VOLUME 27
NUMBER 3,4
SPRING 2009

PENN STATE INTERNATIONAL LAW REVIEW

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**14th Biennial Meeting of the
International Academy of Commercial and Consumer Law
Bamberg, Germany
July 30 – August 3, 2008**

14th Biennial Meeting of the International Academy of Commercial and Consumer Law

Introduction

Louis F. Del Duca*

From its beginning, the International Academy of Commercial and Consumer Law[1] has brought together the best legal minds from the major legal cultures of the world to address commercial and consumer areas of the law, and through its scholarly inquiry contribute to development of a more rational transnational legal order. Presently consisting of approximately 120 leading world scholars from 35 countries, it continues its tradition of Biennial Meetings at important legal and cultural centers around the world to address vital contemporary issues. Since 1983 the International Biennial Meetings of the Academy have been held around the world at the following leading educational institutions:

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1. http://www.dsl.psu.edu/faculty/DelDuca/academy.cfm

Year	Place	Institutional Sponsor	Principal Institutional Hosts, Organizers, Directors, and Facilitators
1983	Mexico City, Mexico	National Autonomous Univ. of Mexico	Miguel Acosto Romero Arcelia Quintana
1984	Castle Hofen, Austria	Univ. of Innsbruck	Heinrick Mayrhofer Donald King
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1992	Stockholm, Sweden	Univ. of Stockholm	Jan Ramberg Jan Helner Ulf Bernitz
1994	St. Louis, Missouri, USA	Saint Louis Univ.	Donald King
1996	Rama Gat, Israel	Bar Ilan Univ.	Shalom Lerner Jacob Ziegel Arie Reich
1998	Gold Coast, Australia	Bond Univ.	David Allan Mary Hiscock
2000	Carlisle, Pennsylvania, USA	Penn State Univ. The Dickinson School of Law	Louis Del Duca
2002	Hamburg, Germany	Max Planck Institute	Juergen Basedow Ulrich Drobnig
2004	Riga, Latvia	Riga Graduate School of Law (RGSL)	Norbert Reich
2006	Austin, Texas, USA	Univ. of Texas School of Law	Jay Westbrook Ross Cranston
2008	Bamberg, Germany	Univ of Bamberg School of Law	Jürgen Basedow Hans Micklitz

Included amongst its published proceedings are:

KING, Fred B. Rothman & Co., now William S. Hein & Co., Buffalo, N.Y. 1986 (2nd Biennial Meeting, held at Castle Hofen, University of Innsbruck, Austria

1987 Ariz. J. Int'l Comp. L. 1 (1987)[2] (3rd Biennial Meeting, held at Harvard law School, Boston, Massachusetts, United States)

KING, ESSAYS ON COMPARATIVE COMMERCIAL AND CONSUMER LAW, Fred B. Rothman & Co. now William S. Hein & Co., Buffalo, N.Y. 1992 (4th Biennial Meeting, held at University of Melbourne, Melbourne, Australia)

CRANSTON AND GOODE, COMMERCIAL AND CONSUMER LAW: NATIONAL AND INTERNATIONAL DIMENSIONS, Clarendon Press, Oxford 1993 (5th Biennial Meeting held at Oxford University, Oxford, England)

39 St. Louis U. L.J. 719 (1995)[3], (7th Biennial Meeting, held at Saint Louis University School of Law, St. Louis, Missouri, United States)

ZEIGEL, NEW DEVELOPMENTS IN INTERNATIONAL COMMERCIAL AND CONSUMER LAW, consulting editor Lerner, Hart Publishing, Oxford 1998 (8th Biennial Meeting, held at Bar Ilan University, Rama Gat, Israel)

106 Dick. L. Rev. 1 (2001)[4] (10th Biennial Meeting, held at Penn State Dickinson School of Law, Carlisle, Pennsylvania, United States)

22 Penn St. Int'l L. Rev 1 (2003)[5] (11th Biennial Meeting, held at the Max Planck Institute, Hamburg, Germany).

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2. http://www.heinonline.org/HOL/Page?handle=hein.journals/ajicl1987&id=1&size=2&collection=journals&index=journals/ajicl

3. http://www.heinonline.org/HOL/Page?handle=hein.journals/stlulj39&id=1& size=2&collection=journals&index=journals/stlulj

4. http://heinonline.org/HOL/Page?handle=hein.journals/dlr106&id=1&size=2&collection=journals&index=journals/dlr

5. http://heinonline.org/HOL/Page?handle=hein.journals/psilr22&id=1&size=2&collection=journals&index=journals/psilr

23 Penn St. Int'l L. Rev. 491 (2005)[6] (12th Biennial Meeting, held at the Riga Graduate School of Law, Riga, Latvia).

42 Tex. Int'l L.J. 369 (2006-2007)[7] (13th Biennial Meeting, held at the University of Texas Law School in Austin, Texas).

27 Penn St. Int'l L. Rev. 545 (2009) (14th Biennial Meeting, held at the University of Bamberg School of Law, Bamberg, Germany).

The 14th Biennial Meeting has spawned a timeframe in which new technologies and globalization have generated opportunities for expanded world commerce in an era of world-wide environmental, financial, commercial and human rights concerns. Simultaneously, regional and global political and economic organizations, and a plethora of treaties, legal guidelines, standard form contracts, and domestic legislation have emerged attempting to respond to new problems and opportunities for their creative resolution.

This special issue of the *Penn State International Law Review* publishes 17 papers presented at the 2008 14th Biennial Meeting of the International Academy of Commercial and Consumer Law. The topics addressed (with some papers listed more than once because of the multiple topics addressed), are as follows:

Class Action Law – Zeigel

Consumer Law – Arroyo, Atamer, Barral, Del Duca, Kritzer, Micklitz, Nagel, Nakata, and Reich

Comparative Law – Arroyo, Atamer, Del Duca, Duggan, Geva, Harmathy, Hiscock, Kritzer, Micklitz, Nagel, and Ziegel

International Business – Arroyo, Atamer, Barral, Del Duca, Geva, Hiscock, Kritzer, Micklitz, Nagel, Nakata, Ramberg, Reich, and Westbrook

Insolvency – Westbrook

6. http://heinonline.org/HOL/Page?handle=hein.journals/psilr23&id=1&size=2&collection=journals&index=journals/psilr

7. http://heinonline.org/HOL/Page?handle=hein.journals/tilj42&id=1&size=2&collection=journals&index=journals/tilj

International Investment – Hiscock

Payment Systems – Geva

Secured Lending/Securitization – Dahan, Duggan, Harmathy, Gedye, and Simpson

Transport Law – Ramberg

Seven papers addressed the subject of consumer law. Individual papers focused on developments in Turkey, Japan, and class actions in Canada and an overview of developments in Latin America. Consumer contracting in e-commerce and proposed development of a soft law on Global Principles of International Consumer Contracts (GPICC) paralleling the already existing UNIDROIT Principles of International Commercial Contracts (UPICC) was also presented. As soft law, the GPICC could be voluntarily incorporated by parties into their business-consumer contracts in a manner comparable to voluntary incorporation by parties into their contract of the International Chamber of Commerce Incoterms.

Secured transactions also continue to be a major area of interest to members of the Academy. Papers were presented on developments in Austria, Hungary, Israel, and New Zealand. A paper on the related subject of insolvency examined barriers which exist to cooperation in multi-national insolvencies.

Payment transactions under the EU payment services directive comparing this system with the United States approach, emerging legal concepts of investment, and possible global unification of transport law also were topics addressed by individual papers.

Jurgen Basedow, President of the Academy and the Max Planck Institute for Private International Law presided over the 2008 14th Biennial Meeting. Hans Micklitz, President elect, then professor of law at the University of Bamberg School of Law and currently a professor at the European Institute in Fiesole, Italy, served as the program organizer hosted by the University of Bamberg University and the Max Planck Institute for Private and International Law. Ron Cumming of the University of Saskatchewan serves as Treasurer of the Academy.

The Implementation of the EU Consumer Protection Directives in Turkey

Yeşim M. Atamer & Hans W. Micklitz

I. OVERVIEW

The first Turkish Consumer Protection Law ("CPL") was issued in 1995 by Parliament, triggered by the establishment of a Customs Union between Turkey and the European Union ("EU") in the same year, obliging Turkey to adapt its legislation specifically in the areas of consumer protection, anti-trust law and intellectual property law.[1] Nevertheless, shortly thereafter, reform was needed, due to the European Council's granting Turkey official status as an accession state in 1999. This act obliged Turkey to adopt the entire *acquis communautaire.*[2] In the area of consumer protection law, the legislature attempted to comply by passing a 2003 revision, which both transformed directives issued in the interim as well as making important changes to the existing law.[3]

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1. Tüketicinin Korunması Hakkında Kanun [Consumer Protection Law], *in* RG 08.03.1995, sayı 22221. In the explanatory memorandum of the law, reference was made to the first and second consumer programs of the EU, 1975 O.J. (C 92) 1; 1981 O.J. (C 133) 1, and the Council Resolution of 23 June 1986 concerning the future orientation of the policy of the European Economic Community for the protection and promotion of consumer interests, 1986 O.J. (C 167) 1. During the preparation of the law, there was no discussion as to whether to integrate the consumer protection provisions into the Code of Obligations, or whether a special regulation was preferable because the working out of the consumer law in Turkey falls within the competence of the Ministry of Industry and Trade which did not consider a cooperation with the Ministry of Justice. For a critical evaluation of this, *see* Yeşim Atamer, *Tüketici Hukukunun Gelişimi: Dünü, Bugünü ve Yarını [The Evolution of Consumer Law and Future Tendencies], in* TÜKETICININ KORUNMASI SEMINERI 21 et seq. (Ceylan ed., 2007).

