ICA in their respective territories by updating the domestic arbitration statutes.<sup>1</sup> The expansion of this 'industry' is proved by the raising caseload of the major arbitral institutions and the increasing demand for institutional arbitration in developing countries. While the system itself turned out be a big business in modern times, the academic world circles has accepted the subject as a major field of study. Universities across globe started offering specialised courses on ICA. On one hand, International business community pushes this as their preferred system of dispute resolution, but on the other, the legal philosophers of International arbitration attempts to find the legitimacy of ICA on an autonomous transnational commercial law, otherwise known as lex mercatoria.

There have been attempts to harmonise and unify international private law by intergovernmental organisations and academia; more importantly, they have been focusing on the trans-nationalisation of international private law. There are many reasons attached to these efforts. When the cross-border trade and commercial transactions are growing steadfastly, the business deals being governed and a concomitant dispute being adjudicated upon under the control of a national legal system seems totally out of tune. However even

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<sup>1</sup> Invisible exports

today, at least in the common law tradition, law making outside the clutches of State is a concept which is not easy to digest. In order to deal with matters that are international, the domestic legal systems incorporated within what is known as the Private International Law or Conflict of laws<sup>2</sup>.

Judges as well as international private lawyers struggled with connecting factors like *lex contractus* and *lex solutionis* to fasten the contract to a particular national law. Later the anglo American jurisprudence evolved the proper law of contract as a theory to identify the most closely connected system of law, which is still considered to be the norm in international contract law.<sup>3</sup> According to Prof. Jan Dalhuisen, “it is often argued that there is at least certainty when domestic law is applied to international cases pursuant to the canons of conflicts of law, but this certainty, even if it results, can be of such a low quality that it destroys everything. It was said that domestic law is seldom meant for international transactions and does not mean to serve their needs or dynamics. In any event, it cannot cover whole portfolios of assets in different countries, nor international cash flows or the movement of assets trans-border”.<sup>4</sup>

It is believed that, having lost the logic to deal with the complexities of current commercial world through the canons of traditional private international law, the international marketplace formulated its own legal order, the law merchant. It seems to be less legitimate in the eyes of the legal positivists who believe that formulation of a normative system is impossible without a democratic process. It is quite obvious that alternative methods are devised, when the legal order provided by a state proves unsatisfactory to particular segments of society.<sup>5</sup>

Based on the treatment of this subject by some extremely arbitration friendly jurisdictions and its state courts, the existing academic literature discusses the epistemology of international commercial arbitration.<sup>6</sup> Accordingly, the major debate boils down to whether the normativity of international arbitration system depends on either a national or international legal order, or to a third legal order. Doubtlessly, the international commercial community has been successful in evolving a *nex lex mercatoria*, as a solution to the deconstruction of complex international commercial contracts. There has been commentary on the sources<sup>7</sup> and content<sup>8</sup> of the new *lex mercatoria* as well as attempts to codify this as an autonomous legal order.

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<sup>2</sup> Nomenclature problems. Nothing international

<sup>3</sup> Proper law of contract

<sup>4</sup> Opinion juris <http://opiniojuris.org/2012/04/04/the-notions-of-certainty-finality-and-predictability/> April 4, 2012

<sup>5</sup> J paulsson , 3 dimensions of arbitration p.20

<sup>6</sup> E gaillard , three representations.

<sup>7</sup> Gaillard

<sup>8</sup> Berger

### What is Lex Mercatoria ?

One of the most remarkable developments in international commercial law over the last fifty years has been the gradual acceptance of the existence of a new ‘merchant law,’ or *lex mercatoria*, spontaneously generated by the international community in the shadow of national legal orders. This new *lex mercatoria* is composed of commercial customs, but also includes a variety of other international norms that are regularly respected by international commercial actors.<sup>9</sup>

There is a general perception that this subject has been more theoretical than practical, and is being treated as a doctrine lying outside the tradition of anglo saxon jurisprudence<sup>10</sup>. It is said that the modern New Lex Mercatoria has been resurged from the medieval law merchant. Nevertheless, with the revival of the *lex mercatoria* there has also been formation of species of the transnational commercial law like *lex maritima*, *lex sportiva*, *lex constructionis*, *lex petrolea*, etc.

Basically, two approaches have been identified to ascertain *lex mercatoria*. First is the codification method, where the principles of *lex mercatoria* would be identified and collated as a list. The creeping codification by Professor Berger is one such method. The other theory identifies *lex mercatoria* as a decision making process, as opposed to a list.<sup>11</sup> Some claim that the *lex mercatoria* is an autonomous legal order in the sense that it is distinct from both national legal orders and the international legal order. In the operational sense, however, such a claim will prove futile. Although one national legal system may be autonomous from another, this claim cannot be set forth in the context of the *lex mercatoria*. Due to its insufficiency in form and substance, it sometimes turns to national legal orders for its implementation, its substance, and its efficacy.

There is a controversy amongst the proponents of the *lex mercatoria* concerning the sources from which it is drawn and the relative importance of the sources they deem admissible. Some scholars have listed several “elements” rather than “sources” of the *lex mercatoria* as follows: (a) public international law, (b) uniform laws, (c) the general principles of law, (d) the rules of international organizations, (e) customs and usages, (f) standard form contracts, (g) reporting of arbitral awards. Different proponents have tried to derive its contents from different numbers of sources. As we have seen, the proponents do not agree with regard to the sources of the *lex mercatoria*, and it is not surprising that with regard to its contents the result is much the same. The truth commonly recognized by the proponents is that “it is not possible to provide an exhaustive list of all the elements of the law merchant.” There have been attempts by some jurists, however, to enumerate the rules of the *lex mercatoria* in seriatim.

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<sup>9</sup> GILLES CUNIBERTI, Three Theories of Lex Mercatoria

<sup>10</sup> Mustill. 25 yrs

<sup>11</sup> E. gaillard



## **II. Choice of law in International Commercial Arbitration**

The principle of Party autonomy has been treated as the corner stone of international arbitration. According to this, parties have the freedom to choose the substantive law applicable to the merits of the dispute to be adjudicated by an arbitrator(s). The tribunal shall respect the choice and bound to apply this law while resolving the dispute. Most of the national arbitration statutes, international conventions as well as institutional arbitration rules contain the principle of party autonomy. But the question is whether this autonomy is absolute or restricted? Before answering this question, it is important to mention that most of the modern arbitration laws as well as the institutional rules allows parties to designate Rules of law instead of Law, meaning thereby, parties are not restricted to the choice of a specific national law but they can opt for general principles of law, transnational legal rules, etc. So, the autonomy is virtually unfettered. However, it must be bonafide and not violative of public policy.

This power to determine the substantive law provides flexibility to the parties and enables them to reach at a consensus regarding the particular law after thorough negotiation and analyzing the pros and cons of every legal system, calculating the risks involved and choosing the one that will lead to a favourable outcome. However, arriving at a consensus is not always that easy and uncomplicated with the result that the arbitration agreement is silent on the substantive law to be applicable. Sometimes this inability motivates the choice of 'general principles of law' with the parties believing that such a selection will lead to neutral and unbiased outcomes. Parties also sometimes supplement their choice of the law or avoid it altogether by referring to *lex mercatoria*.

Parties power to choose the substantive law applicable are provided in the arbitration laws of the majority of the jurisdictions. For instance, under the English law the power to choose the applicable substantive law can be found under Section 46 of the English Arbitration Act, 1996, under Article 17 (1) of the ICC Arbitration Rules and in the Indian law it can be found under Section 28 of the Arbitration and the Conciliation Act, 1996 . The law dealing with the power to choose the substantive law, both under the English law and the Indian law, has been modeled on Article 28 of the UNCITRAL Model law .

Section 28(1) (b) of the act provides that in cases of international commercial arbitration the substantive law designated by the parties shall be applicable. However, in the absence of such a designation the arbitral tribunal shall apply the rules of law it considers to be appropriate given all the circumstances surrounding the dispute by trying to infer the intention of the parties or by choosing that system of law which the transaction has its closest and most real connection.

This section has been modeled on Article 28 of the model law. However, Section 28(1) which deals with the law applicable in cases of domestic arbitration has been enacted by the Indian legislature and was not present under the Model law. Section 28(1)(b)(i) and (ii) correspond to the Article 28(2) of the Model law albeit the content and the intent of the two provisions being radically different. Article 28(2) of the Model law mandates that in case of absence of

designation of law by the parties the arbitral tribunal shall apply the law determined by the conflict of law rules which it considers applicable. But section 28(1)(b)(iii) is a notch liberal and provides for a freedom of choice to the arbitral tribunal and enables the tribunal to apply the rules of law it considers to be appropriate given all the circumstances surrounding the dispute.

However, as stated earlier, the parties may fail to designate the rules of law applicable to the substance of the dispute. This is not problematic in cases of domestic arbitration since Section 28 clearly provides that the substantive law existing in India shall be applicable. However, in cases of international commercial arbitration the discretion lies with the arbitral tribunal who has the default power to apply the rules of law it considers to be 'appropriate' bearing in mind all the circumstances surrounding the dispute and trying to look for the law that parties are presumed to have intended to choose. The section also provides that the tribunal shall take into account the terms of the contract taking into account the usages of the trade applicable to the transaction.

Jurists are of the opinion that in when exercising discretion in such situations the arbitral tribunal should not resort to either municipal laws or international laws for dealing with international commercial disputes when the different parties are involved. They believe that a national legal system is insensitive to the expectations of a disputing party from a different national legal background and international law is not adequate to deal with cross border transactions. There have been several instances, when the choice of law does not designate the specific substantive law, the arbitral tribunal has decided the case in accordance with *lex mercatoria*, perhaps equating it with the concepts drawn from their own legal experience or commercial background and their awards have been held to be enforceable under various jurisdictions where significant tests have arisen.

### Law or Rules of law?

As long as International Commercial Arbitration is autonomous and its legitimacy is founded on transnational legal principles, the authority of an arbitral tribunal to determine the *lex contractus* as empowered by the parties has not been restricted to national legal system including any private international law rules. International arbitral practice and publicly available awards shows that the tribunal follows an appropriate conflict of laws methodology which is different from the traditional conflict of laws generally adopted by national courts. In fact, many of the modern arbitration statutes provide for a *Voie Directe*<sup>12</sup> approach in determining the applicable substantive law.

International contract disputes may be settled by applying certain principles, rules, or usages, rather than a legal system itself. The relevance of a legal system may be minimal in such cases. The system may not have any bearing on public policy matters, whether national, international, or transnational. The concerned parties are happy with the settlement of their

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<sup>12</sup> Direct approach

disputes as such and abide thereby. Hence, it is questionable whether the use of such principles, rules, or usages should be determined by their existence within a legal framework, rather than by their suitability for resolving disputes. Often, the facts of a case require an approach to be of a more practical nature rather than theoretical. This is not to say that the arbitrator will override the parties' choice of a national law and resort to the *lex mercatoria*. The arbitrator may apply the *lex mercatoria* when the parties have expressly provided so in their contract, or when the parties have failed to make an express choice of law and the applicable arbitration rules permit the application. The trend seems to be in that direction in certain recent international arbitration rules as well as in relevant national legislation. Parties, as well as arbitrators, are allowed wider freedom to choose "rules of law" and are not required to confine themselves to a legal system.<sup>13</sup>

In the absence of parties' choice, the arbitrator is no longer required to resort to conflicts rules in order to determine the "law" or "rules of law" applicable to the dispute. As resorting to conflicts rules may lead to the application of a national legal system, arbitrators are freed from this requirement and are left to employ their own practical wisdom and prudence to determine the appropriateness of the applicable law or rules of law. This is a radical move that breaks away from the traditional control of a national legal order and endorses the autonomist theory of arbitration. This means that there is no need to cling to the positivistic notion of a legal system in settling a dispute. The authority to resort to "rules of law" by the parties or the arbitrator paves the way for the application of transnational rules, general principles of law, the *lex mercatoria* rules, and principles or rules of international law, both customary and conventional, whichever are deemed to be most appropriate in the circumstances. For instance, the parties or the arbitrator may resort to the UNIDROIT Principles of International Commercial Contracts, which "represent a system of rules of contract law," and the awards rendered on that basis should be enforceable.<sup>14</sup>

#### Determination of applicable law by arbitrator(s)

There is no natural legislator and international arbitrators have much freedom in formulating and further developing the applicable law even if they are not free. They are not *amiables compositeurs* and must find on the basis of the law, but they have substantial power in this regard and act in fact much in the manner of equity judges.<sup>15</sup>

One may argue that if an arbitrator applies any law other than the parties' chosen one, the parties' expectations would be frustrated. If this is allowed, contrary to the parties' wishes, the international business community may lose its trust in the arbitration institution itself and the prospect of arbitration will be in limbo. Since arbitration itself is based on party autonomy, this principle must be respected in various matters in the context of arbitration. The arbitrator's revision of the parties' contract by substituting the applicable law, however equitable, should be prohibited in principle for the sake of the sanctity of the contract. Thus,

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<sup>13</sup> ICSID Article 42

<sup>14</sup> UPICC

<sup>15</sup> Jan H Dalhuisen, International arbitrators as equity judges in Making Transnational Law work in the global economy.

the *lex mercatoria* should not oppose the well-established principle of party autonomy, as it is one of the general principles of private international law. Professor Reisman justly pointed out, “It is unfair to the parties and dangerous for the future of arbitration if arbitrators can arrogate to themselves a change of the rules once parties have selected a set of them to govern their transactions.”<sup>16</sup>

### Lex Mercatoria and Conflict of Laws

The proponents of the *lex mercatoria* contend that one of its goals is to get rid of the cumbersome exercise of applying conflict rules. As Dr. Mann noted, “One of the purposes of [the *lex mercatoria*] is to eliminate the search for the proper law of the contract or, more generally, the rules of conflict of laws.”<sup>17</sup> He added, however, that “it would be possible to have a specialist conflicts system with only one rule namely, that all disputes concerning international trade should, when referred to arbitration, be regulated by the *lex mercatoria*.” Professor Juenger, similarly summed up the effect that “the *lex mercatoria* threatens the very existence of the conflict of laws because once supranational norms emerge, choice-of-law rules and principles become superfluous.”<sup>18</sup> This approach is antithetical to the role traditionally attributed to the rules of private international law, reflecting a territorial sovereign’s need to control private relationships involving foreign elements to protect its own social and economic policies for the sake of its self preservation. The main thrust of this approach is that private interests in a transnational context should prevail over wider community interests in a given territorial domain even though this may appear contrary to conventional wisdom. Juenger further remarked that “traditional conflict of laws tenets, rooted as they are in statism and positivism, seem out of tune with our times, when commercial practices are being freed from state interference.” Thus, in the transnational context, there appears to be a tension and conflict between the conventional positivistic choice-of-law approach, which Juenger considers to be a parochial one in the discharge of judges’ or arbitrators’ transnational functions, and the modern supranational approach of the *lex mercatoria*. Some jurists, like Professor Goldman, mention the possibility of such a body of supranational conflicts rules, but unfortunately very few of them have satisfactorily explained the meaning and nature of such rules.<sup>19</sup>

At present there are no adequate or developed *lex mercatoria* conflict of laws rules, nor does there lie any prospect of such rules in the foreseeable future. This is true not only in the context of both international trade and investment matters but also in other fields. If the *lex mercatoria* conflict of laws rules are based on the general principles of conflict of laws, one may wonder how the *lex mercatoria* would be found applicable when the choice-of-law clause is absent. This is because one of the general principles of conflict of laws is the “centre of gravity” or “the most significant connection” or “the closest connection” principle, and

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<sup>16</sup> Reisman

<sup>17</sup> Frederick A. Mann, *England Rejects “Delocalised” Contracts and Arbitration*, 33 INT’L & COMP. L.Q. 193

<sup>18</sup> Friedrich K. Juenger

<sup>19</sup> Goldman

according to this principle the national law of the country with which the transaction has the most significant connection applies. Again, the argument is a circular one as far as the substantive applicable law is concerned. Professor Juenger and others, however, anticipate a way out through teleological techniques in the choice-of-law process, the objective of which is to uphold the spirit of transnational relationships.

Even if it is accepted that the *lex mercatoria* directly applies as the substantive law to the dispute without any reference to any conflict rules, there may be cases in which the *lex mercatoria* may not be sufficient to govern all the aspects of the dispute. In such cases, the arbitrator may have to apply some national or international conflict of laws rules to determine which law applies to those aspects of the dispute not covered by the *lex mercatoria*. Article 7(2) of the Vienna Convention on Contracts for the International Sale of Goods includes such a provision.<sup>20</sup> It is clear that the disregard of conflict rules is not absolutely possible in all disputes. Even many mercatorists did not hesitate to admit that the *lex mercatoria* cannot claim to be a complete and autonomous system of law, and consequently the existence of the *lex mercatoria* cannot eliminate the need for a choice-of-law clause in an international contract.

Another criticism that can be leveled against the contention for the automatic application of the *lex mercatoria* is that it cannot be the arbitrator's first step to reject any national law as the applicable substantive law where the choice of law is clear, either because the parties have unequivocally agreed to it or because one particular State's law simply has the closest and most real connection with the particular transaction. In particular, in the context of State contracts, such as economic development agreements, the host State's law, having the closest and most real connection with the transaction concerned, proves to be the most relevant and applicable. In any event, the *lex mercatoria* may be helpful when the national law is not adequate to govern a matter. From that perspective, the *lex mercatoria* may be an additional option in the search for the applicable law rather than an alternative to that search. Various arbitration rules and relevant national legislation also provide for an additional role of the applicable trade usages in all cases, whether or not the parties have chosen an applicable law.

### **III. Convergence of International Commercial Arbitration and Lex Mercatoria**

It is said that the concept of *lex mercatoria* cannot be discussed in isolation. In other words, this phenomenon becomes alive only within the framework of international commercial arbitration.<sup>21</sup> Legal scholars argue that, the legitimacy of International Commercial Arbitration is founded on *lex Mercatoria*. Is it true? Rather, the existence and revival of *lex Mercatoria* is depended on International Commercial Arbitration. Three reasons:

1. National parliaments have been updating the arbitration statutes in line with the international standards of arbitration law and practice. Most of which allows the parties to select 'Rules of law', instead of Law in governing their international contracts. This directly

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<sup>20</sup> CISG provision

<sup>21</sup> Veronica luiz

or indirectly permits the parties to explore the options available in the *lex mercatoria* system. As an example Article 28 of UNCITRAL Model Law that relates to the rules applicable to the substance of the dispute to its national arbitration laws permits this option and many countries have incorporated the same to their arbitration statutes.

2. International arbitrators in the absence of an express designation of governing law made by the parties may apply transnational rules and they are allowed to arrive at this through a comparative law methodology. The authority of an arbitral tribunal to determine the *lex contractus* as empowered by the parties has not been restricted to national legal systems including any private international law rules. International arbitral practice and publicly available awards shows that the experienced tribunals follow an appropriate conflict of laws methodology which is different from the traditional conflict of laws generally adopted by national courts. In fact, many of the modern arbitration statutes provide for a *Voie Directe* approach in determining the applicable substantive law.

3. National courts have been showing a positive attitude to the awards that are decided on the basis of *lex mercatoria*, during the challenge procedure or at the enforcement stage. The underlying pro-enforcement bias of the New York Convention fortifies the likelihood of national courts respecting arbitral awards based on transnational commercial principles.

#### Use of UNIDROIT Principles of International Commercial Contracts and its advantage as substantive law

The most significant of the codifications are the Principles of International Commercial Contracts, which were published in 1994 by the International Institute for the Unification of Private Law (UNIDROIT). A primary architect of the UNIDROIT Principles, Professor Michael Joachim Bonell, describes them as “a totally new approach to international trade law.”<sup>22</sup> They are not model clauses, contract forms, international trade terms, or international legislation adopted by states through international agreement.

In their concept and genesis, the UNIDROIT Principles are similar to the various Restatements issued by the American Law Institute, which have exerted enormous influence on the development of U.S. law. The UNIDROIT Principles consist of 119 “black-letter” articles, described as “general rules” conceived for international commercial contracts. Generally, the Principles are terse but broadly stated. Furthermore, like the Restatements, the UNIDROIT Principles are accompanied by commentary and factual illustrations to guide users from disparate legal and linguistic traditions.

In one important respect, however, the UNIDROIT Principles differ from the Restatements: while the Restatements ostensibly “attempt to state and clarify existing law,” the UNIDROIT Principles consciously, and progressively, seek in many instances to state the best law for drafting and interpreting international commercial contracts, regardless of whether each

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<sup>22</sup> Prof Bonell article

Principle constitutes extant *lex mercatoria*.<sup>23</sup> Thus, the UNIDROIT Principles expressly lay claim to being either “common to existing national legal systems” or those rules deemed “best adapted to the special requirements of international commercial transactions.” As such, the UNIDROIT Principles do not restate the law, but seek to influence its development through their incorporation in international commercial contracts and through their application by arbitral tribunals and national courts.

Notably, those who drafted the UNIDROIT Principles - legal scholars, practitioners, judges, and civil servants expert in contract, comparative, and international commercial law did so in their private capacities and not as representatives of government or particular commercial interests. UNIDROIT's Governing Council, which drafted and maintains the UNIDROIT Principles, has acknowledged that the Principles “do not involve the endorsement of Governments” and “are not a binding instrument.” Indeed, many governments reportedly would have refused to consent to the UNIDROIT Principles as a restatement of international contract law. As a result, the Governing Council promulgated these principles as draft law, thus obviating the need for state approval and avoiding further rounds of debate, delay, and compromise. In fact, given the UNIDROIT Principles' broad subject matter and universal ambit, it is doubtful whether even a majority of the now nearly 200 independent states could have reached a meaningful consensus on the subject.

The history of the UNIDROIT Principles clearly shows that the conscious exclusion of governments from a formal role in this extensive codification of transnational commercial law has greatly enhanced, if not enabled, its progressive development and application. The UNIDROIT Principles thus embody the creeping codification of transnational commercial law. This phenomenon is most evident in the context of international arbitration - a forum in which adjudicators arguably have greater freedom (and certainly have greater disposition) to apply transnational law than do judges in national courts. Indeed, international arbitration is proving to be the crucible in which the UNIDROIT Principles are tested.

It must be mentioned that the UNIDROIT Principles of International Commercial Contracts are considered suitable for application to cross-border transactions. The Preamble of the UNIDROIT Principles indeed provides that “the principles may be applied when the parties have agreed that their contract be governed by ‘general principles of law’, the ‘*lex mercatoria*’ or the like.” Such codification of general principles of law is a great milestone for the development of the *lex mercatoria*. The status of both sets of principles remains, however, as *lex ferenda*. Time will determine their true status. If, in fact, they are well received by the international business community and applied by arbitrators, a new chapter will be added to the life of the modern *lex mercatoria*. Bonell considers the UNIDROIT Principles as a well defined set of rules.<sup>24</sup> And he is very sanguine that in resorting to these Principles arbitrators “would succeed in reducing considerably the uncertainty and unpredictability which has so far characterized their decisions.”

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<sup>23</sup> Comparision *lex mercatoria* - Restatement

<sup>24</sup> Bonell

UPICC can be used to solve problems of characterization, preliminary questions, and choice of law to the merits of the dispute. In this sense, it appears clearly that these rules are to be construed under a triangular scheme. Thus, *lex mercatoria* and transnational rules like the UNIDROIT Principles will intervene more and more in the arbitral choice-of-law process in three competing contexts: (1) as a *lex contractus*; (2) as a means to interpret, supplement, or adapt national law; and (3) as a means to resolve matters of interpretation or gap-filling in international conventions. Criticism by conservative private international law scholars towards the choice of *lex mercatoria* and transnational rules seems therefore to have been overcome by arbitral practice.

International commercial contracts should be governed by the most closely connected law, in other words, this ought to be the law that is accepted as the rules of law and principles which would lead to the most fair and most appropriate solution to the circumstances of the dispute and the expectations of the parties. The better law for international commercial contracts is the body of general rules and principles upon which there is an international consensus. The localisation of complex international contractual relations by connection to a certain national law determined by reference to characteristic performance or other presumptions is artificial. The presumptions which define the most closely connected law with the contract by geographical connections restrict the application of a-national rules of law. The classical conflict of laws method depending on geographical connections should be left aside to provide space for resolutions depending on quantitative connections. The law whose content is appropriate to the needs of international commerce and which promotes the validity of the contract between the parties, and that recognises the legal concepts used by the parties in their contracts, instead of necessarily having a geographical connection to the dispute, should be the most closely connected law with the contract.

The application of the UNIDROIT Principles is generally accepted in arbitral proceedings either when the parties have chosen them as the applicable rules of law to the merits of their dispute or, in the absence of such choice of law, as the most appropriate law. However, further time is still necessary for the European or Turkish courts to respect the choice of a-national rules of law by the parties; let alone their application as the most closely connected law of contract.<sup>25</sup>

It should not be forgotten that the courts are not only obliged to apply their own national laws, they are also expected to serve for the preservation of the integrity of international commerce. Although national judges are obliged to apply their own national laws, they are also expected to decide the international disputes with an international perspective. This is expressly accepted by Art. 7 of the CISG. It is acknowledged by the 74 contracting states that in the interpretation of CISG, “regard is to be had to its international character and to the need to promote uniformity in its application”. In other words, it is set forth that national judges applying the CISG to disputes arising out of international relations shall consider the international character of the dispute. This indeed extends the role of national judges in resolving international disputes; in that not only do they need to ensure correct application of

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<sup>25</sup> Am. U.Intl. Law Rev.



national law but must also have an international perspective when international relations are at issue.

#### IV. Conclusion

Having made observations and cautionary remarks on the various important aspects of the *lex mercatoria*, a few conclusions may be drawn. Although, from the positivists' point of view, the *lex mercatoria* is not a legal system per se and hence cannot be itself the proper law of an international commercial contract, there seems to be a recent trend to endorse the view, in both national and international arbitration practice, that "rules of law," which could include the *lex mercatoria*, may be applied in certain circumstances as well as on their own. The philosophy seems to be that if "rules of law" provide suitable resolutions to a dispute, it is not necessary to consider whether they constitute a legal system.

Since there still remains serious disagreement among jurists as to the sources, methodology, and contents of the *lex mercatoria*, some are content to hold the view that the *lex mercatoria* may serve the purpose, at best, of subsidiary rules for the settlement of a dispute in hand. Professor Lowenfeld has considered that the status of the *lex mercatoria* "is not, in other words, supposed to be revolutionary. What it does do, if properly used, is to clarify, to fill gaps, and to reduce the impact of peculiarities of individual countries' laws, often not designed for international transactions at all."<sup>26</sup>

Even in the corpus of the *lex mercatoria*, some may claim that certain rules belong to it, while others are doubtful that those rules apply. Thus, the differences in formulation may lead to an incoherent body of rules to be claimed as the *lex mercatoria*, which, in turn, may cause the unpredictability of the outcome of any dispute. It should be noted that the application of the *lex mercatoria*, or the third legal order, has been found to be acceptable either as an express choice of law provision or directly as applicable substantive law, in the absence of any choice of law, without reference to any conflict rules. In the present state of development of law, the application of the *lex mercatoria* to an international contract contrary to an express choice of a different law is not tolerated.

Sometimes arbitrators seem to be overtaken by their preconceived views and legal dogma, even in disregard of the actual context of the case. In many arbitral awards, arbitrators fail to provide sufficient reasons for their decisions on substantive matters, which may lead to ambiguous interpretations among jurists. This state of affairs in the context of international commercial arbitration is not favorable for the sound growth and development of the *lex mercatoria*. A global institutional control mechanism should be established to standardize international arbitral practice and jurisprudence and to help develop a consistent body of arbitral *lex mercatoria*. On the threshold of the twenty-first century, international commercial arbitration as an institution, with its growing popularity amongst the international business community, faces a tremendous challenge to develop a consistent body of international jurisprudence on the *lex mercatoria* that may be universally acceptable. It is expected that the application of uniform international rules of law will become more widespread as there are

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<sup>26</sup> Lowenfeld

voices defending them and it will be seen that their application will ensure fairer, faster and less costly resolutions compatible with the expectations of modern merchants and the needs of international trade. It is hoped that this will be achieved in the near rather than far future.

Undoubtedly, arbitrators will play a crucial role in the success or failure of the UNIDROIT Principles, as they offer, in appropriate circumstances, an attractive alternative to the application of domestic law in the resolution of transnational disputes. Despite the UNIDROIT Principles' manifest appeal, however, arbitrators must not invoke them reflexively or shirk choice-of-law analyses that may call for the application of national law. If the UNIDROIT Principles truly are to flourish, it is not enough that arbitrators invoke them to render equitable decisions; they must be used in furtherance of party autonomy. If arbitrators can balance these dual concerns, the UNIDROIT Principles not only will be accepted in the resolution of international commercial and investment disputes; their invocation will be expected.

# **THIRD PARTY LIABILITY DUE TO GNSS MALFUNCTION: LIABILITIES ARISING FROM THIRD PARTY STATES**

## **Case study: The disappearance of Malaysian aircraft MH370**

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### **Executive summary:**

*In recent years, a few studies propose an international regime to govern the utilization of Global Navigation Satellite System (GNSS) operation, especially issues related to liabilities of malfunction. According to the proposals, an international convention is needed to subject the operators to strict liability with limitation in the amount, supplemented by the compensation fund<sup>1</sup>. However, these proposals have been denied by the majority of scholars all over the world. "It is not the right time" can be considered as the main reason for such denial.*

*While the whole world is still struggling with the question of whether or not there should be an existence of an international regime to deal with the issue of liability due to malfunction of GNSS, the disappearance of Malaysian aircraft MH370 in early 2014 gives raise to some liabilities related to third party states that might not be dealt in normal ways. Particularly, several satellite-based services have been rendered to detect the location of the unlucky aircraft. Some results have been published, leading to the moral responsibility of third party states involving in the salvation campaign. Three month from the disappearance, the location of the unlucky aircraft and all the passengers has not been identified. The question on accuracy of positioning information provided by satellite as well as a legal issue on the liability of satellite operator toward the expenses and effort of searching countries has emerged.*

*It is essential to identify the liability regime for the erroneous information provided from GNSS. Based on the accident of MH370, this paper provides herein a number of analyses as regard to the potential liabilities arising related to third party States. As conclusion, we come to a distinctive view that these types of liability cannot be covered just only by domestic law or a contractual relationship or international customary. Apparently, it is mandatory to have an international regime, convention or organization to provide its prejudice in answering such questions.*

### **I. INTRODUCTION:**

Nowadays, the utilizations of satellite technology are no longer the works of scientists. Only with a smart phone, people, from young to old, are able to use satellite application completely and efficiently. The satellite applications can be seen in different sector of socio - economic life, from navigation, through transport, financial and telecommunication-related services. Among them, the satellite navigation and positioning applications play a significant role for the economic development, national security and public safety. Moreover, in many countries, this application becomes the core of development campaign on national infrastructure of telecommunication.

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<sup>1</sup> KOZUKA SOUICHIROU, *Third party liability arising from GNSS-related services*, (2009).

The growing number of GNSS-based services generates demand for a legal framework, which will cover any legal issues raised during the utilization. In particular, many scholars raise questions on the legal liability regime for cases of damages to property, health and life due to the malfunction of GNSS, especially for third party liability. A number of studies were drafted; however, none of them proposes a desirable regime for the situation. As part of the project, by analyzing the disappearance of Malaysian aircraft MH370, this paper points out some types of liability arising from third party states in salvation due to the malfunction of GNSS. Moreover, it constitutes a strong ground for the need of an international convention.

### ***1. Preliminary studies on Third party liabilities due to GNSS malfunction***

Nowadays, the interest of the public has been attracted by the prominence of commercial use of GNSS-based services. The widespread utilization of GNSS-based services requires the existence of a legal framework in governing it. Currently, the liabilities toward the third party in case there is an error in the services provided becomes the key legal issues that catch the attention of legal scholars. From the early days of the civil use of the system, a number of studies were conducted to discuss the issue<sup>2</sup>. However, it appears that the current satellite system in operation, GPS (Global Positioning System) of the United States and GLONASS<sup>3</sup> of the Russian Federation, hardly become subject of liability due to malfunction. Thus, the issue was rather theoretical than practical.

In recent years, the European Union (EU) and European Space Agency (ESA) are developing a new project – Galileo for the commercial purpose only. The emergence of this system opened a new window for the legal scholars in continuance of the liability regime. The issue is no longer a subject of theoretical arguments but an agenda for international rule making<sup>4</sup>. In this sense, theoretical analysis of the issue plays a significant role in concluding an international instrument so as to provide an effective framework for the development of services using the system. To find the answer for this question, legal individuals and organizations actively initiate various studies related to third party liability due to GNSS malfunction.

**International Civil Organization (ICAO):** ICAO was the first organization hosted the early discussion about the legal framework about GNSS-based services, especially the liability of its operators focused on the air traffic navigation. ICAO formed a Study Group on “legal aspects of CNS/ATM.” However, the opinion within the Study Group were divided about the need for an international convention on the liability from GNSS services and the report presented to the ICAO General Assembly contained both opinion without a compromise.<sup>5</sup> Thus, ICAO has no further action in developing an international instrument.

**International Institute for the Unification of Private Law (UNIDROIT):** At its 88th session in 2009, the Governing Council entrusted the Secretariat with the preparation of a detailed feasibility study focusing on gaps in liability resulting from the malfunctioning of satellite-based navigation systems based on preliminary study of some UNIDROIT’s

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<sup>2</sup> See Jonathan M. EPSTEIN, “Global positioning System (GPS): Defining the Legal Issues of its Expanding Civil Use”, 61 Air Law & Commerce (1995-1996), 243 et seq. 248.

<sup>3</sup> GLONASS does not yet offer services for commercial purposes and is reported regularly to face problems with its satellite

<sup>4</sup> KOZUKA SOUICHIROU, *supra* note at 1

<sup>5</sup> Final Report on the Work of the Secretariat Study Group on Legal Aspects of CNS/ATM Systems, A35-WP/75 LE/5 Appendix, paras.5.2.1 -5.2.7 (2004)

professors<sup>6</sup>. The findings of that study point out that the current international convention have numerous gaps and none of them provide rules governing liability for space activities apply to third party liability<sup>7</sup>. Furthermore, the study proposes to make clear the rights and liability of the third parties due to GNSS failure. In particular, the right for exemption of damage of the carrier, the limitation of damages that a claimant may claim against GNSS service providers and the right to take action of insurer against the signal provider. The role of the new instrument (if possible) in comparing with the existing instruments is also being considered in the study. Whether it is a superimposition or a supportive instrument or co-existence with current convention?

To cope with these issues, the study presents three possible measures: (i) the first one, which is called a strict approach, consider that the current liability regime under domestic law adequately addresses GNSS liability issues. Therefore, it is neither feasible nor desirable to develop a universal liability system; (ii) the second one, broad approach, strongly support the establishment of a new universal liability system or convention; and (iii) the last one is middle ground approach. This measure proposes a contractual approach accompanied by a framework agreement containing some uniform rules, including rules on liability;

Furthermore, in Munich Satellite Navigation Summit 2012, Lena Peters, Senior Officer of UNIDROIT introduced the proposal to examine the possibility of international instrument for third party liability resulting from GNSS malfunctioning. However, participants were undecided about the topics, some believed that current legislation was sufficient, some saw the possible gaps, some preferred to refrain from giving an opinion at this stage. Unfortunately, final decision results that such an instrument should not be prepared at this stage<sup>8</sup>.