2. *Cf.* HEIDERHOFF, GRUNDSTRUKTUREN DES NATIONALEN UND EUROPÄISCHEN VERBRAUCHERVERTRAGSRECHTS (2004); RÖSLER, EUROPÄISCHES KONSUMENTENVERTRAGSSRECHT (2004); WEATHERILL, EU CONSUMER LAW AND POLICY (2005); HANS-M. MICKLITZ & NORBERT REICH, THE BASICS OF EUROPEAN CONSUMER LAW (2007).

3. Tüketicinin Korunması Hakkında Kanunda Değişiklik Yapılmasına Dair Kanun [Law amending the Law on Consumer Protection], Nr. 4822, RG 14.03.2003, sayı 25048. For a critical appraisal regarding the proposal to amend the Law on Consumer Protection, *see* Yeşim Atamer, *Tüketicinin Korunması Hakkında Kanunda Değişiklik Öngören*

The aim of this article is, first, to provide a short, general overview of the Turkish Consumer Protection Law and, second, to explain the implemented directives on advertising, unfair commercial practices,[4] sales contracts,[5] product liability,[6] unfair terms,[7] time-share[8] package-holidays,[9] door-to-door[10] and distance contracts,[11] consumer credit[12] and actions for an injunction.[13] Only those provisions will be considered that serve the implementation of these directives.[14] As far as is necessary in this context, the EU Draft Directive on Consumer Rights will also be

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Tasarının Sözleşme Hukukunun Bazı Yönleri Açısından Avrupa Birliği Mevzuatıyla Karşılaştırılması [A Comparative Analysis of EC-Law and of Certain Contract Law Related Issues within the Draft Law Amending the Consumer Protection Act], 21 MHB no. 1-2 (2001), at 1-32.

4. *See* Council Directive 84/450/EEC, On Misleading Advertising, 1984 O.J. (L 250) 17; Council Directive 97/55/EC, 1997 O.J. (L 290) 18 (amending Directive 84/450/EEC so as to include comparative advertising; Council Directive 2005/29/EC, 2005 O.J. (L 149) 22 (concerning unfair business-to-consumer commercial practices in the internal market and amending Council Directive 84/450/EEC, Directives 97/7/EC, 98/27/EC and 2002/65/EC of the European Parliament and of the Council and Regulation (EC) No 2006/2004 of the European Parliament and of the Council ("Unfair Commercial Practices Directive")).

5. Council Directive 99/44/EC, On Certain Aspects of the Sale of Consumer Goods and Associated Guarantees, 1999 O.J. (L 171) 12.

6. Council Directive 85/374/EEC, On the Approximation of the Laws, Regulations and Administrative Provisions of the Member States Concerning Liability for Defective Products, 1985 O.J. (L 210) 29, *altered by* Council Directive 1999/34/EC, 1999 O.J. (L 141) 20.

7. Council Directive 93/13/EEC, On Unfair Terms in Consumer Contracts, 1993 O.J. (L 95) 29.

8. Council Directive 94/47/EC, On the Protection of Purchasers in Respect of Certain Aspects of Contracts Relating to the Purchase of the Right to Use Immovable Properties on a Timeshare Basis, 1994 O.J. (L 280) 83. This Directive is currently under revision. The European Parliament has approved the proposal for amendment on 22 October 2008. *See* http://ec.europa.eu/consumers/rights/docs/timeshare_position_en.pdf.

9. Council Directive 90/314/EEC, On Package Travel, Package Holidays and Package Tours, 1990 O.J. (L 158) 59.

10. Council Directive 85/577/EEC, To Protect the Consumer in Respect of Contracts Negotiated Away from Business Premises, 1985 O.J. (L 372) 31.

11. Council Directive 97/7/EC, On the Protection of Consumers in Respect of Distance Contracts, 1997 O.J. (L 144) 19; Council Directive 2002/65/EC, Concerning the Distance Marketing of Consumer Financial Services and amending Council Directive 90/619/EEC and Directives 97/7/EC and 98/27/EC, 2002 O.J. (L 271) 16.

12. Council Directive 87/102/EEC, For the Approximation of the Laws, Regulations and Administrative Provisions of the Member States Concerning Consumer credit, 1987 O.J. (L 42) 48; Council Directive 2008/48/EC of the European Parliament and of the Council of 23 April 2008, On Credit Agreements for Consumers and repealing Council Directive 87/102/EEC, 2008 O.J. (L 133) 66.

13. Council Directive 98/27/EC of the European Parliament and of the Council of 19 May 1998, On Injunctions for the Protection of Consumers' Interests, 1998 O.J. (L 166) 51.

14. The analysis of Professor Micklitz is based on the English translation of the relevant provisions and bylaws, which were provided by the Ministry of Industry and Trade in 2004.

discussed.[15] The Draft intends to unite four directives: door-to-door selling, distance contracts, consumer sales and unfair terms. Beyond conceptual changes, the Draft attempts to eliminate the concept of minimum harmonization and to replace it with the concept of full harmonization.

II. STRUCTURE AND APPLICATION OF THE CONSUMER PROTECTION LAW[16]

A. Structure

The Turkish Consumer Protection Law is divided into five parts, in which substantive and procedural questions of consumer protection are regulated. In the first part (Art. 1 *et seq.*),[17] the aim and scope (Art. 2) of the law are set out as well as definitions of the terms used in the law (Art. 3). The second and main part is dedicated to the rules about protection and the information of the consumer. In the current version, this part contains rules on the following: consequences of the delivery of defective goods (Art. 4); inadequate performance of services (Art. 4/A); contractual duties of traders on displayed goods (Art 5); unfair terms in consumer contracts (Art. 6); installment sales (Art. 6/A); time-share agreements (Art. 6/B); package holiday contracts (Art. 6/C); campaign sales (Art. 7); door-to-door sales (Arts. 8, 9); distance sales (Art. 9/A); consumer credit contracts (Art. 10); credit card transactions (Art. 10/A);[18] mortgages (Art 10/B); marketing of print media (Art. 11); subscription agreements (Art. 11/A); labeling duties and content (Art. 12); producer and importer guarantees (Art. 13); instruction manuals (Art. 14); post-sale repair services (Art. 15); commercial advertising and announcements (Art. 16); advertising oversight committee (Art. 17); warnings about damaged and dangerous goods and services (Art. 18); quality control (Art. 19) and education of the consumer (Art. 20).

The third part, entitled "consumer organizations," introduces two new institutions into Turkish law. First, Article 21 forms the consumer

15. *Proposal for a Directive of the European Parliament and of the Council on Consumer Rights*, COM (2008) 614 final (Oct., 8, 2008); *see also* Hans-M. Micklitz & Norbert Reich, *The Commission Proposal for a Directive on Consumer Rights*, 46 COMMON MKT. L. REV. 471 (2009).

16. *See also* Yeşim Atamer, *Die autonome Umsetzung der Verbrauchsgüterkaufrichtlinie 1999/44 in der Türkei – Zugleich ein Beitrag zum Stand des Konsumentenschutzes in der Türkei*, 2005 ZEITSCHRIFT FÜR EUROPÄISCHES PRIVATRECHT [ZEuP] 566, 568-76.

17. Provisions without another indication are those of the Turkish CPL.

18. In 2006, a separate law on Banks and Credit Cards was issued (RG 01.03.2006, sayi 26095) but preserves the condition in the CPL.

council, an institution which must be convened at least once annually by the industry and trade ministry. The council includes representatives of various ministries, state and non-state organizations. Second, Article 22 establishes the dispute resolution committee for consumer law disputes, which must be formed in every state and commune, and whose usage is obligatory for disputes with a value under approximately 426 Euros before a claim can be brought in the consumer court.

The fourth part of the Consumer Protection Law is dedicated to procedural issues and administrative sanctions. In Article 23, the establishment of specialized consumer courts is provided for,[19] in which not only consumers but also consumer organizations[20] and the ministry have standing. The advantages of this are the relief of process charges and the usage of the Article 507 ff. Turkish Civil Procedure Law setting out a simpler and therefore expedited process. The jurisdiction of the courts at the domicile of the defendant and, alternatively, the courts of the consumer's domicile are recognised (Art. 23(3) CPL).

The fifth and final part of the law contains various rules, including a competence norm, which empowers the Industry and Trade Ministry to issue regulations to implement the CPL (Art. 31 CPL), and the prescription that, regarding questions left open in the CPL, the "general provisions" should apply (Art. 30 CPL). This article must be interpreted as referring to the Turkish law of obligations and the civil code.[21]

The legislature conceptualized the CPL as a regulatory framework and left most of the minutiae to the Industry and Trade Ministry (Art. 31 CPL). Though faster regulation is made possible by the capacity to issue regulations,[22] from the consumer protection point of view, this is not a

19. By August 2008 the High Council of Judges and Prosecutors had established 26 consumer courts, of which 8 are seated in Ankara, 7 in Istanbul, and 3 in Izmir. In the towns where there is no special court, the civil courts of first instance are responsible, to resolve consumer disputes. Traders have no right to file a case at consumer courts, even if they sue against a consumer. *See* Y3HD 15.11.1998, 11141/12254, printed in ZEVKLILER & AYDOĞDU, TÜKETICININ KORUNMASI HUKUKU [LAW OF CONSUMER PROTECTION], 930-31 (2004).

20. Consumer organisations are, pursuant to Article 3(p) CPL, "Clubs, associations or their umbrella organizations, which were established with the goal of protecting consumers."

21. *See* ZEVKLILER & AYDOĞDU, *supra* note 19, at 493. The Turkish law of obligations (Borçlar Kanunu), which became effective in 1926, is an almost word-for-word translation of the Swiss law of obligations. *See* Yeşim Atamer, *Rezeption und Weiterentwicklung des Schweizerischen Zivilgesetzbuches in der Türkei*, 72 RABEL J. COMP. INT'L PRIVATE L. (RabelsZ) 723-54 (2008) (discussing the reception of the Turkish law).

22. Until today, Regulations have been issued in particular fields: defective products, abusive clauses, time-shares, package holidays, distance sales, door-to-door sales and campaign sales (all published in RG 13.06.2003, sayı 25137), commercial advertisements

welcome development because it largely defeats the goal of collating all relevant consumer regulations in one code. Further, the prescriptions give rise to administrative law questions including, for example, regarding the hierarchy of norms.

B. Scope of application

1. Consumer Transactions

According to Article 2 of the CPL, the law covers all trade in goods and services in which the consumer is on one side of the transaction. In Article 3(1), the "consumer" is defined as follows: "[t]he consumer is every natural or juridical person, who procures, uses, or benefits from goods or services for a purpose that is neither commercial nor professional." Thus, the Turkish legislature connects the status of consumer to the presence of functional characteristics.[23] That is, the classification of a transaction depends entirely on its function and purpose, not on the characteristics of the contracting person.[24] The status of consumer is established for the particular transaction and is created by the same. The moment of classification is at the time of concluding the contract.

In the examination of whether a natural person qualifies as a consumer, the purpose of the transaction is determinative. Pursuant to Article 21 of the Turkish Commercial Code ("TCC"), there is a presumption that tradespeople are acting in the course of their trade.[25] This presumption can be rebutted by a businessman who is a natural person if he evidences that his contracting partner was or must have been aware of the private character of the trade.

In contrast to the laws of the EU, a juridical person can also enjoy protection under Turkish consumer law. However, it is important to make a distinction. For juridical persons who carry the title of a tradesperson, the presumption of Article 21 cannot be rebutted.[26] For

(published in RG 14.06.2003 sayı 25138), structure and function of the advertising council and consumer credit (both published in RG 01.08.2003 sayı 25186).

23. *See* Ozanoğlu, *Mukayeseli Hukuk ve Tüketicinin Korunması Hakkında Kanun Açısından Tüketiciyi Koruyan Düzenlemelerin Kişi Bakımından Uygulama Alanı* [*The personal scope of application of the CPL*], *in* KEMAL OĞUZMAN'IN ANISINA ARMAĞAN 667 et seq. (Barlas, Kendigelen & Sarı eds., 2000).

24. Ozanoğlu, *Tüketici Sözleşmeleri Kavramı* [*The material scope of application of the CPL*], AÜHFD 55, 72 (2001).

25. According to Article 14 TCC a tradesperson is someone who runs a business entirely or partly in his own name.

26. Alike, the Turkish Court Y11HD 26.6.1997, YKD 1997, 1564, 1566 (In this case, a stock company bought a car, which proved defective). This case was confirmed

juridical persons in civil law—e.g. societies and foundations—there is no obstacle to their classification as consumers.[27]

The other contracting party must be a person who, in the framework of their commercial or professional ability, offers the consumer wares or services. The contracting party can be a natural or juridical person, who, according to the type of trade, is classified as a seller (Art. 3(1)f), service provider (Art. 3(1)g, or creditor (Art. 3(1)k).

2. Goods

In its version of Article 3(1)c, CPL rewrites the term "goods" to be much broader, to reflect the CPL of the EU. Since the revision, not only movables but also intangible goods and land qualify as wares.

The term "movables" is not defined in the CPL. Pursuant to Article 762 of the Turkish Civil Code ("TCivC"), moveable physical things, as well as forces of nature which can be legally owned and which are not, according to Article 704 TCivC, part of the land, are chattels. It must therefore be taken into account that the provision of services like electricity, gas, and water are within the scope of the CPL.[28]

Subsequent to the revised Article 3(1)c, intangibles intended for use in the electronic medium are also goods. The legislation mentions, in particular, software, sound and picture data, without furnishing an exhaustive list. In this way, the lawmakers wanted to secure that the consumers in internet transactions for digital products would be protected by the law.[29]

With the revision of 2003, real estate intended for use as accommodation also qualifies as wares.[30] Precisely which properties are

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in the Senate of the Turkish Court, YHGK 11.10.2000, E.2000/19-1255, K.2000/1249, published at www.kazanci.com.

27. Y11HD 26.6.1997, YKD 1997, 1564, 1565; *see also* ZEVKLILER & AYDOĞDU, *supra* note 19, at 81.

28. On the other hand, Directive 1999/44 excludes from its scope electricity, water and gas; they are not put up for sale in a limited volume or set quantity (Art. 1(2)b Directive). *Cf.* Draft Directive on Consumer Rights, art. 2 (4) b, c.

29. Consider Article 1(2)b Directive 1999/44, which describes its subject as "tangible movable item." Thus, only a *corpus mechanicus*, in which an immaterial good is crystallized, can be a consumer good. *See, e.g., Luna Serrano, in* Grundmann/Bianca (Hrsg.), EU-Kaufrechts-Directive, Kommentar, 2002, Art. 1 Rn.32-33. These would be cassettes, CD's, records, etc. The wording of the Turkish definition however does not presuppose such materialization.

30. In the explanatory memorandum of the law, the reason is given that an unfair distinction is created, where credit transactions for a private car purchase are protected by CPL, though credit transactions for a house are not (4822 Sayılı Kanunun Madde Gerekçeleri, m.3). In the case law before the change of the law: Y11HD, 14.01.2002, E.7701/K.244, *printed in* ZEVKLILER & AYDOĞDU, *supra* note 19, at 976. Out of 29 decisions on sale contracts, which were decided after the 2003 Revision and were publicized in the databank "www.kazanci.com," not a single one involving defective

covered will have to be further clarified by the judicature. Problems might arise, for example, in the case of a transaction regarding a second house. It is conceivable that only the transaction regarding the first home or holiday home will qualify as a consumer contract and the others count as business, denying the purchaser the status of consumer.

III. ADVERTISING AND UNFAIR COMMERCIAL PRACTICES

A. Overview

The rules on unfair commercial practices, to use the terminology of Directive 2005/29/EC, are found in various places in the CPL. They follow the classic separation between "marketing methods" and "advertising." Dubious marketing tactics seem to play an important role in Turkey. One rule in particular was needed for campaign sales (Art. 7), which was further distinguished in the Campaign Sales Regulation.[31] Special prescriptions can also be found on "periodica" (Art. 11 CPL). However, the main section is taken up by advertising rules. Article 16, the Advertising Regulation ("AdvertR"),[32] Article 17, and the Advertising Council Regulation ("AdvertCouncilR"),[33] specify the control, competence, and organisation of the oversight committee. The Turkish legislature has taken it upon itself to implement Directive 84/450/EC on misleading advertising and Directive 97/55/EC on comparative advertising. Directive 2005/29/EC on unfair commercial practices was adopted after the CPL and could not, as a result, be considered in the implementation. Nevertheless, it provides the standard against which Turkish law must be measured today.

B. Definitions and Scope of Application

Article 3(1) CPL defines the "advertiser" and Article 3(m) defines "advertising agency." Article 4(d) and (e) of the AdvertR repeat the terms and add definitions of media organisations and commercial adverts in Article 4(f) and (h) respectively. The division of potential addressees in the client of the adverts, that is the trader who will benefit from the advertisement, and the advertising agency, which executes the advert, is extraordinary. Normally the trader is in the foreground of the rules about fair competition. The trader is considered responsible for the actions of

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delivery of real estate can be found, which indicates that the disputes are concentrated on movables.

31. *See supra* note 22.

32. *See id.*

33. *See id.*

the advertising agent. On the contrary, the Turkish rule establishes legal responsibility for the advertiser, the advertising agency, and the media (Art. 21 of the AR).[34]

The material scope of the rule is broad. Article 4(h) encompasses commercial advertising as well as marketing methods. Different from the Directive 2005/29/EC, what is not apparent is the extent to which marketing after the conclusion of the contract is also encompassed by the provisions (Art. 3(1) of the Directive).[35] Conversely, no products or services are exempted from its ambit.