## **2. Aim of this paper**

In “*Third party liability arising from GNSS related-services*”, the writer proposes a prodigious vision that the regime should not be a single rule applicable to every kind of services. It should base on two elements: the degree of processing made to the information and the behavior expected of the recipient. In conclusion, he proposes to separate the liability into different mode, respectively to different third party users and there should be exemption of liability for GNSS service providers as regards the basic positioning signal<sup>9</sup>. This paper, at one hand, agree with the theory and proposal of Kozuka, at the other hand aims to add some potential kind of liabilities that GNSS service providers might face in the future when the third party is a state and the damage is huge. In particular, the foremost objectives of this paper are as follow:

- Identifying potential damages and liabilities that might occurred during the operation of GNSS service, especially positioning in specific case.

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<sup>6</sup> They are BOLLWEG H.G., “Initial consideration regarding the feasibility of an international UNIDROIT Instrument to cover liability for damage caused by malfunctions in global (navigation) satellite systems”, *Uniform Law Review*, 2008 p.917 and CARBONE S.M., E. DE MAESTRI, “The Rationale for an International Convention on Third Party Liability for Satellite Navigation Signals”, *Uniform Law Review*, 2009, p.38

<sup>7</sup> An instrument on third party liability for Global Navigation Satellite System (GNSS) services: a preliminary study, 2010

<sup>8</sup> See Munich Satellite Navigation Summit 2012, Session 6, GNSS legal framework, available at [http://www.munich-satellite-navigation-summit.org/Summit2009/picture/upload/file/Session%2006\\_Summit2012.pdf](http://www.munich-satellite-navigation-summit.org/Summit2009/picture/upload/file/Session%2006_Summit2012.pdf)

<sup>9</sup> KOZUKA SOUICHIROU, supra note at 1

- Legal issues that should be considered seriously while a third party is neither an individual nor company, but a state with full sovereignty right.

### **3. Research Methodology**

The features of the paper require studying both theoretical and practical. Studies prepared by various scholars participating in the project are the main resources for the paper. The following document provided the necessary data for this study: international legal documents (international agreements), bilateral treaties, domestic legislation from selected countries and working paper and other reports from international organization and leading scholars, specifically from UNIDROIT and ICAO. Besides, practical information published on the internet is indispensable resources for accomplishment of the paper.

## **II. Case study: The Disappearance of Malaysian Aircraft MH370**

### **1. Case brief:**

MH370, a Malaysian aircraft from Kuala Lumpur to Beijing lost contact with air traffic control on 8 March 2014 around an hour after takeoff. The Malaysia Airlines officially announce the flight missing. The aircraft was carrying 12 Malaysian crew members and 227 passengers from 14 nations. There has been no confirmation of any flight debris and no crash site has been found.

A multinational search and rescue effort, later reported as the largest and most expensive in history, began in the Gulf of Thailand and the South China Sea. Within a few days, the search was extended to the Strait of Malacca and Andaman Sea. On 15 March, based on military radar data and radio "pings" between the aircraft and an Inmarsat satellite, investigators concluded that the aircraft had diverted from its intended course and headed west across the Malay Peninsula, entering the maritime territory of Australia. The search in the South China Sea was abandoned. Three days later, the Australian Maritime Safety Authority began searching the southern part of the Indian Ocean. On 24 March, the Malaysian government confirmed independent analyses by the British Air Accidents Investigation Branch (AAIB) and Inmarsat, and announced that search efforts would be concentrated on the Australian area. Until now, the location of the unlucky aircraft has remained in puzzle.

### **2. Cost and Expenses<sup>10</sup>:**

The search for Malaysia aircraft MH370 has cost millions of dollars for the countries that have sent vessels and aircraft to find the plane. According to mass media, twenty-six countries have been involved in the search effort. The scale has significantly exceeded that of the search for Air France flight 447 which crashed into the Atlantic Ocean in 2009. MH370 becomes the largest salvation campaign ever.

Vietnam, the first country to take action in search and rescue efforts, has spent around US\$8 million for patrolling the South China Sea for at least ten hours the period from March 8 to 15. It is said that, it costs US\$950,000 a day and around US\$10,000 per hour for each aircraft involved.

The United States prepared a US\$4 million budget for the search. The US Pacific Fleet said the two destroyers and their helicopters cost around US\$100,000 per day each to

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<sup>10</sup> The search for flight MH370: How much does it cost? Available at <http://www.wantchinatimes.com/news-subclass-ent.aspx?id=20140329000051&cid=1101>

operate while the two patrol aircraft cost around US\$77,000 and US\$43,000 per day, respectively.

As the majority of passengers on MH370 are Chinese, China has put the most effort in search and rescue. Three Chinese vessels together with two helicopters and two Il-76 cargo planes have been searching in the area off Western Australia according to satellite images have shown. Besides, China also deployed a dozen military satellites to scan the Indian Ocean. It has hard to estimate the financial costs China has had to bear in the campaign. However, according to unofficial information, the total cost is estimated at around US\$ 20 million.

Following the information provided by Inmarsat, the searching area will now be focused on a much larger area of the ocean floor rather than the surface, and involve commercial contractors utilizing additional sonar mapping equipment, with an estimated cost of US\$60 million. To cover these expenses, the Australian government will seek contributions from other countries.

Lastly, Malaysia, as the host country of MH370 is said to pay around US\$10 million for search and rescue. As the salvation campaign has not finished, the amount of money is predicted to be increased abundantly as Australian government stating its purpose to ask for contribution from relevant countries, especially Malaysia.

### ***3. Possibility of GNSS Malfunction:***

More than three months after MH370 disappeared over Southeast Asia, searchers have found no trace of the aircraft or the 239 people onboard, making it one of the most mysteries missing in aviation history. In the latest news, the AAIB and satellite Inmarsat are very confident in the analysis and reporting of its experts as regard to the location of the crash. In its report, Inmarsat said that the Australian team is not looking at the right point of the crash site as their description. Thus, the search and rescue effort have to be longed for several months more. In such context, as there has been no confirmation of trace of the aircraft and all passengers of MH370, the accuracy and authenticity of the information provided by Inmarsat are still in question. Therefore, people turn their attention to other issues arising from this accident:

- What are the cost and expenses of the salvation campaign?
- Other potential liabilities or damages bound by countries taking part in the salvation campaign?
- Who will pay for the cost and expenses incurred by countries taking part in the salvation campaign?
- If, unfortunately, this information were erroneous, how the AAIB and the satellite Inmarsat face with the costs, expenses of the salvation campaign and other potential liabilities?

## **III. POTENTIAL ISSUES ARISING FROM MH370**

### ***1. State's budget issue:***

As indicated above, it cost millions dollars for countries participating in the salvation campaign. The amount affects significantly to the State's budget if there is no solution for refund. In fact, it is not major issue to developed countries like China, the US or Australia, however, for Vietnam, a Third World country, the cost for searching and rescuing is not a small figure. Therefore, countries like Vietnam need a financial solution for pursuing other salvations in the future. Besides, Australia, the current chief character of the salvation

campaign, also admits that the cost of finding MH370 supposed to be more than US\$ 90 million and it exceeds their capacity. They are looking for sharing and contribution from relevant countries.

## **2. Sovereignty issues:**

In salvation, country shall provide all means to rescue and support vessels, airplane of other countries to pursuing the salvation. Among them, if not use their own resources to search, country must allow other countries 'vehicles to conduct searching in their territory. This issue, somehow, might affect adversely to the sovereignty right of country.

## **3. International relationship issues:**

As the positioning in salvation mostly related to maritime territory, it is not only influent the sovereignty of country but also the international relationship between countries. For example, MH370 *de facto* puts Vietnam in a dilemma situation. Vietnam and China has been long time engaged in territorial dispute over the Paracel Island on South China Sea or East Sea (as Vietnamese called). In the latest action, China deploys a rig named HD981 within the maritime territory of Vietnam<sup>11</sup>. Thus, Vietnam, at one hand, as international cooperation, has to bear expenses to support in searching for MH370, where majority of passengers are Chinese, or allow China entering its maritime territory to conduct the searching, at the other hand, Vietnam has to use all means to claim its sovereignty on the maritime territory where China deploying the rig. This dilemma might only be resolved with the interference of international voices.

# **IV. CALL FOR NEW INTERNATIONAL INSTRUMENT:**

## **1. The irrelevance of existing international instruments:**

At present, there is no uniform global liability regime<sup>12</sup> for damages caused by GNSS in place under any international convention<sup>13</sup>. There is also no legal requirement for other countries or companies to contribute towards the cost of the search and rescue effort. To date, only Article 25 of Chicago Convention<sup>14</sup> stipulates that parties to the treaty must collaborate on "coordinated measures" in the search for missing aircraft, but is silent on the allocation of costs. Other conventions in aviation like The 1963 Tokyo Convention, the 1970 Hague Convention, the 1971 Montreal Convention provide only limited use in determining burden sharing in the context of MH370.

In theory, it is rational for states such as Australia look to other states (Malaysia most obviously) or entities (manufacturers, for example) for contributions to the cost of the massive search and rescue effort. However, while international agreements are silent regarding either who conducts or bears the cost of international search and rescue in circumstances like those of MH370, state parties will for the moment bear their own costs.

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<sup>11</sup> See also Why did china set up an oil-rig within Vietnamese waters, available at <http://thediplomat.com/2014/05/why-did-china-set-up-an-oil-rig-within-vietnamese-waters/>; Vietnam protests China's illegal operation of drilling rig in Vietnamese waters, available at <http://tuoitrenews.vn/politics/19443/vietnam-protests-china-for-illegally-operating-drilling-rig-in-vietnams-waters>

<sup>12</sup> The current international convention in effect like Outer Space Treaty and Liability Convention 1972 have no provisions on the issue.

<sup>13</sup> Magnus Ulrich, "Civil liability for Satellite-based services", *Uniform Law review*, 2008

<sup>14</sup> Convention on International Civil Aviation 1944, to date it has 191 states signed on, and it sets out principles and arrangements such that international civil aviation can "be developed [and proceed] in a safe and orderly manner"



## ***2. Approaching by Unidroit methods:***

In its preliminary instrument, Unidroit proposes three possible approaches to deal with third party liability due to GNSS malfunction<sup>15</sup>. Three possible approaches have been identified by the proponents of the project: strict approach, middle ground approach and broad approach.

It seems clearly that when the third parties are countries, domestic law has no authority in the situation. Therefore, it is not feasible to apply such approach. A contractual approach accompanied by a framework agreement containing some uniform rules, including rules on liability somehow might be efficient. However, in the context of salvation, there is no time for parties as countries to sit and reach an agreement. The last measure, broad approach, which considers that a universal liability system or convention should be worked out; therefore it is the most desirable in this case.

## ***3. Proposal for Features of the New Instrument:***

Taken into account the potential liabilities might arise regarding third party States due to GNSS malfunction, the new instrument is expected to feature the following issues:

- providing clear and reasonable financial regime for states participating in the salvation under the instruction of GNSS positioning signal. It is recommended that the financial regime should be a shared contribution among those involving in the salvation like host states, GNSS service provider and third party states who conduct the salvation.
- providing specific provisions on liabilities for GNSS service providers in case of entering other states' territory. As this issues is very sensitive and might seriously affect the sovereignty right of states, the instrument should establish a regime to guarantee the sovereignty right of states for avoidance of misuse of satellite services.
- providing unanimous commitment of states in using GNSS services only for proper purpose as well as providing a sanction regime imposed on those states abuses the application of GNSS services to infringe rights and interests of other states.

## **V. CONCLUSION:**

There is no dispute on the superior and widespread of GNSS application in social life. In the context that people become more and more relying on GNSS services and non-military operator (Galileo) or a similar system on a regional basis (QZSS) is expected soon, the liability for GNSS malfunction needs to be considered seriously. While conservative scholars keep arguing that the current regime, which mainly depend on domestic law, is capable to handle legal issues arising from GNSS services, the third party liabilities arising from MH370 case reflects to the contrary. It is obvious to see that domestic law is incapable in handing neither the cost of salvation campaign nor the potential liabilities. MH370 showed that only an international instrument might be able to deal with these issues completely.

Some proposals for an international convention have been made in order to meet such needs and suggest a regime of liability to be adopted. And such a regime must be based on the analysis of cases and doctrines on the liability for defective information. However, these proposals have not covered completely issues relating to third party liabilities due to GNSS malfunction. In addition, this paper refers insightfully on the situation where information provided satellite positioning. As this kind of signal is, by its nature, likely to impose various liabilities on the recipients, especially related to major interests and sovereignty of States as in

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<sup>15</sup> Supra Note at 7

case of MH370, thus, the legislator, in consideration of the instrument, must consider all relevant factors such as politician, territorial dispute, state's resources, etc. As analyzed above, a specific regime should work out to guarantee the proper right and interest of third party states.

In conclusion, this paper proposes that it is desirable to have an international instrument. The instrument, in its legislation, should take into account various right and interest of third party countries as those supposed to be imposed on relevant countries involving in the salvation campaign of MH370.

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**LEGAL POLICIES AND REGULATIONS  
GOVERNING CONTRACT FARMING IN  
VIETNAM**

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**Rome, July 2014**

## ABSTRACT

Contract farming, or the agricultural manufacture contract, has recently risen to high concentration for the development of agriculture in most countries of the world. This stems from the potential benefits that may result from professional contractual practices in agricultural manufacture and the interests which may be generated much faster than in other business. In Vietnam, agricultural business has developed very fast recently and there are many gaps between the economy's development and the legal terms regulating the area.

This research is made with a purpose to provide basic knowledge and understanding of the writer about contract farming in general, why contract farming is needed and how it is developing in Vietnam. The research also goes in-depth to the legal policies and regulations regarding the contract farming in Vietnam in order to show both the positive and negative sides of those regulations, evaluate their successes and failures and provide some recommendations for a better application of contract farming in Vietnam.

This research may be helpful for the comprehensive understanding of contract farming in Vietnam as well as its legal regulations, by analyzing the current situation in an emerging market economy such as Vietnam which has recently become a topic of consideration for international researchers.

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## **I. GENERAL UNDERSTANDING ABOUT CONTRACT FARMING**

### **1.1 What is contract farming?**

Producing and selling on a contractual basis is a common arrangement in agriculture all around the world. Contract farming (CF) has existed for a long time, particularly for perishable agricultural products delivered to the processing industry, such as milk for the dairy industry or fruits and vegetables for making preserves.<sup>1</sup> By the end of the 20th century, CF has become more popular in the agricultural and food industries of both the developed and developing countries and continues to gain importance as a mechanism for governing transactions in agri-food supply chains, and additionally as a tool to promote the access of smallholder farmers to markets.

In general, CF can be defined as an agricultural manufacture system carried out according to an agreement between a buyer and farmers, which establishes conditions for the manufacture and marketing of a farm product or products.<sup>2</sup> More specifically in an economic approach, the term “contract farming” has been described as referring to “a particular form of supply chain governance adopted by firms to secure access to agricultural products, raw materials and supplies meeting desired quality, quantity, location and timing specifications”.<sup>3</sup> The specifications may cover provisions regarding manufacture technology, price discovery, risk sharing and other product and transaction attributes.

Under legal approach, CF presents a particular contractual relationship between the farmer (producer) and another party (buyer or contractor) in which the producer undertakes to produce and deliver designated agricultural commodities, while the contractor undertakes to acquire the produce at a predetermined price, and (may) provide a certain degree of manufacture support, mainly through the supply of inputs and the provision of technical advice.<sup>4</sup>

### **1.2 Why contract farming is needed?**

While sharecropping contracts between tenants and landowners have been a feature of agricultural economies for millennia (such as in ancient Greece and China),<sup>5</sup> contracts between firms and farmers with tenure over their own land appears to be an innovation of the last 100 years or so. Since then, CF has expanded to become a significant and expanding form of agricultural organization. Rehber suggests that it accounts for around 15% of agricultural output in developed countries.<sup>6</sup>

In Southeast and South Asia, CF has also increased rapidly in recent decades.<sup>7</sup> For example, since 1956 the Indonesian government has promoted contract farming through the Federal Land Development Agency (FELDA) with a considerable success.<sup>8</sup> In Malaysia, CF is also

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<sup>1</sup> Little and Watts (1994) provide a historical overview of contract farming in the USA, in Latin America and particularly in Sub-Saharan Africa. The authors discuss economic, social and political aspects of CF.

<sup>2</sup> The Food and Agriculture Organization of the United Nations, Guiding principles for responsible contract farming operations, Contract Farming Resource Center, Rome (2008).

<sup>3</sup> Da Silva, The growing role of contract farming in agri-food Systems development: drivers, theory and practice, Agricultural Management, Marketing and Finance Service FAO, Rome (2005).

<sup>4</sup> UNIDROIT 2013 – Study 80A – Doc. 3 – *Draft Introduction*.

<sup>5</sup> Eaton and Shepherd, 2001.

<sup>6</sup> Erkan Rehber, *Contract Farming: Theory and Practice*, 2007.

<sup>7</sup> Swinnen and Maertens, 2007.

<sup>8</sup> Ibid.

widespread, mainly based on state-promoted out-grower arrangements.<sup>9</sup> In Vietnam, over 90% of cotton and fresh milk, and over 40% of rice and tea comes from CF (UNCTAD, 2009).<sup>10</sup>

Generally, small farmers in developing countries often face a number of constraints that limit their productivity.<sup>11</sup> First, they have insufficient information about manufacture methods and market opportunities, particularly for new crops and varieties. Second, even with sufficient information about profitable investments, small farmers often lack the necessary financial reserves to be able to exploit those opportunities. Additionally access to credit is often limited by a lack of collateral. Third, small farmers operating near subsistence are understandably more risk averse than larger farmers. They generally prefer to assure themselves a minimum supply of food before expanding to a commercial manufacture in an uncertain market. CF is seen as a solution to the problems of information, credit, and market risk that small farmers face in commercial manufacture. They see CF as facilitating the integration of small farmers into commercial agriculture, leading to income growth and poverty reduction. On the other hand, CF can also be seen as a way for large firms to take advantage of the land and poverty of small farmers, effectively paying them less than a minimum wage and “taking control” of their farms. The integration of small farmers into commercial agriculture can therefore also be seen as a negative trend, leading to higher risk, indebtedness, and income inequality for the farmers.<sup>12</sup>

### **1.3 The important role of contract farming in Vietnam**

With three quarters of the population of Vietnam, and 90 per cent of the poor, living on agriculture in the rural areas by growing and selling, agriculture plays an indispensable role even if the structure of the economy is changing toward industrialization. In Vietnam 90% of cotton and fresh milk, 50% of tea and 40% of rice are purchased through contracts. Hence, CF is considered as a measure to foster better linkages in agriculture, in particular between the farmers, the scientists, the government and the agribusiness. The Government has formally recognized the CF and has been actively encouraging the use of it with the issuance of the *Decision 80/2002/QĐ-TTĐ* on 24 June 2002. The purpose of this decision is to encourage the selling of agricultural commodities through contracts. This decision has then been modified and supplemented by the *Decision 62/2013/QĐ-TTĐ* on 25 October 2013 regarding the development of cooperation, the link between the manufacture and the marketing of agricultural products, and constructing large fields. This is considered as the most important regulation relating to contract farming in Vietnam.

The growing importance of the CF for the agri-food industries of developing countries has created a demand for better insights in the advantages and disadvantages of CF for both the farmers and the contractors, as well as in the conditions under which CF works both efficient and fair. The purpose of this paper is to review the empirical literature and legal regulations on CF in Vietnam, focusing on the effects on smallholder farmers.

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<sup>9</sup> Morrison et al., 2006.

<sup>10</sup> Singh (2002), cited in Rehber (2007), reports that the Thai experience with contract farming has been mixed and that despite active promotion and mediation by government many contract farming initiatives have failed.

<sup>11</sup> A “small farmer” is defined as one who relies primarily on family labor with modest or only occasional use of hired labor. In many developing countries, this definition would correspond to farms of less than three to five hectares.

<sup>12</sup> Little and Watts 1994; Singh 2002 – Improving Farm to market linkages through Contract Farming.

## **II. LEGAL POLICIES AND REGULATIONS GOVERNING CONTRACT FARMING IN VIETNAM**

Within domestic legal orders, the norms governing agricultural manufacture contracts may be found in civil codes, general contract legislation, specific agricultural contract legislation and product-specific legislation.<sup>13</sup> Under the Vietnamese legislation, regulations regarding contract farming can be found in Civil Code, Trade Law and some specific regulations.

### **2.1 Civil Code 2005**

In Vietnam, whose legal system originates from French law, the Civil Code is considered a reference for the general contracts as well as the agricultural manufacture contracts, particularly the provisions related to types of contracts and contractual obligations. Regulations governing such contractual obligations are prescribed in Part III: Civil Obligations and Civil Contracts of the Civil Code. There are general provisions in Chapter XVII (Article 280 to Article 427) which stipulate the entry, performance and termination of contract while Chapter XVIII (Article 428 to Article 593) describes the common contracts in Vietnamese practices.

### **2.2 Trade Law 2005**

The Law on Trade of 2005 covers the commercial activities of the traders with a set of principles and stipulates specifically the regulations related to the purchase and sale of goods. Chapter II includes the general provisions, forms of contracts, the rights and obligations of the parties to contracts for purchase and sale of goods, and the purchase and sale of goods through the goods exchange. The 29 articles from the Article 34 to the Article 62, defines the most important rights and obligations of the parties in the sale of goods. These include articles on delivery, quantity and quality of goods, remedies in case of goods in insufficient quantity or inappropriate quality, transfer of ownership over goods, intellectual property right, warranty, pricing, payment, receipt, and pass of risks in the transactions. These provisions creates a legal framework for the producers and contractors who enter into a contract, which may apply to some types of contract farming situations, even if the producers are not considered as traders in accordance with the Trade Law. However, as the Trade Law requires only at least one party to the transaction to be a trader, and the role of the contractor fulfills that requirement, those provisions of the Trade Law are applicable.

### **2.3 Decision 80/2002/QĐ-TTĐ and its application in Vietnam**

On 24 June 2002, Decision No.80/2002/QĐ-CP (Decision 80) was issued by the Prime Minister on policies to promote contracting between agribusinesses and agricultural producers within Viet Nam. It consists of ten articles that mainly regulate the forms, entry to and the performance of the sale contract of farm produce, policies of the government to encourage the contractors to enter into the farm product sale contract with the producers, remedies in events of default, and responsibilities of local governments as well as concerned ministries and associations. This decision aims to promote agricultural transformation from subsistence to a commercialized and export-oriented agriculture. It was directly binding to parties who have entered into the contract and was often known as a four-party contract, and

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<sup>13</sup> Uniform Law Review 2012-1/2, Caterina Pultrone, An overview of contract farming: Legal issues and challenges, p. 267 (2012).



it has attempted to increase the use of contracts to improve procurement and efficiency, and to promote technological innovation in the rural economy.<sup>14</sup>

It is recognized that the Decision 80 has provided incentives to trigger the participation of farmers and enterprises to the contracts as well as the establishment of cooperatives and farmer groups for contract farming. It was one of the few explicit government attempts anywhere in the world to improve contractual links specifically in the agricultural sector. Following are some of the key elements of this Decision:

*2.3.1 Subjects of the Decision:* enterprises of all economic sectors signing contracts on sales of agriculture products with producers/sellers (cooperatives, farmer's households, farm owner, farmer household's representatives).

The contracts, after being signed, shall serve as the legal basis for the responsibilities and obligations of the parties, protecting the rights and legal interests of the raw materials producers and the manufacture, business, processing and exporting enterprises under the contractual provisions.

*2.3.2 Forms of contract between an enterprise and a producer:* the contract must ensure the contents and forms as prescribed by law, falling into these forms:

- Prepayment of capital, materials, technical and technological supports by buyer, and the purchase of the agriculture products from a farmer;
- Selling materials and purchasing agriculture products;
- Direct marketing of agriculture products;
- Cooperation of manufacture: The farmers' households may use their Land Use Right<sup>15</sup> for capital contribution, joint venture, cooperate with enterprises or sublease land to enterprises, and after that the farmers may carry out the manufacture on such land, and after that selling the agriculture products to enterprises.

*2.3.3 Incentive policies of the Government*

To encourage contract farming, the Government provides favorable conditions and offers supports. Priority is given to farmers and enterprises making contracts in the fields of land, investment, credit, transfer of technical and technological advances, markets, and trade promotion.

*2.3.4 Requirements of the contract*

The follow-up Decision 77/2002/QĐ-BNN of Ministry of Agriculture on guiding the Contract on sales of agriculture products form under Decision 80/2002/QĐ-TTĐ (dated 28 August 2002) detailed requirements for the contract contents and forms:

- There are contents that must be prescribed in the Contract. First the basis for making contract and necessary information of parties of the Contract. Second, there must be an agreement on the quantity of product, quality standards, product specification, measure, timing, place of delivering, and receiving product. Third, conditions for parties (if any) to build the cooperation. Fourth, payment method. Fifth, a way to resolve extraordinary events on the process of implementing the contract. Sixth, responsibilities in implementing the contract. Seventh, methods for dispute settlement. Eighth, the validity of the contract. And ultimately the Decision requires valid signatures, seals of parties of contract etc.

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<sup>14</sup> Asian Development Bank, *30 Cases of Contract Farming: An Analytical Overview* (2005), p. 9.

<sup>15</sup> Private ownership of land is not permitted in Vietnam and the people hold all ownership rights with the State as the administrator. The laws of Vietnam only allow ownership of a right to use land. This right is called the Land Use Right.

- Relating to the form, it is required that the articles of the contract must be clear, closed and straightforward. The signed contract must be authenticated by the People's Committee of Commune or certified by the Notarized Office of District when implementing the contract. The signed contract must be informed to the People's Committee of Commune and to the Vietnam Farmer Union of Commune for their supervision and support.
- After the contract has been signed by the parties and been authenticated by the People's Committee of Commune or certified by the Notarized Office of District it becomes fully valid and enforceable. Any party that fails to perform as required by the contract and this failure leads to damages to the innocent party shall compensate the aggrieved party.

### 2.3.5 *Application of the Decision in Vietnam*

Decision 80, often known as a four-party contract, has attempted to increase the use of contracts to improve procurement and efficiency, and to promote technological innovation in the rural economy, as mentioned earlier in this paper. Although much was expected of the Decision 80, as it is one of the few explicit governmental attempts anywhere in the world to improve contractual links specifically in the agricultural sector, its results have been disappointing. Four major issues have arisen when implementing this Decision in Vietnam:

- The proportion of contract sale is quite low, often less than 30 percent of total output. Only for some agricultural products with high processing requirement, like sugarcane, cotton, milk, cigarette, tea, and rubber, the proportion of contract sale may reach 30 percent.<sup>16</sup>
- Reneging on contracts is quite common, including reneging by the farmers refusing to deliver the product to repay the advances on inputs and the credit provided by the processors. Especially in 2010, according to Ms. Dao Thi Ha, Agriculture Department of Hai Phong province, many cases of unilateral breaches of contract happened in the province, bringing negative effects to the manufacture and business activities of enterprises. There are "output" contracts between farmers and contractors, but in fact, around 5-10% of farmers breached the contract unilaterally by intentionally not selling agricultural products to enterprises. This causes the enterprises to not have enough products to provide for their customers and forces them to purchase from other sellers, which is more expensive. The reason behind is simple: normally the market price is higher than the price that the farmer gets from the contract. Besides, there are no specific and clear provisions or sanctions to bind parties into the contracts. Not only the farmers but also the enterprises may breach the contract. This could happen in the event of a good harvest for example. The products become very cheap and can be easily bought from many purchasers, and the enterprises just choose the best deal for them without caring about the contracts.
- Contract farming is more likely to favor only large-scale farmers in highly commercialized regions like the Southeast and the Mekong Delta.
- The supporting provisions are not specific and are unclear. For the farmers, most of them do not even know what are the governmental supports or how to receive it.

It is generally agreed that the contracts that dates under the Decision 80 have largely been unsuccessful. It is probably necessary to make some substantial changes both in policy and its application.

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<sup>16</sup> Kim Son, Nguyen Minh Tien et al. 2005: 9

## **2.4 New Decision 62/2013/QĐ-TTĐ**

Recently, a great number of enterprises have been changing their business direction to agriculture manufacture. The reason is that investing in the agriculture takes only several months to get interest. This is a much shorter time than for example in the real estate or hydroelectricity, where it can take years to get back the original capital. Hence, it is attractive enough for the enterprises to change their investment direction. Simultaneously, legal policies should be updated to catch up with the development of agriculture manufacture market.

Therefore, on 25 October 2013, the Prime Minister has issued the Decision 62/2013/QĐ-TTĐ on the policy encouraging development of the co-operation and the linkage between the manufacture and the marketing of agricultural products and the construction of large field. This Decision replaces the Decision No. 80/2002/QĐ-TTĐ from 2002. With ten articles, the new Decision provides various kinds of support to the linkage between farmer and contractor, including sanctions in case there is a breach of contract.

Different from the Decision 80, the Decision No. 62/2013-QĐ-TTĐ clearly prescribed a number of preferential and support policies of the State, aiming to encourage the manufacture coordination between the processing and marketing of agricultural products, which belongs to the large field projects that are being planned and are approved by competent authorities. Following are some of the key elements of this Decision:

### *2.4.1 Subjects of the Decision*

Enterprises, representative organizations of farmers, farmers having a contract on cooperation, associations of manufacture linked with the processing and marketing of agricultural products, and having a construction of large field project are subjects of this Decision.

Large field project is a manufacture arrangement measure based on cooperation and association between farmers, companies and the representative organizations of farmers in the linkage of manufacture, process and sales of agricultural products in the same area, with a large scale of land field. The purpose of this project is to make concentrated and high quality products and to increase the competitive capacity of agricultural products in the market.

### *2.4.2 Forms of contract between an enterprise and a producer*

There are four types of forms of contract in the Decision:

- Cooperation between marketing enterprises. In this form the enterprise provides input materials with representative organizations of farmers or with a farmer;
- Cooperation of manufacture between an enterprise and a farmer;
- Cooperation of manufacture between enterprises and representative organizations of farmers;
- Cooperation of manufacture between representative organizations of farmers and farmers.

There are standard forms of above-mentioned contracts which are stated in the Annex 1 of the Decision.

### *2.4.3 Incentive policies of Government*

#### *a. For enterprise:*

- The enterprises shall be allowed to use land free from rent, if the enterprises are being granted land or subleased land by the Government for the implementation of construction projects. These projects include processing factories, storehouses, accommodations for workers, and public houses, which serves for large field projects.
- The enterprises shall be granted priority for participating in the implementation of exporting contracts on agriculture products or in temporary storage of agriculture product programs of the government.

- The enterprises shall be supported a part of the expenditures of the enterprises in conducting plans, renovating fields, completing transportation systems, irrigation, electrical system serving for agricultural manufacture in large field projects.
- The enterprises shall be supported a maximum of 50% of the expenditure on training and technical guidance for the farmers under contract.
- b. For representative organizations of farmers:
  - The representative organizations shall be allowed to use land free of rent if the organization is granted land or subleased land by the government for the implementation of construction projects (dry, process, storage) serving for a large field project.
  - The representative organizations shall be granted priority for participating in the implementation of exporting contracts on agriculture products or temporary storage of agriculture product programs of the government.
  - The representative organizations shall be supported a part of actual expenditures on pesticide, labor-working, and machine renting.
  - The representative organizations shall be supported 50% of the training expenditure for a staff of co-operative or a conjugate co-operative
  - The representative organizations shall be supported 100% of the training and technical guidance expenditures for farmers under contract.
- c. For farmer:
  - Farmers shall be trained and guided on techniques related to manufacture and free market information of products joining large field.
  - Farmers shall be supported for the expenditure of crop plants variety for the first crop in large field projects.
  - Farmers shall be supported 100% of the storage expenditure in enterprises with maximum duration of 3 months.

#### 2.4.4 *Breach of contract*

- Party that fails to implement the contract shall be liable under the present laws and regulations.
- If the enterprises, farmers or the representative organizations of farmers who are receiving support from the government are found in a breach of contract without a reasonable reason, their governmental supports shall be revoked and they shall have no right to receive support for the next year.

#### 2.4.5 *Standard form of contract*

Beside Decision 62, the Ministry of Agriculture also issued a *Circular 15/2014/TT-BNNPTNT* on 29 April 2014 offering an interpretation and guidance on a number of articles of the Decision 62, and providing a standard form of contract on cooperation of manufacture and marketing of agricultural products (detailed in annex I below). The form includes general contents of contract, such as: information of parties; details of contents (period of manufacture, area, expected output, place, quantity, quality, etc.); time, place of delivery; price and payment method; obligation of parties; dispute settlement; etc. It is the standard form of contract, so that all of the agricultural manufacture contract must include all the contents stated in the form. It is an essential way to protect rights of parties and ensure the good faith of the trade.

Since the Decision has only been effective for a couple of months, it is still too early to say whether it is successful or not. But so far, with the development of agriculture manufacture market, this new Decision is one of the Government's efforts to fill the gaps in the legal

system, minimize the risks of the parties and to encourage the cooperation between buyer/enterprise and the producer/farmer.

#### *2.4.6 Roles and impacts of government*

Generally speaking, the government plays a role of support, guidance, supervision and examination regarding the projects. Details are as the following:

- Ministry of Agriculture and Rural Development:
  - To issue the policies and regulations relating to the large field project.
  - To guide the project arrangement.
  - To examine, supervise and summarize periodical work and report to the Prime Minister.
- Ministry of Industry and Trade: Support participating companies in order to intensify the sales of agricultural products from large field projects.
- The People's Committee of province, city under the central government:
  - To appraise and approve the project according to its competence.
  - To give the specified supports based on current policies and financial capacity.
- To direct the specialized agencies, the political – social organizations and professional associations to guide and consult the legal aspects such as the process, procedure of signing contract, termination of contract, dispute settlement, etc. for the farmers and the co-operative.
- Department of Agriculture and Rural Development
  - To advise the People's Committee in issuing the criteria of scale, area and other criteria, and the specific supports relating to the large field projects.
  - To act as a counselor or advisor of the People's Committee in the settlement of disputes, breaches of contract; to consider, decide or propose to competent authorities to revoke the supports, preferences of government in case of breaches and disputes of contracts.

#### *2.4.7 The differences – improvements between Decision 62/2013 and Decision 80/2002*

Comparing the Decision 80 with the Decision 62 includes a number of changes and improvements which can be specified as follows:

- The new decision clearly specifies the obligations of parties in the manufacture cooperation, in which a farmer, a representative organization of farmers and an enterprise are the main subjects of manufacture cooperation and marketing process of agricultural products. The Government role is to make a framework, providing assistant policies for parties, and examining and supervising the process.
- The capital sources for conducting assistant policies are also specified clearly under the new Decision. The Chairman of the People's Committee of province, city under central government shall have the right to use the local budget, supportive sources from programs, projects of central government and other lawful capital sources, to decide the detailed assistance to the beneficiaries.
- The assistant policies and their conditions to receive assistance from the Government are explicitly prescribed in the new Decision. Farmers, representative organizations of the farmers and the enterprises know which requirements they have to meet in order to receive support from the Government.
- Settlement mechanism for a breach of contract is also clearly regulated in the new Decision. It is a very important provision since in fact, many contracts are breached by either the farmers or the enterprises without any specific remedy.