Adverts for financial services also fall within the ambit of the Turkish law, like adverts geared towards the health and safety of the consumer. The Directive takes unique approach. Advertisements for financial services fall within the ambit, pursuant to Article 3(9), but the directive defines only minimum requirements, which the member states can go beyond. For the particularly relevant area of consumer credit, the EC, in the interim, set up more severe requirements in Article 4 of Directive 2008/48/EC. These concern information about credit costs. It is politically contentious in most member states whether more extensive measures are necessary. A big problem in practice is caused by "baiting." Banks advertise lavishly with interest rates that no one (or only a minimal percentage of applicants) receives because they do not pass the credit check. As is well known, the level of interest levied depends on the score of the individual consumer.[36] The Turkish law contains special rules on consumer credit. These can be found in Articles 7(e) and (f) of the AR. They specify the prohibition on misleading advertising but are less clear regarding what information is necessary pursuant to Article 4 of EC Directive 48. Here, there is a need for harmonization.[37]

Health related advertisements seem to have a particular weight in Turkey. It is not surprising, therefore, that they are explicitly mentioned in both Article 16(2) CPL and Article 5 of the AR. According to Article 16(2), advertisements should not endanger the life of the consumer or, more specifically, pursuant to Article 5(1)c of the AR, advertisements should not include any presentation or prescriptions that do not follow

34. The law establishes a separate liability for the named institutions. Article 21(4) creates a special regulation for the "media," and probably the television companies are intended, who will be held liable for malfeasance of intermediaries.

35. *See* Busch, *Ein europäischer Rechtsrahmen für das Lauterkeitsrecht?—Der Vorschlag der Europäischen Kommission für eine Direktive über unlautere Geschäftspraktiken*, 2004 EUR. LEGAL FORUM [EuLF] 93.

36. Germany discusses whether or not there should be a provision in the Directive, which makes clear that the interest rates offered in the adverts are also achieved in practice.

37. *See infra* part XI.C.

safety rules and describe hazards to to human users. On the contrary, in Article 3(3), the Directive largely excludes health-related advertisements from its scope because the Community does not have regulatory competence when it comes to health.[38] Also in contrast to the Directive, the Turkish rule extends as far as environmental advertising (Art. 19 AR).

C. *The Yardstick of the Average Consumer and Particularly Vulnerable Groups*

The CPL lists in Article 16(2) the diverse target groups. The determinative factor with respect to the yardstick of control can be found in Article 5(e) of the AR. This takes account of the perception of the advertisement from the perspective of the average observer, or it evaluates the influence of the advertisement on the consumer without reference to the average consumer.[39] This formulation might well be traced back to the jurisprudence of the European Court of Justice ("ECJ"), which created out of Art. 28 EC, the construction of the average, informed, circumspect and sensible consumer.[40] Even if it only makes an appearance in the preamble to the Directive and not in the text itself, this concept is the yardstick against which every advertisement in Europe must be measured.[41] The Turkish law is special in only one respect: it makes reference to the "transparency" of the advertisement. According to Article 5(e)1-3, written information in advertisements and posters must be legible and the message must be announced in a comprehensible and clearly formulated manner.

The protection of particularly vulnerable groups of consumers, in the sense of Article 5(3) of the Directive, can be found repeatedly in the Turkish law. In Article 16(2) CPL, children, the elderly and disabled people are named as protectees. These requirements are made concrete in Article 6(d) and (e) as these groups—including patients—may not be

38. On the difficult questions as to when an advert is health-related, *see, e.g.*, the interpretation of the Cosmetics Directive, Micklitz *in* MÜNCHENER KOMMENTAR ZUM LAUTERKEITSRECHT, Band 1, 2006 (MünchKommUWG), Teil III, K para 77 ff.

39. For the specification of the term "average consumer" in jurisprudence, *see* INAL & BAYSAL, REKLAM HUKUKU VE UYGULAMASI 26-28 (Werberecht und Praxis 2008).

40. *See* Case No. C-470/93, Mars, 1995 E.C.R. I-1923; Case No. C-210/96, Gut Springenheide, 1998 E.C.R. I-4657; Case No. C-303/97, Sektkellerei Kessler, 1999 E.C.R. I-513; Case No. C-220/98, Lifting-Crème, 2000 E.C.R. I-117; Case No. C-465/98, Darbo naturrein, 2000 E.C.R. I-2297.

41. *See* Thomas Wilhelmsson, *Misleading Practices*, *in* HOWELLS, MICKLITZ & WILHELMSSON, EUROPEAN FAIR TRADING LAW: THE UNFAIR COMMERCIAL PRACTICES DIRECTIVE ch. 5(b)(iii) (2006) (stating that the average consumer is not the measure of things); Helm, *Der Abschied vom verständigen Consumer* 2005 WRP 931 (advocating for the restoration of the German consumer model).

portrayed in advertisements. Article 18 of the AdvertR is dedicated entirely to the protection of children and minors. Going much further than the Directive, the restrictions and provisions on advertising applying to children are formulated there.[42]

D. Unfair Advertising

To betray the result: Turkish law contains no crystal clear ban on unfair advertising. Nevertheless, a whole plethora of rules can be found in the law and regulations, which, taken together, come close to prohibiting unfair advertising.

The starting point is Article 16 (1) CPL, which is to the following effect: advertisements and modes of advertising must correspond faithfully to the laws, rules of the Board of Advertising, as well as the moral, the public order and individual rights. This command is elaborated in Articles 5 and 6 of the AR. Article 5(a) repeats Article 16(1) CPL almost word for word. More interesting is 5(b), which states that the advertisement must be in conformance with the principle of fair trade, in so far as it is recognized in working convention and in public opinion. Fair trade is understood as an expression of economic and social responsibilities. Article 5(f) aims to prevent measures which injure human dignity, and 5(g) those which violate individual rights. Article 5(g) and (h) ought to be read in context, which reveals that the law is concerned with the protection of the individuals' private sphere. Article 5(j) augments the basic principles of Article 5 in order to establish a broad prohibition on discrimination. Advertisements may not discriminate on grounds of language, religion, race, political conviction or sex. These rules are clearly the product of a multicultural society, but the influence of the EC prohibition on discrimination is apparent.[43]

Article 6 of the AdvertR concerns itself with public morals. Advertising, so goes the credo, may not violate principles, which can be understood as an expression of public morality. For instance: immoral expressions and pictures, sexual abuse and pornography, the misuse of fear and superstition, the misuse of expressions and pictures which concern children, old people, the disabled and patients. The panorama of the laws is rounded off through Article 7(a), which forbids, in a general form, advertising that betrays the trust of the consumer or exploits his inexperience or ignorance.

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42. The rules ought at the very least to be inspired by the provisions of the International Chambers of Commerce, http://www.iccwbo.org/id925/index.html.

43. On the significance of the rule on prohibition of discrimination especially for private law, *see* Basedow, *Grundsatz der Nichtdiskriminierung im Europäischen Privatrecht*, 2008 ZEuP 230-51.

The difficulty with the Turkish regulations lies in the mixture of bans and prohibitions of unfair trade with moral precepts, which reach deep into the social conditions in Turkey.[44] The Directive establishes a mere ban on unfair trade. This is crystallized on the basis of two criteria: professional care and significant influence on the commercial conduct of the consumer. It leaves to the member states competence in questions of taste, decency, as well as with respect to social, cultural and linguistic characteristics. Difficulties arise where national moral standards are deployed as arguments to restrict advertising in a manner that goes beyond the ban on unfair trade. Here, with respect to the harmonization of the Turkish law with the provisions of the Directive 2005/29/EC and the general clause formulated there, it is desirable to draw a sharp distinction between, on the one hand, "unfair" trade, and, on the other, "immoral" trade.[45]

E. Misleading Actions and Omissions

Article 16(2) CPL establishes, amongst other things, a ban on deceptive and misleading adverts that is reiterated in Article 7(c) of the AR. In contrast to Directives 84/450/EC and 2005/29/EC, the Turkish law requires an actual deception of the consumer, not merely the likeliness to deceive. Article 7(c)1-8 lists the criteria that must be taken into consideration when investigating such deception. The provisions, which hearken back to Article 3 of Directive 84/450/EC, must, in the course of the implementation of Directive 2005/29/EC, be made coherent with reference to the far more comprehensive rules in Article 6.

It is not immediately apparent from the Turkish law the extent to which misleading omissions in terms of Article 7 Directive 2005/29/EC are covered. Nor is it clear whether Turkish law in any way establishes a general mandate that information must be provided. Article 16(1) CPL points in this direction, where it positively requires that advertising be "true" and "correct." Interestingly, in the AR, the relevant passage in Article 5(a) and 7(a) only refers to advertisements being "correct" and "fair." No explicit mention of a prohibition on misleading information is made. Here, Article 7, Directive 2005/29/EC creates confusion in the interpretation of the ban on misleading information and the mandate to

44. *See e.g.*, for decisions of the advertising council, forbidding the advertisement of sexual stimulants on the basis of this provision, INAL & BAYSAL, *supra* note 39, at 21-22.

45. *See* Micklitz, *Das Konzept der Lauterkeit in der Richtlinie 2005/29/EG*, *in* Liber Amicorum Bernd Stauder 297 et seq. (Thévenoz & Reich eds., 2006).

provide information. It will be interesting to see how member states implement these rules.[46]

F. Comparative Advertising

Comparative advertising has been, to date, only cursorily regulated. Article 16(3) CPL legalizes comparative advertisement in the same way as Directive 97/55/EC. Article 11 of the advertising regulation defines the borders of the permission: comparative advertising should only be allowed if the name of the products, services or marks are not mentioned; if the product is of the same quality; and if fair and not misleading competition is respected.

In this regard the Turkish regulation is lagging behind the provisions of Directive 97/55/EU,[47] which permits the mentioning of names on certain conditions. Basically, the Directive involves a two-stage analysis. Comparative advertisement should improve rational decision-making. This concerns mandates to avoid violations regarding price comparison, comparison on the need and the intended usage purpose and on the comparison of characteristics. If these mandates are fulfilled, it is necessary to approve the comparison. The Directive forbids discrediting or denigration, the dishonest exploitation of reputation, the imitation of an advertisement and is intended to prevent the danger of confusion of products.[48]

This two-stage test is only partially replicated in Turkish law. Unlike the Directive, Article 11 does not define the provisions regarding the strengthening of the decision-making capacity, but formulates a far-reaching limitation of the scope of comparative advertising. Articles 14, 15 and 16 of the regulation on advertising forbid the exploitation of reputation, imitation of adverts, and denigration. These three articles belong to the complex of comparative advertising, which is clear from the subtitles of the regulation on advertising. Nevertheless, they lack any reference to the provision on comparative advertising and, as a result give the impression, that general standards are set out, which mainly regulate the relations between tradesmen based on conventional understandings. Lastly, it should be noted that Article 13 allocates the burden of proof in the context of comparative advertising. Here Article 6 of the Directive 97/55/EC was clearly the template.

46. The Commission has set up a website on which the status of the implementation can be followed, http://ec.europa.eu/consumers/rights/index_en.htm.

47. *E.g.*, INAL & BAYSAL, *supra* note 39, at 56 et seq. (providing a critical perspective).

48. *See generally* Micklitz, *supra* note 38, at Teil III, F ¶ 297 ff.

G. *Aggressive Advertising*

Because the last changes to the Turkish consumer law date from 2003, it is not entirely correct to rely on the provisions of Articles 8 and 9 of the Directive 2005/29/EC, which regulate aggressive advertising—that is harassment, intimidation or undue influence.[49] Nevertheless, the concept of the aggressive advertisement is not fundamentally new as rules feature in all the relevant regulations of the member states, including Turkey, which concern this phenomenon.

Many scattered rules can be subsumed under the umbrella of aggressive advertising. Article 16(2) CPL forbids the misuse of experience and knowledge, the threatening of the life or safety of property, the incitement to force and encouragement to commit crime. Article 5(j) mandates that advertising measures do not disturb public order or have content that incites, encourages or supports violence. Article 7(a) prohibits the abuse of consumer trust. In these provisions there are bans on three elements of aggressive advertising: harassment, intimidation, and undue influence.

H. *Enumeration of Forbidden Trade Practices*

The regulatory technique of the Turkish law is not yet in harmony with the provisions of Directive 2005/29/EC. To that extent, a list of forbidden measures, like the one contained in Appendix I, is wanting. Although the thirty-one prohibitions of the Directive do not appear in the Turkish law, they do represent important starting points. That is a result of the fact that the Turkish regulations are in part far more detailed than both the European template and also the rules of many member states. This is due to the conviction that particular shortcomings in advertisements require special rules.

Without categorizing them under unfairness or misleading or aggressive advertising, the following prohibitions from the regulation can be listed in chronological order: Article 5(h) reference to private life without prior consent; Article 5(e) before and after pictures of the treatment of patients; Article 6(b) sexual abuse or pornographic scenes; Article 7(b) subliminal advertisements; Article 7(d) advertisements with guarantees that contain nothing more than the enforceable statutory rights of performance; and Article 7(g) the misrepresentation of scientific or technical results.

Even this overview shows how difficult it is to set up lists of prohibitions for diverse cultures. None of the known states has adopted

49. *See* Howells, *in* EUROPEAN FAIR TRADING: THE UNFAIR COMMERCIAL PRACTICES DIRECTIVE ch. 6 (Howells, Micklitz & Wilhelmsson eds., 2006).

special rules about advertisements with patients. Obviously the rule about comparison is aimed at the "before and after" treatment comparisons. This affects, above all, cosmetic surgery. The same goes for sexuality. The rules of the member states differ considerably. The Directive instructs that taste and decency ought to be taken into account, but different interpretations exist and so varying rules are needed.

I. Distribution Methods, Gifts, Campaign Sales and Periodicals

Article 8 of the Advertising regulation also governs sales-boosting measures. Article 8(a) regulates gifts, wares, or services, as well as bonus systems designed to keep the consumer buying. Article 8(b) concerns gambling and lotteries. The legislature's role is not to set up prohibitions but, rather, to license and regulate the permissibility of the gambling. In essence, it must be insured that the consumer has a clear picture of the conditions in which he takes part. This goal also informs 8(c), which expressly mandates that the advertising measures reflect a realistic picture.

The regulation of Article 11 CPL is directly related to Article 10 of the AR. The goal of 11(1) is to delimit the gifts in the area of periodicals to certain objects, which serve further education, e.g. books, DVDs, encyclopedia, talking books, etc. The background to the regulation is the mid-1990s newspaper subscriptions war. Big newspapers offered subscribers, for instance, washing machines as gifts. With the help of Article 11 CPL, smaller undertakings should be protected, which cannot afford such gifts. Similar rules could be found in the old German law on unfair competition ("UWG") in the provisions of section 6. These so-called middle class protection rules were in the course of the ECJ-led liberalization of advertising demolished bit by bit. They are no longer featured in the UWG of 2004.[50]

Article 9 of the AdvertR defines the restrictions on direct-marketing. Here the goal is not discrediting or prohibiting but to formulate basic conditions that must be fulfilled by sellers before getting into direct contact with the consumer; that is, advertisement for door-to-door sales. Traders must indicate that the goods will be delivered to the address of the consumer, that the products and the price will be declared on the spot, and that the consumer has the possibility to send the goods back to the vendor. This provision can be explained against the

50. They also became the subject of a preliminary hearing before the ECJ; especially the interpretation of the prohibition on price comparison. *See* Case No. C-126/91, Yves Rocher, 1993 E.C.R. I-2361.

backdrop of the shortcomings, which have led to the relatively comprehensive and strict regulation of door-to-door sales.[51]

Campaign sales are a peculiarity of the Turkish market. They are regulated in Article 7 CPL as well as in the Campaign Sales Regulation. Article 7(1) CPL contains a definition, and 7(2) establishes a ministerial duty of certification. The majority of provisions are aimed at the form of the contract, which in this context, are of no interest. Directly relevant is Article 7 of the Campaign Sales Regulation. Article 7(1) refers to Articles 16 and 17 CPL, regulating the advertising of campaign sales. Article 7(2) prohibits the mention in the advert of the ministerially approved certificate, and 7(3) mandates that there is a price in the advert itself—be it cash or pro-rata, as well as the details of the beginning and the end of the campaign.

Lastly, the provisions of Article 10 of the AdvertR and Article 9 of the Directive 97/7/EC on distance-ordering should be mentioned with respect to the delivery of unsolicited goods. This regulation bans the usage of advertisements that give the impression that the consumer can, by the delivery of unsolicited goods, be forced into a contract. It is incomplete because it only bans advertisements of this type; it does not make clear that the consumer cannot be forced into a contract by the delivery of unsolicited goods. This is valid if the wares are so valuable that the consumer feels himself obliged to trade, either by rejecting the offer or by sending the items back at his own cost.[52]

Leaving the rules on the delivery of unordered goods to one side, there remains the question of compatibility with EC law with respect to the regulation of gifts and lotteries and all sales boosting measure including campaign sales. As is well known, originally the EC wanted to issue a particular arrangement on sales boosting measures.[53] The EC failed to achieve this vision not least because the regulating clause of the Directive 2005/29/EC proved itself farther-reaching and likely to achieve consensus in the member states. However, the problem remains that the Directive only cursorily considers sales promotion measures. General regulations are absent. Instead some marked and incriminating practices are listed as forbidden methods. But the Directive aims at complete regulation. To this extent, the question whether the members states are at liberty to control sales promotion measures with the large (ban on unfair advertisements) or smaller (ban on misleading consumers) general

51. *See infra* part IX.A.

52. It must yet be discussed whether the Consumer has a duty to store, especially when he cannot exclude that there has been an errant delivery. *See* Kramer, *in* MÜNCHENER KOMMENTAR ZUM BGB § 241a para. 6 et seq. (5th ed., 2007) (focusing especially on paragraphs 21 und 22).

53. *Communication on Sales Promotion*, COM (2001) 546 final (Oct. 2, 2001).

clause, and whether the few listed acts in the Annex of the Directive restrict the member states in prohibiting practices that go above and beyond those enumerated, will have to be answered. Precisely this question is in issue in a preliminary ruling pending before the ECJ.[54]

J. Control of Dishonest and Misleading Advertisements

Article 17 leaves the control of dishonest and misleading advertisements in the hands of the Advertising Council, which is trusted with the investigation—ex officio—and the declaration of advertising malfeasance.[55] The decision is executed pursuant to Article 17(1)2 by the ministry.