### III. RECOMMENDATIONS

From the author's perspective, there are some key elements that have a significant effect on the success of the contract farming in Vietnam:

- The clear and close relationship between the parties to a contract shall lead to a successful contract. This relationship shows cooperative relation and preferential conditions under contract. Contractual relation should be a cooperative relation between parties, not a competitive relation, or benefit only one party. The essential key is good faith between the enterprise and the farmer; they both should understand that the interest of one party always closely connects with the interest of the other party. Parties should give their partner some special preferences in order to maintain and encourage the development of contractual relationship in the future. Payment price and negotiation conditions must be attractive for both the buyer and the seller. Alternatively they should share the ownership and interest, then both parties shall contribute to their own business.
- It will be more effective if the farmers sign the contract through a representative organization rather than by themselves. In fact, it is quite impossible for a company to sign contracts with thousands of farmers. Therefore, signing the contract through social cooperatives or associations shall be a better choice for the farmers. It reduces the management and transaction fees and saves time for the enterprises. In addition, joining an association also brings favorable conditions for the farmers, since such associations usually have clear regulations, and may become the intermediary party to protect farmers' rights. And normally, the association may have some kinds of *risk prevention funds* to ensure the income of the farmers in a case of market fluctuation or an act of God, or when the farmers have a bad harvest. In Vietnam, there is a number of official and unofficial communities such as farmer groups, public associations, etc. However, the organization which has the highest legal entity and possibility to sign contract is a social co-operative.
- The contract should also match the parties' conditions. The contract between an organization and a farmer should be as clear and simple as possible, since the farmers normally do not have much legal knowledge.
- Furthermore, it is better if there is a re-negotiation provision included in the contract. Even if the legislation does not provide for this option, the parties may re-negotiate in some specific period such as before the validation of the contract, two weeks before harvesting, or right when harvesting. Such provision would make the contract more flexible and minimize the likelihood of breaches. The contract should include more preferential provisions (price, payment) to attract parties. In some cases, provision may regulate a flexible price, such as market price plus preferential percentages, which will encourage the providers to keep their commitments.

#### **IV. CONCLUSION**

This research includes some of the discussion of legal regulations in agricultural manufacture contracts in Vietnamese legislation such as the Civil Code, the Trade Law, the Decision 80/2002, the Decision 62/2013, and some other provisions. Although it is still too early to say if the new Decision 62/2013 and its following documents will be successful or not, at least they have showed that the agricultural manufacture contracts are becoming more and more important and are taken into account by the Vietnamese Government. At the moment, the Government is trying hard to effectively implement the Decision 62 and the Circular 15/2014 guiding this Decision into practice, in order to provide the best benefits for parties to a contract. With the fast development of the agricultural field, it is worth to expect many successful cases of contract farming in Vietnam in the near future.

**ANNEX I**

**FORM OF CONTRACT ON COOPERATION OF MANUFACTURE AND  
MARKETING OF AGRICULTURAL PRODUCTS**

**THE SOCIALIST REPUBLIC OF VIETNAM**

Independence – Freedom – Happiness

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**CONTRACT ON COOPERATION OF MANUFACTURE AND MARKETING  
OF.....**

*No.: ...../ 20/ HDSXTT*

Pursuant to:

- Civil Code 2005
- .....

Today, on ....., at....., we are:

**PARTY A: COMPANY/ REPRESENTATIVE ORGANIZATION OF FARMER  
.....**

Address: .....

Tel: ..... Fax.....

Tax Code: .....

Account No.: .....

By Mr/Ms.: .....

Position: ..... is a representative.

**PARTY B: REPRESENTATIVE ORGANIZATION OF FARMER/  
FARMER.....**

By Mr/ Ms: ..... Position: ..... is a representative.

ID No.: ..... Date of issue..... Place of issue: .....

Address: .....

Tel: .....

Account No.: .....

After negotiation, two parties agreed to sign the contract as followed:



## Article 1. Main contents

1. Party B agrees Contract on manufacture and sale (marketing) ..... to party A:
  - Time of manufacture: from ..... to .....
  - Area: ..... ha
  - Expected output: ..... Tons
  - Place: .....
2. Party A will sell (pay immediately or debit) to party B seeds, materials serving for manufacture as detailed:

Name of product	Manufactured area	Quantity (tons)	Unit price (Vietnamese dong/tons)	Price (Vietnamese dong)
1.				
2.				
Total				

3. If party B buys (seeds or materials) by himself: .....: ..... (seeds or materials) which party B buys by himself must be falling in type of: ..... meet the requirement, quality of seeds ....., certified by a competent authority.
4. Party B will sell ..... products to party A:
  - Quantity: .....
  - With the specification, quality, measure of examination, evaluation of products' quality ..... (product's name) agreed by the two parties in Article 3 hereinafter and within actual quantity when harvesting.

## Article 2. Time, place of delivery and load of product

1. Time of delivery
2. Place of delivery, receipt of product
3. Load, transport, exchange of product

## Article 3. Price and measure of payment, place of delivery

1. Seeds and agricultural materials (apply when party A debit to party B)
  - Price of materials, fertilizer, charge of labour.
  - Method of payment.
  - Time of payment.
2. Products
  - Standard: (requirement which product must meet)
  - Expected price:
  - Measure and time of payment:
3. Place of delivery
  - Specify place to which party B will deliver agricultural products to party A.

#### **Article 4. Obligations of party A**

- To recommend a company providing agricultural materials (fertilizer, pesticide, food) to party B if required by party B.
- To ensure to provide seed with exact quantity and quality, type, specification and period which undertook (in case party A debit to party B seeds for manufacture)
- To ensure purchase products with exact specification – quality which is committed and the actual quantity.
- To cooperate with party B to organize means of purchase which is suitable for cropping time of party B and exchange plan of party A.
- To provide packing of ..... to party B (if required) after agreement of the two parties.
- .....

#### **Article 5. Obligations of party B**

- Party B must comply with the cultivate specifications as required by party A and in accordance with the agricultural field's advices.
- To deliver, sell products in appropriate with specification of virtue, quality (as actual crop), with time, place of delivery as agreed by parties.
- To provide party A with information of cultivate process, time of harvest, place of exchange, etc.
- To make a list of farmers participating in large field project.
- .....

#### **Article 6. Settlement on breach of contract**

1. In case party A breaches contract

If party A fails to implement contract without a reasonable reason, party A shall be responsible to compensate contract of party A to party B.

2. In case party B breaches contract

If party B fails to implement contract without a reasonable reason, party B shall be responsible to compensate contract of party B to party A.

#### **Article 7. General provisions**

1. In case there are any problems arising out of the contract, parties are responsible to handle them together.
2. Parties undertake to seriously carry out the Contract, if any changes happened during the implementation process, parties shall negotiate and the Contract shall be supplemented by document or annex. If there is any breach which cannot be settled by negotiation, then parties can bring case to the court.  
The Contract shall be made into..... copies, each party keep ..... copies which have the same validity.

**REPRESENTATIVE OF PARTY B**

**REPRESENTATIVE OF PARTY A**

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UNIDROIT 2013 – Study 80A – Doc. 3 – *Draft Introduction*.

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**REPORT AT END OF PERIOD OF RESEARCH BETWEEN FEBRUARY 3, 2014  
AND MARCH 07, 2014 (Working Paper enclosed)**

**The impact of foreign (institutional) investments on domestic retail participation in the  
capital markets in India**

**Name and Details of Researcher:** Vanya Singh, B.A. LL.B. (Hons.), India

**Professional background of Researcher:** Graduated from the National University of Juridical Sciences, India, with an integrated B.A. LL. B. (Hons.) degree in 2007, and has been working with the Securities and Exchange Board of India since then. Currently working with the Office of the Whole-Time Member.

**Name and Position of Research Supervisor:** Ms. Sujata Roy, Assistant Professor, Business and Corporate Laws, National University of Juridical Sciences, India.

**Description of Research Project**

- **Specific interest of the researcher in the subject** As a lawyer employed with the capital markets regulator in India my work has included drafting of regulations pertaining to disclosures required to be made in public issues in the Indian capital markets, defence of regulatory orders in Tribunals and courts, rendering of legal advice on interpretation of unfair trade practices, takeovers, and other securities law. It has often been on my mind how the Indian capital markets often experience considerable fluctuations in the quantum of foreign institutional participation in the stock markets, which is often directly related to rise and fall in the stock price indices. When viewed in the context of recent policy emphasis on channelling more of household savings into the securities markets, the prospects for retail investment and how it is affected by foreign institutional investment assume significance. India's regulatory authorities have been coming out with measures to protect and encourage retail investment and monitor foreign institutional investment. It remains to be seen whether these measures will have the desired impact.
- **General Scheme of the paper and Keywords**
  - Introduction
  - The Objective of Securities Regulation
  - Institutionalisation of the markets and its implications for retail investors
  - Meaning and definition of foreign institutional investment
  - FII behaviour and role in the capital markets - why they buy and sell, what they take into account, their risk and investment period profiles, role in risk distribution, volatility, liquidity, participation in corporate governance

- Definition, behaviour and role of retail investors in the capital markets - increasing liquidity, source of capital for companies, stable ownership base for corporations, overall importance for macroeconomic reasons – savings and growth rate of economy, to counterbalance impact of FIIs on Indian stock market; noise trading has been observed which affects stock price volatility, less risk-taking, help in price setting by bringing valuable information to the markets (Alicia Davis), how concerned are retail investors with corporate governance
- Withdrawal of retail investors from Indian securities market - analysis – including effect of FII on retail investors, especially in the Indian context – applicability of investor credulity theory - Retail investors do march to their own drummer when investing in the securities market in India. (However, they are not immune to the impact of FII inflow and outflow on the indices. Also, retail investors are known to react based on credulity, herding and noise trading.) Evidence of wariness of retail investors in the Indian equity markets has been observed in 2013-14. In fact, retail investors have been net sellers in the equity markets despite FIIs bringing in several billion dollars into the Indian equity markets. Therefore, evidence suggests that retail investors may be withdrawing from the equity markets due to a general lack of faith in corporate performance and corporate governance, and due to availability of less risky investment alternatives. FII investment does not *per se* appear to have any negative impact on retail investment in the equity markets.
- Indian securities law – how does it protect retail investors from any negative effects of FII? How can securities law encourage retail investment into the securities market? Legal measures for incentivising and protecting retail investors - Recommendations

#### **Essential Points of Law (detailed in paper) – Legal Measures for incentivising and protecting retail investors**

- **Legal controls over FII** - How Indian securities law tries to control FII – lock-in requirements to contain volatility, overall investment ceilings to contain excessive exposure to foreign institutional investors' world-economy dictated investment strategies
- **FIIs, retail investors and corporate governance** - Need to encourage FIIs to have a bigger stake in corporate governance, so that retail investors can benefit, and the cost of their engaging actively in corporate governance is reduced. The free rider problem needs to be addressed by providing regulatory incentives for collective action by all shareholders including institutional and minority shareholders. Regulators also need to consider whether FIIs have access to more information about the company by virtue of their size. The new corporate governance and insider trading laws in India are intended and designed to improve confidence of investors in corporations,

which should help retail investors feel more confident about investing in the capital markets.

- **FIIIs to not be permitted to be controllers of investee companies, only “watchers”** - According to Moshe Pinto, whose research is discussed in the paper, FIIIs should not be allowed to control the investee since institutions often need oversight themselves)
- **Cross-border trading and risk optimisation for retail investors** - Cross-border trading could reduce overall risk of trading for retail investors, so adequate conflict of law rules should be evolved so that cross-border trading is incentivised. With reference to the UNIDROIT Principles and Rules Capable of Enhancing Trading in Securities in emerging Markets, as far as conflict of law issues are concerned, there is an attempt in the current securities regulation framework in India to reconcile these issues by accounting for and making allowances for the securities laws of other countries, when registering or allowing foreign investors to operate in India. Eg:- Protected Cell Structure in FIIIs which was recently allowed by SEBI. This deference to/recognition of the laws of other countries where the FII is incorporated/registered/regulated may be read in congruence with the principle of enforcement of mandatory laws of another state, to avoid contradictions between mandatory rules of different states, as recognised by Schuster, G., “*Securities transactions on or off-exchange*”, in THE LAW OF CROSS-BORDER SECURITIES TRANSACTIONS, Ed. Van Houtte, Hans, Sweet and Maxwell, London, 1999 at page 87. Further, as stated by Garcimartin Alferez F. J. in CROSS-BORDER LISTED COMPANIES, Recueil des Cours, Martinus Nijhoff Publishers, 2007 at page 27, “*from the point of view of the investor, buying foreign securities also offers some advantages, such as reducing the “home-country specific risks”. In principle, the acquisition of equity from issuers of different countries diversifies the portfolio of investments, and reduces the risks associated with a particular country.*” Capital account convertibility for Indian investors may also be a concern with respect to cross-border trading by Indian investors abroad who might want to try to diversify their portfolios or minimise risk.
- **Enforcement of securities laws** - Better enforcement of existing securities laws dealing with anti-fraud, disclosures and regulation of market participants will generate more confidence in the capital markets amongst retail investors. Class action in the U.S. has helped in better enforcement of law and hence contributed to the perception that investor confidence in the securities markets in the U.S. is higher than in ‘light touch’ regulation areas like Europe.
- **Protection of retail investors through a disclosure-based securities laws regime** – It is required to ask ourselves the question - is a

disclosure-based regime adequate to ensure retail investor protection? Although information asymmetry is what ultimately enables trading and arbitrage, diversity and depth requirements of the securities markets require that adequate material disclosures be made by companies, especially so that retail investors are completely informed prior to taking a decision regarding investment into a company. There is evidence to show that individual investors are prone to various biases when reading information, and that therefore disclosure may not be a panacea to all the problems besetting regulators when dealing when trying to protect retail investors. However, the alternative of excessive regulatory intervention is also prone to problems of self-serving interests and bias, and therefore imperfect. In the light of this, it has been recommended that complete material disclosure is a bare minimum necessary prerequisite for efficient markets.

### **Practical applications of the research**

- The new corporate governance and insider trading legal regime being crystallised in India (both finalised in February 2014) is aimed primarily at the protection of genuine investors through provision of a level playing field and prevention of market malpractices or abuse. The researcher intends to make suggestions to India's capital markets regulator regarding consideration of the legal issues arising in the light of the literature pertaining to behavioural economics etc. affecting investment by retail investors. Systematic regulatory impact assessments for quasi-legislative measures enacted by the regulatory bodies are necessary to ensure that the objective of protection of retail investors is achieved by regulators without compromising market efficiency.
- In association with Professor Sujata Roy, research supervisor for this paper, the researcher proposes inputs on the law of regulation, and particularly, case studies on the effectiveness of retail investor protection-oriented laws, in the Securities Laws Module being taught at the W.B. National University of Juridical Sciences, India.

### **Advantages obtained by the researcher through research at the UNIDROIT**

Access to extensive reading material on corporate governance, international securities regulation and cross-border securities transactions/conflict of laws issues. Excellent interaction with fellow researchers, extremely supportive officers and staff at UNIDROIT who go out of their way to ensure that researchers are able to function in an atmosphere conducive for research.

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## 1. Introduction

- 1.1 The issues discussed in the course of this paper arise from recent policy emphasis on incentivising domestic retail individual investors for channelling greater proportions of household savings into the securities market in India. Regulatory bodies posit that this will serve to increase market liquidity, depth and efficiency. At the same time, the regulatory regime for foreign investment into the securities market in India has been progressively liberalised over the years, beginning with the early 1990s. This has exposed the Indian securities market, and particularly, retail investors (who are, at least *prima facie*, not as sophisticated or capable of dealing with risk as institutional or foreign institutional investors, as will also be seen in the course of this paper), to the effects – positive and negative – of what appear to be substantial foreign investment inflows and outflows, often at short intervals.
- 1.2 Retail investors constitute an important part of the capital markets. Many regulatory bodies in several jurisdictions were formed with the express objective of protecting the interests of retail investors and ensuring a free and transparent capital market regime for trading and discovery of value for all investors, especially the retail investors which were more vulnerable to non-disclosures and information asymmetries than sophisticated institutional investors.<sup>1</sup> Since one of the primary concerns of regulators of capital markets is to ensure that retail individual investors and small investors do not get dominated by, lose out to, or get negatively affected by dominant players like foreign institutional investors in the stock markets, it is worth analysing whether foreign institutional investment affects retail investment in the domestic capital markets. It has also been noted that securities regulation serves different purposes with respect to institutional and retail investors (Burke, 2009)<sup>2</sup>. The former require regulation “to ensure adequate capital reserves, to protect against fraud, and to prevent systemic failure of the financial system”. The latter require protection “to ensure that markets provide a level playing field, to assure that market prices are not manipulated, but set by material information about listed companies, and to provide effective remedies against breach of market rules. Investor protection legislation is designed to induce investors to take risks.”
- 1.3 The objective of this paper is to identify the relationship, if any, between foreign institutional investment and retail individual investment, especially in the Indian context, and then to see whether some of the laws intended to protect retail investors are doing what they set out to do. The differences between the investment behaviour of FIIs and RIIs are drawn out. It appears that retail investors are more risk-averse, prone to errors of judgement, and less thoroughly informed about fundamentals of the securities they invest in, than foreign institutional investors.

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<sup>1</sup> Some scholars have, however, argued that retail investors can never match up to the skills of institutional investors, and therefore, even if disclosures are made more transparent, retail investors are bound to lose out to institutional investors. Therefore, it has been suggested non-professional investors are best protected by investing in index funds or investment grade bonds - See Burke, John J.A., “*Re-examining Investor Protection in Europe and the U.S.*”, Murdoch University Electronic Journal of Law, Volume 16, No. 2, 2009 available at <https://elaw.murdoch.edu.au/index.php/elawmurdoch/article/viewFile/38/13>).

<sup>2</sup> Ibid.

## 2. The Objective of Securities Regulation

- 2.1 We try to examine whether there is a need for regulators to treat retail and foreign institutional investors differently when it comes to the Indian capital markets. Some papers (Burke, 2009) suggest that the regulatory approach followed by regulators the world over for protection of retail investors through information symmetry and creation of a level playing field are largely ineffective. Good enforcement is probably the better way to ensure that market malpractices are discouraged and retail investors are protected.
- 2.2 On the other hand, other research also suggests that regulation to ensure disclosure and to enforce anti-fraud and malpractice in the securities market ensures that retail investors feel protected and therefore feel freer to invest in the securities market.
- 2.3 Reference may also be made to the works of Lynn A. Stout (2000)<sup>3</sup> and that of Burke (2009), which make the argument that investor behaviour can be explained by two models – the rational investor model and the trusting investor model. Information is key for the rational investor, while faith in the sincerity of market insiders and outsiders who advise them are important for the trusting investor. Burke suggests that most retail investors are trusting investors, but that once they burn their fingers or if their trust is belied, they do not return to the markets. The securities markets have such a high information cost that rational investors would be discouraged, and that therefore only trusting investors appear to take the risk of investing in the securities markets. It is also reasonably well-documented that retail investors always need to be given stronger incentives to invest in the securities market, because they are more risk-averse than institutional investors.
- 2.4 Overall, reduced volatility and increased liquidity are understood to be good for the financial markets. Both excess volatility and lack of liquidity produce uncertainty in the securities markets.<sup>4</sup> Therefore, regulatory intervention to protect retail investors would also include attempts to reduce volatility and increase liquidity in the markets.
- 2.5 Retail investor protection is also inextricably tied up with rights of minority shareholders and better corporate governance, especially if investment horizons of retail investors are to be encouraged to be made longer<sup>5</sup>. Investor protection needs to be considered at two levels – at the stage of entry into the securities markets through the primary or secondary market, and at the stage when an investor becomes a shareholder.

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<sup>3</sup> See Stout, Lynn A., in “*The Investor Confidence Game*”, Brooklyn Law Review, Vol. 68, 2000 at page 407, cited in Burke’s article, available at <https://elaw.murdoch.edu.au/index.php/elawmurdoch/article/viewFile/38/13>

<sup>4</sup> [Liquidity and volatility are also said to be related (Persaud)]

<sup>5</sup> This is because returns from the market have been seen to be better over a longer term, and this could be particularly true for retail investors who in all likelihood lack the resources to undertake well-informed short-term buy and sell transactions in the market. It is also worth examining whether the existing short investment horizons have to do with lack of confidence in the corporate governance environment today. It is also useful to refer here to the work of Alicia J. Davis (2009) where she states that investment horizons are more important than the institutional or individual status of an investor when it comes to involvement and interest in corporate governance of the investee companies.

2.6 Scholars<sup>6</sup> have suggested that financial instruments used by retail investors be strictly regulated, and those used by professional investors be lightly regulated, to ensure diversity in markets and limit herding and contagion effects.

2.7 There is a need to determine the utility of securities laws which seek to incentivise retail investors. It is observed that the current regulatory regime for protection of retail investors is moving towards reduction of excess volatility and risk, but India has a long way to go yet in this direction.

### **3. Institutionalisation of the markets and its implications for retail investors**

**3.1** Scholars have observed that worldwide, the securities markets have moved towards institutionalisation – with institutions enjoying a progressively higher share of the marketplace than retail investors. Some news reports<sup>7</sup> had suggested that while around a decade ago in 2003 the share of retail investor participation as a percentage of the total turnover of the markets in India was as high as 84%, the retail participation in India's bourses came down to 34%, a ten-year low. According to the International Finance Corporation, 60 % of estimated equities investment is held by international institutional investors.<sup>8</sup>

**3.2** On the other hand, Foreign Institutional Investors ("FIIs") have gradually developed into a dominant player in the Indian securities market since 1992 when they were first allowed to invest in the market. FIIs have been permitted to invest in all types of securities, including government securities, and can freely repatriate the proceeds from the sale of their investments. Taken together they can invest in a company under the portfolio investment route up to 24 per cent of the paid-up capital of the company. This can be increased up to the sectoral cap/statutory ceiling, as applicable, provided this has the approval of the Indian company's Board of Directors and also its general body. All FIIs are required to register with SEBI. As on March 2010, the total number of registered FIIs in India was 1,713 with a net cumulative investment of US\$ 89.34 billion.<sup>9</sup>

**3.3** SEBI FII data<sup>10</sup> provides FII Investment Details which show that in the last ten years between 2003 and 2013, net FII investment has been negative only in the year 2008 (on account of the global financial crisis). However, FII investments do fluctuate considerably from one year to the next. For example, in the year 2011 net FII investment in debt and equity was approx. Rs. 39352 cr., while in 2012 it increased to Rs. 163350 cr. In 2013, net FII investment was approx. Rs. 62288 cr.

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<sup>6</sup> Persaud, Avinash, *Liquidity Back Holes*, available at [http://institutional.union-investment.de/docme/risikomanagement/risikomanagementordner/d6cd60b38c1315551ba57cadefefa27a.0.0/1.5\\_Liquidity\\_black\\_holes.pdf](http://institutional.union-investment.de/docme/risikomanagement/risikomanagementordner/d6cd60b38c1315551ba57cadefefa27a.0.0/1.5_Liquidity_black_holes.pdf)

<sup>7</sup> See Nandi, Suresh, "*End of the Affair for Retail Investors*", The Deccan Herald, February 24, 2014, also available at <http://www.deccanherald.com/content/368159/end-affair-retail-investors.html>.

<sup>8</sup> "*The State of Sustainable Investment in Key Emerging Markets*", Synthesis Report of the International Finance Corporation, May 2011, available at [http://www.ifc.org/wps/wcm/connect/f0dd0c8048855cd88cfcde6a6515bb18/IFC\\_Brief\\_DoingSL.pdf?MOD=AJPERES&CACHEID=f0dd0c8048855cd88cfcde6a6515bb18](http://www.ifc.org/wps/wcm/connect/f0dd0c8048855cd88cfcde6a6515bb18/IFC_Brief_DoingSL.pdf?MOD=AJPERES&CACHEID=f0dd0c8048855cd88cfcde6a6515bb18)

<sup>9</sup> See the SEBI-NCAER Report of July 2011.

<sup>10</sup> Available at <http://www.sebi.gov.in/sebiweb/investment/statistics.jsp?s=fii>

**3.4** It has been suggested that institutional investment helps guide the market towards prices based on more information about fundamentals, decreases harmful information asymmetries<sup>11</sup>, and improves liquidity of shares etc. and is in a better position to monitor corporate governance practices of investee companies. However, the impact of foreign institutional investment on retail investment into the securities market remains to be seen.

#### **4. Definition of Institutional Investor**

- 4.1 According to the “OECD Report on the Role of Institutional Investors in Promoting Good Corporate Governance, 2011”,<sup>12</sup> “(i)nstitutional investors are financial institutions that accept funds from third parties for investment in their own name but on such parties’ behalf. They include pension funds, mutual funds and insurance companies.”
- 4.2 Investment by SEBI registered Foreign Institutional Investors (“FIIs”) is regulated under SEBI (FII) Regulations, 1995 and Regulation 5(2) of Foreign Exchange Management (Transfer or Issue of Security by a Person Resident outside India) Regulations, 2000 issued by the RBI vide Notification No. FEMA 20/2000-RB dated May 3, 2000<sup>13</sup>, as amended from time to time. FIIs are defined in the Foreign Portfolio Investor Regulations, 2014, cross-referring to the FII Regulations, 1995. The FII Regulations in turn defines an FII in reg. 2 (f) as “an institution established or incorporated outside India which proposes to make investment in India in securities”. The FII Regulations also refer to a pre-requisite that FIIs should have been granted permission by the RBI under the provisions of the Foreign Exchange Regulation Act, 1973 (“FERA”) to invest in India as FII. Although the FERA does not say anything about the permission granted by RBI for investment as FII, regulation 29 (1)(b) of the FERA does stipulate, *inter alia*, that a company incorporated outside India shall not purchase shares of an Indian company without special or general permission of the RBI.
- 4.3 FIIs include Asset Management Companies, Pension Funds, Mutual Funds, and Investment Trusts as Nominee Companies, Incorporated / Institutional Portfolio Managers or their Power of Attorney holders, University Funds, Endowment Foundations, Charitable Trusts and Charitable Societies. SEBI acts as the nodal point in the registration of FIIs. The Reserve Bank of India has granted general permission to

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<sup>11</sup> See [https://lirias.kuleuven.be/bitstream/123456789/85623/1/TEM\\_4-07\\_HUYGHEBAERT.pdf](https://lirias.kuleuven.be/bitstream/123456789/85623/1/TEM_4-07_HUYGHEBAERT.pdf)

<sup>12</sup> Available at <<http://www.oecd.org/daf/ca/49081553.pdf>>

<sup>13</sup> Regulation 5 of the Foreign Exchange Management (Transfer or Issue of Security by a Person Resident outside India) Regulations, 2000 deals with “Permission for purchase of shares by certain persons resident outside India :-

(1) A person resident outside India (other than a citizen of Bangladesh or Pakistan or Sri Lanka) or an entity outside India, whether incorporated or not, (other than an entity in Bangladesh or Pakistan) , may purchase shares or convertible debentures of an Indian company under Foreign Direct Investment Scheme, subject to the terms and conditions specified in Schedule 1.

(2) A registered Foreign Institutional Investor (FII) may purchase shares or convertible debentures of an Indian company under the Portfolio Investment Scheme, subject to the terms and conditions specified in Schedule 2.

(4) A non-resident Indian or an overseas corporate body or a registered FII may purchase securities, other than shares or convertible debentures of an Indian company, subject to the terms and conditions specified in Schedule 5.

SEBI registered FIIs to invest in India under the Portfolio Investment Scheme (“PIS”). Investment by a SEBI registered FII and its sub-accounts cannot exceed 10 per cent of the paid up capital of the Indian company. However, in case of foreign corporates or High Net-worth Individuals (HNIs) registered as sub accounts of an FII, their investment shall be restricted to 5 per cent of the paid up capital of the Indian company. All FIIs and their sub-accounts taken together cannot acquire more than 24 per cent of the paid up capital of an Indian Company. This cap of 24% for portfolio investments by foreign investors can be raised by the investee Indian company to the sectoral cap for FDI<sup>14</sup>, by passing a BoD Resolution followed by a Special Resolution by the General Body of the company. FIIs can purchase Government securities, Treasury Bills and corporate debt in India too, with certain conditions/restrictions like requirements of minimum remaining maturity period at the time of buying debt.

## **5. FII Investment behaviour and Role in the Capital Markets**

5.1 A study of the investment behaviour of FIIs needs to take into account that FIIs often buy or sell securities on account of liquidity requirements.<sup>15</sup> It has also been shown (Paul Stanworth, 2008), for example, that U.K.’s main institutional investors – banks, pension schemes and life insurance schemes – value the liquidity of their assets and liabilities differently depending on various factors. Importantly, liquidity needs of institutional investors are often more than those of retail investors<sup>16</sup>. This might also explain the investment behaviour of institutional investors as being different from that of retail investors.

5.2 There is also evidence to suggest that FIIs encourage diversity and thus, liquidity in the equity markets. The liquidity of financial markets itself is said to be encouraged by diversity of investment behaviour (Avinash Persaud)<sup>17</sup>. Herding behaviour<sup>18</sup> in

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<sup>14</sup> It may be noted that foreign investment in an Indian company is Foreign Direct Investment (“FDI”) if made in equity shares, fully and mandatorily convertible preference shares, and fully and mandatorily convertible debentures, with the price or formula for calculating price decided upfront. Any foreign investment which gives an option to the investor to convert into equity, or does not involve upfront pricing of the instrument, is not FDI but External Commercial Borrowings (“ECB”), and has to comply with the ECB Guidelines of the Reserve Bank of India. Further, as per RBI rules, there are some sectors in which FDI is prohibited (eg: in sectors like atomic energy or gambling) or restricted with several conditions.

<sup>15</sup> See Stanworth, Paul et al., “*Working Paper: How Valuable is Liquidity?*”, May 2008, available at <<http://www.actuaries.org.uk/system/files/documents/pdf/liquidityworkingparty.pdf>>

<sup>16</sup> See IOSCO Report on “Development and Regulation of Institutional Investors in Emerging Markets” of June 2012 which states that due to the specific investment guidelines they must comply with, institutional investors typically have much higher diversification and liquidity requirements than retail investors.

<sup>17</sup> See Persaud, Avinash, *Liquidity Back Holes*, available at [http://institutional.union-investment.de/docme/risikomanagement/risikomanagementordner/d6cd60b38c1315551ba57cadedefa27a.0.0/1.5\\_Liquidity\\_black\\_holes.pdf](http://institutional.union-investment.de/docme/risikomanagement/risikomanagementordner/d6cd60b38c1315551ba57cadedefa27a.0.0/1.5_Liquidity_black_holes.pdf). Persaud also states that “in popular commentary on the equity market, liquidity conditions often refer to new demand for equities coming from the flow of savings from investors”. He also states that “most measures of liquidity in the stock markets focus on the size of the bid-ask spreads quoted by market-makers on electronic brokerage systems”. Persaud also discusses data to show that not mere illiquidity, but variable illiquidity (which is less when a person invests, and increases when a person is trying to exit the market) is what investors in general are worried about. Persaud also makes an interesting point about how liquidity increases and then may gradually decrease with free markets and more players entering the markets, and with a few efficient, dominant players staying, reducing diversity as well as liquidity. This can serve as a pointer for policy-makers, who should therefore try to ensure that diversity of the markets is not compromised

banks has been seen to increase volatility and market risk, as discussed by Persaud.<sup>19</sup> Persaud also suggests that regulators can treat short-term risk and long-term risk differently when creating risk-management models.

5.3 It has also been observed that worldwide, over a period of time, certain kinds of institutional investors (i.e. non-banking investors) have increased. Further, “dedicated” investors have declined relative to “crossover” investors resulting in increased volatility but also diversity in the securities markets.<sup>20</sup>

5.4 It has been suggested that FIIs investing in India are essentially “asset allocators who are looking for the benefits of international diversification. They are not stock pickers or market timers”. This is aided by the fact that FIIs enjoy complete capital account convertibility (Adil Rustomjee)<sup>21</sup>.

5.5 Then there is the question regarding whether FII investments help in better risk-distribution. An IOSCO Report on “Development and Regulation of Institutional Investors in Emerging Markets” of June 2012,<sup>22</sup> states that “markets with large numbers of institutional investors tend to be less volatile and allocate resources and capital more efficiently to companies requiring funding”. In this context we may also refer to IMF’s Global Financial Stability Report, Chapter IV, 2004<sup>23</sup> which mentions that “Institutional investors provide smaller individual investors with a means of pooling risk, thus providing diversification and enhanced risk-return opportunities for end investors”. The IMF Report also states that institutional investors also have a superior capacity to absorb and process information (something akin to economies of scale) and they can conduct large volumes of transactions, lowering the cost of intermediation and thus benefiting investors and issuers alike. Institutional investors also have greater capacity for long-term investments (Researchers like Avinash Persaud have suggested that regulators should let hedge funds play the role of diversifiers in the securities market by taking alternative positions to the rest of the

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by dominant FIIs over a period of time. Retail participation should be incentivised to maintain market diversity and depth.

<sup>18</sup> Daniel, Hirshliefer and Teoh state that herding is the tendency to follow the prevailing consensus, and this tendency is not stronger when the consensus proves to be correct than when it is wrong (also, Welch, 2000).

<sup>19</sup> The researcher has not come across any specific evidence to show that herding behaviour is more pronounced in institutions than retail individual investors. It would seem that retail investors can also engage in noise-trading and herding which can have significant impact on prices, and push them away from fundamentals, though it is not possible to tell whether the herding behaviour of retail investors is random or planned. In this regard, reference may also be made to the work of Burghardt, Matthias, Retail Investor Sentiment and Behaviour: An Empirical Analysis, Springer, 2011.

<sup>20</sup> See IMF’s Global Financial Stability Report, Chapter IV, 2004 available at <<https://www.imf.org/external/pubs/ft/gfsr/2004/01/pdf/chp4.pdf>>

<sup>21</sup> See Rustomjee, Adil, The Dilemma of being an FII in India, February 3, 2014, available at <http://www.firstbiz.com/money/the-dilemma-of-being-an-fii-in-india-only-entry-no-exits-47731.html/2>.

Rustomjee also suggests that there aren’t enough retail investors to counteract any selloff by FIIs. Therefore, he suggests that FIIs cannot sell, because that will bring the market down on themselves. See also Asthana, Shishir, Are FIIs trapped in the Indian market?, Business Standard, July 9, 2013.- suggesting the same thing as Rustomjee, and available at [http://www.business-standard.com/article/markets/opinion-are-fiis-trapped-in-the-indian-market-113070900123\\_1.html](http://www.business-standard.com/article/markets/opinion-are-fiis-trapped-in-the-indian-market-113070900123_1.html). The fact that portfolio investments spread risk for foreign investors, and supplement foreign exchange reserves and domestic savings of the country receiving such investment, was recognised early on in research by Chalapati Rao, K.S., Ranganathan, K.V.K., and Murthy, M.R., “*Foreign Institutional Investments and the Indian Stock Market*”, Journal of Indian School of Political Economy, Vol. XI, No. 4, October-December 1999, also available at <http://isidev.nic.in/pdf/wp9906.pdf>.

<sup>22</sup> Available at [http://awareness.sca.ae/Arabic/IntReports/Report\\_2012\\_08.pdf](http://awareness.sca.ae/Arabic/IntReports/Report_2012_08.pdf)

<sup>23</sup> Available at <https://www.imf.org/external/pubs/ft/gfsr/2004/01/pdf/chp4.pdf>

market, over a longer-term). Foreign institutional investment through portfolio investments in various countries further helps diversify risk. However, the IOSCO Report also notes the possibility of institutional investment leading to volatility in the securities markets.<sup>24</sup>

### **Do FIIs play a constructive role in corporate governance?**

- 5.6 Transparent and smoothly functioning systems of corporate governance are necessary to incentivise investment (including retail investment) and generate confidence in the capital markets. However, the OECD Report on the Role of Institutional Investors in Promoting Good Corporate Governance, 2011<sup>25</sup> finds that not all FIIs are active participants in the corporate governance systems of the investee companies. The reasons provided are that most institutional investors are not remunerated on the basis of the performance of the portfolio companies, but on the basis of the volume of assets under management, and further, fund performances are reviewed on the basis of performance vis-à-vis a benchmark index, therefore diminishing the incentives for institutional investors to play an active role in corporate governance of companies in their portfolio. At the same time, the OECD Report also finds that institutional investors mostly are locked into the shareholding of most large investee companies because of their diversification and indexing needs – so in-principle they have incentives to play a more active part in corporate governance of the investee companies.
- 5.7 Further, the OECD Report also highlights the free rider problem with the institutional investors who monitor corporate governance incurring all the costs while the benefits are shared with all. Therefore, it has been suggested that arrangements need to be made to promote collective action by shareholders for monitoring corporate governance. Regulatory control over institutional investors should include permission to jointly monitor corporate management except where required to comply with takeover law or prevention of market abuse law. The Report also mentions the U.K. Stewardship Code and United Nations Principles of Responsible Investment, introducing the concept of stewardship, akin to that of shareholder responsibility.<sup>26</sup> This is supposed to go beyond the problems of short-termism in investment - as merely being invested in a company over a longer time period does not guarantee that the investor will make efforts to monitor corporate governance. The OECD Principles of Corporate Governance, 2004, especially Principles II.F and II.G cover aspects like disclosure of voting policies, managing conflicts of interest and co-operation between investors.

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<sup>24</sup> In this regard, it is also useful to note the IMF Report, 2004, on “*Institutional Investors in Emerging Markets*” at page 127, with respect to the behaviour of hedge funds in emerging markets. It has been observed that hedge do not often observe in herding or positive feedback trading behaviour, and tend to take more well-informed decisions about investments in the stock markets. There is a possibility of their being “imitated” by other investors, though.

<sup>25</sup> Available at <<http://www.oecd.org/daf/ca/49081553.pdf>>

<sup>26</sup> In this context, may also see the U.K. Stewardship Code of September 2012, created by the Financial Reporting Council, which sets out principles for effective stewardship by investors, and also assists institutional investors to better exercise their stewardship responsibilities, available at <https://www.frc.org.uk/getattachment/e2db042e-120b-4e4e-bdc7-d540923533a6/UK-Stewardship-Code-September-2012.aspx>

- 5.8 As a slight departure from the general cynicism over the role of large foreign institutional investors in corporate governance, the work of Chang Dong Park (2010)<sup>27</sup> should also be referred to as a refreshingly optimistic picture of institutional investor participation in corporate governance of Korean companies. It mentions that institutional investors in Korea, especially investment trust companies, started showing strong interest in corporate governance since the late 1990s. It has been proposed by Park that this is also because foreign investors increased their investment in Korean companies with clear sights on corporate governance, in line with the global trend of increasing ‘shareholder activism’. Park also provides examples of involvement of institutional investors in corporate governance – proposing candidates for outside directors, establishing shareholder advisory committees for advising the management, asking to remove managers for cause etc.
- 5.9 A UNIDROIT Colloquium<sup>28</sup> on Corporate Governance and Shareholders’ Rights in Emerging Markets, also, *inter alia*, specifically discussed the ICGN Statement of Principles for Institutional Investor Responsibilities (2013)<sup>29</sup> and the various ways in which institutional investors and retail investors can collaborate for engaging with the management of investee companies.
- 5.10 The role of institutional investors in corporate governance in an era of large corporations where shareholder passivity is more viable or convenient, has been discussed at length in works of scholars including Moshe Pinto<sup>30</sup>. Pinto makes a case for laws facilitating joint shareholder action (not directed at control) for better institutional oversight. Conferring control is to be avoided because institutions might try to control their company for interests specifically beneficial to them. Corporate managers and small shareholders can in turn keep watch on any excesses of the institutional investors. It has even been seen that institutional efforts have had a substantial impact on board structure – having a majority of independent directors on the board of a company and having an independent nominating committee – have been the result of institutional efforts. Interestingly, Pinto also points out that because institutional investors are often portfolio investors which invest in several companies industry-wise, they might be more sensitive to regulatory compliance and other issues affecting the industry, which to one single company might appear to be an externality.
- 5.11 In India, a recent example of shareholder activism has been observed in the case of opposition to the proposal by Maruti Suzuki India Limited to convert its Gujarat plant into a wholly-owned subsidiary of Suzuki, which in turn would manufacture and sell cars to Maruti.<sup>31</sup> This has raised corporate governance issues of related party transactions, apart from raising serious doubts about Maruti’s premium.

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<sup>27</sup> See also Park, Chang Dong, *Institutional Investors in Corporate Governance of Korea*, The Asian Business Lawyer, 2010, Vol. 5, p. 66.

<sup>28</sup> Held in association with the International Corporate Governance Network on November 11, 2013, Istanbul, Turkey, and presented by Dr. Melsa Ararat.

<sup>29</sup> Available at <http://www.unidroit.org/english/documents/2013/study78b/cem-03/presentations/session-03/ararat-corporate.pdf>.

<sup>30</sup> See Pinto, Moshe, “*The Role of Institutional Investors in Corporate Governance*”, available at [http://www.emle.org/data/Moshe\\_Pinto\\_-The\\_Role\\_of\\_institutional\\_Investors\\_in\\_the\\_Corporate\\_Governance.pdf](http://www.emle.org/data/Moshe_Pinto_-The_Role_of_institutional_Investors_in_the_Corporate_Governance.pdf).

<sup>31</sup> See Deoras, Neha Pandey, “*Minority Shareholders Find their Voice, Finally*”, Business Standard, March 5, 2014, available at [http://wap.business-standard.com/article/companies/minority-shareholders-find-their-voice-finally-114030301245\\_1.html](http://wap.business-standard.com/article/companies/minority-shareholders-find-their-voice-finally-114030301245_1.html).



Therefore, seven leading MF houses including HDFC MF, Reliance MF, UTI, DSP Blackrock, Axis, SBI MF and ICICI Prudential wrote a strongly worded seven page letter to the management of Maruti Suzuki. Studies by proxy advisory firms in India have shown that institutional investors generally tend not to raise awkward questions at board meetings, and they typically abstain from voting on routine resolutions. The situation is better abroad, where institutional investors are more active. Eg:-Walmart Mexico bribery case, institutional investors demanded the resignation of Walmart U.S. CEO. In India, however, mostly minority (including institutional) shareholders protest by dumping stock of the company, which does not help the company or the retail investors. This is because when stocks are dumped for perceived corporate governance issues, few companies remain for investors to put money into, leading to high volatility, increase price-to-earnings ratios, risk. Therefore, it is better for shareholders to engage with the company rather than dump stock when in disagreement with the corporate management. SEBI is now considering creating a platform for non-controlling shareholders.

5.12 The Companies Act 2013 and the proposed amended Clause 49 of the Listing Agreement also suggest changes like –

- (i) mandatory representation in the board for minority investors,
- (ii) provision for class-action suits to allow shareholders to seek damages from the company and its directors for any fraudulent act. Shareholders can also seek damages from auditors for mis-statement of facts.
- (iii) Exit option to shareholders who do not agree, in case company wants to use remaining funds raised from IPO for purposes other than those for which the funds were raised.

5.13 With regard to corporate governance, it will also be interesting see whether foreign institutional investors actually help improve corporate governance of investee companies, in which case, retail investors would also be drawn back into the markets. This would be an interesting scenario where foreign institutional investment would actually encourage retail investment as well, ensuring diversity and depth of the securities markets. As mentioned later in the course of this paper, retail investors have been withdrawing from the equity markets mostly because of a decline of trust in “corporate India”. Better corporate governance is a good way of regaining lost retail investment in the equity markets. Thus, it is proposed that encouraging FIIs, domestic institutional investors and retail investors to collaborate and engage with managements of investee companies on corporate governance issues is a potent policy tool in the hands of regulators, for protecting and encouraging retail investment.

5.14 **FIIs and the impact on Indian equity markets** Effect of FIIs on Indian stock markets has been discussed by S.V. Adithya Vidyasagar in his paper on the subject<sup>32</sup>, especially on the subject of comparison with FDI. Some studies have found that FIIs impact stock market returns, and that the nature of inflow and outflow of funds by FIIs is volatile. It has also been found that FIIs devise their trading strategy based on their previous investment as well as market return. Herding and momentum trading

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<sup>32</sup> Available at [http://www.indialawjournal.com/volume3/issue\\_3/article\\_by\\_s\\_v\\_adithya.html](http://www.indialawjournal.com/volume3/issue_3/article_by_s_v_adithya.html)

has also been detected in the trading pattern of FIIs in the Indian stock market between January 2000 and December 2009.<sup>33</sup>

## 6. Retail Investors

### 6.1 Definition

For the purpose of this paper, retail investors are understood in the manner defined in regulation 2 (1) (ze) of the Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2009, which defines “retail individual investor” to mean an investor who applies or bids for specified securities for a value of not more than two lakh rupees”. Therefore, essentially, small retail investors are the focus of examination in this paper.

### 6.2 Retail Investor behaviour and Role in the Capital Markets

**6.2.1 Primary markets** Some studies<sup>34</sup> have shown that retail investors often exit directly after an initial public offer (“IPO”) in an attempt to make capital gains (which contradicts the perception that retail individual investors tend to stay invested in the securities they buy, while foreign institutional investors buy and sell short-term and thus cause stock price volatility), and their shares end up in the hands of foreign institutional investors. This has caused scholars like Chalapati and Ranganathan to raise questions regarding the usefulness of reservations made for retail individual investors during IPOs. For example, between March 2004 to 2005, the share of Indian retail investors declined in about 72% of listed companies with market capitalisation of at least Rs. 500 crores. IPOs have also declined over the last few years.

Another reason why retail investors appear to be withdrawing from the IPO market is that financial savings of households in India have also declined over a period of time, which should concern macroeconomic policy analysts. Savings and capital formation data – particularly data showing that financial savings by the household sector in India have declined over the period between 2004-05 and 2012-13 (from 10.1% to 7.1% of the GDP at current prices) – is available at [http://www.epw.in/system/files/pdf/2014\\_49/7/Saving\\_and\\_Capital\\_Formation.pdf](http://www.epw.in/system/files/pdf/2014_49/7/Saving_and_Capital_Formation.pdf).

The Report of the National Council of Applied Economic Research (sponsored by the Securities and Exchange Board of India), July 2011, on “How Households Save and Invest”,<sup>35</sup> indicates the following:-

1. The rate of participation of households in the securities markets in India is very low.
2. Degree of risk aversion amongst households is high. 54% of households treat commercial banks and insurance schemes as their primary choice for savings. Only 21.25 % of households prefer to invest in secondary markets.

<sup>33</sup> See Thiripalraju, M. and Acharya, Rajesh, “*Dynamic Interaction between Institutional Investment and Stock returns in India: A Case of FIIs and MFs*”, available at [http://www.utiicm.com/Research/PDFs/dynamic\\_interaction\\_sr8.pdf](http://www.utiicm.com/Research/PDFs/dynamic_interaction_sr8.pdf).

<sup>34</sup> See Rao, K.S. Chalapati and Ranganathan, K.V.K., “*Indian Stock Market: Some Issues*”, available at <http://isidev.nic.in/pdf/WP0503.pdf>.

<sup>35</sup> Available at -[http://www.sebi.gov.in/cms/sebi\\_data/attachdocs/1326345117894.pdf](http://www.sebi.gov.in/cms/sebi_data/attachdocs/1326345117894.pdf).

3. A majority (53%) of the surveyed investing households fall in the least risk taker category.
4. Risk-taking ability of households is also affected by degree of information asymmetry in the market, extent of market regulation, household budget constraints, age, sex, marital status, dependency, macroeconomic factors like inflation. Risk aversion is less amongst more educated persons.
5. Substantial proportions of investors feel that the prices of IPOs may not be transparent, or that SEBI's role in preventing unexplained volatility in share prices is not clear. 39% of households wanted SEBI to take some action about the availability of information regarding investment choices.
6. The role of SEBI and MCA in delisting non-performing forms was not known to most investors. (This indicates that retail investors are not aware of the role of the regulatory bodies in ensuring a protected and relatively safe investing environment).
7. The survey identifies information asymmetry and poor quality of information as the source of retardation of the in the rate of participation by Indian households in the market. A significant majority depend on advice given by intermediaries and friends while participating in the secondary market or while investing in mutual funds.
8. Availability of information, good market regulation affect the risk taking ability of household investors.
9. Household savings when pumped into the securities markets can create liquidity and dynamism in the markets.
10. The time horizon of investments by households, and preferences for speculation and liquidity have a similar relationship with asset ownership levels. Other factors affecting the time horizon of investment of households are education levels, income, occupation etc.

**6.2.2 Secondary market** It is also observed that retail investors do not always blindly follow foreign institutional investors when deciding whether to buy or sell securities. While retail investors in India mostly invest in small and mid-cap stocks (BSE small and mid-cap indices have declined between 2012-13 by as much as 23% and 18% respectively), FIIs tend to invest in large-cap stocks which are a part of the BSE Sensex or the NSE Nifty. The movement in the indices is more affected by foreign institutional investors than retail investors.

As compared to the behaviour of foreign institutional investors, there is a possibility that retail investors indulge more in behaviour-based trading than information-based trading.<sup>36</sup> There is no specific studies which the researcher has come across to show that retail investors are more sensitive to market volatility, but Siby Joseph et al. have found that the behaviour of individual investors is irrational to a greater extent, with a high level of involvement and over-confidence, alongwith risk-aversion, and less optimism about the future outlook of the capital markets.<sup>37</sup> This could also give rise to a likelihood that retail investors probably react with more biases in judgement than foreign institutional investors.

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<sup>36</sup> See Akiko Kamesaka et al, *Investment patterns and Performance of Investor Groups in Japan*, Pacific Basin Finance Journal 11 (2003) 1-22.

<sup>37</sup> See Siby Joseph K. and Abeymon Francis, *Determinants of Retail Investors' Behaviour and its Impact on Investment Decision*, available at [http://www.academia.edu/1169465/Determinants\\_of\\_Retail\\_Investors\\_Behaviour\\_and\\_its\\_Impact\\_on\\_Investment\\_Decision](http://www.academia.edu/1169465/Determinants_of_Retail_Investors_Behaviour_and_its_Impact_on_Investment_Decision) .

Retail investor participation is believed to enhance market efficiency<sup>38</sup> – by increasing liquidity and there is reference to liquidity provided by retail investors for institutional investors as well. It is also an important source of capital for corporations, though it has been declining relative to the participation by institutional investors. Also, according to Alicia Davis, since most individual investors trade infrequently, their investments provide a relatively stable ownership base for corporations.<sup>39</sup>

According to research conducted by some academics, retail investors often behave as noise-traders, which causes volatility in the stock markets.<sup>40</sup> Alicia Davis<sup>41</sup>, however, argues that unlike common assertions, there is evidence in international markets – like the Australian equity market - to indicate that retail investors may not be noise traders after all. Alicia Davis presents some evidence to show that it is possible that trading by retail individual investors enhances market efficiency by bringing relevant private information the market, which is valuable in helping set market prices.

**6.3 Withdrawal of retail investors from the Indian securities markets? Are FIIs responsible?** Retail participation in financial instruments has been affected by a decline as the overall savings rate from a high of about 37 per cent to about 32 per cent of the GDP, and a decline in the share of household financial savings as percentage of GDP from about 12 per cent to eight per cent last year.<sup>42</sup> Retail investment in the stock markets declined by as much as 20% between 2012 and 2013 as well, despite high turnovers and benchmark indices at the BSE and NSE. Trade reports have revealed that retail investors have often sold shares even

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<sup>38</sup> See Davis, Alicia J., “*A Requiem for the Retail Investor?*”, Va. L. Rev. 95, No. 4 (2009) at 1105-29.

<sup>39</sup> This appears to contradict findings of other researchers like Kamesaka (2003) and Siby Joseph et al., who found that retail investors tend to react more sensitively to market information. This would imply that retail investors buy and sell frequently, and do not stay invested over longer periods as suggested by Alicia Davis. However, her analysis would hold true in a scenario where retail investors remain aloof or passive for certain periods of time, in order to beat short-term fluctuations and make profits over the longer term, as recommended by many investment advisors and market analysts.

<sup>40</sup> Foucault et al., *Individual Investors and Volatility*, Journal of Finance, Vol, LXVI, No..4, August 2011 (<http://www.princeton.edu/~dsraer/SRD.pdf>). Volatility has been defined by Raju, M.T. and Ghosh, Anirban, *Stock Market Volatility – An International Comparison*, SEBI Working Paper Series No. 8, April 2004 as a measure of “variability or dispersion about a central tendency...a measure of how far the current price of an asset deviates from its average past prices. (The) greater this deviation, (the) greater is the volatility. Volatility is a standard measure of financial vulnerability, and plays a “key role in assessing the risk/return trade-offs and forms an important input in asset allocation decisions”. In fact, Raju and Ghosh remark that the volatility of individual stocks may be related to the amount of institutional ownership. However, this fact requires separate data analysis and verification.

<sup>41</sup> See Davis, Alicia J., “*A Requiem for the Retail Investor?*”, Va. L. Rev. 95, No. 4 (2009) at 1105-29.

<sup>42</sup> See text of valedictory address delivered by Harun R. Khan, Deputy Governor, Reserve Bank of India at the 8th Annual National Conference on Capital Markets on the theme “Confidence Building Measures for Retail Investors” on January 9, 2013 at Mumbai available at

[http://www.rbi.org.in/scripts/BS\\_SpeechesView.aspx?Id=767](http://www.rbi.org.in/scripts/BS_SpeechesView.aspx?Id=767) . Also see PIB Press Release dated January 10, 2013 on Survey conducted by the National Council of Applied Economic Research in 2011 indicated that among all the households in India, less than 11 percent are investment households and the rest are saver households which have nil exposure to equities, derivatives, mutual funds, debentures, government bonds and corporate bonds. And only 1.3 % of the Indian population participates in the capital markets - <http://pib.nic.in/newsite/erelease.aspx?relid=91490>).

when FIIs have bought shares. Daily cash market average volumes of retail investors is also very low compared to that of the FIIs.<sup>43</sup>

Nandi (2014) has pointed out that retail investors always need to be driven to the securities market.<sup>44</sup> Also, retail investors are now looking at other assets like mutual funds, gold and insurance, because they have lost a lot of money on the stock markets during recession, and are looking for less risky investment avenues. The problem of eroding retail investor participation is not new – as L.C. Gupta pointed out in his paper in 1998<sup>45</sup>, retail investors have been withdrawing from the securities market because they are losing “confidence in corporate India”. Recent news reports have suggested that retail investor participation in the securities markets in India has been on the decline because of “lack of trust in India’s volatile markets”.

At this stage it would be useful to try to appreciate the reasons for retail investors’ behaviour, and their reactions to foreign institutional investment. One of the ways to understand this would be to look at the theory of investor credulity which has been proposed by analysts in the field of behavioural economics. Daniel, Hirshleifer and Teoh (2001)<sup>46</sup> state that limited attention and processing capacity create “investor credulity”, because investors often do not discount enough for incentives of interested parties such as firms, brokers, analysts, or other investors to manipulate available information. More particularly, they argue that investors are excessively credulous about the strategic motives of managers and other providers of information to the market, and that if so, then investor perceptions are subject to manipulation by interested parties. Excessive investor credulity is thus sought to be explained on account of limited attention/processing power, and overconfidence.<sup>47</sup>

## **7. Legal Measures for incentivising and protecting retail investors – Recommendations**

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<sup>43</sup> See Nandi, Suresh, “*End of the Affair for Retail Investors*”, The Deccan Herald, February 24, 2014, also available at <http://www.deccanherald.com/content/368159/end-affair-retail-investors.html>).

<sup>44</sup> As an example of measures taken by the Indian capital markets regulator to incentivise retail investors, it may be noted that on 3rd November 2012, the government notified a new tax saving scheme called the Rajiv Gandhi Equity Savings Scheme (“RGESS”), exclusively for first-time retail investors in the securities market. This scheme provides 50 per cent deduction of the amount invested from taxable income for that year to new investors who invest up to Rs. 50,000 and whose annual income is below Rs. 10 lakh. The operational guidelines were issued by SEBI on 6 December 2012.

<sup>45</sup> See Gupta, L.C., “*What ails the Indian capital market*”, The Economic and Political Weekly, Vol. XXXIII, No. 29-30, July 18, 1998.

<sup>46</sup> See Daniel, K. et al., “*Investor Psychology in Capital Markets – evidence and policy implications*”, Journal of Monetary Economics, Volume 49, 2002 at pages 139-209.

<sup>47</sup> Daniel, Hirshleifer and Teoh have also stated on risk-aversion that one of the reasons why arbitrage by rational traders does not completely eliminate mispricing is that when traders are risk-averse, prices reflect a weighted average of beliefs. Irrational investors arbitrage away rational prices. Limited attention and human processing capacity lead to heuristic simplification. Reasons for systematic decision errors – salience and availability effects, overconfidence, confirmatory bias, hindsight bias, fear due to risky choices, problems of self-control et al. Individuals are loss-averse, prone to naïve extrapolation with respect to future performance of stocks. Individuals measure gains and losses vis-à-vis arbitrary reference points.

In view of the preceding discussion in this paper, it is clear that retail investment is necessary to ensure diversity and depth in the securities markets. The researcher has not come across any concrete evidence that “herding behaviour” or other patterns of investment by retail investors in India contribute to excess volatility in the capital markets. Further, the researcher has not found any evidence of foreign institutional investment negatively affecting retail investor participation in the securities markets, though retail investors may be quick to react, as behaviour-based traders, to any pullout of investments by FIIs.

It appears that retail investors, though constituting a minority in terms of shareholding patterns of most listed companies in India, have a considerable stake in effective, transparent and ethical corporate governance practices, as they are risk-averse and good corporate governance systems minimise risk by generating confidence in the investment regime. It is strongly recommended that (foreign) institutional and retail investors collaborate to engage with managements and monitor corporate governance in listed companies.

Some of the legal measures recommended for retail investor protection in this context are presented below:-

- **Legal controls over FII** - Indian securities law tries to regulate FII through lock-in requirements to contain volatility and overall investment ceilings to contain excessive exposure to foreign institutional investors’ world-economy dictated investment strategies. It may also be noted that SEBI often issues circulars to determine/re-determine the limits for investment by FIIs and QFIs in the capital markets in India in specific categories and sub-categories of the former, like corporate debt.<sup>48</sup> This is done in consonance with banking law and in consultation with the RBI. SEBI Circulars have also been in tandem with RBI Circulars with respect to increase or decrease in government and corporate debt limits. For example, SEBI Circular No. CIR/IMD/FIIC/3/2013 dated February 8, 2013, dealing with Increase in FII Debt Limit for Government and Corporate Debt Category<sup>49</sup>, Restrictions like specific requirements of a certain period of “residual maturity” of the debt instruments purchased by the FIIs, and lock-in period mandates mentioned in this Circular are examples of regulatory restrictions on FII investments. There have also been various Circulars regulating reporting of Offshore Derivative Instruments issued by FIIs. Among recent circulars there is the SEBI Circular CIR/MRD/DRMNP/2/2014 on FII Position Limits in Exchange Traded Interest Rate Futures.<sup>50</sup> SEBI

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<sup>48</sup> See SEBI Circular CIR/IMD/FIIC/4/2014 – available at [http://www.sebi.gov.in/cms/sebi\\_data/attachdocs/1392383298231.pdf](http://www.sebi.gov.in/cms/sebi_data/attachdocs/1392383298231.pdf)

<sup>49</sup> Available at [http://www.sebi.gov.in/cms/sebi\\_data/attachdocs/1360334660053.pdf](http://www.sebi.gov.in/cms/sebi_data/attachdocs/1360334660053.pdf).

<sup>50</sup> Available at [http://www.sebi.gov.in/cms/sebi\\_data/attachdocs/1387453216048.pdf](http://www.sebi.gov.in/cms/sebi_data/attachdocs/1387453216048.pdf)

Circulars have also been regulating the adequate disclosure levels required from FIIs regarding aspects like their structure.<sup>51</sup>

- **FIIs, retail investors and corporate governance** – There is a definite need to encourage FIIs to have a bigger stake in corporate governance, so that retail investors can benefit, and the cost of their engaging actively in corporate governance is reduced. The free rider problem needs to be addressed by providing regulatory incentives for collective action by all shareholders including institutional and minority shareholders. Regulators also need to consider whether FIIs have access to more information about the company by virtue of their size. The new corporate governance and insider trading laws in India are intended and designed to improve confidence of investors in corporations, which should help retail investors feel more confident about investing in the capital markets.
- **FIIs to not be permitted to be controllers of investee companies, only “watchers”** - According to Moshe Pinto, whose research is discussed in the paper, FIIs should not be allowed to control the investee since institutions often need oversight themselves. In the Indian context, FIIs rarely participate in management of companies, even where their stake in the listed company is substantial. This is likely because FIIs are more in the nature of portfolio investors, which prefer to withdraw investment from companies rather than attempt to resolve day-to-day management issues of companies which they invest in. As research has revealed, contrary to popular perception, FIIs are often suited to being long-term investors, and therefore, need regulatory incentives to actively monitor or “watch” the management of the companies they invest in.
- **Cross-border trading and risk optimisation for retail investors** - Cross-border trading could reduce overall risk of trading for retail investors, so adequate conflict of law rules should be evolved so that cross-border trading is incentivised. As far as conflict of law issues are concerned, there is an attempt in the current securities regulation framework in India to reconcile these issues by accounting for and making allowances for the securities laws of other countries, when registering or allowing foreign investors to operate in India. Eg:-

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<sup>51</sup> See SEBI Circular CIR/IMD/FIIC/21/ 2013 on Declaration and Undertaking regarding Protected Cell Companies, Multi Class Share Vehicles, available at [http://www.sebi.gov.in/cms/sebi\\_data/attachdocs/1387453216048.pdf](http://www.sebi.gov.in/cms/sebi_data/attachdocs/1387453216048.pdf). See also the SEBI Circular No. CIR/MIRSD/ 07 /2013 dated September 12, 2013 on “Know Your Client Requirements for Eligible Foreign Investors” available at [http://www.sebi.gov.in/cms/sebi\\_data/attachdocs/1378989676484.pdf](http://www.sebi.gov.in/cms/sebi_data/attachdocs/1378989676484.pdf) , which laid down certain norms for the FIIs, sub-accounts and QFIs investing under the Portfolio Investment Scheme, by dividing the said foreign investors into Categories I, II and III based on risk. The intermediary has to adopt different risk-based KYC practices for the three categories.

Protected Cell Structure<sup>52</sup> in FIIs which was recently allowed by SEBI. This deference to/recognition of the laws of other countries where the FII is incorporated/registered/regulated may be read in congruence with the principle of enforcement of mandatory laws of another state, to avoid contradictions between mandatory rules of different states, as recognised by Schuster, G., “*Securities transactions on or off-exchange*”, in THE LAW OF CROSS-BORDER SECURITIES TRANSACTIONS, Ed. Van Houtte, Hans, Sweet and Maxwell, London, 1999 at page 87. Further, as stated by Garcimartin Alferez F. J. in CROSS-BORDER LISTED COMPANIES, Recueil des Cours, Martinus Nijhoff Publishers, 2007 at page 27, “*from the point of view of the investor, buying foreign securities also offers some advantages, such as reducing the “home-country specific risks”. In principle, the acquisition of equity from issuers of different countries diversifies the portfolio of investments, and reduces the risks associated with a particular country.*” Capital account convertibility for Indian investors may also be a concern with respect to cross-border trading by Indian investors abroad who might want to try to diversify their portfolios or minimise risk.

- **Enforcement of securities laws** - Better enforcement of existing securities laws dealing with anti-fraud, disclosures and regulation of market participants will generate more confidence in the capital markets amongst retail investors. Class action in the U.S. has helped in better enforcement of law and hence contributed to the perception that investor confidence in the securities markets in the U.S. is higher than in ‘light touch’ regulation areas like Europe. Thus, any measures to incentivise small and retail investors to entrust their savings into the equity markets should be accompanied with a rigorous and completely dependable system of law enforcement.
- **Protection of retail investors through a disclosure-based securities laws regime** – It is required to ask ourselves the question - is a disclosure-based regime adequate to ensure retail investor protection? The literature in this regard offers different views. Although information asymmetry is what ultimately enables trading and arbitrage, diversity and depth requirements of the securities markets require that adequate material disclosures be made by companies, especially so that retail investors are completely informed prior to taking a decision regarding investment into a company. There is evidence to show that individual investors are prone to various biases when reading information, and that therefore disclosure may not be a panacea to all the problems besetting regulators when dealing when trying to protect retail investors. However, the alternative of excessive regulatory intervention is also prone to problems of self-serving

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<sup>52</sup> See SEBI Circular CIR/IMD/FIIC/21/ 2013 on Declaration and Undertaking regarding Protected Cell Companies, Multi Class Share Vehicles, available at [http://www.sebi.gov.in/cms/sebi\\_data/attachdocs/1387453216048.pdf](http://www.sebi.gov.in/cms/sebi_data/attachdocs/1387453216048.pdf).



interests and bias, and therefore imperfect. In the light of this, it has been recommended that complete material disclosure is a bare minimum necessary prerequisite for efficient markets.

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# Research Report.

Research Scholarship developed at the International Institute for the Unification of Private Law UNIDROIT from October 20 to December 20, 2014

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Research Scholarship developed at the International Institute for the Unification of Private Law UNIDROIT from October 20 to December 20, 2014.

By Jenner Alonso Tobar Torres

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## Background

Within the program of doctorate in law of the University of Buenos Aires i'm developing the ph.d research entitled "The normative self-regulation of private actors in international trade: the case of the UNIDROIT Principles of international commercial contracts", for which it was of fundamental importance to have access to UNIDROIT library, and mainly make some interviews with the professors who have worked firsthand the subject of the UNIDROIT Principles of International Commercial Contracts.

For this reason, I applied to the scholarship program of UNIDROIT having the fortune of being selected for a two months research stay between October 20 and December 20, 2014. I arrived in Rome on October 18, 2014 and since then UNIDROIT placed at my disposal a Studio and the pocket money required for my sustenance.

## Research tools available at the Institute.

Arriving at the Institute, i found a wide variety of bibliographic tools that were quite useful during the development of the research:

- A. The extensive library bibliographical catalog, through which I had access to hundreds of books, journals, reviews, and serial publications of the highest quality in the fields of private international law, international trade law, contract law, and of course , the UNIDROIT Principles of International Commercial Contracts.
- B. Several online databases, including HeinOnline and WestLaw with great utility in my research
- C. Availability of the research team of the Institute to guide my research through discussions and exchange of ideas on personal interviews.

## Developed activities

### A. Bibliographic research

Runtime: 20 October-28 November 2014.

The main objective of the stay at the Institute was to advance the construction of a chapter of the thesis about the structure, nature, characteristics and application of the UNIDROIT Principles of International Commercial Contracts. However, because of the limited time available, I prioritized the search for relevant literature.

I checked literature about the UNIDROIT Principles of International Commercial Contracts (its origin, characteristics, nature, scope and limits), the lex mercatoria, soft law, imperative and public order rules, international contracts, and other related topics for research.

The results of the bibliographic research can be consulted in Annex 1.

## **B. Interviews with professors of the Institute**

Thanks to the kindness and courtesy of the entire team of the Institute was possible to develop several interviews and email exchanges with two experts with extensive knowledge of the UNIDROIT Principles of International Commercial Contracts, which was immensely useful to guide research . Thus, individual interviews were held with Dr. Anna Veneziano and Dr. Michael Bonell (chief of the UNIDROIT Principles working group)

These interviews helped me clarify some doubts, and to focus better the research development.

## **C. Attendance at the meetings of the working groups of the Institute.**

During my stay at the Institute, I was invited by Unidroit to participate as observer in two events undertaken as part of the projects developed by Unidroit.

From 17 to 20 November Unidroit was held the fourth meeting of the Working group on contract farming with the presence of several international delegations and important academic authorities. This meeting was a great academic and personal enrichment experience, not only for the opportunity to hear the views of prestigious academics (like the professors Marcel Fontaine, Henry D. Gabriel, Michael Bonell, just to mention a few) but also for the opportunity that I had to observe the functioning and methodology of the working group, which allowed me to understand the dynamics and the kind of discussions that develop in these working groups where soft law instruments are developed.

On 27 and 28 November took place in UNIDROIT the joint meeting of working groups for the formulation of regional procedural rules in the European framework, within the context of ALI / UNIDROIT Principles of Transnational Civil Procedure. In this meeting I also had the opportunity to participate as observer, and listen valuable exposures working groups on issues such as access to information and evidence, provisional and protective Measures, and service of documents.

## Research achievements. Report summary.

After completion the literature search, from 1 December 2014 until the end of the research stay, was started the drafting of a document which aims to become a chapter of the Ph.D. thesis. Although for obvious reasons of time was not possible to consider the full development of the doctoral research, the stay at UNIDROIT was most useful because:

- ✓ was identified and consulted wide range of relevant literature (see Annex 1).
- ✓ was identified the appropriate structure for the development of the chapters of the Ph.D. thesis about the UNIDROIT Principles of International Commercial Contracts
- ✓ was began the drafting of a chapter about to the UNIDROIT Principles of International Commercial Contracts, achieving an advance of 50% in its development

Thus, below is summarily expose the structure and contents developed during the research stay, about the UNIDROIT Principles of International Commercial Contracts.

The paper begins with a brief study of the International Institute for the Unification of Private Law UNIDROIT, identifying their origin, structure, main objectives and working methods.

Then, a development of the **context of the emergence of the UNIDROIT Principles** is done, there are performed a series of reflections on how the work of production rules have changed in recent years, showing a panorama in which within the economic law international non-state actors have generated a dynamic fully consistent and identifiable of independent production rules, whose purpose is to regulate those areas that the state as a sovereign entity has lost the ability to permeate efficiently, or simply decided not to intervene.

Consequently, from the dynamics of self- regulation directed by private actors in international trade, have generated a series of normative corpus whose production characteristics, insertion, operation and implementation go beyond the scope of so-called traditional sources. Precisely there are currently many institutions that have produced multiplicity of normative corpus, in order to achieve legal harmonization of international trade, among which is the UNCITRAL, ICC, OAS, UNIDROIT, the Hague Conference, among other<sup>1</sup>.

After these reflections, the study of the Unidroit Principles begin, starting for outlining its origins, history and sources, there is exposed that although the first edition of the UNIDROIT Principles

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<sup>1</sup> MORENO RODRIGUEZ, Jose A, "El derecho no estatal en la Contratación Latinoamericana actual", *Contratos y arbitraje en la era global*, Centro de Estudios de Derecho, Economía y Política CEDEP, Ediciones y Arte S.A, Asunción, 2012, pp 286-288.

appeared in 1994, the process of creation of these principles goes back to 1968, year in which with occasion of the 40th anniversary of Unidroit, M. Matteucci, then Secretary General of Unidroit, first proposed the idea of creating a kind of international restatement<sup>2</sup> of general principles of contract law<sup>3</sup>.

In regard to **the sources of the UNIDROIT Principles** can be identified both domestic and international influences. Regarding the latter, one of the most notable influences on the Principles is the United Nations Convention on Contracts for the International Sale of Goods, 1980 (CISG). Other sources of influence on the Principles at international level are the Incoterms and the Uniform Customs and Practice for Documentary Credits (UCP) of the International Chamber of Commerce, the Convention on the Limitation Period in the International Sale of Goods and its protocol, Convention on Agency in the International Sale of Goods 1983, the International Convention on factoring 1988, the UNCITRAL Legal Guide on Drawing Up International Contracts for the Construction of Industrial Works, models FIDIC contracts, among others<sup>4</sup>.