The yardstick of the control is Article 16 CPL together with the relevant regulations. Article 8 of the AdvertCouncilR supplements this by referring to the international advertising rules, in essence those of the International Chamber of Commerce in Paris.

The Advertising Council is comprised of 29 members, including a representative of a consumer organisation. Each member is elected for three years. The Council meets at least once a month and, when necessary, more often. The decision lies with the incumbent Director of the Industry and Trade Ministry. There is voting on the resolutions of the Advertising Council at which time fourteen members must be present. Majority voting is determinative and where votes are equal, the vote of the director is decisive. The resolutions of the council are publicized. They serve the education of consumers and the protection of their trade interests (Art. 17(10) CPL and Art. 13 ACR). The Council can delegate its work to subgroups (Arts. 19 and 20 ACR). In particular, the evaluation of particular problems can be delegated to subgroups.

The Advertising Council can decide to suspend the advertisement for three months or to censor it entirely. They also have the power to fine the advertising agency and the advertiser. The Ministry executes these measures. The vendor can appeal the decision of the Ministry in law.

From the Community perspective the control measures are unproblematic. It is notable that neither the law nor the regulation introduce a preliminary procedure, although there ought to be

54. Joined Cases 261 & 299/07, VTB-VAB NV v. Total Belgium NV; Galatea BVBA v. Sanoma Magazines Belgium NV (Requests for preliminary ruling of Rechtbank van Koophandel Antwerpen (Belgien) submitted on June 1 and June 27, 2007, respectively); *see also* J. Stuyck, E. Terryn & T. van Dyck, *Confidence through Fairness?*, 43 COMMON MKT. L. REV. 141 (2006).

55. For a critical analysis of the decisions of the Advertising Council, *see* INAL & BAYSAL, *supra* note 39, at 80 et seq.

correspondence between the Ministry and the advertiser in practice prior to any punishment.

IV. SALE OF CONSUMER GOODS AND ASSOCIATED GUARANTEES

A. Overview

Sale of consumer goods was already dealt with in the first version of the law in 1995 (Art. 4), before the issuance of Directive 1999/44. The reason was that the conditions of the Turkish contract law with respect to a sale contract did not fit consumer transactions. There was no right to repair, the limitation period was only a year and purchasers had a duty to examine the goods, which seemed more suitable for commercial sales.[56] The legislature was also deciding to put disputes about consumer sales contracts under the special jurisdiction for consumer disputes which was introduced with the CPL. In 2003, Article 4 CPL was revised, and harmonisation with the Directive 1999/44 was advised. The success was, however, as we will see, limited.

Article 4 CPL is concerned only with the rights of the consumer in case of delivery of goods which are not in conformity with the contract. Other aspects of the sale contract were not included so that, pursuant to Article 30 CPL, a return to the Law of Obligations provisions is necessary. All in all, the most important aspects of the Sales Directive—like conformity with the contract (Art. 2 Dir. 1999/44), the right of the consumer in the case of unconformity (Art. 3 Dir. 1999/44), the time limits (Art. 5 Dir. 1999/44)—are adopted in Article 4 CPL. The terms on guarantees (Art. 6 Dir. 1999/44) are handled separately in Article 13 CPL.

Since the horizontal directive on consumer contract law plans to set also the delivery time and the moment of the transfer of risk for all member states, in this respect, another piece of legislation will be required.[57] The Turkish law sets out in Article 183 Law of Obligations, that in principle, the risk in a sale of goods contract transfers to the buyer at the conclusion of the contract, whereas the draft directive fixes the time of delivery as the decisive moment.[58]

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56. For the background of this norm, *see* Bucher, *Der benachteiligte Käufer*, SJZ (1971), at. 1-6, 17-24.

57. *See Proposal for a Directive of the European Parliament and of the Council on Consumer Rights*, at 29, COM (2008) 614 final (Oct. 8, 2008)..

58. *See* Yeşim Atamer, *Satım Sözleşmesinde Hasarın İntikal Anı - Hukuk Tarihi, Karşılaştırmalı Hukuk ve Milletlerarası Hukuk Açısından BK m.183'ün Farklı Okunması Gereği [The passing of risk in the sales contract: the need to reinterprate Art. 183 turkish Law of Obligations in the light of legal history, comparative law and international law]*,

B. Prerequisites of a Warranty According to Article 4 CPL

A warranty is given when non-conforming goods are delivered. According to Article 4(1):

> goods, which do not match, or fail to match in large part, the quality which was stated on their packaging, labeling, their instructions for use, or in their adverts or announcements or which were declared by the seller, or the quality set out in standards or technical regulations, or goods which have a physical, legal or commercial defect, which decrease or eliminates their value in light of their intended purpose or the purpose for which they are used or the purpose for which they were purchased by the consumer, shall deemed to be non-conforming.

This corresponds largely to the definition from Article 2 Directive 1999/44, which stipulates that goods show the quality and performance which are normal in goods of the same type and which the consumer can reasonably expect. Different from Article 2, the legislature has neither made clear from whom the public statement must come in order to bind the vendor, nor has it given the vendor the possibility to free itself of this responsibility for public statements.[59] The equivalence of incorrect installation and incorrect installation instructions with a physical non-conformity is also wanting in the Turkish law. Admittedly, the Turkish Court of Appeal considers non-conformities that are caused by incorrect installation to be covered by Article 4 CPL.[60]

Deviating from Article 2(3) of the Directive, Article 4(5) CPL provides that the consumer cannot make use of legal remedies if he knew of the non-conformity at the time of the conclusion of the contract. Although Article 197 Turkish Law of Obligations excludes liability not only for known non-conformities but also for non-conformities which the buyer could have noticed with customary care,[61] in the Turkish literature it is frequently represented that the different wording in the CPL was

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in KEMAL OĞUZMAN'IN ANISINA ARMAĞAN 131-67 (Barlas, Kendigelen & Sari eds., 2000).

59. *See* Magnus, *in* GRABITZ, HILF & WOLF, DAS RECHT DER EUROPÄISCHEN UNION (Band III 34. EL 2008), RL (EC) 1999/44 Art. 2 para 55 et seq.

60. Y13HD, 8.3.1999, E.1999/528, K.1999/1657, published in www.ajanstuba.com.tr (defective installation of a solar power system). *See also infra* part IV.D. The direct claim against a producer, from whom defective instructions for construction normally originate.

61. If the vendor assures the purchaser of the freedom from defect or a particular quality, he is notwithstanding the careless ignorance of the consumer, liable (Art. 197 TLC).

intentional so that the warranty is only not available for those non-conformities about which the consumer positively had knowledge.[62]

Article 4(2) CPL sets out that the consumer must convey to the vendor the non-conformity, within thirty days of delivery of the wares, in case he wishes to invoke his legal rights. The condition contains no comment on how to adjudicate on hidden non-conformities. Thus, the Turkish rule is, in many respects, a departure from the Directive. The first deviation lies in the length of the time limit—Article 5(2) of the Directive foresees a two month limit. The more important divergence, however, is that the consumer must inform the vendor, not on discovery of the defect, but after thirty days of delivery of the goods. The literature tries to interpret this provision as consumer-friendly. *Aslan* takes the view that the thirty-day limit is only applicable to defects that become apparent within this period.[63] For all defects that become apparent after that time, because of lack of regulation in the CPL, Article 198 (2) and (3) Turkish Law of Obligations will find application. Pursuant to this rule, the consumer has to give notice immediately after the discovery of the defect.[64]

The buyer bears the burden of proof regarding the existence of the defect at the time of the transfer of risk in a case where he has already taken delivery of the goods.[65] The switching of the burden of proof in Article 5(3) Directive finds no equivalent in the Turkish law.

C. *Remedies According to Article 4 CPL*

Article 4(2) CPL recognizes the same remedies as Article 3 Directive, repair, replacement, price reduction, and rescission of the contract. No ranking of these remedies is assumed. Other than in Article 3 Directive, no stages are established; the buyer can immediately have

62. *E.g.*, Özel, *Tüketicinin Korunması Açısından Ayıplı Maldan Doğan Sorumluluk Kapsamında Yapımcının Sorumluluğu Sorunu [Product liability in connection with warranty for consumer goods]*, *in* KEMAL OĞUZMAN'IN ANISINA ARMAĞAN 771, 778 (Barlas, Kendigelen & Sari eds., 2000), p. 771, 788; Serozan, *Tüketiciyi Koruma Yasasının Sözleşme Hukuku Alanındaki Düzenlemesinin Eleştirisi [Critique of the CPL provisions concerning contracts]*, YASAHD, 1996, at 579, 588; Karahasan, *Tüketicinin Korunması [Consumer Protection]*, XV YASAHD 42, 47 (1996).

63. ASLAN, TÜKETICI HUKUKU [CONSUMER LAW] 141 (2006). Zevkliler and Aydoğdu assume it is the consumer's responsibility to examine the goods. *See* ZEVKLILER & AYDOĞDU, *supra* note 19, at 121.