As national influences deserve special attention the Uniform Commercial Code (UCC) and the American Restatement (Second) of Contracts of the same country. Additionally the UNIDROIT Principles found inspiration in other national models like the Algerian Civil Code 1975; the Civil Code (CC) Dutch 1992; and the draft of the new Civil Code of Quebec (entered into force in 1994)<sup>5</sup>.

In the next section, the content of the UNIDROIT Principles is analyzed. It is noted that since 1994 these principles have been two subsequent editions, the most recent edition of 2010, which consists of a preamble and 211 articles divided into 11 chapters, namely: i) General provisions, ii) Formation and authority of agents, iii) Validity, iv) Interpretation, v) Content, third party rights and conditions, vi) Performance vii) non- performance, viii) set- off ix) assignment of rights, transfer of obligations and assignment of contracts, x) limitations periods and xi) plurality of obligators and of obligees.

Subsequently, is addresses one of the most relevant excerpts of this part of the research: **the nature of the UNIDROIT Principles**. There is identified that to analyze the nature of the UNIDROIT Principles we must be expanded the range given by traditional sources of law, then is studied in detail each of the possible natures of the UNIDROIT Principles, concluding that denote the nature of the Principles

<sup>2</sup> "Restatement of law es una serie de volúmenes publicados por el American Law Institute sobre el estado actual y proyección hacia el futuro de distintas áreas del derecho (p.ej., ley de contratos, ley de responsabilidad extracontractual). Estos volúmenes que actúan como "autoridad persuasiva" del derecho norteamericano son frecuentemente citados seguidos por sus tribunales (Knapp, *fundamentals of American law*, p. 203)" refered in MARZORATI, Osvaldo J, *Derecho de los negocios internacionales*, Editorial Astrea, 3ª Edición, Buenos Aires, 2003.

<sup>3</sup> MARZORATI, ob. Cit., p. 13; FERNANDEZ ROZAS, José Carlos, *Ius mercatorum Autorregulación y unificación del Derecho de los negocios transnacionales*, Colegios Notariales de España, Madrid, 2003, p. 231.

<sup>4</sup> Bonell, Michael, "The CISG, European Contract Law and the Development of a World Contract Law", en *American Journal of Comparative Law*, Winter 2008. Disponible online en <http://www.cisg.law.pace.edu/cisg/biblio/bonell4.html>, consultado en 27 de octubre de 2014.

<sup>5</sup> MARZORATI, ob. Cit., P 14; PERALES VISCASILLAS, María del Pilar, *El derecho uniforme del comercio internacional: los principios de Unidroit*, disponible online en: [http://www.cisg.law.pace.edu/cisg/biblio/pcci.html#nota\\*](http://www.cisg.law.pace.edu/cisg/biblio/pcci.html#nota*), consultado 3 de febrero de 2014.

under a single concept or as a single unit is not appropriate if we take in consideration seriously its features.

We found that the analysis of the nature of the Principles should be performed outside the traditional normative production margins given its non-binding and persuasive character, in such a way that these principles can be identified as a soft law product, which in its text containing formulations of different categories (general principles, commonly accepted rules and rules with desirable solutions but without wide acceptance) with potential to form part of the new *lex mercatoria* depending on the effective acceptance of each its provisions in international practice, and with ability to be used as a normative system governing the fund of commercial disputes, although of their actual use thus far seem to function more as a *global background* of international trade.

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In any case, only the effective use of the Principles can gradually show more light about its nature in international trade, as noted Fernández Rozas when he says that *“con independencia de cualquier consideración tradicional acerca de su naturaleza, y al margen de la valoración que pueda darse a la funciones codificadoras de Unidroit, no cabe duda que estamos ante un conjunto muy elaborado de reglas jurídicas que conforman una suerte de Código Uniforme en materia de contratos internacionales que ha recibido una influencia muy directa de la Convención de Viena de 1980 y de otras experiencias codificadoras en la materia. Su alcance y relevancia futura estará, pues, en función del empleo que de ellos hagan los operadores privados y los árbitros”*<sup>6</sup>.

The section concerning the **scope of the UNIDROIT and its general field of application**, is also of great relevance in the investigation. In this section, we analyze in detail the pretension of the UNIDROIT Principles to be applicable to international commercial contracts, studying one by one these concepts.

With respect to the **notion of contract**, after discussing some proposals made by doctrine points out that if we tried to make a contract definition within the framework of the UNIDROIT Principles, we might note that in the context of the Unidroit Principles on contract should be understood as *an agreement which produces reciprocal obligations generated by the free and informal consent of the parties*.

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<sup>6</sup> FERNANDEZ ROZAS, ob. Cit, p. 234.

In any case, the absence of a definition of contract in the text of the UNIDROIT Principles is not accidental but rather deliberate, because this concept can be considered under many edges derived from the various legal systems, and given the international pretention of principles we can not create a unique concept of contract in its context, and also in practice the absence of a definition of contract is not a problem because the scope of the Principles can be inferred from the content thereof<sup>7</sup>.

Regarding the **concept of commercial**, it is stated that define the merchantability of a contract is a question that may have different solutions in each of the jurisdictions, for this reason neither in the Principles or its comments definition of commercial is offered, however in the comments is indicated that the objective is not enter in the distinction of some laws between the civil or commercial character of the contract, but for purposes of the Principles the aim is that these cover as many possible operations, interpreting the commercial concept of broadest possible way, excluding only calls "consumer operations", defining consumer *"to the party that enters into the contract otherwise than in the course of its trade or profession"*<sup>8</sup>.

After analyzing some controversies facing the definition of consumer inside the comments of the Principles, makes clear that the intention is to exclude from their scope those commercial operations performed to meet consumption requirements strictly, keeping open a wide application that, unless this restriction, does not have major limitations.

With regard to the **notion of international**, to set the international character of a contract can be complicated due of the multitude of criteria that doctrine and national and international norms establish in this regard. There may be many criteria to define the internationality of the contracts. As far as international instruments are concerned, the situation is not different. Several multilateral conventions have established different criteria for determining when a contract is international for the purposes of the respective convention.

This was observed by the drafters of the Principles, therefore they did not inclined to any existing criteria, and was established that for the purposes of the Principles of Unidroit the international element of the contract must be interpreted in the broadest possible way in such a way that only excluded contracts lacking any element of internationality.

Now, although the focus of the Principles is directed towards contracts with international character, because like we observed the UNIDROIT Principles arise in response to needs identified in international trade, the fact is that only a small part of the articles of the principles responds

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<sup>7</sup> MICHAELS, Ralf, "Preamble I Purposes, legal nature, and scope of the PICC; applicability by courts: use of the PICC for the purpose of interpretation and supplement and as a model", en VOGENAUER, Stefan, KLEINHEISTERKAMP Jan (editores), *Commentary on the Unidroit Principles of the international comercial contracts*, Oxford University Press, New York, 2009, p. 33.

<sup>8</sup> INTERNATIONAL INSTITUTE FOR THE UNIFICATION OF PRIVATE LAW UNIDROIT, *Unidroit Principles of International Commercial Contracts 2010*, Rome, 2010, p. vii.



exclusively to international contracts, with the most part of their text potentially susceptible of application also on purely domestic contracts<sup>9</sup>. Thus, at least in theory nothing prevents individuals can use the Principles on purely domestic contracts under the autonomy of the parties but not as applicable substantive law but rather as contractual provisions.

Finally, a detailed analysis of **the limits of the UNIDROIT Principles** is effected, noting that the Principles have been mainly conditioned by the mandatory rules and public policy rules. However, in our opinion should be a conceptual clarity on each of these concepts, because the concept of mandatory rule has been much discussed, varies according to legal tradition where it is considered, and on many occasions it has been assimilated to the notion public policy rules, in that line Marrella indicates that *“is a certain uniformity of views (at least in continental Europe) that mandatory rules (lois de police in French literature, norme di applicazione necessaria in Italian writings; international zwingende Rechtssdtze or Zweckgesetze in German works) are intended to protect essential interests touching the political, economic, and social organization of the forum law”*<sup>10</sup>.

For us, is of vital importance to clearly differentiate between simply mandatory rules and mandatory rules of public policy, even aware of the difficulty of defining public policy. To begin we start from the assumption that every rule of public policy is imperative, but not all mandatory rule is of public policy, nor all mandatory rule is based on public policy.

As indicated above, the present investigation is still under development, and it is expected that in the following months will develop a detailed analysis of applicability dynamics of the UNIDROIT Principles, study to will be approached from a quantitative and qualitative perspective.

We will focus on how and how much is being used UNIDROIT Principles in international trade and the behavior of the arbitral jurisprudence in relation to the Principles will be discussed. To do this will be immensely useful the bibliography collected during this research stay, besides the design of a survey intended to be applied the next year among lawyers, arbitrators, judges and merchants about the implementation of the Principles.

## Concluding remarks and acknowledgments

The experience of these two months has been quite enriching both academically and personally. In the first area, is clear the progress that my doctoral research because of have the opportunity to interact with those who have led the development of the UNIDROIT Principles, and of course, having available an extensive bibliography on the subject.

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<sup>9</sup> Cfr. MICHAELS, Ralf, ob. Cit, p. 34

<sup>10</sup> MARRELLA, Fabrizio, “Choice of Law in Third-Millennium Arbitrations: The Relevance of the UNIDROIT Principles of International Commercial Contractst”, en *Vanderbil journal of transnational law*, volumen 36, p. 1183.

I want to especially highlight the personal enrichment that this experience has represented for me. I have had the opportunity to meet part of the UNIDROIT team, and I had the pleasant surprise of finding people with a great human quality. The kindness of each of UNIDROIT staff members made this experience a truly enjoyable time.

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Finally, as is only logical, of course once the research is complete, I will send a copy of the final product for the UNIDROIT library, recognizing in the research the support of the Institute.

## ANNEX 1

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**TRANSNATIONAL LAW AND BUSINESS UNIVERSITY**

**INTELLECTUAL PROPERTY LAWS IN ASEAN  
ECONOMIC COMMUNITY –  
A LESSON FROM EU**

**VU KIM HANH DUNG**

**July 2014**

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## Abstract

A roadmap was set up by the ASEAN Economic Community (AEC) under its Blueprints for establishing an ASEAN “single market” by 2015. AEC envisages the following key characteristics: (a) a single market and production base, (b) a highly competitive economic region, (c) a region of equitable economic development, and (d) a region fully integrated into the global economy.<sup>1</sup> Similarity to the European Union (EU) powerful common market, ASEAN’s notion of a “single market” represents a loose integration. However, even this requires countries to move beyond trade liberalization. As a result, the AEC Blueprint has set goals in a number of policy areas. This paper focuses only on one aspect which is intellectual property policy.

The AEC Blueprint states that a sound system of intellectual property policy provides static and dynamic efficiency benefits. Basically, it ensures that success of a firm does not come from monopolization and collusion but because of efficiency and innovation. The World Trade Organization (WTO) Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS) sets the minimum standard, as all ASEAN countries are signatories to TRIPS. There is, however, no intent from the ASEAN member state to harmonize national laws or create any common enforcement bodies; instead, the countries intent to build a regional network basing on cooperation and coordination.

Up to now, the purpose of creating ASEAN common market in 2015 is becoming un-realistic, however, building a sound legal system to preparing for the AEC in a near future is in emergency. This paper provides an assessment of the achievements of ASEAN countries on the road to AEC up to 2015 and draws lesson from other regional agreements and case laws to provide some pitfalls that ASEA may encounter. It also provides some suggestion on legal system that may be considered to build up a ASEAN common market in 2015. It also highlights some yet unaddressed issues and suggests some refinements that ASEAN may wish to consider as it prepares for 2015. The first section provides a general overview of intellectual property (IP) and the goals of the AEC. Section 2 provides an overview of Intellectual Property Rights (IPRs) and also draws on case law from TRIPS and the EU. Section 3 discusses integration of IP law in ASEAN. Section 4 provides the relationship between IP law and competition law and the issues that arise at the intersection of IP law and policy. Section 5 concludes the chapter and provides an assessment and some suggestions for ASEAN to consider.

### 1. Intellectual Property Laws and the ASEAN Economic Community

IP laws protect innovators’ rights as allow them to appropriate the rewards from new products, more efficient production processes and artistic works which are created by them, and therefore, encourage their creation. The AEC Blueprint recognizes that sound IP policy helps the creation, adaptation and adoption of new technology and impacts foreign direct investment flows and the willingness of firms to share and transfer advanced technology. Ultimately, in addition to providing a healthy environment for investors and inventors, this contributes to higher productivity and competitiveness. In the area of IP, ASEAN seeks to foster *cooperation* on copyrights, traditional knowledge, genetic resources and cultural traditional expressions. In addition, it seeks to establish an

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<sup>1</sup> ASEAN Economic Community, <http://www.asean.org/communities/asean-economic-community> (assessed on 10 June 2014)

ASEAN *filing system* for design and to promote *consultation and information exchange* between national agencies responsible for the protection of IP rights.<sup>2</sup>

The interest of countries in creating IP standards and levels of enforcing them are largely depending on their levels of development. The TRIPS agreement sets up only the minimum standards on IPRs for contracting countries and leaves the room for countries' flexibility on stipulating these provisions. Free trade agreements (FTAs) between countries usually involve higher standards of IPRs. Countries should set IP standards to balance the domestic interests of IPR holders with the interests of consumers. The balance between these two interests in developed countries is unlikely to be the same balance for developing countries which have less research and development and lack of the legal and other institutional capacity to administer a complex IPRs system. Therefore, proven in reality, harmonizing IP laws and their enforcement in regional level are approached with considerable caution.

There are more complex to deal with the issue of IP law across borders. IPRs are national, so that a patent granted in Singapore does not stop a firm copying the idea of it in Indonesia. This issue took long time to reach consensus in European Union (EU). In the 1960s, the EU permitted an agreement between firms in different EU countries to limit trade by exercising national IPRs. So, an agreement within the EU stopped cross-border sale by the owners of the same trademark. It was soon seen that protecting IPRs on the basis of national boundaries was incompatible with the idea of a common market, so the European Court of Justice (ECJ) adopted a doctrine of Community IPR Exhaustion. This means that once a firm introduces a product protected by IPR in one Member State of the EU, the IPRs are "exhausted" with respect to that product in the other Member States. So once a product has been put on the market in Germany by the owner of the trademark, the owner cannot prevent the importation of that product into another EU Member State, such as France, despite the fact that trademarks are held on a country basis.<sup>3</sup>

While IP law is national law with national enforcement, it is increasingly subject to international agreements, which include "national treatment" provisions. It should be noted that TRIPS sets minimum IP standards but does not require countries to have the same IP enforcement system. Thus, IP enforcement is left to general procedural laws, which differ considerably between countries. The signing at the thirteenth ASEAN Summit in Singapore in 2007 of both the ASEAN Charter and the Declaration of the AEC Blueprint was a significant step toward achieving the goal of a single economic market. Of particular importance was the commitment to move away from the soft-law approach of political commitments dealing with trade and investment liberalization toward an "adherence to rules-based systems for effective compliance and implementation of economic commitments".<sup>4</sup> It remains to be seen how much progress toward an ASEAN rules-based system occurs in the foreseeable future.

The AEC Blueprint provides a master plan toward establishing a "single market" by 2015. The AEC comprises four key pillars (see below). In addition, it will also particularly focus on twelve sectors which are perceived as vital components for integration: agro-based products, air travel, automotives, e-ASEAN, electronics, fisheries, healthcare, logistics, rubber-based products, textiles and apparel, tourism, and wood-based products.

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<sup>2</sup> ASEAN Secretariat 2009, *Implementing the roadmap for an ASEAN community 2015*, pp. 32–33.

<sup>3</sup> Sanchita Basu Das, Jayant Menon, Rodolfo C Severino, Omkar Lal Shrestha, *The ASEAN Economic Community: A Work in Progress*, Institute of Southeast Asian Studies and Asian Development Bank, 2013.

<sup>4</sup> ASEAN Secretariat 2009, p. 21

**Table 1. AEC Blueprint Goals and Measures<sup>5</sup>**

A single market and production base	Measures to ensure the free flow of 1) goods, 2) services, 3) investment, 4) skilled labor, and 5) the freer flow of capital within ASEAN. Measures on the flow of goods cover tariffs, NTMs, rules of origin, trade facilitation, custom integration, standards, and technical regulations.
A highly competitive economic region	Actions on competition policy, consumer protection IP rights, taxation, e-commerce, and infrastructure development.
A regional equitable economic development	Actions to develop small and medium sized enterprises and to implement and enhance the IAI (initiative on ASEAN Integration)
A regional fully integrated into the global economy	Actions to develop a coherent approach among ASEAN members on external economic relations to enhance participation in global supply networks.

Until 2007 the main focus of ASEAN countries was on the first pillar dealing with trade and investment liberalization. Now more emphasis is focused on the second pillar which is to develop a highly competitive region. To reach goal of the second pillar, there is a must of countries to examine domestic policies that may impinge on integration, such as competition policy, taxation, infrastructure development, e-commerce, and intellectual property rights. For ASEAN to become a competitive region, goods and services within ASEAN should be produced at the lowest possible cost. This means lowering intra-regional barriers and harmonizing laws to some extent to allow the resources to be used in the most efficient ways. Some steps toward harmonization have already occurred. Relating to the area of IP laws, the TRIPS agreement has set minimum IP standards, including national treatment (that is, once the product or factor crosses the border, it is given the same treatment as domestic products and factors), and ASEAN has also introduced “Action Plans”, which partly specifically mentioned IP laws.

Full economic integration would necessarily mean the same IP laws — similar to a single country, which means standards of IP protection would be the same and once an IP registered in one country, it would be recognized throughout ASEAN. Harmonization across countries at different levels of development leads to distributional issues, for example, would create more unemployment and lower growth in the less developed countries. The same applies to business regulation, setting high product standards, for example, may discriminate not only against domestic consumers who want cheaper products but also against producers in less developed countries in the region which cannot meet those standards — either because of a lack of technological capacity or an inability to pay the necessary IP license fees for more sophisticated products. Mutual recognition is another alternative. That is, if a product complies with the exporting country’s laws in the region (this could be environmental, workplace or IP standards), it can be sold within the trading party’s borders. Manufacturers do not have to adapt products to satisfy different standards in the country of export. But if there are considerably different

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<sup>5</sup> US International Trade Commission 2010, *ASEAN: Regional Trends in Economic Integration, Export Competitiveness, and Inbound Investment for Selected Industries*, Investigation No. 332-511, USITC Publication 4176. August.

standards between countries, there could be a race to the lowest standard. Mutual recognition is only appropriate where there are minor differences in regulation between trading partners. ASEAN countries appear to be too far apart in their levels of economic development for any meaningful harmonization or mutual recognition; however, these can be long term goals. The experience of the European Union shows that creation of a single market takes many decades. ASEAN cannot reasonably expect to leapfrog this process just because it feels compelled to react to the growing economic importance of India and the PRC. Laws and regulations have to reflect local circumstances. Thus, ASEAN should focus on coordination and cooperation and the uniform and transparent application of the laws that do exist, to both domestic and foreign firms.

IPRs give inventors and artists the right to exclude others from using their ideas, expression, etc. This allows IPR holders not only to appropriate the returns from their innovation but also, by creating a legal property right, allows them to transfer their innovation to others who can better produce or distribute the resulting products or services by sale or license. IPRs are usually classified as either industrial or artistic and literary property. The former includes patents but also industrial designs, trademarks, geographical indications and trade secrets, and the latter covers copyright. There are several other “tailor-made” IPRs covering database protection, integrated computer chips, and plant breeder rights.

Knowledge has public good characteristics and is usually non-excludable. If a new technology is valuable it will be copied unless it can be protected. This reduces the original innovator’s profits, so the incentive to engage in innovation is reduced. Knowledge is also non-rival. One person’s use of the knowledge does not diminish another’s use, so there is no scarcity value. For economic efficiency then, once created, knowledge should be available to all at the marginal cost of transferring it, which may be close to zero. But, access to knowledge at its marginal transfer cost reduces the rewards to innovators and thus the incentives to innovate. While IPRs provide incentives for inventors to create new knowledge and for artists to create new expressions exclusivity comes at a price: limited dissemination of the technology or expression during the life of the IPR protection. At the single-country level, there is a trade-off between promoting innovation (long-term dynamic efficiency) and its dissemination (short-term static efficiency). IP protection, given in the short term to encourage innovation, leads to temporarily higher prices and therefore less access. So in a closed economy, governments have to make a policy choice between short and long-term effects.

When innovation occurs in one country and is sold in another, this welfare trade-off becomes more complicated. IP laws are national, and governments naturally focus on maximizing their own country’s economic welfare. A small number of developed countries produce most innovation. Their interest is in having strong IPRs in the countries to which they sell. On the other hand, for developing countries, with limited research and development, imitation and adaptation of new technology is more important than its creation; thus their interest is in having weak enforcement or non-enforcement of IPRs. For a less developed country the introduction of IPRs can reduce the profits of local imitators and increase the profits of the innovator in the developed country, a difficult idea to sell to locals in a developing country.

In summary, there are a number of possible economic effects from introducing IPRs or harmonizing and enforcing them to a higher standard. These include:

1. A loss of employment in any pre-existing imitative industries. Due to the closure of the imitators, the innovator has greater demand in the importing country for their (now) IPR protected-product.

2. Possibly greater innovation in the importing country, which leads to both locally made goods and services replacing imports and more exports, but the evidence for this is weak.<sup>6</sup>
3. The innovator has greater market power in the importing country. This allows the exporting IPR owner to charge a higher price. Maskus (2000) calls this the market-power effect. Maskus and Penubarti (1995) suggest that the market-power effect is probably greater for countries with a low capacity to imitate with the opposite likely in countries with a high ability to imitate.
4. Possibly greater research and development by developed countries on adapting and tailoring their products to developing country problems, but this is only likely if there is sufficient demand and income in developing countries.
5. A greater willingness to invest in the importing country or form a joint venture or license production of now IPR-protected products, processes and expressions.

The welfare effects of IPRs in an open economy context are mixed, as is the empirical evidence on the impact of IPRs on trade, investment, and growth. This is by no means a new debate. Now it is generally acknowledged that IPRs rarely create monopolies, but their owners justifiably use them to maximize the profits from innovation. But how do IPRs affect trade and growth? A recent survey by Bessen and Meurer<sup>7</sup> concluded that:

... with the cross-country studies in particular, the quality of general property rights institutions has a substantial direct effect on economic growth. Using the same methodology and in the same studies, intellectual property rights have at best only a weak and indirect effect on economic growth ... the positive effects of patents appear to be highly contingent.

Bessen and Meurer also conclude that less developed countries benefit less from patents, but those with higher levels of trade benefit more.<sup>8</sup> Insofar as FDI and technology diffusion are concerned, Kiriyama<sup>9</sup> concluded, after surveying the empirical literature, that:

... the state of domestic intellectual property legislation and enforcement has improved in recent years, and evidence suggests that this has facilitated technology diffusion through various channels, including FDI and trade.

Another recent paper, by Breitwieser and Foster<sup>10</sup>, summarizes the available empirical evidence on IPRs and technology diffusion. The empirical evidence examined deals mainly with patents. They conclude that:

... views on the importance of IPR protection tend to be polarised. On the one side, it is believed that stronger IPR protection can encourage innovation, technology diffusion and enhance growth. On the other it is thought that stronger IPR protection

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<sup>6</sup> Lerner, Josh, 2002, *"Patent protection and innovation over 150 years"*. NBER Working Paper no. 8977. Cambridge, MA: National Bureau of Economic Research.

<sup>7</sup> Bessen, James E. and Michael J. Meurer, 2008, *"Do Patents Perform Like Property?"* Working Paper No. 08-08, Working Paper Series, Law and Economics, Boston University School of Law, pp. 20-21.

<sup>8</sup> *Id.*

<sup>9</sup> Kiriyama, Nobuo. *"Trade and Innovation: Synthesis Report"*. OECD Trade Policy Working Papers No. 135. Paris: OECD, 2012, <http://dx.doi.org/10.1787/5k9gwprtbtxn-en> (accessed 26 June 2014).

<sup>10</sup> Breitwieser, Anja and Neil Foster. *"Intellectual Property Rights, Innovation and Technology Transfer: A Survey"*. MPRA Paper No. 36094, 20 January 2012, p. 55, <http://mpa.ub.uni-muenchen.de/36094> (accessed 30 June 2014).

leads to monopoly power for patent holders, reduces the incentive to innovate and limits the diffusion of knowledge. The evidence reviewed supports neither claim.

Similarly, the UK Commission on IPRs (2002, p. 23) concluded the evidence that IPRs provide incentives for FDI is lacking:

If this was the case, then large countries with high growth rates but weak IPR regimes would not have received large foreign investment inflows in the past and even now. This includes many of the East Asian and Latin American economies which have received the bulk of such flows. If the question is addressed in terms of what factors are most important in determining foreign investment, it is quite common for IPRs to be omitted altogether.

They do find, however, that IPRs in developing countries are important in “IPR sensitive” industries such as chemicals and pharmaceuticals. The Commission Report also indicates that developed countries traditionally regard IP laws as part of their industrial policy, establishing and changing them to suit their own stages of economic development. On the relationship between IPRs and growth, the Commission concluded that (p. 22):

... in most low income countries, with weak scientific and technological infrastructure, IP protection at the levels mandated by TRIPS is not a significant determinant of growth. On the contrary, rapid growth is more often associated with weaker IP protection.

International agreements on IPRs such as TRIPS, by setting minimum standards, have already harmonized IP laws across countries and indeed within ASEAN, at least on paper. But there is a gap between TRIPS minimum standards and the actual enforcement of those standards.

## **2. Lessons from other international and regional Intellectual Property Agreements**

### **2.1 TRIPS Agreement**

IP laws started to internationalize and harmonize from 1960s when developed countries argued that developing countries are in need to have a healthy IP law to attract more foreign investment on both capital and technology. Over time, developed countries was trying to find way to extend overseas the IP protection standards stated in their own countries by setting minimum international IP standards under international forum, which arguably benefitted developed countries more than developing.<sup>11</sup> For a long time developed countries lobbied through the World Intellectual Property Organization (WIPO) for better worldwide IP protection, but the developed countries failed to achieve the IP outcomes they wanted.<sup>12</sup> At the beginning of the Uruguay Round the US try to argue for the introduction of IPRs as part of the trade

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<sup>11</sup> Finger, J. Michael. “*The Doha Agenda and Development: A View from the Uruguay Round*”. ERD Working Paper Series No. 21. Manila: Asian Development Bank, September 2002.

<sup>12</sup> Finger, J. Michael. “*The Universality of Intellectual Property Rights: Origins and Development*”, Background Paper for Panel Discussion on Intellectual Property and Human Rights. Geneva: World Intellectual Property Organization, 1998. <http://www.wipo.int/export/sites/www/tk/en/hr/paneldiscussion/papers/pdf/drahos.pdf> (accessed 20 June 2014).



negotiations agenda, since its proposals could be defeated by coalitions of developing countries in other forums such as WIPO and UNCTAD.<sup>13</sup>

The Uruguay Round led to create the TRIPS Agreement, which set minimum IP standards for WTO Members which covers copyright, patents, trademarks, geographical indications, industrial designs, the layout designs of integrated circuits, and protection of undisclosed information, including trade secrets and test data, and the control of anti-competitive practices in licenses on the basis that IPRs affect trade flows. TRIPS *incorporated provisions* from pre-existing international agreements on IPRs, such as the Paris and Berne Conventions administered by WIPO. However, TRIPS also added provisions dealing with *enforcement* and a *dispute resolution mechanism*, which were lacking in previous treaties. Of particular importance was the extension of the principles of “*national treatment*” and “*most favored nation*” to all IPRs.

Developing countries approved TRIPS for several reasons: pressure from developed countries (mainly the US and EU); a belief that there would be greater access to developed country markets particularly for agriculture and textiles; some lobbying by innovators in the developing countries themselves; and a belief that stronger IP protection would lead to increased capital and technology transfer through foreign direct investment and increased technology licensing. It should be mentioned again that TRIPS does not fully harmonize international IP laws as IPRs still can be tailored in different countries due to their differences on developing level. The advent of TRIPS means that countries now find it difficult to adapt IP laws to suit their stage of development through imitation like developed countries had previously done. Instead, countries must now place less reliance on imitation and instead rely primarily on using IPRs to develop domestic innovation and to increase FDI and cross-border IP licensing. TRIPS recognized that IP licensing and other practices can have “adverse effects on trade and may impede the dissemination of technology”.<sup>14</sup> As a result members have discretion to specify “in their legislation licensing practices or conditions that may in particular cases constitute an abuse of intellectual property rights having an adverse effect on competition in the relevant market”.<sup>15</sup>

Since TRIPS was signed, developing countries have tried to explain its provisions in many ways. For example, to clarify the scope of TRIPS with respect to medicines, a new round of talks was opened in the Doha Declaration in 2001. One outcome of the talks was an agreement that TRIPS should be interpreted in light of the goal “to promote access to medicines for all”.<sup>16</sup> In addition, the WTO Council extended the period for least developed countries to implement TRIPS commitments. Least developed countries need not protect pharmaceutical products until 2016. While TRIPS has uniform protection standards, it does not provide for a uniform enforcement system. Articles 41 to 47 require TRIPS members to set up national enforcement systems for the rights agreed to in TRIPS. Members must ensure that IPR holders have fair and equitable enforcement procedures. The mechanisms must include the authority to require the production of evidence and remedies such as injunctions and compensation for

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<sup>13</sup> Drahos, Peter, “*Developing Countries and International Intellectual Property Standard-Setting*”, Study Paper No. 8, UK Commission on Intellectual Property Rights, 2002, [http://www.iprcommission.org/papers/pdfs/study\\_papers/sp8\\_drahos\\_study.pdf](http://www.iprcommission.org/papers/pdfs/study_papers/sp8_drahos_study.pdf) (accessed 20 June 2014).

<sup>14</sup> TRIPS, art. 40

<sup>15</sup> WTO TRIPS Agreement, available at: [http://www.wto.org/english/docs\\_e/legal\\_e/27-trips\\_01\\_e.htm](http://www.wto.org/english/docs_e/legal_e/27-trips_01_e.htm) (accessed 20 June 2014).

<sup>16</sup> See Section 4 of the “Declaration on the TRIPS agreement and public health”, Doha WTO Ministerial, 20 November 2001, available at: [http://www.wto.org/english/thewto\\_e/minist\\_e/min01\\_e/mindecl\\_trips\\_e.htm](http://www.wto.org/english/thewto_e/minist_e/min01_e/mindecl_trips_e.htm) (accessed 20 June 2014).

damages. But the harmonization of IP laws in ASEAN countries is assessed to be facing many challenges<sup>17</sup>:

... the problems of harmonizing procedural rules in developing Asia are much more severe than those experienced in Europe and North America, with law in Asia drawn not only from different traditions, but also from different colonial periods, and with a judiciary that is often struggling to free itself from political influence and from a negative image of being corrupt to some degree.

While increasing IP protection takes time, harmonization is even more difficult in practice given that IP laws are generally national in nature. For example, even the European Union has not achieved full IP integration; *most patent and utility model law is solely national, while trademark, design and copyright law has been harmonized to a degree through EU Directives. Only community trademarks and community designs law are EU-wide.*<sup>18</sup> The European efforts toward harmonization of IP laws are discussed next.

All ASEAN countries are members of TRIPS, which has observer status and is currently negotiating access, and have enacted IP laws based on imported Western models. Little attempt has been made by ASEAN countries to develop IP laws due to their different stages of economic development or institutional capacity.

## **2.2 Intellectual Property Laws in the European Union**

As an economic union, Europe has had the most experience in harmonizing IPRs. The task has not been easy. This section provides a brief discussion of the EU IP law system and the likely IP harmonization issues ASEAN might have to deal with.

The idea of an EC patent was considered when the EC was set up in 1957. In 1973 the European Patent Convention (EPC) was signed in Munich.<sup>19</sup> European patents are only granted to inventions that are new, involve an inventive step and are susceptible to industrial application. Changes were made to the EPC in 2000 (EPC 2000), which came into force at the end of 2007. The EPC 2000 concerned only with matters of patent prosecution and, to a limited extent, invalidation proceedings within the opposition framework, and does not address issues of enforcement or provide any enforcement means.<sup>20</sup> There is no appeal from the national courts to a European Court or Tribunal. Patents in Europe can only be enforced, and their validity, in the absence of opposition lodged at the EPO, challenged, in national courts under national laws, even though those laws are based on the EPC. There is no one single court charged with enforcing a patent throughout Europe or which exercises a supervisory jurisdiction over the manner in which the national courts exercise their jurisdiction over substantive questions of patent law. In relation

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<sup>17</sup> Antons, Christoph. "Introduction". In *The Enforcement of Intellectual Property Rights: Comparative Perspectives from the Asia-Pacific Region*, edited by Christoph Antons. The Netherlands: Kluwer Law International BV, 2011, p.2.

<sup>18</sup> *Id.*, p. 5.

<sup>19</sup> Convention on the Grant of European Patents 1973 (European Patent Convention (EPC))

<sup>20</sup> Articles 75-86 relate to filing and the formal requirements for European patent applications and articles 90-98 set out the procedure up to grant. Of particular note are the requirements set out in articles 82-84. Article 82 requires that the application relate to one invention only or to a group of inventions so linked as to form a single inventive concept. Article 83 requires the application to disclose the invention in a manner sufficiently clear and complete for it to be carried out by a person skilled in the art, and article 84 requires that the claims, defining the matter for which protection is sought, shall be clear and concise and supported by the description.

to patents, national courts are subject to the overall supervision of the ECJ only to the limited extent that such disputes concern the “exercise” of patent rights in the way laid down by the ECJ as, for example, in parallel import cases. As a result, a European patent may be interpreted differently in different member countries. This could be an important issue for ASEAN in the future. A working party was set up in 1999 to address the fact that there was no single dispute resolution mechanism. In 2003, a draft European Patent Litigation Agreement (EPLA) was proposed, which would commit member states to an integrated judicial system, including uniform rules of procedure and a common appeal court for patent disputes.<sup>21</sup> The Council of the European Union proposed a Community Patent with its own Patent Court (EUPC) in 2009. To date, nothing has happened.

Trademarks give the owner an exclusive right to use distinctive signs to identify the source of the product. Trademarks, unlike patents, do not promote research and development directly but mainly exist to protect the producer’s reputation and to encourage product development. Usually, trademarks can be renewed indefinitely. An international registration of marks system (the Madrid system) is administered by WIPO. This system allows a trademark owner to file one application with their national trademark office. Once registered, the mark is protected in the countries chosen by the applicant, unless the trademark office of any of those countries refuses protection within a certain time. The first step in harmonizing trademark law within the EU was the 1988 Trade Mark Directive, which harmonized the conditions for obtaining and continuing to hold a registered trademark. Next, Regulation 40/94 on the Community Trade Mark [1994] OJ 11/1 introduced an EU trademark. This gave uniform protection in all countries with a single registration, but individual country trademarks coexist and are often more important, given difficulties in demonstrating community-wide eligibility. Though the EU has been relatively successful in harmonizing trademark law, there is some lack of clarity in the legislation and, therefore, a considerable amount of case law.

Copyright covers copying and not independent creation. It covers literary and artistic work, music, television, broadcasts, computer software, databases, advertising ideas and multimedia products. TRIPS requires that copyright must last for at least 50 years after the death of the author (70 years in the US and the EU). Copyright must be granted automatically and not based on registration. Computer programs must be regarded as “literary works” under copyright law and so receive the same terms of protection. Copyright is difficult to harmonize, because it covers such a broad range of subject matter. There is no EU copyright. Instead, there are a number of directives dealing with particular areas (for example, databases, satellite broadcasting and rental rights). However, the Commission is interested in examining the issue of copyright in promoting competition and innovation through the exploitation of cross-country rights. There is a difference between common law and civil law countries with respect to copyright. The common law seems mainly concerned with economic rights while the civil law usually gives priority to the natural rights of authors. Civil law makes a distinction between author’s rights and “entrepreneurial” rights. However, both systems have much in common. Copyright protection is affected considerably by changes in technology. For example, digitization allows for low-cost, almost perfect copies. International copyright protection started because of the lower costs of international travel in the nineteenth century. Copyrighted English books would be sent to the United States and re-published at a lower cost, because the publisher had only to pay the printing costs. Pressure by authors and artists led to the Berne Convention in 1886 based on the principle of national treatment, that is, it required signatories to recognize the copyright of works of authors from other signatory countries in the same way that it

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<sup>21</sup> See [http://en.wikipedia.org/wiki/European\\_Patent\\_Litigation\\_Agreement](http://en.wikipedia.org/wiki/European_Patent_Litigation_Agreement) (accessed 20 June 2014).

recognized its own authors (the United States was not a signatory). Initially, the Convention only covered literary and artistic works, including cinematographic. No protection was provided for performers, sound recording, broadcasters or publishers. A separate agreement was negotiated (the Rome Convention 1961), dealing with performers, producers of phonograms and broadcasters. TRIPS further harmonized and raised the level of copyright protection.<sup>22</sup>

Another important IPR issue for economic integration is the protection of designs. Design refers to the appearance and composition of an article and to any preliminary drawings or models. It can include product or packaging design, web design, software design, graphic design, theatre design, colour design, architectural design, automotive design, fashion design, environmental design, furniture design, industrial design, interior design, etc. Patent protection is rare for designs, but trademarks or copyright may be used to protect designs. Lack of harmonization of design IPRs can affect the free movement of goods.

In 1991, the European Commission issued a Green Paper, which proposed a Community Design system (somewhere between patent and copyright). A Directive was adopted in 1998 to harmonize design IPRs including registration, the extent and time of protection and the conditions for refusal. Remedies and enforcement were left to national laws. Regulation 6/2002 on Community Designs followed [2002] OJ L/1. The EU has acceded to the Geneva Act of the Hague Agreement concerning the international registration of industrial designs, which allows for a single application at WIPO for protection not only within the EU, but in all countries that are signatories to the Geneva Act of the Hague Agreement. However, the breadth of designs has led some EU countries to use different protection through copyright, patent and sui generis design protection. While the conditions for obtaining registration, and the extent and terms of protection have been harmonized, many procedural elements are left to individual countries.

Trade secrets allow owners to protect their research and development without disclosing the property (as required by patents). Trade secrets are protected, as long as they remain secret and are protected by laws against unfair acquisition or unauthorized disclosure. The EU does not have any specific legal provisions to protect trade secrets or undisclosed information. TRIPS (Section 7) provides for minimal legal standards for trade secret protection, leaving individual countries considerable discretion. All that is required is that the secret information has commercial value because it is secret, and the person controlling the information has taken reasonable steps to keep it secret. Because of its secretive nature, there is potential for such information to be used anti-competitively.

The ECJ has interpreted IP rights narrowly when there is a conflict with competition law. In particular, the ECJ has found that, while the EC Treaty did not interfere with the existence of IPRs, competition laws could curtail the exercise of IPRs. In other words, the exercise of IPRs should not impede the essential freedom of movement of goods between member states (which includes the possibility of parallel imports).<sup>23</sup>

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<sup>22</sup> Sanchita Basu Das, Jayant Menon, Rodolfo C Severino, Omkar Lal Shrestha, *The ASEAN Economic Community: A Work in Progress*, Institute of Southeast Asian Studies and Asian Development Bank, 2013.

<sup>23</sup> *Id.*

### 3. Integration of IP Laws in ASEAN

EU integration saw IPRs as playing an important part in its overall regional growth strategy, called the Lisbon Strategy, which called for the harmonization of IP laws to establish an internal market in knowledge. Like the EU, ASEAN also sees an important role for IPRs in fostering economic growth. In particular, according to the ASEAN IP Rights Action Plan 2011–2015, ASEAN seeks to accelerate the pace of IP asset creation and commercialization so as to transform the region into one where growth is driven primarily by innovation. More importantly, it seeks to attract foreign direct investment and, to that end, sees the need to ensure the protection of IPRs of trading partners. However, nowhere does the Plan explain how IPRs actually help economic integration, particularly with differing standards of actual protection (harmonization is ruled out). Nor is it explained how improved protection of trading partners' IPRs will encourage FDI. As summarized earlier the evidence on the relationship between IPRs and FDI is not conclusive. Even if FDI is encouraged the investment need not necessarily involve technology transfer, which stresses the importance of looking at IPRs as part of a broader technology policy.

Like the EU, ASEAN has worked on IP integration issues for some time. The ASEAN Working Group on Intellectual Property Cooperation (AWGIPC) has served as the consultative body for ASEAN cooperation since 1996. The ASEAN Project on the Protection of Intellectual Property Rights (ECAP III) has followed the EC-ASEAN Patents and Trade Marks or ECAP (1993–1997) and the EC-ASEAN Intellectual Property Rights Co-operation Programmes (ECAP II 2000–2007), which were funded by the EU (€13.8 million) and the European Patent Office (€1.5 million). The 4-year ECAP III program started in January 2010 with an additional funding of €5.1 million from the EU and European Patent Office. The goal is to enhance regional integration “by strengthening institutional capacity, and legal and administrative frameworks for protecting IPRs in the region”.<sup>24</sup>

More recently, the AEC Blueprint includes several measures that relate to IP protection, including the full implementation of the ASEAN IPRs Action Plan 2004–2010. Under that plan and the more recent ASEAN IPRs Action Plan 2011–2015, ASEAN members have set out a number of priority goals and actions. These include the improvement of IP legislation, protection and enforcement; accession to international IP treaties (Madrid Protocol); establishing an ASEAN filing system for design; promoting regional cooperation on traditional knowledge, genetic resources and cultural traditional expressions; consultations and information exchange among national IP enforcement agencies; the simplification and harmonization of IP registration and procedures.

Harmonization of IP laws is central to the European approach and, as discussed earlier, it has yet to be achieved on the enforcement side. ASEAN rules out harmonization. It takes a “soft-law” approach to integration, that is, commitments are declarations of political will, often voluntary and non-binding, rather than legally binding agreements backed up by a binding dispute resolution mechanism. This allows member states to implement rules when they are able to do so and to incorporate differences that reflect national conditions. This is the approach used for IP. The ASEAN IPRs Action Plan 2011–2015 states (p. 2) that:<sup>25</sup>

Instead of trying to formulate a single set of laws and designing a harmonised regional system in IP, the AWGIPC has crafted its own means of integrating through a higher level of cooperation by undertaking programmes and activities together, with

<sup>24</sup> See Overview ECAP III: [http://www.ecap-project.org/index.php?q=overview\\_ecap\\_III](http://www.ecap-project.org/index.php?q=overview_ecap_III) (accessed 20 June 2014).

<sup>25</sup> ASEAN IPRs Action Plan 2011–2015, Final, 31 July 2011, <http://www.asean.org/documents/ASEAN%20IPR%20Action%20Plan%202011-2015.pdf> (accessed 20 June 2014).

AMSs strengthening linkages with each other to improve their capacity and participating in global IP structures, subject to the capacity and readiness of each AMS.

Harmonizing both rules and enforcement is an important element of reducing trade barriers. The latter is difficult, particularly in developing countries. Europe only started on the path of harmonizing enforcement in 2004. A 2004 European Commission Directive noted that harmonization “promoted the free movement of goods between European Union countries and made the rules more transparent, the means of enforcing intellectual property rights have not been harmonized at all until now”. The Directive was aimed at harmonizing enforcement and promoting innovation and business competitiveness.<sup>26</sup> Given ASEAN’s relative infancy and major differences in levels of economic development, harmonized regional standards and enforcement are a long-term agenda item, one that could nevertheless lead to major benefits in terms of development of a regional market. These include:

1. Better protection and enforcement of IPRs will mean greater confidence that goods or services produced in one ASEAN country can be sold in another without copying, leading to more investment not only by non-ASEAN countries but also by ASEAN companies as well. However, in the short term, more developed countries in ASEAN may gain more.
2. Reduced cross-border transaction costs for the sale and licensing of IPRs.
3. A reduced level of national ‘strategic’ use of IPR regimes within ASEAN; for example, granting wide patents to local industry but giving narrow protection to other countries in ASEAN and elsewhere.
4. A consistent level of protection and enforcement within the region will lead to FDI into ASEAN being made on the basis of the comparative advantage of countries rather than just the IP regime.

Without harmonization, those seeking IPR registration or enforcement within ASEAN will have different requirements in each country. This may impact on FDI to the region. Since TRIPS sets a minimum level of protection, there seems little point in setting ASEAN IP standards at a higher level. The ASEAN commitments are to greater cooperation, which over time should be able to resolve the institutional and public policy issues involved with integration. The main problems are likely to be the use of national IP laws to limit intra-ASEAN trade (which could be corrected by each ASEAN country allowing for parallel importation) and limiting private anti-competitive conduct which inhibits intra-ASEAN trade and integration (which, due to problems of proof and the impact of anti-competitive conduct, which differs in different ASEAN countries can only be resolved by cooperation or an ASEAN-wide competition law). This is discussed in the next section.

#### **4. Relationship between Intellectual Property and Competition Laws**

IPRs give a property right over an idea, expression, trademark, commercial secret etc. It is appropriate, then, that IPRs be subject to competition law as are other property rights. Should competition law treat IPRs in exactly the same way as real property rights? This has been the subject of considerable

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<sup>26</sup> Directive 2004/48/EC of the European Parliament and of the Council of 29 April 2004 on the enforcement of intellectual property rights: [http://europa.eu/legislation\\_summaries/fight\\_against\\_fraud/fight\\_against\\_counterfeiting/l26057a\\_en.htm](http://europa.eu/legislation_summaries/fight_against_fraud/fight_against_counterfeiting/l26057a_en.htm) (accessed 22 June 2014).

debate in developed countries in the last 20 years or so as IPRs have become more important to their economies.<sup>27</sup>

It should not be surprising that competition laws and IP laws overlap. Competition laws are concerned with maintaining competition. IP laws protect against copying, which may provide some market power, but help competition by allowing competition from follow-on substitute products. Generally, developed countries do not give IPRs immunity from competition law but do allow for some differences in treatment from normal competition laws. As previously mentioned, IP law is mainly determined by international treaty (TRIPS), while competition laws are determined nationally. Article 8.2 of TRIPS says, "... appropriate measures, provided that they are consistent with the provisions of this Agreement, may be needed to prevent the abuse of intellectual property rights by rights holders or the resort to practices which unreasonably restrain trade or adversely affect the international transfer of knowledge."

The anti-competitive use of IPRs can be divided into three main types:

1. Strategic conduct by firms in setting too wide a scope for intellectual property rights due to deficiencies in the procedures for examining and granting the IPR. This is mainly a problem with patents, where patent applications may be given too easily or too broadly and so are used to block other beneficial patents. Differences between ASEAN countries in patent grants could lead to disputes. Harmonizing registration systems (for patents and trademarks) would reduce future conflicts.
2. Where the IPR grant is correct but used in a way that limits competition in either the product market, innovation (licensing) market or a research and development market; for example, a dominant firm tying an unrelated good or service X, which reduces competition in the market for X.
3. Where there is abusive enforcement of IPRs by either ASEAN or non-ASEAN countries; for example, a firm with considerable resources prevents, improperly, a less well-resourced firm from exploiting a new idea by predatorily claiming the small firm's patent has infringed an existing patent. The only solution here is rigorous IPR examination systems and sophisticated courts. The Action Plan is, by stressing institutional development, likely to address this problem.

Each problem is discussed in turn as follows.

#### **4.1 Problems in the Procedures for Examining and Granting an IPR**

While the boundaries of copyright protection are clear, patent boundaries are usually vague and settled only through expensive litigation. Jaffe and Lerner<sup>28</sup> describe how the US patent system:

... provides incentives for applicants to file frivolous patent applications, and for the patent office to grant them. It likewise encourages patent holders to sue, and those accused of patent infringement to give in and pay under threat, even if the patent is of dubious validity.

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<sup>27</sup> Sanchita Basu Das, Jayant Menon, Rodolfo C Severino, Omkar Lal Shrestha, 2013.

<sup>28</sup> Jaffe, Adam B. and Josh Lerner. *"Innovation and Its Discontents: How Our Broken Patent System is Endangering Innovation and Progress, and What to Do About It"*. Princeton, NJ: Princeton University Press, 2004, p. 6.

Uncertain patent boundaries affect the ability of others to improve products and processes. These could be improvements that better suit a country's circumstances, such as the development of drugs for tropical conditions. Uncertainty also allows firms to use a number of strategies, such as making a broad claim. Firms could set up a number of narrow claims with gaps in between, which a would-be patentee would have trouble negotiating, or build a cluster of patents around a new technology. Challenges to these large numbers of patents are much costlier to litigate.

Externally imposed regulation can also provide the holder of an IPR with market power. For example, environmental regulations requiring the best or cleanest technology will limit competition from older technologies. Countries can try to stifle imports by setting technology standards best suiting local companies. Or companies in a country could agree to an industry-wide technology standard that favors their own technology.

In dealing with the potential anti-competitive impact of patent grants, the OECD has recommended a number of measures, including stricter examination of patent applications or a discount for successful grants, thus raising the cost of unsuccessful applications and so deterring frivolous claims and the greater use of petty patents or utility models as alternative for minor inventions, which are protected for a shorter time period.<sup>29</sup>

Trademarks may not last forever, if the trademark relates to an expired patent. For example, LEGO's patents on the geometrical patterns on the studs on top of the bricks expired, but LEGO tried to protect those designs by trademark. The Canadian Supreme Court ruled against it, saying, "A purely functional design cannot be the basis of a trademark and trademark law should not be used to perpetuate monopoly rights enjoyed under now-expired patents. [40–61]"<sup>30</sup>

#### **4.2 Problems When IPR is Used to Limit Competition**

As the pace of globalization increases and companies (and countries) develop a better understanding of their intangible assets, companies look for more imaginative strategies to maximize the value of their IPRs and to stop others from using them. For example, pharmaceutical companies may try to "patent-flood" to stop generics or deliberately raise the costs of rivals legally imitating them or by refusing to license or supply drugs when faced with terms they do not like. Or dominant firms may offer cumulative discount schemes designed to prevent the entry of new competitors. Or micro-processor manufacturers may acquire a patent portfolio to use when either negotiating cross-licenses with other manufacturers or trying to avoid patent litigation. In these cases, IPRs provide some kind of market power, which is then used to reduce competition by new or existing competitors. Of course, the market power may be domestic or derived from overseas.

Copyright has a smaller breadth than patents but can still be used anti-competitively. In both *Magill* and *IMS* the ECJ said that in exceptional circumstances the European Commission could prevent a refusal to license as an abuse of a dominant position by imposing a compulsory copyright license.<sup>31</sup> For example, in *Europe*, in *Microsoft*, the General Court upheld the European Commission's decision to order compulsory access to interface codes protected by IPRs on the grounds that technological progress was impeded. When these problems arise across countries the only solution is cooperation between national

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<sup>29</sup> OECD 2004, p. 29.

<sup>30</sup> *Kirkbi AG v. Ritvik Holdings Inc.*, 2005 SCC 65, 2005, 3 S.C.R. 302.

<sup>31</sup> *C-241-2/91P Radio Telefis Eireann & ITP v. Commission* [1995] ECR I-743 (*Magill*). *C-418/01 IMS Health GmbH & Co OHG v. NDC Health GmbH & Co* 2004, 4 CMLR 1543.



competition agencies or an ASEAN-wide competition law. Cooperation alone is likely to be problematic, as the effects of anti-competitive conduct will differ across countries. For example, a merger between two firms in ASEAN could be beneficial for one country (which gains employment) and worse for another (which loses research or production facilities). In these kinds of situations, there will be a direct conflict between overall ASEAN economic welfare where resources go to countries that can best use them and the interests of individual countries who may use industrial policies to advantage their own country at the expense of other ASEAN countries. While these kinds of problems are mainly political and can be resolved through existing means, there is still a place for independent examination of the likely effects through perhaps the ASEAN Experts Group on Competition or cooperation among competition regulators.

#### **4.3 Where There is Abusive Enforcement of IPRs**

Firms may seek injunctions through the courts to try and stop legitimate competition. In the United States, the fraudulent procuring of a patent by a firm with market power can violate s. 2 of the Sherman Act, i.e., the monopolization or abuse of dominance.<sup>32</sup> In addition, competition law may sanction situations where litigation by a firm with market power is either “objectively baseless” or used by the firm as an anticompetitive weapon.<sup>33</sup> Similarly, sometimes customs authorities have the power to detain goods suspected of infringing IP laws.<sup>34</sup> These kinds of problems can only be resolved through proper enforcement.

#### **4.4 Getting the ASEAN Balance Right between Competition Law and IPRs**

Competition law limits the exercise of IPRs based on the adverse economic effects of the conduct. But getting the balance right between giving incentives to create new ideas and their dissemination is not easy. Importantly, from a regional integration perspective, the balance will differ between countries. Countries with considerable research and development like the United States and Japan will not want to limit their company’s strategic use of IPRs in other countries, if it damages their own future research and development (R&D). Countries without domestic R&D will be more concerned with the low-priced dissemination of goods and services involving IPRs (almost all from overseas), because there is negligible domestic economic impact on innovation in the short term. But as countries develop and engage in domestic R&D, there will be greater concern to develop and protect local innovation. Hence, there will be an increasing concern with anti-competitive use of domestic innovation if it hinders further innovation.

Countries in ASEAN are at different stages of development and have different levels of R&D and domestic competition. Singapore is the most developed and has the highest level of IPR protection coupled with considerable international competition due to an absence of trade barriers. Other countries, like Cambodia, Lao People’s Democratic Republic and Myanmar, have negligible R&D and undeveloped, uncompetitive markets. Determining a one-size-fits-all model of competition law and IPRs would not seem possible. Some countries will not want to sacrifice static efficiency losses, particularly when the innovative benefits go elsewhere. Countries with high levels of research and development will

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<sup>32</sup> Walker Process Equipment v. Food Machinery & Chemical Corp. 382 US 172 (1965).

<sup>33</sup> Professional Real Estate Investors, Inc., v. Columbia Pictures Industries, Inc. 508 US 49 (1993).

<sup>34</sup> e.g., see European Regulation 1383/2003.

want their firms to maximize their profits in other countries. Because ASEAN countries have different interests in balancing static efficiency and dynamic efficiency, firm conduct that may be in the interests of one country may not be in the interests of another. For example, Singapore, with its much higher level of research and development and living standards may not want to affect research incentives and so will be careful about using competition law to limit what innovators can do in Singapore. On the other hand, a less developed country in ASEAN, with negligible research and development, may find it in its interest to limit the anti-competitive use of IPRs.

Thus, harmonization of the standards used to judge anti-competitive use of IPRs may not be justified. If national interest is paramount, then each ASEAN country should develop its own standards for the anti-competitive use of IPRs, as whether a practice is anti-competitive or not depends on its impact or effect in their own country. Harmonization of IPR competition rules would inevitably favor some countries within ASEAN over others.

#### **4.5 Some Examples of Anti-Competitive Practices That Can Affect Intra-ASEAN Trade**

Anti-competitive conduct can occur in any of the areas normally proscribed by competition law, i.e., single-firm conduct by a dominant firm, anti-competitive agreements involving IPRs, and anti-competitive mergers that involve IPRs. An important area in practice in developed countries has been refusals to supply IPRs. Generally, competition law in developed countries regards IPRs in the same way as other forms of property and so owners have the right to refuse sale or license. However, in certain circumstances some countries enable compulsory licensing to allow others to compete, the circumstances differing from jurisdiction to jurisdiction. It is important to note that developed countries use compulsory licensing to correct violations of competition laws (for example, unilateral refusals to license). In the United States, the Federal Trade Commission (FTC) has used compulsory licensing to remedy an antitrust violation.

Rambus had concealed essential patents it held from an industry-wide standards-setting organization. The FTC imposed a compulsory license by setting a maximum royalty rate.<sup>35</sup> In the EU, competition law has been used to force compulsory copyright licenses.<sup>36</sup> Compulsory licensing is not inconsistent with TRIPS. Article 8.2 of the TRIPS Agreement recognizes that: Appropriate measures, provided that they are consistent with the provisions of this Agreement, may be needed to prevent the abuse of intellectual property rights by right holders or the resort to practices which unreasonably restrain trade or adversely affect the international transfer of technology. Section 8 of Part II of TRIPS provides for international cooperation in the control of anti-competitive practices in contractual licenses and allows members to take appropriate remedies, such as the grant of a compulsory license. Where a compulsory license is granted to remedy a practice determined after judicial or administrative process to be anti-competitive, there is no longer a requirement to seek first a voluntary license on reasonable commercial terms and conditions, the goods produced under the license need not be predominantly for the supply of the domestic market of the member granting the compulsory license, and the need to correct anti-competitive practices may be taken into account in determining the amount of remuneration of the right holder.

Developing countries have also used competition laws to force supply, particularly for pharmaceutical products. In 2003, the Competition Commission of South Africa found that

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<sup>35</sup> In the matter of Rambus Inc., Docket No. 9302, Opinion of the Commission on Remedy, 5 February 2007.

<sup>36</sup> C-418/01 IMS Health GmbH & Co OHG v. NDC Health GmbH & Co [2004] 4 CMLR 1543.

GlaxoSmithKline and BoehringerIngelheim had abused their dominant positions in their anti-retroviral markets and violated prohibitions against excessive pricing. The Commission also found that the firms had refused access to essential facilities and the exclusionary activities had anti-competitive effects, which outweighed any technological, efficiency or other precompetitive gains. Menzi Simelane, Commissioner at the Competition Commission said (Competition Commission of South Africa Press Release 2003): Our investigation revealed that each of the firms has refused to license their patents to generic manufacturers in return for a reasonable royalty. We believe that this is feasible and that consumers will benefit from cheaper generic versions of the drugs concerned. We further believe that granting licenses would provide for competition between firms and their generic competitors.

Other kinds of dominant firm conduct can include tying (i.e., forcing consumers to buy a product as a condition of selling a product they do not want). This could be a patent or copyright tie (e.g., block booking of films where one copyrighted film is licensed on condition that the exhibitor also licenses another film) or trademark. It could also involve deceptive conduct before standard setting organizations, such as failing to disclose the holding of a patent that could be used to stop other firms from manufacturing products according to the standard.

Anti-competitive agreements could include IPR price-fixing, patent pooling, blanket licensing of copyright works (to collecting societies), standards setting organizations that set standards to exclude particular technologies, and market allocation (e.g., firms distributing products incorporating IPRs across countries), where parallel importing is not available. This means that firms can set different prices in different countries, because arbitrage across countries is not allowed due to the fact that the IPR holder has sole right to sell in each country.

## **5. Conclusions and Implications for ASEAN**

The welfare effects of strong IPR protection in a regional integration context are ambiguous. This is supported both by theory and empirical evidence. For less developed countries, the introduction of IPR protection legislation can reduce employment and the profits of local imitators. Yet, it may also lead to more research and development by developed countries by adapting and tailoring their products to developing country problems. In addition, there may be a greater willingness on the part of developed countries to invest in developing countries or to form joint ventures, or license production. The empirical evidence suggests that, although strong IPR protection may facilitate technology diffusion, the link with economic growth is weak. If anything, the growth experience of East Asian countries shows that strong IP protection is not an important determining factor for foreign direct investment. For developing countries, rapid growth is more often associated with weaker IP protection.

Inside ASEAN, the TRIPS agreement sets a minimum standard of protection, since all countries are signatories, yet TRIPS allows IPRs to be tailored to a national level of development. More importantly, while in principle, protection standards may be uniform under TRIPS, it does not provide for a uniform enforcement system. Harmonizing both rules and enforcement is an important element of reducing trade barriers. But the latter is difficult, not just in developing countries but also in single markets such as the European Union. Europe only started on the path of harmonizing enforcement in 2004, and the progress has been slow. However, in the absence of a harmonized ASEAN IPR system, IPR registration or enforcement within ASEAN will have different requirements in each country. This could mean less foreign direct investment into the region compared to a harmonized system. Cooperation among ASEAN countries and capacity development may be sufficient to resolve issues such as setting too wide a scope for IPRs and abusive enforcement of IPRs. However, only aggressive enforcement of

competition law can solve issues related to the exclusionary use of IPRs by both domestic and foreign firms. Given the diversity in the level of economic development among ASEAN countries, it is reasonable to expect that countries will balance static and dynamic efficiency goals differently. Countries without domestic research and development (R&D) will be more concerned with the low-priced dissemination of goods and services involving IPRs (almost all from overseas) because there is negligible domestic economic impact on innovation in the short term. For the more developed members of ASEAN, which engage in domestic R&D, there will be greater concern to develop and protect local innovation. Because ASEAN countries have different interests in balancing static efficiency and dynamic efficiency, firm conduct that may be in the interests of one country may not be in the interests of another. It is not evident that this issue can be resolved only by cooperation. So it may prove to be another impediment to achieving the goal of a single market and production base. It appears then that ASEAN countries, like those in many other regions are adopting these policies for signalling and symbolic reasons. The focus of IP law now and post-2015 should be on the institutional arrangements to ensure the effective implementation and enforcement of agreed policies.

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# The Possibility of Introducing Close-Out Netting Provision into China's Legal System

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## I. Introduction

China's financial market has experienced tremendous growth and presented significant new business opportunities and advantages for both foreign and domestic companies. The growth of China's financial market, including derivatives market heightened the necessity for a solid legal and regulatory infrastructure and thus the financial regulation landscape has changed. Close-out netting is a kind of contractual arrangement adopted by market participants, particularly the financial institutions, to reduce the credit risk of the counterparties. Furthermore, this mechanism can enhance the stability of the financial system. The absence of explicit close-out netting arrangements in China has posed obvious problems to market participants, particularly international companies. They need statutory support to eliminate legal risks arising in transactions and stimulate the expansion of derivative market. Legal certainty is needed for counterparties entering into derivative transactions, particularly in insolvency cases.

This article will track developments in China about the adoption of close-out netting arrangements. Part II describes the general understanding of close-out netting provisions in the scale of the global markets. Part III examines the set-off concept in China's bankruptcy law and compares it with typical close-out netting provision. The policy reasons behind set-off is examined. Part IV concludes the emergence and development of close-out netting provisions in master agreements in China. Part V emphasizes the consideration of close-out netting in capital adequacy and the adoption of close-out netting concept in China's supervision of capital adequacy of commercial banks. Part VI focuses on the ambiguity in the conflict-of-laws regime governing cross-jurisdictional bankruptcies, and analyses whether the selection of close-out netting provisions in contract violates China's mandatory law. Part VII draws some conclusions as to the application of close-out netting in future.

## II. Adoption of Close-out netting on a Global Scale

A close-out netting provision is "a contractual clause or agreement referring to underlying contracts between the same parties that provides for the termination of these contracts upon the occurrence of a predefined event, either automatically or at the election of one of the parties to the agreement, followed by a valuation of the mutual obligations under the terminated contracts and the determination of a net aggregate value for all of these obligations".<sup>①</sup> Close-out netting has reduced OTC derivatives credit exposure by over 85 percent, if there is no netting, banks throughout the world might face a capital deficit of over \$500 billion.<sup>②</sup> According to Prof. Ole Boger, the legal officer at the UNIDROIT Secretariat's survey, there is a clear trend in the world that close-out netting provisions are recognized and their enforceability is admitted before and after the insolvency proceedings.<sup>③</sup> But the scope, extent and legal effects in different jurisdictions are not uniform.<sup>④</sup> Thus, the UNIDROIT released the Principles on the Operation of Close-Out

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<sup>①</sup> Ole Boger, *Close-out Netting Provisions in Private International Law and International Insolvency Law*, Unif. L. Rev., 18, 232,235(2013).

<sup>②</sup> David Mengle, *Research Notes: The Importance of Close-out Netting*, 2010, available at <http://www.isda.org/researchnotes/pdf/Netting-ISDAResearchNotes-1-2010.pdf>(last visited on Feb. 1, 2014).

<sup>③</sup> *Supra* note 1, at 234.

<sup>④</sup> Stephanie Loizou, *Close-out Netting and Introduction to the UNIDROIT Principles on Its Enforceability*, 27 J.I.B.L.R., 429, 430(2012).



Netting Provisions at its 92nd session on May 10, 2013. These Principles provide further guidance on revising or introducing close-out netting into national legislation.<sup>⑤</sup>

On the other hand, the International Swap and Derivatives Association ('ISDA') introduces close-out netting arrangements by another approach, the standard contracts. The close-out netting provision appears in Section 6 of ISDA Master Agreements. It emphasizes the right to terminate contracts following event of default or termination event and each party should calculate and net the termination values of those transactions to produce a single amount payable between the parties. Along with standard documentation, ISDA engages in constructive consultations with policymakers and legislators and publishes industry legal opinions on the enforceability of close-out netting.<sup>⑥</sup> On Nov. 10, 2008, ISDA submitted to China's Banking Regulatory Commission about concluding close-out netting arrangements in China's drafting Financial Institution Bankruptcy Law.<sup>⑦</sup> Later on Feb. 25, 2014, ISDA commissioned King & Wood Mallesons to provide updated analysis of close-out netting of privately negotiated derivatives transactions under ISDA Master Agreements in China.<sup>⑧</sup>

### III. The Application of Set-off and Close-out Netting in China's Law System

China's legal system is similar to civil law jurisdiction, and the bankruptcy law is traditionally debtor-friendly. China's Enterprise Bankruptcy Law applies to a legal person 'fails to clear off its debt as due, and its assets are not enough to pay off all the debts or is obviously incapable of clearing off its debts'.<sup>⑨</sup> The Enterprise Bankruptcy Law also applies to financial institutions, *eg.* a commercial bank, securities company or insurance company.<sup>⑩</sup> Compared to the application for bankruptcy of general enterprises could only be proposed by debtors or creditors, financial regulatory authority under the State Council could lodge an application with the court for reorganization or bankruptcy liquidation of financial institutions instead of debtors and creditors to prevent further losses.<sup>⑪</sup> Furthermore, the Enterprise Bankruptcy Law authorizes the State Council formulates the measures effecting financial institutions bankruptcy according to the provisions of this Law and other laws. In the history, from the beginning of China's reform and opening-up policy in 1978 till now, there was only one bank, Hainan Development Bank failed and went bankrupt. However, with the effort to push banks to be more competitive, China is preparing to release bank deposit insurance system and then promulgate special regulation on the bankruptcy of financial institutions.<sup>⑫</sup>

In theory, China's Enterprise Bankruptcy Law does not support close-out netting and it is likely that the court should apply set-off rules instead. Set-off is always found in civil country when paying off the debt, the creditor may claim the right of offset against the debtor's claim a debt owed by the debtor's to the defendant.<sup>⑬</sup> The term set-off could be found in China's 1999 Contract Law and China's 2006 Enterprise Bankruptcy Law. When a creditor is indebted with its debtor when an application for bankruptcy is accepted, it may claim for offset against the bankruptcy administrator.<sup>⑭</sup> In China, set-off by the creditor is based on application but not an

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<sup>⑤</sup> UNIDROIT, *Principles on the Operation of Close-out Netting Provisions*, Unil. L. Rev., 18, 330, 338(2013).

<sup>⑥</sup> ISDA, *About ISDA*, available at <http://www2.isda.org/about-isda/> (last visited on Mar. 23, 2014).

<sup>⑦</sup> ISDA, *ISDA submission to China Banking Regulatory Commission on Close-out netting*, Nov. 10, 2008, available at <http://www2.isda.org/search?headerSearch=1&keyword=china+netting> (last visited on Mar. 23, 2014).

<sup>⑧</sup> ISDA, *Memorandum on Enforceability of Close-out Netting in China*, Feb. 25, 2014, available at <http://www2.isda.org/news/memorandum-on-enforceability-of-close-out-netting-in-china> (last visited on Mar. 25, 2014).

<sup>⑨</sup> Art. 2 of China's Enterprise Bankruptcy Law.

<sup>⑩</sup> Art. 134 of China's Enterprise Bankruptcy Law.

<sup>⑪</sup> *Id.*

<sup>⑫</sup> Xinhua, *China Moving Closer to Bank Failures*, Jan. 13, 2014, available at <http://english.caijing.com.cn/2014-01-13/113810663.html> (last visited on Mar. 25, 2014).

<sup>⑬</sup> Mark Hsiao, *Does China Need Financial Derivatives' Regulation: Catch 22 or a Vicious Circle?*, 27 B.F.L.R. 445, 455(2012).

<sup>⑭</sup> Art. 40 of China's Enterprise Bankruptcy Law.

automatic process.<sup>15</sup> Thus, compared to other creditors, the non-defaulting party could take advantage of set-off when the counterparty is in liquidation.

On Sep. 12, 2013, the Supreme People's Court of China released the Provisions(II) on Several Issues concerning the Application of the Enterprise Bankruptcy Law('the Provisions(II) of the Enterprise Bankruptcy Law'). The purpose of the Provisions(II) of the Enterprise Bankruptcy Law was to correctly apply the Enterprise Bankruptcy Law, in light of judicial practice. The Provisions(II) of the Enterprise Bankruptcy Law make set-off mechanism more practicable, and ISDA praised that 'China has made great progress toward becoming a netting enforceable jurisdiction'.<sup>16</sup> It states that the court will not support the administrators' objection, that the debts are of a different nature or the obligations are not due when the court accepts the application for bankruptcy.<sup>17</sup> That is to say, set-off, as well as close-out netting could accelerate transactions despite of the payment dates of which would otherwise differ.

However, as the mechanism and application of set-off and close-out netting are not the same, there are still two related factors determining the difference between them. Bankruptcy administrator might demand 'cherry picking' of contracts favorable to the insolvency party, but reject contracts burdensome to it. China's Enterprise Bankruptcy Law provides that after the court accepts an application for bankruptcy, the bankruptcy administrator shall decide to rescind or continue to perform a contract that has been established before acceptance yet has not been fully performed by both parties concerned and notify the opposite party concerned of its decision.<sup>18</sup> Where the bankruptcy administrator fails to inform the opposite party concerned within 2 months as of the day of acceptance or to make any reply to an urge made by the opposite party concerned, it shall be deemed as rescission of the contract.<sup>19</sup> Without close-out netting, the non-defaulting party would pay in full to the out of money transactions while an ordinary creditor just receives little or nothing of the in the money transactions. Another question is whether the court recognizes the concept of a single agreement under the master agreement where all transactions between the same parties are treated as one single transaction. The close-out netting provision requires the termination and settlement of derivatives transactions under a single agreement, so that to limit or prevent potential losses of the solvent party. But it is obvious that if the bankruptcy administrator executes the right of 'cherry picking' under set-off, the transactions between the same parties will not calculate as a single agreement.

#### IV. The Development of Master agreements in China

The practice regarding documentation is considered as the market matures. Close-out netting provisions also can be found in China's standard derivative products contract, *eg.* the National Association of Financial Market Institutional Investors('NAFMII') Master Agreement. NAFMII is a self-regulatory organization founded to promote sustainable development of China's OTC market by innovations, self-discipline and serving market players.<sup>20</sup> The NAFMII Master Agreement is structured like the ISDA Master Agreement. It has rules for performance of payment or delivery obligations under the transaction, events of default, termination events, handling of events of default and termination events, dispute resolution, etc. The NAFMII Agreement define the types of transactions covered to 'including but not limited to, interest rate derivative transactions, currency derivative transactions, bond derivative transactions, credit derivative transactions, gold derivative transactions, and any combination of such transactions'.<sup>21</sup>

Upon the effective designation or occurrence of an Early Termination Date, close-out netting

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<sup>15</sup> *Id.*

<sup>16</sup> *Supra* note 8.