64. Y13HD 20.6.2005, E. 2005/5982, K. 2005/10357 (www.kazanci.com).

65. YAVUZ, TÜRK BORÇLAR HUKUKU, ÖZEL HÜKÜMLER [LAW OF OBLIGATIONS, SPECIAL PART] 100 (2007); DEMIRELLI, DIE SACHMÄNGELHAFTUNG DES VERKÄUFERS BEIM KAUF BEWEGLICHER SACHEN NACH DEUTSCHEM UND TÜRKISCHEM RECHT MIT EINEM BLICK AUF DAS INTERNATIONALE PRIVAT - UND ZIVILVERFAHRENSRECHT 164 (1990).

the contract rescinded or ask for price reduction.[66] Further, the details in Article 3(3) Directive 1999/44 regarding the usage of the right to subsequent performance are missing. However, this does not have much effect on the results to be expected under Turkish law. Claims for performance in case of impossibility or disproportionality (Art. 3(3)) or of rescission in case of a slight non-conformity (Art. 3(6)) with the contract can be restricted through the general prohibition on abuse of rights (*abus de droit*) in Article 2(2) Turkish Civil Code. If the suggested horizontal Directive on consumer contracts law is adopted,[67] there is another problem: in Article 26(2) of the Draft, the consumer is given only a claim to subsequent performance, but the choice between repair and replacement is left to the vendor. The consumer seems to have lost his right to choose in this respect.

Article 4(2) CPL mentions the gratuitous nature of repair but not of replacement. In doctrine as well as practice it is nevertheless acknowledged that a replacement must also be provided free of charge.[68] The Supreme Court has developed a practice, in connection with replacement in car purchase contracts, that arguably contradicts the *Quelle* decision of the ECJ.[69] Pursuant to this approach, the vendor must deliver a new car from the same year. However, if the vendor no longer has such a vehicle and cannot perform, according to Article 24 of the Dept Enforcement and Bankruptcy Law, the price should be reimbursed. The Supreme Court has declined to enforce delivery of a new model. The indirect result of this decision is that the costs of the substitution, at least of a new model, are borne by the consumer.

In case of rescinding the contract, both partners must give back any part of the performance/payment received. The return of the non-conforming goods must take place simultaneously with the return of the payment.[70] The high senate of the Supreme Court does not apply the principle expressed in Article 208(1) Turkish Code of Obligation that the

66. It is an open question whether the limitations foreseen for the right of election of the purchaser in the TLC also apply to the right of election of the consumer. *See* Atamer, *supra* note 16, at 566, 587.

67. *See Proposal for a Directive of the European Parliament and of the Council on Consumer Rights*, COM (2008) 614 final (Oct. 8, 2008).

68. *See* ASLAN, *supra* note 63, at 199 & n.68.

69. Case No. C-404/06, Quelle AG v. Bundesverband der Verbraucherzentralen und Verbraucherverbande, NEUE JURISTISCHE WOCHENSCHFIRT [NJW] 2008, at 1433. *See also* Schneider & Amtenbrink, *"Quelle": The possibility, for the seller, to ask for a compensation for the use of goods in replacement of products not in conformity with the contract,* REVUE EUROPÉENNE DE DROIT DE LA CONSOMMATION 2/2007-2008, at 301-09; Herresthal, *Die Richtlinienwidrigkeit des Nutzungsersatzes bei Nachlieferung im Verbrauchsgüterkauf*, NJW 2008, at 2475-78.

70. Y13HD 24.3.2003, E. 2003/845, K. 2003/3235 (www.kazanci.com).

buyer must provide compensation for usage to consumer contracts.[71] The vendor does, however, owe the buyer the interest on the purchase price.[72]

D. Liability and Recourse

Pursuant to Article 4(3) CPL, "the producer, vendor, dealer, middle man, importer, and the creditor according to Article 10(5) or 10/B(9) [are liable] jointly to the consumer for the non-conforming goods and for the remedies mentioned in this article. Lack of knowledge of the non-conformity does not absolve from liability." In contrast to the Directive and many European legal orders,[73] the Turkish CPL establishes with this provision a strict liability not only of the seller but also of the producer and all actors in the distribution chain.[74] The direct liability is based on a statutory obligation and is justified by the idea that especially the producer must account for the trust a certain product has earned in the market.[75]

Although Article 4 of the Directive 1999/44 foresees that the national laws must contain the possibilities for recourse of the last vendor,[76] this problem is entirely ignored by Article 4 CPL. If the last vendor is liable because of a non-conformity, which was caused by someone earlier in the distribution chain, the recourse against this person can fail for various reasons: either because exclusion or restriction of liability clauses have been stipulated, or because the limitation period for claims of the last vendor against the previous seller has expired. Because, under Turkish law, commercial sales are subject to a six months limitation period (Art. 25 of the Turkish Commercial Code) and because this period begins upon delivery of the goods in most cases, the last vendor or the middle man must bear the risk of delay between delivery and resale.

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71. YHGK 22.6.2005, E. 2005/4-309, K. 2005/391 (www.kazanci.com).

72. *See, e.g.*, Y13HD, 24.4.2003, E.194/K.5005 (printed in: ÖZDAMAR, TÜKETICININ KORUNMASI HAKKINDA KANUN [THE CONSUMER PROTECTION LAW] 277-78 (2004)

73. *See* lastly, the Communication from the Commission to the Council and the European Parliament on the implementation of Directive 1999/44/EC of the European Parliament and of the Council of 25 May 1999 on certain aspects of the sale of consumer goods and associated guarantees including analysis of the case for introducing direct producers' liability. COM (2007) 210 final (May 25, 1999).

74. For the liability of the creditor in joined transactions *see infra* part XI.F.

75. On this direct claim and the problems that it causes, *see* Yeşim Atamer, *Third Persons' Liability for Non-Conformity in Sales Contracts and Sellers' Right of Redress in Turkey*, *in* EUROPEAN PERSPECTIVES ON PRODUCERS' LIABILITY—DIRECT PRODUCERS' LIABILITY AND THE SELLERS' RIGHT OF REDRESS 579-600 (Ebers, Janssen & Meyer eds., 2009).

76. *See* MICKLITZ & REICH, *supra* note note 2, § 4.19 - 4.22.

E. Limitation Periods

Pursuant to Article 4(4) CPL, the claims of the consumer of movables expire two years after delivery, and those of a fixed property expire in five years. This tracks Article 215(3) Turkish Code of Obligations, which regulates purchase of real estate. If the vendor intentionally or negligently failed to mention the non-conformity, he cannot rely on the limitation period (Article 4(4) CPL). In such a case, the regular limitation period of ten years is valid (Article 125 Turkish Code of Obligations).

F. Guarantees

Unlike Article 6 of the Directive, Article 13 CPL introduces the duty of producers and importers to provide a guarantee certificate for all industrial products made public by the Industry and Trade Ministry.[77] The guarantee must last at least two years and begins on delivery of the goods to the consumer. The guarantee must include claims for repair, replacement, price reduction and rescission (Art. 13(3)) and must be certified in writing[78]; the vendor is responsible to deliver the certificate to the consumer.

The extent to which such an obligation to provide guarantees makes sense next to the direct claim enjoyed by the consumer need not be discussed here. In practice, one does not take the trouble to clarify whether the claim is based on the producer's obligatory guarantee or the statutory obligation between the producer and the consumer.[79] Of course, there is a risk that such a forced guarantee will interfere too much with the economic liberty of the importer/producer. Aside from that, there is the danger that such a requirement constitutes a trade restriction in the sense of Article 28 EC, because all European imports that are offered on the Turkish market would have to provide such a guarantee with the necessary content.

77. A list is provided in the annex of the Garanti Belgesi Uygulama Esaslarına Dair Yönetmelik [Regulation regarding guarantee certificates], RG 14.06.2003, sayı 25138.

78. In Article 7 of the Regulation, *supra* note 77, the obligatory content of the certification duty is governed. The issued certificates must be confirmed by the Ministry.

79. *See supra* part IV.D.

V. Product Liability

A. Overview

In Article 4, the Turkish legislation considers not only the rights of the buyer in case of delivery of non-conforming goods but it also tries to introduce strict liability for defective products into Turkish law; this attempt, unfortunately, fails absolutely.[80] The consumer's claims arising under a sales contract due to delivery of non-conforming goods was confused with the tortious claim for damages of a person injured by a defective product. This confusion was underlined by the 2003 Regulation on liability for defective goods ("ProdLR"). Although the regulation represents a far-reaching translation of the product liability Directive,[81] it was enacted on the basis of Article 4 CPL and correspondingly gives a claim only to the consumer.[82] The legislation did not address a claim to damages against the producer of the goods, which was independent of the sales contract regarding these goods.

Article 4 (2) CPL states that the consumer can claim damages from the producer for death and/or bodily injury and/or for damage to other goods in use. This is the only expression that relates to product liability in the CPL. All other questions are dealt with in the Regulation, an approach justifiably highly-criticized in Turkey, because strict liability can only be introduced by law and not by regulation.[83]

80. For relevant criticism on the old Artitcle 4 CPL, *see* Özel, *supra* note 62, at 771, 812; Serozan, *supra* note 62, at 579, 592.