<sup>17</sup> Art. 43 of the Provisions(II) of the Enterprise Bankruptcy Law.

<sup>18</sup> Art. 18 of China's Enterprise Bankruptcy Law.

<sup>19</sup> *Id.*

<sup>20</sup> NAFMII, *About NAFMII*, available at <http://www.nafmii.org.cn/english/> (last visited on Feb. 23, 2014).

<sup>21</sup> Section 25 of the NAFMII Master Agreement.

shall apply to all Terminated Transactions between the Parties under this Agreement(NAFMII Art9(I)(3)). Furthermore, in the calculation formula, NAFMII Master Agreement requires the termination currency equivalent of the aggregate amount is determined by all Terminated Transactions.<sup>22</sup> This is another evidence that NAFMII Master Agreement adopts the single agreement concept, because parties do not need to make individual payments according to each Early Terminated Transaction. On the other hand, the parties could agreed on the ‘Automatic Early Termination’ in the Supplement, the early termination date is determined on: (A) the date of the occurrence with respect to a Party of an Event of Default specified in items 1, 4, 6, 7 or, to the extent analogous thereto, 9 of Section 6(VIII) of the Master Agreement; or (B) if an Event of Default specified in item 5 or, to the extent analogous thereto, 9 of Section 6(VIII) of the Master Agreement occurs in respect of a Party, the Early Termination Date shall be the date of the institution of the relevant proceeding or the presentation of the relevant petition.<sup>23</sup> Most of these specified events are related to the occurrence or possibilities of financial and/or business operational difficulties. In addition, NAFMII Master Agreement deals with the calculation of the respective obligations of the parties. Under NAFMII Master Agreement, the Early Termination Payment Amount should be calculated ‘in good faith and in a commercially reasonable manner without any duplication’.<sup>24</sup>

## V. Close-out Netting and Capital Adequacy

Close-out netting arrangements are also important to financial institutions when referring to prudential capital requirements, as they may be permitted to report a net exposure when calculating the efficacy of capital.<sup>25</sup> In other words, it could limit a party’s exposure when open contractual obligations are to be performed, if its counterparty defaults.<sup>26</sup> The Basel Committee on Banking Supervision published a set of requirements for capital adequacy, including the Basel Capital Accord of 1988, subsequent Basel II of 2004 and now effectively superseded by Basel III of 2010. Both Basel II and Basel III specifically recognize it as a risk reduction tool, requiring supervisors to recognize the importance of close-out netting for capital adequacy purposes.

In China, the Banking Regulatory Commission issued the Administrative Measures for the Capital of Commercial Banks(‘the Administrative Measures’) on Jun. 7, 2012. The Administrative Measures were to strengthen the stable operation, capital supervision and administration of commercial banks,<sup>27</sup> but effectively, it also bring the netting legislation in line with recommendations of Basel Capital III. Annex 6 of the Administrative Measures names Regulatory Requirements for Risk Mitigation in the Internal Rating-based Approach for Credit Risk, and outlines ‘netting’ in Annex 6(3) that is similar to close-out netting arrangements in Basel Capital III. This change may facilitate banks to reach the capital requirements under the Administrative Measures. It seems that the supervisory administration responds to the requests from the financial institutions for the clarifications. Although the Administrative Measures addresses some market concerns over the close-out netting arrangement, there are still potential weaknesses. The Enterprise Bankruptcy Law prevails over the Administrative Measures in jurisdiction. Anyhow, it could still be a step to adopt close-out netting arrangements, because the insolvent party’s credit analysis is dependent upon close-out netting for the qualified transactions between the non-defaulting party and the insolvent bank.

<sup>22</sup> Section 9(II)(2) of the NAFMII Master Agreement.

<sup>23</sup> Items 1, 4, 5, 6, 7, 9 of Section6(VIII) of the NAFMII Master Agreement are: dissolution; transfer agreement or settlement agreement to all or substantially all of its assets; passes a resolution for its winding-up; liquidation or application for bankruptcy, seeks or becomes subject to the appointment of a provisional liquidator, custodian, trustee, official manager or other similar official for it or for all or substantially all its assets; any other event that has a similar effect.

<sup>24</sup> Section 9(2) of the NAFMII Master Agreement.

<sup>25</sup> Mark Dunlop, *Statutory Recognition of Netting, Contractual Subordination and Non-Petition Provisions*, 6 J.I.B.L.R., 359, 360(2006).

<sup>26</sup> Georgie Coleman, *Netting Considered by the Australian Courts*, 26 B.F.L.R., 283, 283(2011).

<sup>27</sup> Article 1 of the Administrative Measures.

## VI. Conflict of Laws Questions

Until now, the Supreme People's Court of China remained silent on close-out netting and didn't try to resolve the ambiguity of Enterprise Bankruptcy Law ahead of an actual bankruptcy case.<sup>28</sup> Therefore, if the counterparty is located in different jurisdiction, could it choose the law to give effect to the close-out netting provisions? Many jurisdictions provide protection for counterparty by bankruptcy law of close-out netting. Then, the successful enforcement of close-out netting provisions depends on the insolvency rules adopted where bankruptcy proceedings is initiated. As mentioned above, the uncertainty for entering derivatives with a Chinese participant is high as China's legislation and jurisdiction didn't clarify close-out netting arrangements. The effectiveness of close-out netting provision in derivative contracts depends on what China's law would classify the contracts when calculating values.

In practice, enforceability includes two elements: firstly, enforceability under the governing law of the contract; secondly, consistency with the insolvency laws of the jurisdiction where the counterparty is located.<sup>29</sup> Under China's Contract Law and the Law on Choice of Law for Foreign-related Civil Relationship, the parties may explicitly choose the laws applicable to foreign-related civil relations.<sup>30</sup> However, if there are mandatory provisions on foreign-related civil relations in the laws of China, these mandatory provisions shall directly apply.<sup>31</sup> According to Art. 10 of the Interpretations of the Supreme People's Court on Several Issues Concerning Application of the Law of China on Choice of Law for Foreign-related Civil Relationships(I), set-off in China's Contract Law or Enterprise Bankruptcy Law is not included in the provisions of the laws and administrative regulations in connection with the social public interests of China, the application of which the parties cannot preclude by agreement, and that can be directly applicable to the foreign-related civil relationship without guidelines on conflict rules, thus is not the mandatory provisions. Overall, although it is not expressly recognized under China's law or tested by courts, I still hold the opinion that the selection of close-out netting provisions in contracts would be enforceable and recognized under China's law in the bankruptcy proceeding initiated by China's court.

## VII. Conclusion

As a legal term, close-out netting has stood the test of time and has proven to be adapted to a wide variety of legal jurisdictions,<sup>32</sup> but it is never recognized by China's law. The contracting parties have to resort to the similar concept 'set-off'. On the other hand, close-out netting as a contract provision has been increasingly recognized in master agreements. Therefore, participants in China's financial markets have long called for the admission of close-out netting. The UNIDROIT has provided a set of coherent principles to harmonize different jurisdictions, so was ISDA. China should push on the legislative effort to strengthen the enforceability of early termination, close-out netting provisions and related arrangements. However, before explicitly introducing close-out netting into China's law, the interpretation of Supreme People's Court should firstly admit that close-out netting clauses in derivative contracts are valid and enforceable. Thus, the bankruptcy administrator cannot attempt to set aside close-out netting that appeared in terms of contracts.

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<sup>28</sup> Chinese Courts Unlikely to Rule on Netting Law, Jun. 26, 2013, *available at* <http://www.globalcapital.com/article/jby6cksny9dw/chinese-courts-unlikely-to-rule-on-netting-law>(last visited on Mar. 28, 2014).

<sup>29</sup> ISDA, The Legal Enforceability of the Close-out Netting Provisions of the ISDA Master Agreement and Their Consequences for Netting on Financial Statements, *available at* [http://www.isda.org/c\\_and\\_a/pdf/The-effectiveness-of-netting.pdf](http://www.isda.org/c_and_a/pdf/The-effectiveness-of-netting.pdf)(last visited on Apr. 10, 2014).

<sup>30</sup> Art. 3 of the Law of China on Choice of Law for Foreign-related Civil Relationships.

<sup>31</sup> Art. 4 of the Law of China on Choice of Law for Foreign-related Civil Relationships.

<sup>32</sup> *Supra* note 2.

Study Report

**Comparative Study on Fundamental Breach  
under the CISG, PICC and Chinese Contract  
Law**

By Yang Jiuying<sup>1</sup>

As a result of the research at UNIDROIT from April to May 2014

Rome

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## **I. Background and purposes of the report**

The doctrine of 'fundamental breach' is at the heart of law of contract, more especially contract of sale of goods. Defining fundamental breach is always to some extent case-specific. Since the definition is so vague, it is difficult to settle on strict rules for all cases. If the breach is regarded as fundamental, consequences, such as termination of the contract, can be very serious. Therefore in an international context, the concept of fundamental breach of contract is the subject of discussion. International instruments for the regulation of international civil transactions (United Nations Convention on International Sales of Goods (CISG)<sup>2</sup>, UNIDROIT Principles of International Commercial Contracts (PICC)<sup>3</sup> and European Union instruments concerning contract law (The Principles of European Contract Law (PECL)<sup>4</sup>) harmonize and unify the concept of the fundamental breach and are at the core of research. Principles, Definitions and Model Rules of European Private Law/ Draft Common Frame of Reference' (DCFR)<sup>5</sup> is an important source for defining the concept of the fundamental breach of contract, not only as an academic text, but also as "a possible model for an actual or 'political' Common Frame of Reference (CFR)<sup>6</sup>". China as a member of CISG, fundamental breach is applicable when solve the dispute under CISG. However, The concept of fundamental breach is different between under CISG, PICC and China's contract law. This report will make an analysis of the doctrine of fundamental breach under the CISG, UNIDROIT principles and Chinese contract law. This analysis becomes necessary because of various roles the doctrine plays under these laws.

## **II. Fundamental Breach in General**

Prerequisites of a fundamental breach (foreseeability, substantial detriment, reasonable man criterion, intention or recklessness, strict compliance, the essence of the contract, loss of reliance, disproportionate loss) depend on 1) an objective criterion, i.e. conditions of express agreement, suffered damages; and 2) a subjective criterion, indicating the aggrieved party's expectations and each party's perception of the breach. Since fundamental breach has connection with remedies or obligations, so that fundamental breach is a gateway provisions. There is hardly any better legal doctrine, which anchors activities surrounding international sale of goods like the doctrine of fundamental breach of contract. It is an important legal instrument that rears its head up from time to time due to induced or sometimes supervening commercial non-performance.

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<sup>2</sup> <<http://www.cisg.law.pace.edu/cisg/text/treaty.html>> (Accessed on 24-4- 2014).

<sup>3</sup> UNIDROIT principles on international commercial contracts 2004, International Institute for the Unification of Private Law

<sup>4</sup> The Commission of European Contract Law/ edited by Ole Lando, Hugh Beale 'Principle of European contract Law' Parts I and II, 2000, Kluwer Law

<sup>5</sup> Study Group on a European Civil Code and the Research Group on EC Private Law (Acquis Group) 'Principles, Definition and Model Rules of European Private Law/ Draft Common Frame of Reference (DCFR)'/ edited by Christian von Bar and Eric Clive, 2009, Munich

<sup>6</sup> Study Group on a European Civil Code and the Research Group on EC Private Law (Acquis Group) 'Principles, Definition and Model Rules of European Private Law/ Draft Common Frame of Reference (DCFR)'/ edited by Christian von Bar and Eric Clive, 2009, Munich, p. 3



The concept of fundamental breach has assumed many other names and descriptions over the years, the UNIDROIT Principles refers to it as fundamental non- performance, while under the common law regime, the meaning and connotation of the concept of fundamental breach is slightly different and without any major pith or substance.

### **III. Fundamental Breach in CISG**

#### **3.1 From Article 10 of the ULIS to Article 25 of the CISG.**

Article 10 of the 1964 Convention on Sale Annex Uniform Law On the International Sale of Goods (ULIS) was the forerunner of Article 25 of the CISG, the doctrine of 'Fundamental Breach of Contract' in the international sales law was a s a result of work of Ernst Rabel while articulating the distinction between allowing an aggrieved party the leave to declare a contract avoided where there is a substantial breach or restricting him to a claim of damages where the breach is less severe<sup>7</sup>. Article 10 of the ULIS provides that:

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.

This provision made case for a subjective interpretation of what situations can give rise to a fundamental breach. Since it made it susceptible to multiplicity of interpretations, this without doubt defeated the uniformity mantra of the law of international sales. There was no criterion to be based on to judge what magnitude of breach would constitute a fundamental breach. Article 10 of the ULIS dependent on the 'reasonable person rule' that is worthless in the domain of the international law, since various jurisdiction can make dis-similar decisions while applying it. Article 25 of the CISG is therefore a great improvement from its predecessor, it does not only categorically states that the breach must result in a detriment in order to be regarded as being fundamental, but the detriment must in turn substantially deprived the aggrieved party of his honest expectations under the contract. Article 25 defines the term "fundamental breach," which is used in various provisions of the Convention. It differs from all other similar concepts in contemporary domestic laws.<sup>8</sup> A fundamental breach as here defined is a prerequisite for certain remedies under the Convention, including a party's right to avoid the contract under articles 49 (1) (a) and 64 (1) (a), and a buyer's right to require delivery of replacements for goods that failed to conform to the contract (article 46 (2)). The phrase is also used in other provisions of the Convention in connection with avoidance of contract (see articles 51 (2), 72 (1), 73 (1) and (2)). A fundamental breach

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<sup>7</sup> Peter Schlechtriem and Ingeborg Schwenzer, *Commentary on the UN Convention on the International Sale of Goods* Oxford Press, 2nd Edn, 2005, Para 2, 282

<sup>8</sup> The "fundamental breach" in CISG "has nothing to do with the English doctrine of fundamental breach". The latter was used to "determine whether disclaimer clauses survived a particular breach of contract", and was abandoned in 1980. Hence it is said that the phrase "fundamental breach" in CISG has "no familiar parentage in other jurisdictions". In sum, "fundamental breach is not fraught with history. It is a fresh legal concept, born from compromise." See Michael R. Will, in: Bianca & Bonell (ed), *op. cit. supra* note 7 at 209-210.

also impacts the operation of the passage-of-risk provisions of the Convention—see article 70 and paragraph 13 of the Digest for Part III, Section III, Chapter IV. In general article 25 defines the border between situations giving rise to “regular” remedies for breach of contract— like damages and price reduction—and those calling for more drastic remedies, such as avoidance of contract.

### 3.2 Analysis of Article 25 CISG

Article 25 CISG provides that:

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 that a reasonable person of the same kind in the same circumstances would not have foreseen such a result.

According to Article 25 CISG, there are several crucial requirements to be met in addition to the breach of the contract by the other party: the first requirement is that the breach committed results in detriment to the other party. Secondly, this detriment must be so severe as substantially to deprive it of what it was entitled to expect under the contract. The third condition is that the party in the breach foresaw or a reasonable person of the same kind in the same circumstances could have foreseen this result.<sup>9</sup>

Two main concepts are begging for an explanations whenever the issue of fundamental breach is mentioned under the CISG, they are (a) substantial detriment and (b) foreseeability.

#### 3.2.1 Substantial detriment

Under the CISG, the basic criterion for a breach to be fundamental is that "it results in substantial detriment to the injured party."<sup>10</sup> Compared with ULIS, the substantial detriment test is one of the innovations of the Convention.<sup>11</sup> The Secretariat Commentary to Article 23 (former draft of Article 25) states that "the determination whether the injury is substantial must be made in the light of the circumstances of each case, e.g., the monetary value of the contract, the monetary harm caused by the breach, or the extent to which the breach interferes with other activities of the injured party."<sup>12</sup> From this comment, we can see the drafters simply and naturally intended the word "detriment" to be synonymous with monetary injury or harm, or with a consequential harm, and that the determination of a fundamental breach was to be made on a case-by-case basis.<sup>13</sup>

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<sup>9</sup> Leisinger, Benjamin K. :Fundamental breach considering non-conformity of the goods, Sellier European Law Publishers, 2007.

<sup>10</sup> Commentary on the Draft Convention on Contracts for the International Sale of Goods, prepared by the UNCITRAL Secretariat (Doc. A/ CONF. 97/5), Official Records, 26 , cited as <<http://untreaty.un.org/cod/avl/ha/ccisg/ccisg.html>> ( Accessed 28-4-2014).

<sup>11</sup> Will, M, ‘Article 49,’ cited as <<http://www.cisg.law.pace.edu/cisg/biblio/will-bb49.html>, > (Accessed on 28-4-2014).

<sup>12</sup> Official Record 26, cited as< <http://www.cisg.law.pace.edu/cisg/text/secomm/secomm-23.html>, >(Accessed on 28-4-2014).

<sup>13</sup> Andrew Babik, "Defining "Fundamental Breach" under the United Nations Convention on Contracts for the

Article 25 is not referring to the extent of the damage, but instead to the importance of the interests which the contract and its individual obligations actually create for the promise. This means that there is a fundamental breach of contract, if the injured party has no further interest in the performance of the contract after the particular breach. This suggests not merely a substantial or material breach of contract, or one which substantially impairs the value of the contract to the injured party, but a breach which goes "to the root" of the contract and renders it a contractual bunkum.<sup>14</sup> In the case of Shoes Case,<sup>15</sup> the German court was called upon to consider whether a breach in the sale of stock of women shoes was fundamental, the court held that this requirement was not met because the detriment (defect in the shoes) was not substantial as to deprive the buyer of his expectations in the contract.

### 3.2.2 Foreseeability

According to the second part of Article 25, a breach of contract causing material prejudice is not fundamental if 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." This means that the party in breach must have foreseen the injury, as well as a reasonable person would in the same circumstances. Therefore, the fundamentality of a breach is made dependant not only on its consequences, but also on its foreseeability by the breaching party.<sup>16</sup> It is the responsibility of the aggrieved party to prove that he suffered a detriment that substantially deprived him of what he is entitled to expect under the contract. Where such detriment and substantial deprivation are established, the burden of proof is said to shift to the party in breach. To successfully invoke un-foreseeability, the party in breach should prove two things: first, that he himself in no way anticipated the substantial detriment caused by the breach; and second, that a reasonable person in his place would not have done so.

If the party in breach can prove that he did not foresee the substantial loss of expectation interest that the breach caused the non-breaching party, and can prove that a reasonable person similarly situated, facing the same market conditions, would not have foreseen that the breach would cause a substantial loss of expectation interests, there is no fundamental breach.<sup>17</sup> It has been held in the Shoe's case that the seller's/ manufacturer's breach of the ancillary duty of preserving exclusivity constituted a fundamental breach, and by their action, they would have foreseen that the buyer would have no further commercial interest in the shoes which are the subject matter of the contract.<sup>18</sup>

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International Sale of Goods," (1992) Temple International and Comparative Law Journal, P. 120 , cited as <<http://www.cisg.law.pace.edu/cisg/biblio/babiak.html>> (Accessed on 28-4- 2014).

<sup>14</sup> Ziegel, J.S. "The Remedial Provisions in the Vienna Convention: Some Common Law Perspectives", cited as <<http://www.cisg.law.pace.edu/cisg/biblio/ziegel6.html>> (Accessed on 28-4-2014).

<sup>15</sup> Oberlandesgericht Frankfurt am Main of 18 January 1994 [5U 15/93], UNILEX, D. 1994-2 at 183 cited as <<http://www.cisg.law.pace.edu/cisg/text/peclcomp25.html>> (Accessed on 28-4-2014).

<sup>16</sup> Hossam El-Saghir, Guide to article 25, Cited as <<http://www.cisg.law.pace.edu/cisg/text/peclcomp25.html#18>> (Accessed on 28-4-2014)

<sup>17</sup> Will, M., op. Cit. P. 216-217.

<sup>18</sup> Germany 17 September 1991 Appellate Court Frankfurt , Cited as <<http://cisgw3.law.pace.edu/cases/910917g1.html>> (Accessed on 28-4-2014)

### 3.3 General Mode of Application of Article 25 CISG

Courts have decided whether certain typical fact patterns constitute fundamental breaches. It has been determined on various occasions that complete failure to perform a basic contractual duty constitutes a fundamental breach of contract unless the party has a justifying reason to withhold its performance. This has been decided in the case of final non-delivery<sup>19</sup> as well as in the case of final non-payment.<sup>20</sup> However, if only a minor part of the contract is finally not performed (e.g., one delivery out of several deliveries is not made), the failure to perform is a simple, non-fundamental breach of contract.<sup>21</sup> On the other hand a final and unjustified announcement of the intention not to fulfill one's own contractual obligations has been found to constitute a fundamental breach.<sup>22</sup> Likewise, the buyer's insolvency and placement under administration has been held to constitute a fundamental breach under article 64 since it deprives the unpaid seller of what it was entitled to expect under the contract, namely payment of the full price.<sup>23</sup> Similarly, a buyer's refusal to open a letter of credit as required by the contract has been held to constitute a fundamental breach.<sup>24</sup> It has also been determined that non-delivery of the first installment in an installment sale gives the buyer reason to believe that further installments will not be delivered, and therefore a fundamental breach of contract was to be expected (article 73 (2)).<sup>25</sup>

As a rule late performance—whether late delivery of the goods or late payment of the price—does not in itself constitute a fundamental breach of contract.<sup>26</sup> Only when the time for performance is of essential importance either because it is so contracted<sup>27</sup> or due to evident circumstances (e.g., seasonal goods)<sup>28</sup> does delay as such amount to a

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<sup>19</sup> CLOUT case No. 90 [Pretura circondariale di Parma, Italy, 24 November 1989] (only partial and very late delivery); CLOUT case No. 136 [Oberlandesgericht Celle, Germany, 24 May 1995].

<sup>20</sup> CLOUT case No. 130 [Oberlandesgericht Düsseldorf, Germany, 14 January 1994].

<sup>21</sup> CLOUT case No. 275 [Oberlandesgericht Düsseldorf, Germany, 24 April 1997].

<sup>22</sup> See CLOUT case No. 136 [Oberlandesgericht Celle, Germany, 24 May 1995]. In that case the seller gave notice that he had sold the specified good to another buyer. See also CLOUT case No. 595 [Oberlandesgericht München, Germany, 15 September 2004] (seller's refusal to deliver on the assumption that the contract had been cancelled was a fundamental breach) (see full text of the decision); Tribunal of International Commercial Arbitration at the Russian Federation Chamber of Commerce, Russia, award in case No.387/1995 of 4 April 1997, Unilex (final refusal to pay the price).

<sup>23</sup> CLOUT case No. 308 [Federal Court of Australia, 28 April 1995].

<sup>24</sup> CLOUT case No. 631 [Supreme Court of Queensland, Australia, 17 November 2000], citing CLOUT case No. 187 [Federal District Court, Southern District of New York, United States, 23 July 1997].

<sup>25</sup> CLOUT case No. 214 [Handelsgericht des Kantons Zürich, Switzerland, 5 February 1997].

<sup>26</sup> Corte di Appello di Milano, Italy, 20 March 1998, Unilex (late delivery); CLOUT case No. 275 [Oberlandesgericht Düsseldorf, Germany, 24 April 1997] (late delivery); CLOUT case No. 301 [Arbitration—International Chamber of Commerce No. 7585 1992] (late payment).

<sup>27</sup> In the Italian case of Foliopack v. Daniplast, the court found that according to the statements and conduct of the parties the contract was to be considered concluded at the time the order was confirmed, and that the seller was bound to dispatch all the goods within the following week. It was held that the delay by the seller in delivering the goods, together with the fact that two months after the conclusion of the contract the seller had delivered only one third of the goods sold, amounted to a fundamental breach of the contract according to article 49(1) (a) CISG, thus the seller would be reasonably held to have foreseen his non-performance of the contract according to its terms would cause the buyer some untold hardship. Case laws have to some extent developed guidelines that may help to determine in similar cases whether or not a breach of contract qualifies as fundamental. It has been found on various occasions that the final non-delivery by the seller constitutes a fundamental breach of contract unless the seller has a justified reason to withhold its performance.

<sup>28</sup> Corte di Appello di Milano, Italy, 20 March 1998, Unilex (the buyer had ordered seasonal knitted goods and pointed to the essential importance of delivery at the fixed date, although only after conclusion of the contract); ICC International Court of Arbitration, France, award No. 8786, January 1997, ICC International Court of Arbitration Bulletin 2000, 70.

fundamental breach.<sup>29</sup> But even if a delay is not fundamental breach, the Convention allows the aggrieved party to fix an additional period of time for performance; if the party in breach fails to perform during that period, the aggrieved party may then declare the contract avoided (articles 49 (1) (b) and 64 (1) (b)).<sup>30</sup> Therefore in such a case, but only in that case, the lapse of the additional period turns a non-fundamental delay in performance into a sufficient reason for avoidance.

If defective goods are delivered, the buyer can avoid the contract when the non-conformity of the goods is properly regarded as a fundamental breach of contract (article 49 (1) (a)). It therefore is essential to know under what conditions delivery of non-conforming goods constitutes a fundamental breach. Court decisions on this point have found that a non-conformity concerning quality remains a mere non-fundamental breach of contract as long as the buyer—without unreasonable inconvenience—can use the goods or resell them even at a discount.<sup>31</sup> For example, the delivery of frozen meat that was too fat and too moist, and that consequently was worth 25.5 per cent less than meat of the contracted quality (according to an expert opinion), was not regarded as a fundamental breach of contract since the buyer had the opportunity to resell the meat at a lower price or to otherwise process it.<sup>32</sup> On the other hand, if the non-conforming goods cannot be used or resold with reasonable effort this constitutes a fundamental breach and entitles the buyer to declare the contract avoided.<sup>33</sup> This has been held to be the case as well where the goods suffered from a serious and irreparable defect although they were still useable to some extent (e.g., flowers which were supposed to flourish the whole summer but did so only for part of it).<sup>34</sup> Courts have considered a breach to be fundamental without reference to possible alternative uses or resale by the buyer when the goods had major defects and conforming goods were needed for manufacturing other products.<sup>35</sup> The same conclusion has been reached where the non-conformity of the goods resulted from added substances the addition of which was illegal both in the country of the seller and the buyer.<sup>36</sup>

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<sup>29</sup> CLOUT case No. 275 [Oberlandesgericht Düsseldorf, Germany, 24 April 1997] (late delivery constitutes a fundamental breach when the buyer would prefer non-delivery instead and the seller could have been aware of this).

<sup>30</sup> See, e.g. CLOUT case No. 301 [Arbitration—International Chamber of Commerce No. 7585 1992].

<sup>31</sup> CLOUT case No. 171 [Bundesgerichtshof, Germany, 3 April 1996]; CLOUT case No. 248 [Schweizerisches Bundesgericht, Switzerland, 28 October 1998].

<sup>32</sup> CLOUT case No. 248 [Schweizerisches Bundesgericht, Switzerland, 28 October 1998].

<sup>33</sup> CLOUT case No. 150 [Cour de Cassation, France, 23 January 1996] (artificially sugared wine); CLOUT case No. 79 [Oberlandes- gericht Frankfurt a.M., Germany, 18 January 1994] (shoes with splits in the leather) (see full text of the decision); Landgericht Landshut, Germany, 5 April 1995, Unilex (T-shirts which shrink by two sizes after first washing).

<sup>34</sup> CLOUT case No. 107 [Oberlandesgericht Innsbruck, Austria, 1 July 1994].

<sup>35</sup> See CLOUT case No. 138 [Federal Court of Appeals for the Second Circuit, United States, 6 December 1993, 3 March 1995] (compressors with lower cooling capacity and higher power consumption than the goods contracted-for, which were required for the manufacture of air conditioners by the buyer); CLOUT case No. 150 [Cour de Cassation, France, 23 January 1996] (artificially sugared wine) (see full text of the decision); CLOUT case No. 315 [Cour de Cassation, France, 26 May 1999] (metal sheets absolutely unfit for the foreseen kind of manufacture by the buyer's customer) (see full text of the decision); see also Tribunale di Busto Arsizio, Italy, 13 December 2001, published in *Rivista di Diritto Internazionale Privato e Processuale*, 2003, 150–155, also available on Unilex (delivery of a machine totally unfit for the particular use made known to the seller and that was incapable of reaching the promised production level represented a “serious and fundamental” breach of the contract, since the promised production level was an essential condition for the conclusion of the contract; the lack of conformity therefore was a basis for avoidance).

<sup>36</sup> Compare CLOUT case No. 150 [Cour de Cassation, France, 23 January 1996] (artificially sugared wine which is forbidden under EU-law and national laws) (see full text of the decision); CLOUT case No. 170 [Landgericht Trier, Germany, 12 October 1995] (watered wine) (see full text of the decision).

Special problems arise when the goods are defective but repairable. Some courts have held that easy repairability precludes finding a fundamental breach.<sup>37</sup> Courts are reluctant to consider a breach fundamental when the seller offers and effects speedy repair without any inconvenience to the buyer.<sup>38</sup>

The violation of other contractual obligations can also amount to a fundamental breach. It is, however, necessary that the breach deprive the aggrieved party of the main benefit of the contract and that this result could have been foreseen by the other party. Thus, a court stated that there is no fundamental breach in case of delivery of incorrect certificates pertaining to the goods if either the goods were nevertheless merchantable or if the buyer itself could—at the seller's expense—easily acquire the correct certificates.<sup>39</sup> The unjustified denial of contract rights of the other party—e.g., a refusal to recognize the validity of a retention of title clause and the seller's right to possession of the goods,<sup>40</sup> or the unjustified denial of a valid contract after having taken possession of samples of the goods<sup>41</sup>—can amount to a fundamental breach of contract. The same is true when resale restrictions have been substantially violated.<sup>42</sup>

A delay in accepting the goods will generally not constitute a fundamental breach, particularly when the delay is only for a few days.<sup>43</sup> It has also been settled in the *Clothes* case,<sup>44</sup> that as a rule, late performance does not constitute by itself a fundamental breach of contract. Only when the time for performance is of essential importance either because it is so stipulated between the parties or because it results from the circumstances (e.g., seasonal goods) -- can the delay amount to a fundamental breach. The court went ahead to rationalize that one-day delay in dispatch of seasonal goods is no fundamental breach.<sup>45</sup>

The same result has been reached where the delay in the performance came close to non- performance, for instance when the agreed delivery date was one week and the seller had delivered only one third of the goods after two months. But even if there is no fundamental breach, the Convention allows the buyer to fix an additional period of time after the unsuccessful lapse of which the buyer may declare the contract avoided. Therefore in case of delay of performance, the lapse of an additional period for performance turns a non- fundamental breach into a fundamental one.<sup>46</sup>

The cumulation of violations of several contractual obligations makes a fundamental breach more probable, but does not automatically constitute a fundamental breach.<sup>47</sup> In such cases, the existence of a fundamental breach depends on the circumstances of the

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<sup>37</sup> Handelsgericht des Kantons Zürich, Switzerland, 26 April 1995, *Schweizerische Zeitschrift für Internationales und Europäisches Recht* 1996, 51.

<sup>38</sup> CLOUT case No. 152 [Cour d'appel, Grenoble, France, 26 April 1995]; CLOUT case No. 282 [Oberlandesgericht Koblenz, Germany, 31 January 1997].

<sup>39</sup> CLOUT case No. 171 [Bundesgerichtshof, Germany, 3 April 1996].

<sup>40</sup> CLOUT case No. 308 [Federal Court of Australia, 28 April 1995].

<sup>41</sup> CLOUT case No. 313 [Cour d'appel, Grenoble, France, 21 October 1999] (see full text of the decision).

<sup>42</sup> CLOUT case No. 2 [Oberlandesgericht Frankfurt a.M., Germany, 17 September 1991]; CLOUT case No. 154 [Cour d'appel, Grenoble, France, 22 February 1995]; CLOUT case No. 82 [Oberlandesgericht Düsseldorf, Germany, 10 February 1994], (see full text of the decision); CLOUT case No. 217 [Handelsgericht des Kantons Aargau, Switzerland, 26 September 1997].

<sup>43</sup> CLOUT case No. 243 [Cour d'appel, Grenoble, France, 4 February 1999].

<sup>44</sup> Cited as <<http://cisgw3.law.pace.edu/cases/960327g1.html>> (Accessed 30-4-2014)

<sup>45</sup> *Cloth* case *supra*.

<sup>46</sup> ITALY Pretura circondariale case, *supra*.

<sup>47</sup> CLOUT case No. 171 [Bundesgerichtshof, Germany, 3 April 1996] (see full text of the decision).

case as well as on whether the breach resulted in the aggrieved party losing the main benefit of, and its interest in, the contract.

Finally, it goes without saying that the doctrine of fundamental breach is still evolving under the CISG, the provision of Article 25 is not just enough to contain many faces of fundamental breach, however, the various case laws and opinions of learned writers from various backgrounds are no doubt doing enough in fashioning out consistent and uniform trend in the application of this doctrine under the international sales law.

## **IV. Fundamental Breach in PICC**

### **4.1 Background**

Some renowned scholars advocate making use of the UNIDROIT Principles as a means of interpreting ambiguous terms of the Convention. They suggest employing them in the determination of fundamental breach of contract, arguing that both the UNIDROIT Principles and the Convention follow the same policy, namely to preserve the enforceability of the contract whenever feasible.<sup>48</sup> This approach would be reflected by offering the breaching party the possibility to cure, requiring the non-breaching party to provide an additional period of performance,<sup>49</sup> and most importantly, by allowing the termination of the contract only when the breach or non-performance qualifies as “fundamental.”

The UNIDROIT Principles provide a more express guideline than does the Convention as to which factors are relevant in determining fundamental non-performance, the counterpart of the Convention’s fundamental breach.<sup>50</sup> In determining fundamental non-performance, the UNIDROIT Principles state that regard shall be had to whether the non-performance substantially deprives the aggrieved party of what it was entitled to expect under the contract. Other factors to be taken into account in each case are: whether strict compliance with the unfulfilled obligation is of essence under the contract;<sup>51</sup> whether the aggrieved party has reason to believe that it cannot rely on the

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<sup>48</sup> See Michael J. Bonell, *The UNIDROIT Principles of International Commercial Contracts: Why? What? How?*, 69 *Tul.L.Rev.* 1121, 1142-1143 (1995); Alejandro M. Garro, *The Gap Filling Role of the UNIDROIT Principles in International Sales Law: Some Comments on the Interplay between the Principles and the CISG*, 69 *Tul.L.Rev.* 1149, 1152-1155 (1995); Luiz Olavo Baptista, *The UNIDROIT Principles for International Commercial Law Project: Aspects of International Private Law*, 69 *Tul.L.Rev.*, 1209, at 1218 (1995); Ulrich Magnus, *The General Principles of the CISG*, 3 *Int’l Trade & Bus. L. A. (Austr.)* 33-56, at 6(b) (1997); Ralph Amissah, *The Autonomous Contract*, in *Seminar on Legal Information* 10, 33 (1997)

[http://itl.irv.uit.no/trade\\_law/papers/The.Autonomous.Contract.18.08.1997.Amissah.c.html](http://itl.irv.uit.no/trade_law/papers/The.Autonomous.Contract.18.08.1997.Amissah.c.html). As to the relationship between the UNIDROIT Principles and the Convention in general, see A. S. Hartkamp, *The UNIDROIT Principles for International Commercial Contracts and the United Nations Convention on Contracts for the International Sale of Goods*, in *Comparability and Evaluation. Essays on Comparative Law, Private International Law and International commercial Arbitration* 95 (1994).

<sup>49</sup> See UNIDROIT Principles, *supra* note 48, at art. 7.1.5 (requiring the aggrieved party to provide an additional period of time to perform upon expiration of which the aggrieved party may proceed with any of the remedial provisions available under the UNIDROIT Principles).

<sup>50</sup> UNIDROIT Principles, *supra* note 48, art. 7.1.1, defines non-performance as a failure to perform any obligation under the contract, and it includes defective performance or late performance. Non-performance under the UNIDROIT Principles has thus the same meaning as “breach of contract” under the Convention. The difference between the two instruments is that the UNIDROIT Principles, unlike the Convention, do not refer to the remedies available to one party in case of a breach by the other, but provide a set of rules applicable to non-performance in general.

<sup>51</sup> See *id.* at art. 7.3.1 para. 2(b).

other's party's future performance;<sup>52</sup> whether the non-performance is intentional or reckless;<sup>53</sup> and finally, whether the non-performing party would suffer a disproportionate loss as a result of the preparation or performance if the contract is terminated.<sup>54</sup>

With the exception of the last two enumerated factors, those applied by the UNIDROIT Principles in determining fundamental non-performance do not differ substantially from those employed by scholars and practitioners in defining fundamental breach under the Convention.<sup>55</sup> There is, however, a significant difference. Unlike under the CISG, Under the PICC, the issue of cure by the seller is not relevant to fundamental breach doctrine. The buyer's right to terminate is suspended provided that the seller's offer to cure is appropriate and the buyer has no "legitimate interest" in refusing an offer to cure.<sup>56</sup> Moreover, the seller's right to cure is not precluded by notice of termination.<sup>57</sup> In other words, the buyer cannot exercise his right of termination for the purpose of denying the seller an opportunity to cure. Under the UNIDROIT Principles, therefore, curability is, de facto, a relevant factor in determining whether or not non-performance is fundamental. According to Official Commentary on the UNIDROIT principles, fundamental non-performance means "the non-performance which is material and not merely of minor importance" this definition left much to be desired, it fails to throw light upon the degree of importance that should be accorded to a breach before it can graduate from minor importance to being of fundamental importance, however any missing ingredient of what fundamental non-performance means can be supplemented from Article 25 of the CISG which can be imported in order to fill in the gap. There is no carte-blanc application of fundamental non-performance under the UNIDROIT Principles, just as can be readily seen under the CISG; It seems to be only associated with the provision of 'termination'.

Certain presumptions that the concept of fundamental non-performance under 'termination' provision of Article 7.3.1 is not based on fault cannot be totally acceptable and may not wholly represent the intentions of the draughtsman under the UNIDROIT Principles which shows a high level of reluctance in allowing termination as a remedy. While some non-fault based events can lead to termination as seen under the doctrine of frustration which provides for the remedy of termination under Article 7.17, nevertheless, the courts or tribunal will be reluctant to allow a party to terminate a contract base on a fault free actions of an obligor, especially where other remedies will

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<sup>52</sup> See id. at para. 2(d).

<sup>53</sup> See id. at para. 2(c).

<sup>54</sup> See id. at para. 2(e).

<sup>55</sup> The reason for this parallel seems to be that many of the same individuals who labored to produce the Convention and later commented on it, such as Michael Joachim Bonell and Allan Farnsworth, continued under UNIDROIT auspices to produce the UNIDROIT Principles. For a list of the members of the working group, who drafted the UNIDROIT Principles, see Bonell, *supra* note 29, at 1126 (1995).

<sup>56</sup> See UNIDROIT Principles, *supra* note 48, at art. 7.1.4. which states in part:

"(1) The non-performing party may, at its own expense, cure any non-performance, provided that (a) without undue delay, it gives notice indicating the proposed manner and timing of the cure; (b) cure is appropriate in the circumstances; (c) the aggrieved party has no legitimate interest in refusing cure, and (d) cure is effected promptly.

"(2) The right to cure is not precluded by notice of termination.

"(3) Upon effective notice of cure, rights of the aggrieved party that are inconsistent with the non-performing party's performance are suspended until the time for cure has expired."

<sup>57</sup> See id. at art. 7.1.4(2).



be adequate.

If termination of a contract can be effected irrespective of whether the non-performing party does so intentionally or recklessly, then the age long commercial law policy of showing caution in the exercise of 'termination' will be defeated, the proper practical interpretations arising from the provision of Article 7.3.1 is to attribute some elements of fault to the action or inactions of an obligor which causes non-performance, this is basically what draws the line between a fortuitous impediment which can excuse performance as is the case with the provision of Article 7.1.7 (Frustration) and a reckless or intentional act of a party which can lead to termination of the contract. Fundamental non-performance thus has a tinge of 'fault' ingredient to it; this is also in consonance with the practice of good faith/bad faith, which is the bedrock of international commercial contract.

#### **4.2 Non-Performance V Fundamental Non-Performance.**

Non- performance simply means the inability to tender or perform an obligation that accrues to a party under a contract, it is frequently used throughout the provisions of the UNIDROIT Principles, but it is doubtful if it has the same gravity, meanings and connotations with fundamental non-performance. While conceding the fact that termination can still be a remedy under the facts that gives rise to frustration situation, but it must be noted that the degree of non-performance needed in a situation of termination is not the same that can easily lead to frustration.

A mere non-performance caused by an impediment that is unforeseeable is enough to buttress a situation that leads to frustration, provided it renders further performance impossible, but under termination, a 'fundamental non-performance is needed by the model law, thus in as much as the same facts bring both frustration and termination of a contract, this essay submits that the degree or standard of non-performance must be separately proved.

If the non-performance is not fundamental as provided specifically under Article 7.3.1, then it is doubtful if termination can be allowed even though frustration has been granted. In this situation also, it is even more doubtful if Article 7.3.1(3) can apply, Nachfrist rule only applies where there is a possibility of performance, but where a non-performance has been clearly excused due to an impediment beyond the control of the parties which they cannot possibly avoid, or which consequences they cannot overcome, then the obligee giving an additional time to the obligor to perform will be an exercise in futility. Under a frustrated contract, an additional period of time to perform cannot cure an impossible performance, neither can it elevate a non-performance to a fundamental non-performance in order for termination to apply. It will be important to add that Nachfrist rule is only available in a situation where the other party has not tendered or executed performance, performance inhibits the possibility to seek redress under the rule.

It can be summarized generally that where a fundamental non-performance which is the same concept as fundamental breach is as a result of the non-performing party failure in fulfilling his obligation, the aggrieved party can easily terminate the contract, but where the non-performance is a result of event beyond the control of the non-performing party,

then it can either result in frustration- if the event is unforeseeable and totally rendered the contract incapable of performance or on the other hand it can result in termination if though the non performing party's fault may be immaterial, but the event is that of fundamental non-performance.

## **V. Fundamental Breach under Chinese Contract Law**

### **5.1 General Introduction**

Contracts for sales are mainly governed by the Contract Law of the People's Republic of China. As the CISG was adopted in China, it applies to contracts for the international sale of goods too. Under article 7(2) CISG, in some cases the Contract Law would be applied as a municipal law by virtue of the private international law.<sup>58</sup>

A uniform civil code is on the schedule of the Chinese legislators to change the status quo of the civil law system of China, which has the General Principles of the Civil Law of the People's Republic of China<sup>59</sup> as a high-level resource with a cluster of laws, codes, statutes and regulations, etc. under it. The Contract Law, which came into force as of 1 October 1999, invalidated simultaneously the old three contract laws: the Economic Contract Law, the Law on Economic Contracts Involving Foreign Interests and the Law on Technology Contracts. Before the uniform civil code is adopted and comes into force, the Contract Law is the most important legal basis in respect of the contracts for sales. During the drafting process of the Contract Law, CISG was one of the legislative resources and inspirations -- some clauses are even transplanted from CISG *mutatis mutandis*.

Throughout the legal provisions of contract law, although there is no legal term "fundamental breach", but essentially establishes a fundamental breach of contract system in section 94, in the fourth paragraph fundamental breach of contract defined as "the purpose of the contract can not be achieved ". As we can see, in Chinese contract law, it adopt the objective criteria and abandon the foreseeability rule which is Art. 25 of CISG. It stripped out the subjective factor, that prone to protect the creditor. Article 94 paragraphs 2 and 3 of Chinese contract law specifically listed the situations of fundamental breach of contract and delay in performance.<sup>60</sup>

In addition, the contract also absorbed the relevant provisions of CISG in the partial delivery. In Chinese contract law, it defines the circumstances of fundamental breach during the partial delivery and solve the issue of retroactivity in the termination of

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<sup>58</sup> CISG, Article 7(2).

<sup>59</sup> The law was adopted on April 12, 1986 and entered into force as of January 1, 1987.

<sup>60</sup> Article 94 The parties to a contract may terminate the contract under any of the following circumstances:

- (1) it is rendered impossible to achieve the purpose of contract due to an event of force majeure;
- (2) prior to the expiration of the period of performance, the other party expressly states, or indicates through its conduct, that it will not perform its main obligation;
- (3) the other party delayed performance of its main obligation after such performance has been demand, and fails to perform within a reasonable period;
- (4) the other party delays performance of its obligations, or breaches the contract in some other manner, rendering it impossible to achieve the purpose of the contract;
- (5) other circumstance as provided by law.

contract. Article 166 of Chinese contract law<sup>61</sup>, it defines the situation of delivery of goods by installments constitute a fundamental breach which basically absorbed the CISG Article 73. There have three reasons. First, in principle, in the delivery of goods by installments, if the fundamental breach occurred, the other party can only declare the contract avoided with respect to that installment; Second is retroactivity, if one party's failure to perform any of his obligations in respect of any installment gives the other party good grounds to conclude that a fundamental breach of contract will occur with respect to future installments, he may declare the contract avoided for the future, provided that he does so within a reasonable time; Third is the interdependence between the various installments, if the fundamental breach of this installment have no significance to any other installment, then the contract voided.

## **5.2 The inadequate of fundamental beach system under Chinese contract law and suggestions for improvement.**

### **5.2.1 The concept of fundamental breach**

Under Chinese contract law, there is only one article related to fundamental breach, that is Article 94:

The parties to a contract may terminate the contract under any of the following circumstances:

- (1) it is rendered impossible to achieve the purpose of contract due to an event of force majeure;
- (2) prior to the expiration of the period of performance, the other party expressly states, or indicates through its conduct, that it will not perform its main obligation;
- (3) the other party delayed performance of its main obligation after such performance has been demand, and fails to perform within a reasonable period;
- (4) the other party delays performance of its obligations, or breaches the contract in some other manner, rendering it impossible to achieve the purpose of the contract;
- (5) other circumstance as provided by law.

As we can see, the concept of fundamental breach under Chinese contract law is quite abstract. Under normal circumstances, the parties just regard fundamental breach as a way to terminate the contract; this could not reflect the value of fundamental breach, which is balancing the parties' interest by limiting their right to terminate the contract. If we refer to the legislative system under CISG, that is make fundamental breach clause

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<sup>61</sup> Article 166 Where the seller is to deliver the subject matter in installments, if the seller fails to deliver one installment of the subject matter or the delivery fails to satisfy the terms of the contract so that the said installment cannot realize the contract purpose, the buyer may terminate the portion of the contract in respect thereof.

If the seller fails to deliver one installment of the subject matter or the delivery fails to satisfy the terms of the contract so that the delivery of the subsequent installments of subject matter can not realize the contract purpose, the buyer may terminate the portion of the contract in respect of such installment as well as any subsequent installment.

If the buyer is to terminate the portion of the contract in respect of a particular installment which is interdependent with all other installments, it may terminate the contract in respect of all delivered and undelivered installments.

become an independent clause, to make this system more clear, maximize the value of fundamental breach.

### 5.2.2 Elements of fundamental breach

Compare to CISG and PICC, under Chinese contract law, the elements of fundamental breach are vague. We only can determine a fundamental breach base on whether it is rendered impossible to achieve the purpose of contract or not, rather than the requirement of detriment. Under Chinese contract law, there is no article to set the standard to judge what is the situation can lead to the impossible to achieve the purpose of contract. Till now, there is no authoritative interpretation of the law to make up for this shortcoming. In order to perfect fundamental breach system under Chinese contract law, Chinese legislative department may give the interpretation to the situations that can rendered impossible to achieve the purpose of contract, or make “detriment” as the elements of fundamental breach.

### 5.2.3 Manifestations of fundamental breach

Under Chinese contract law Article 94, only delayed performance is the manifestation of fundamental breach. Under CISG, fundamental breach is a prerequisite for certain remedies under the Convention, including a party’s right to avoid the contract under articles 49 (1) (a) and 64 (1) (a), and a buyer’s right to require delivery of replacements for goods that failed to conform to the contract (article 46 (2)). The phrase is also used in other provisions of the Convention in connection with avoidance of contract (see articles 51 (2), 72 (1), 73 (1) and (2)). That means under CISG, the situations that can result in fundamental breach is specified, under different circumstances can apply the corresponding provisions. But under Chinese contract law, the manifestations of fundamental breach is not well stipulated. Although there are some provisions laid down the standard for the situations of defective performance or partial breach that can lead to fundamental breach, but these provisions cannot be applied to all kind of situations. There are differences between non-performances, defective performance and partial breach, so we shall set different criteria to judge whether it is fundamental breach.

### 5.2.4 Anticipatory repudiation

Article 72 of CISG states that: ‘If time allows, the party intending to declare the contract avoided must give reasonable notice to the other party in order to permit him to provide adequate assurance of his performance.’ That means, under the situation of anticipatory repudiation by invoking the test for a fundamental breach, the obligor may receive the reasonable notice from the other party. The obligee has been given the choice of avoidance or suspension when apprehending a fundamental breach by the obligor. Under Chinese contract law<sup>62</sup>, as long as it’s a fundamental beach, the only choice to the other party is to avoid the contract. It may lead to the deadlock for the parties, if the

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<sup>62</sup> Article 96 of Chinese contract law, The contract shall be terminated upon the receipt of the notice by the other party. If the other party objects to such termination, it may petition the People’s Court or an arbitration institution to adjudicate the validity of the termination of the contract. Where the laws and administrative regulations so provide, the approval and registration procedures for the termination of the contract shall be gone through in accordance with such laws and regulations.

other party objects to such termination, the only way to solve this problem is to make petition to the People's Court or an arbitration institution to adjudicate the validity of the termination of the contract. This kind of solution is not good for the parties, since it costs lots of time and money, what's more, the aim of the contract may not fulfilled by terminating it. So if we give the chance to obligor to provide adequate assurance of his performance that may not lead to the deadlock easily.

#### 5.2.5 Foresight

If there was a tender of non-conforming goods and it indeed resulted in such detriment to the buyer that it was substantially deprived of what it expected and was entitled to expect under the contract, according to Article 25 of CISG, this is not sufficient for the buyer to be entitled to declare the contract avoided if the seller did not foresee such a result and a reasonable person of the same kind would not have foreseen such a result, either. The foreseeability principle is designed to give the breaching party an opportunity to give special attention to minor details of performance the importance of which he would not otherwise have anticipated.<sup>63</sup>

Under Chinese contract law, foreseeability is not the prerequisite of fundamental breach. Although using the objective criterion, such as substantially detriment, can reduce the subjective effect when determine whether it's a fundamental breach or not. But we cannot deny the requirement of foreseeability can serves as a corrective element in exceptional cases. If we set foreseeability as a prerequisite of fundamental breach, judge may have more space when hearing the cases, so that he can have a comprehensive consideration, making the cases to get a more reasonable solution.

## VI. Conclusion

Under CISG and PICC, fundamental breach have been defined systematically, two basic prerequisites of fundamental breach are detriment and foreseeability. Under Chinese contract law, fundamental breach is unclearly described, this lead to the difficulty when use this doctrine. So it is necessary to make fundamental breach as an independent clause and make it more practical, such as, specified the situations can lead to the impossible to achieve the purpose of contract, give the chance to obligor to provide adequate assurance of his performance, and use the principle of foreseeability which can balance the parties interest and avoid the deadlock of the contract as well. If Chinese Contract law learn the lessons from CISG and PICC, the fundamental breach under Chinese Contract Law will be more practical and make the contract not so easily get into the deadlock so that can achieve the propose of contract well.

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<sup>63</sup> J Honnold and HM Flechtner, *Uniform Law for International Sales* (4<sup>th</sup> edn, Kluwer, Netherland, 2009) 277.

**INSTITUT INTERNATIONAL POUR L'UNIFICATION DU DROIT PRIVE**

**UNIDROIT PROGRAMME DE BOURSE DE RECHERCHE**

**RAPPORT DE RECHERCHE**

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Pour la période du :

19 JANVIER 2014 AU 14 MARS 2014

Sujet de recherche :

**LES TENTATIVES DE CODIFICATION DE LA PERIODE PRECONTRACTUELLE  
DANS L'ŒUVRE LEGISLATIVE CONTEMPORAINE**

**REMERCIEMENTS**

J'ai été honorée d'effectuer un stage à l'INSTITUT INTERNATIONAL POUR L'UNIFICATION DU DROIT PRIVE. Pour ce faire, je tiens à remercier tout l'Institut de m'avoir accueillie durant ces deux mois à Rome.

Je remercie particulièrement Mme Frédérique Mestre, [Fonctionnaire principale](#), chargée du Programme de bourses et les stages, je tiens à lui témoigner ma profonde gratitude pour l'attention et le dynamisme dont elle a fait preuve durant notre séjour. Madame Laura Tikanvaara, pour son professionnalisme, son dévouement et sa grande gentillesse. Toute notre reconnaissance va également au Secrétaire-General Mr José Angelo Estrella Faria. Monsieur le Professeur Marcel Fontaine que j'ai eu l'immense honneur de rencontrer, ce qui a permis de faire de mon rêve de le rencontrer une réalité. Mme Anna Veneziano, Secrétaire General Adjoint pour ses entretiens et ses éclairages sur les Principes UNIDROIT en général. Le Professeur Fatma Bouraoui pour ses conseils précieux et ses orientations.

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## **INTRODUCTION**

Du 19 janvier au 14 mars 2014, j'ai effectué un stage au sein de l'Institut International pour l'Unification du Droit Privé UNIDROIT afin d'amorcer véritablement la recherche documentaire pour débiter ma thèse.

Les deux mois passés au sein de cette institution m'ont permis d'avoir un regard nouveau sur le droit des contrats en général et les principes d'UNIDROIT relatifs au contrat du commerce international en particulier. Mon stage s'est déroulé au sein de la bibliothèque de l' UNIDROIT. L'objectif était d'approfondir l'ensemble de mes connaissances sur la période précontractuelle mais également de jeter un regard plus accru sur les instruments internationaux de codification du droit des contrats tels que la Convention de Vienne sur la vente internationale de marchandises, les principes d' UNIDROIT et les Principes européens du droit des contrats. Il a fallu aussi approfondir la question de la codification du droit des contrats dans l'espace OHADA.

A cet effet, j'ai eu l'insigne honneur d'entrer plus en profondeur dans l'étude du droit unifié. Cela s'est fait à travers l'exploitation desdits principes, de la revue de droit uniforme, et de nombreux autres instruments ayant ainsi contribué à m'édifier davantage sur la question. Dans cette aventure juridique, l'occasion m'a surtout été donnée de côtoyer les grands auteurs et penseurs du droit uniforme.

Dans le domaine plus précis de ma thèse, qui est axée sur les contrats et plus précisément sur la période précontractuelle, j'ai eu le privilège d'exploiter des documents ayant un rapport direct. Enfin, ce stage m'a donné l'opportunité de rencontrer des spécialistes du droit unifié qui, par leur expérience et leurs conseils, ont su me canaliser et mieux m'orienter dans ma thèse.

Ce rapport me donne l'occasion de faire une description de l'ensemble des travaux effectués pendant ce séjour de recherches. Je commencerai par présenter brièvement Unidroit, avant de m'appesantir sur mes travaux de recherche.

## DESCRIPTION BREVE DE L'INSTITUTION

L'Institut international pour l'unification du droit privé (UNIDROIT) est une organisation intergouvernementale indépendante dont le siège est à Rome dans la villa Aldobrandini. Son objet est d'étudier des moyens et méthodes en vue de moderniser, harmoniser et coordonner le droit privé et en particulier le droit commercial entre les États ou les groupes d'États, à cette fin, d'élaborer des instruments de droit uniforme, des principes et des règles.

Elle a été créée en 1926, UNIDROIT abrite en son sein une bibliothèque très fournie qui est non seulement un centre d'étude pour les personnes participant aux travaux législatifs de l'organisation et des chercheurs, mais aussi un lieu de rencontre pour des personnes de culture juridique différente. L'activité législative de cette institution se poursuit depuis plusieurs décennies. Ce stage nous a donné l'immense honneur d'assister aux travaux en cours sur l'agriculture sous contrat.

### Les travaux législatifs d' UNIDROIT en droit uniforme international : l'exemple du projet en vue de l'élaboration d'un guide juridique pour l'agriculture sous contrat

Sur la base des consultations menées avec les agences des Nations Unies pour le développement agricole – l'Organisation pour l'alimentation et l'agriculture (FAO) et le Fonds international pour le développement agricole (FIDA) – ainsi que des contributions faites au Colloque organisé par UNIDROIT en novembre 2011 sur “La promotion de l'investissement pour la production agricole: aspects de droit privé”, le Conseil de Direction d' UNIDROIT, à sa 91ème session tenue à Rome en mai 2012, a estimé qu' UNIDROIT pourrait apporter une contribution utile au développement de l'agriculture sous contrat avec son expertise en matière de droit des contrats en élaborant un guide juridique pour l'agriculture sous contrat.

Le futur guide pourrait offrir une analyse de fond des aspects de droit contractuel et autres questions juridiques connexes en jeu dans les contrats de production agricole. Il pourrait dégager des orientations constituant des références de “bonnes pratiques” en fournissant des indications claires aux parties pour la négociation et la rédaction des contrats, contribuant ainsi à soutenir des relations de confiance et mutuellement avantageuses. Le futur guide pourrait aussi fournir des informations et des recommandations aux Etats qui souhaitent soutenir par des mesures de politiques publiques l'agriculture sous contrat. Au regard de ces différentes applications potentielles, le futur guide pourrait constituer un outil supplémentaire à la disposition des organisations internationales et des agences de coopération bilatérales ainsi que des organisations non gouvernementales qui mettent en œuvre des programmes et des stratégies de soutien à l'agriculture sous contrat dans les pays en développement.

Conformément à l'autorisation du Conseil de Direction d' UNIDROIT à sa 91ème session (Rome, 7–9 mai 2012), le Secrétaire Général d' UNIDROIT a constitué un Groupe de travail chargé de la préparation d'un Guide juridique pour l'agriculture sous contrat, composé d'experts de droit des contrats provenant de différents systèmes juridiques avec la coopération active d'organisations multilatérales partenaires et la participation de représentants d'organisations de producteurs et des milieux agroindustriels.

La réunion la plus récente à laquelle j'ai eu le privilège d'assister s'est déroulée du 03 au 06 mars 2014. J'ai pu voir de façon très concrète comment se déroulent les travaux d'études relatifs à la



conception d'un guide juridique pour l'agriculture sous contrat. J'ai pu faire la connaissance d'imminents Professeurs tels que le Pr Marcel Fontaine, le Professeur Bonell, Ms Marsha A. Echols, Mr Carlos da Silva ainsi que le Secrétaire-General Mr José Angelo Estrella Faria, qui m'ont lors des discussions éclairé sur la méthode et l'importance de la sécurisation de l'agriculture sous contrat.

### **LES CONDITIONS DE TRAVAIL**

Le stage effectué au sein de l' UNIDROIT m'a permis d'apporter véritablement une pierre à l'édifice de ma thèse. Il est question pour nous de présenter les travaux effectués ; ensuite les résultats obtenus grâce au stage.

### **LES TRAVAUX DE RECHERCHE EFFECTUES**

Durant mon stage, j'ai eu le privilège de fréquenter l'une des bibliothèques les plus fournies au monde. En plus de la multitude d'ouvrages et de revues mis à notre disposition (1), un exemplaire des Principes UNIDROIT sur les contrats du commerce international m'a également été offert. Tout cela a permis à mes travaux d'avoir une avancée considérable (2).

### **LES OUTILS MIS A NOTRE DISPOSITION**

Tous les documents et bases de données de son centre de recherche : encyclopédies, ouvrages généraux, ouvrages spécialisés, toutes les revues disponibles, actes de session de formation, les journaux officiels... La bibliothèque numérique et catalogue des notices bibliographiques de l' UNIDROIT ;

- La version électronique de la revue de droit uniforme
- L'accès libre à la photocopieuse et à l'imprimante hautement équipée
- La mise à notre disposition d'une salle équipée d'un réseau internet à très haut débit

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## PRESENTATION DU SUJET DE RECHERCHE

### **Thème : les tentatives de codification de la période précontractuelle dans l'œuvre législative contemporaine**

« Si l'on se rapporte aux articles du code civil relatifs à la formation du contrat, on est frappé par le fait que ces textes n'ont, dans l'ensemble, pas subi de modification depuis 1804. Mais, il faudrait être très profane en matière juridique pour déduire de cet apparent immobilisme législatif la conclusion que l'on est en présence d'une matière éminemment stable, figée autour des notions héritées du droit Romain »<sup>1</sup>.

La lecture de ce propos tenu par le Professeur Henri Blaise en 1970<sup>2</sup> témoigne de l'intérêt porté à la période précontractuelle depuis déjà près d'un siècle. En effet, malgré sa quasi absence dans le code civil, la période précontractuelle a régné -fut-ce t'il dans l'ombre- avec l'aide de la pratique de la doctrine et de la jurisprudence, au point de devenir aujourd'hui l'un des centres d'intérêt des projets de réforme contemporains du droit des contrats.

Pourquoi cette période a-t-elle été lésée par le Code civil ? La réponse à cette question nécessite de faire une rétrospective et de se mettre dans le contexte de la promulgation du Code civil en 1804. Au lendemain de la proclamation de la Déclaration des droits de l'homme et du citoyen de 1789. L'honneur est ainsi donné à la « liberté » dans tous ses démembrements : liberté du commerce, liberté d'entreprendre, liberté d'aller et venir, et, bien sur, la liberté de contracter qui implique le libre choix de l'objet et du type de contrat et bien entendu du choix du contractant. Il n'est pas alors questions à cette époque d'entraver d'une façon ou d'une autre, ou d'écorcher ce « sacro-saint » principe. La liberté contractuelle est indispensable pour permettre aux opérateurs de transférer biens et services, le consensualisme lève tout obstacle formel à la conclusion du contrat, le principe de la convention-loi apporte la sécurité quant à la réalisation des accords valablement formés<sup>3</sup>.

Pourquoi un regain d'intérêt pour la période précontractuelle ? Tout simplement à cause du développement de la pratique contractuelle, du constat des abus dans la formation des contrats et de la conclusion logique d'une inégalité parfois évidente entre les parties à un contrat décrié par la doctrine et recadrée de plus en plus par le juge. La volonté individuelle, classiquement considérée comme la force créatrice d'obligations, n'est plus cependant, aujourd'hui, l'explication unique du contrat. Elle se conjugue avec des considérations d'ordre moral, qui tendent à imposer le respect de la bonne foi et des impératifs d'ordre socio-économique, qui tendent à assurer la sécurité des relations juridiques, voire à réaliser une politique législative<sup>4</sup>. Avec le temps, le législateur se réveille. L'on assiste peu à peu à la mise en place de lois en droit de la consommation, en droit de la concurrence, en droit des assurances, en droit immobilier intégrant et règlementant de façon très précise la période de formation du contrat.

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<sup>1</sup> Reynald Ottenhof, Le droit pénal et la formation du contrat civil, préf. H. Blaise, Librairie Générale de droit e de jurisprudence, 1970, p. 1

<sup>2</sup> H. Blaise, préface de l'ouvrage de Reynald Ottenhof, op. cit.

<sup>3</sup> Marcel Fontaine (dir.), « réexamen critique et proposition », Le processus de formation du contrat. Contributions comparatives et interdisciplinaires à l'harmonisation du droit européen. BRYLANT, LGDJ 2002, p.883.

<sup>4</sup> Ghestin, n°53 et s. ; « L'utile et le juge dans les contrats », D. 1982, chr. P.1., cité par J. Schmidt, Négociation et conclusion de contrats, Dalloz, 1982, p. 1.

Deux cents ans après, la période précontractuelle qui avait brillé par son absence dans le Code civil de 1804 est sur le point d'être codifiée en France et au Cameroun. Si cela est vu comme une innovation pour ces Etats de tradition civiliste, il faut cependant relever que cette étape cruciale du contrat avait déjà fait l'objet d'une codification nationale dans les pays tel que l'Allemagne<sup>5</sup> et l'Italie<sup>6</sup> pour ne citer que ceux là. De même, sur le plan international, plusieurs initiatives ont déjà abouti, aux premiers rangs desquelles on citera la Convention de Vienne sur la vente internationale des marchandises, les Principes relatifs aux contrats du commerce international d'Unidroit et les Principes du droit européen des contrats. Même si ces textes n'ont pas la même portée<sup>7</sup>, ils ont le mérite d'avoir pu servir en un document cohérent, les différentes étapes de la vie d'un contrat.

« *Les tentatives de codification de la période précontractuelle dans l'œuvre législative contemporaine* ». Tel est l'intitulé de notre thèse dont l'objet repose sur l'étude approfondie de la phase de négociation des contrats. Si l'on admet que les contrats de la vie courante se forment généralement de façon instantanée, la réalité est toute autre pour les « gros contrats ». Dans ce cas, les parties peuvent faire précéder la conclusion d'une phase de négociation, au cours de laquelle elles discutent et précisent les modalités de la convention projetée. La proposition initiale peut donc être séparée de la conclusion effective par une période précontractuelle plus ou moins longue<sup>8</sup>.

Un problème se pose : quel est l'opportunité d'une codification de la période précontractuelle?

Les négociations, l'offre et l'acceptation et les avant-contrats sont généralement les phases qui se retrouvent au cœur de cette période. Notre étude consiste à analyser l'état actuel de la période précontractuelle, d'en faire une étude au regard des projets et avant-projets en cours au Cameroun en France et dans le droit unifié, de trouver des solutions qui amélioreront la qualité des transactions dans la formation du contrat, à expliquer de manière cohérente les solutions positives et de guider les solutions futures, mais surtout comprendre et expliquer la montée en puissance des grands principes directeurs que sont la *liberté contractuelle*, la *force obligatoire* du contrat et la *bonne foi* dans les négociations.

La mise à nue de notre recherche nous conduit à orienter temporairement notre travail vers deux axes majeurs :

### **Plan**

Le plan fourni ici n'est qu'une sorte de représentation sommaire de notre travail, il représente juste un condensé structuré de l'ensemble de nos recherches sous réserve des orientations futures.

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<sup>5</sup> BGB 2002, Code civil allemand, traduction commentée BGB, Juriscope Dalloz, 2010.

<sup>6</sup> Codice civile de 1942

<sup>7</sup> « La Convention de Vienne est un texte à pleine valeur normative dans les rapports entre les pays ou elle est applicable, mais son objet est limité au contrat de vente. Les deux autres codifications concernent tout type de contrat, mais elles relèvent de la *soft law*. » propos de M. Fontaine (dir.), « un régime harmonisé de la formation des contrats- Réexamen critique », in Le processus de formation du contrat, contributions comparatives et interdisciplinaires à l'harmonisation du droit européen, Bruylant, LGDJ, p.

<sup>8</sup> J. Schmidt, « la période précontractuelle en droit français », Revue internationale de droit comparé, 2-1990, p. 545.

## **PREMIERE PARTIE : LA RECONSTRUCTION DE LA PERIODE PRECONTRACTUELLE DANS LES REFORMES DU DROIT DES CONTRATS**

### **TITRE I: LA PERIODE PRECONTRACTUELLE : DE LA PRATIQUE A LA LOI**

#### **CHAPITRE 1 : LA PERIODE PRECONTRACTUELLE ET SES ETAPES**

Section 1 : un processus aux étapes plus nombreuses

Section 2 : l'émergence des théories (théorie de l'offre et de l'acceptation, théorie des contrats préliminaires)

#### **CHAPITRE 2 : LA PERIODE PRECONTRACTUELLE ET L'INFLUENCE DE LA PRATIQUE CONTEMPORAINE**

Section 1 : les contrats électroniques

Section 2 : la remise en cause de l'approche offre et acceptation dans la formation des contrats :  
émergence de la *battle of form*

### **TITRE II: LA LOI NOUVELLE ET LA GRADATION DES MOMENTS CONSTITUTIFS DE LA PERIODE PRECONTRACTUELLE**

#### **CHAPITRE 1: LA NEGOCIATION**

#### **CHAPITRE 2: L'OFFRE ET L'ACCEPTATION**

#### **CHAPITRE 3: LES AVANT-CONTRATS**

## **DEUXIEME PARTIE: LA SYSTEMATISATION DES SITUATIONS JURIDIQUES CONFLICTUELLES (CONTENTIEUSES)**

### **TITRE I : LA FIN DE LA PERIODE PRECONTRACTUELLE VOULUE PAR LES PARTIES**

#### **CHAPITRE 1: FIN HEUREUSE PAR LA CONCLUSION DU CONTRAT DEFINITIF**

#### **CHAPITRE 2: UNE FIN AMENAGEE PAR L'INSERTION DES CLAUSES DANS LA PERIODE PRECONTRACTUELLE**

### **TITRE II: LA FIN DE LA PERIODE PRECONTRACTUELLE NON VOULUE PAR L'UNE DES PARTIES**

#### **CHAPITRE 1: LA NATURE DE LA RESPONSABILITE ISSUE DE LA RUPTURE**

Section 1 : responsabilité précontractuelle de nature délictuelle

Section 2 : responsabilité précontractuelle de nature contractuelle

#### **CHAPITRE 2: LE REGLEMENT DES LITIGES ISSUS DE LA PERIODE PRECONTRACTUELLE**

## **CONCLUSION**

Après avoir décrit de façon succincte mon stage à l'INSTITUT INTERNATIONAL POUR L'UNIFICATION DU DROIT PRIVE, nous pourrions conclure en un mot : satisfaisant.

En effet, au regard de la description faite dans mon rapport, le bilan est positif. Durant deux mois, j'ai pu profiter de façon régulière des services de la salle de documentation appuyés par la délicate attention du personnel de l' UNIDROIT. Par ces avantages, j'ai véritablement commencé et fini mon projet de thèse. D'un point de vue intellectuel, je peux dire avec certitude que mes connaissances ont doublé sinon triplé en quelques semaines. De même, la qualité du logement et du staff mis en place pour mon bien être n'ont fait qu'améliorer la qualité de mon séjour. Les quelques difficultés rencontrées n'entachent en rien le souvenir des deux mois riches et inoubliables que j'ai passés à Rome.

La bourse UNIDROIT est une opportunité, mieux, une chance inespérée pour tous les étudiants en général et surtout pour les étudiants africains en particulier qui n'ont pas souvent l'occasion d'avoir accès à une documentation aussi riche. Cette initiative est à saluer, à féliciter et à pérenniser dans le temps. Grace à elle j'en suis sûre, le nombre de juristes compétent ne cessera de s'agrandir. je conclurai en disant une fois de plus merci à tout le personnel, plus particulièrement à Frédérique et à Laura qui contribuent à faire des jeunes étudiants des juristes de demain.