81. That the Regulation serves the implementation of the Product Liability Directive, can be taken from the Turkish National Program for the Implementation of the Acquis Communautaire (RG 24.07.2003, sayı 25178 mükerrer, 1-884), where, in section 23.2.1, this Regulation is portrayed as an implementation measure of the Directive 85/374/EC.

82. The court decided, for example, in November 2003, that the complaint about damages for bodily injury, which was caused by the explosion of a gas bottle, did not fall within the competence of the Consumer Court, because the bottle was designed for use in the workplace. *See* Y13HD 18.11.2003, E.2003/7553, K.2003/13850, published in ÖZDAMAR, *supra* note 72, at 227. A faithful interpretation of this precedent would lead to the result that the applicability of the product liability Regulation excluded non-consumers and therewith created only a claim for consumers.

83. *See* AKÇURA KARAMAN, ÜRETICININ AYIPLI ÜRÜNÜN SEBEP OLDUĞU ZARARLAR NEDENIYLE ÜÇÜNCÜ KIŞILERE KARŞI SORUMLULUĞU [LIABILITY OF THE PRODUCER FOR DAMAGES CAUSED BY DEFECTIVE GOODS TO THIRD PERSONS] 139 et seq. (2008); KIRCA, ÜRÜN SORUMLULUĞU [PRODUCT LIABILITY] 94 et seq. (2007); HAVUTÇU, TÜRK HUKUKUNDA ÖRTÜLÜ BIR BOŞLUK: ÜRETICININ SORUMLULUĞU [A LACUNA IN TURKISH LAW: PRODUCT LIABILITY] 117 et seq. (2005).

B. Product

Due to the aforementioned misconception, neither the law nor the Regulation contains a separate definition of the term "product." The legal definition for "goods" is[84] also determinative in this context (ProdLR Art. 4(2)c), with the result that, on a natural reading, the producer of real estate and intangibles is also strictly liable for damage caused due to a defect. Although for digital products, which are not incorporated in a thing, the decision of the legislature is understandable; for real estate, this is not the case. *Kirca* suggests that in the case of product liability a teleological interpretation is needed.[85] Correspondingly real estate would only be within the scope of the Consumer Protection Law in the context of purchase, loan or time-share transactions, but not regarding the application of the product liability provisions.

C. Producer

According to to Article 4(1)d ProdLR, the "producer" includes the producer of the end product; the producer of any raw material or component of a product; every person who offers the product for sale by putting his name, trade mark or other distinguishing feature on the product; and every person who imports the product for sale. This definition corresponds largely to that of Article 3(1) and (2) of Directive 85/374. There, the producers of the raw material, component parts, and the final product are included as well as the importer. The commercial purpose of the import is emphasized by the aim of the sale.[86] An exclusively private motivation for the import will not suffice to be held liable.

The implementation of Article 3(3) Directive 85/374 is wanting. The secondary liability of the supplier for the event that either the producer/importer of the product cannot be identified or is not nominated in time by the supplier, has been left out without justification.

D. Defect

Pursuant to Article 5 ProdLR, a product is "non-conform[ance] when it does not provide the safety which a person is entitled to expect taking into account all the circumstances and including the presentation of the product, the reasonable use of it and the time the product was put

84. *See supra* part II.B.2.

85. KIRCA, *supra* note 83 at 192; HAVUTÇU, *supra* note 83, at 120-21.

86. Although the law mentions only the sale purpose, the provision should be interpreted so that an import with e.g. the aim of rent or leasing is covered too.

into circulation. A product cannot not be considered defective for the sole reason that a better product is subsequently put into circulation."

Due to the aforementioned misconception of the Turkish legislature with respect to product liability, the Regulation uses the term "non-conformity" instead of the term "defect." The problem has falsely been seen as one of non-conformity with the contract. In practice, these terms are also not kept distinct and the different origin of the provisions is not considered.[87] This, however, is particularly important for the identification of a "defect," which would trigger producer liability. In that situation, only objective standards like safety expectations are decisive, whereas non-conformity is judged subjectively, taking into account the individual contract between the parties. Moreover, the existence of a defect is judged at the moment of putting the product into circulation and not the time of transfer of risk, as is the case for the ascertainment of non-conformity. But beside this terminological mistake, the definition in Article 5 ProdLR corresponds with that of Article 6 of the Product Liability Directive.

E. Liability

The producer is liable pursuant to Article 6 ProdLR, independent of any fault. The defective product must cause the death of a person, injury to body or health, or damage to property. This is enshrined in both Article 4 CPL and Article 6(1) ProdLR. Unlike Article 9 Directive 85/374, there is no limitation in the ProdLR regarding the scope of damaged property. Only in Article 4 CPL does the expression "damage to other goods in use" seem to indicate a limitation. Using an interpretation consonant with European law,[88] one could conclude that this expression, first, only covers damage to things other than the defective good and, second, only to items that are intended for private use or consumption, since the term "goods" is particularly defined in CPL and is mainly aimed at consumer goods.[89] The prerequisite for liability that the item of property has to have a higher value than 500 Euro (Article 9 Directive 85/374) was not introduced to Turkish law.[90]

The burden of proof with respect to the damage, the defect, and the causal link between defect and damage is borne by the claimant, pursuant to Article 6 (2) ProdLR. The principle of joint liability from Article 5

87. *See also* HAVUTÇU, *supra* note 83, at 24 et seq.

88. On the question of how far Turkish courts are bound to produce an interpretation in alignment with the Directive, *see* Atamer, *supra* note 16, at 582 n.84.

89. *See also* HAVUTÇU, *supra* note 83, at 141-42.

90. Immaterial damage can be claimed separately pursuant to Article 49 Turkish Code of Obligations.

Directive 85/374 is adopted by Article 6 (3) ProdLR. The same section states that the liability of the producer can only be reduced where the damage was partly caused by the injured party or any person for whom the injured person is responsible.

The exonerating grounds, listed in Article 7 Directive 85/374, are partly include in the ProdLR Article 7. An important mistake, however, has been made in the implementation of lit. (d), because the Regulation considered it enough that, in the production process, the binding technological standards are adhered to. These standards are, however, minimal requirements for production, so the producer is free to adopt higher standards.[91] Therefore, with a EU-law conforming interpretation, the producer should only be allowed to exonerate himself if the defect arose because he adhered to mandatory legal provisions.

Although the Regulation burdens the injured party with the so-called development risk and allows the producer to avoid liability (Art. 7(1)), Article 6(4) introduces a duty to observe the product after putting it into circulation. That means that if the state of technology and science allows for the ascertainment of the defect within ten years after the product has left the manufacturing process, the producer will not be able to exonerate himself, so long as he cannot prove that he exercised the necessary care, to prevent the damage caused.[92]

F. Exemption From or Limitation of Liability and Temporal Limitation of Liability

In line with Article 8 ProdLR, the liability of the producer cannot be excluded or limited in advance. Contradictory terms in contracts are null.

The strict liability of the producer is limited in time. In conformity with the Directive there is a three year limitation period for any damages claim from the day the injured party has become aware or should reasonably have become aware of the damage, the defect and the identity of the producer (Art. 9 ProdLR). The claim expires after the passing of a term of ten years after putting the product into circulation (Art. 10 ProdLR).

VI. UNFAIR TERMS

Directive 93/13 on unfair terms in consumer contracts was incorporated into the CPL in the 2003 revision and is regulated in Article

91. *See also* KIRCA, *supra* note 83, at 177.

92. *See* HAVUTÇU, *supra* note 83, at 144 et seq. (discussing the duty to follow-up the goods).

6. Contemporaneously, the Ministry issued an Administrative Regulation on Unfair Terms in Consumer Contracts ("UnfairTR").[93] These rules offer, parallel to Directive 93/13, protection only against terms that were not individually negotiated in consumer contracts (Art. 6(1) CPL; Art. 4D UnfairTR).

When contract terms are negotiated, under Turkish law, the principle of freedom of contract dominates (Art. 19 Turkish Law of Obligations). This excludes a general control, even where terms strongly disadvantage one of the parties.[94] The burden of proof with respect to negotiation is principally borne by the consumer. This burden transfers if the contract terms are pre-formulated and especially where they are contained in a standard contract (Art. 6(3) and (5) CPL / Art. 5(1) and (3) UnfairTR). In such a case it falls to the trader to prove a negotiation on the contract or the terms.

The fact that some clauses are negotiated does not exclude that the rest of the contract counts as a standard contract (Art. 6(4)CPL/ Art. 5(2) UnfairTR).[95] These rules are consonant with Article 3 Directive 93/13.

If it is established that certain clauses were not negotiated, they are subject to judicial control and are regarded as unfair if contrary to the requirement of good faith they cause an imbalance in the parties' rights and obligations arising under the contract, to the detriment of the consumer. Unlike Article 3(1) Dir. 93/13, Article 6(1) CPL and Article 4(d) UnfairTR do not prescribe that this imbalance must be "significant." Nevertheless in Turkish law, a minor imbalance will not suffice to evaluate a contract clause as unfair. Article 2 Turkish Civil Code, which covers the rule of good faith and generally prohibits an "obvious" abuse of rights (*abus de droit*), can guide in the matter—the abuse of freedom of contract must also be obvious, that is the imbalance must be considerable. The "grey list," that is, the list of contract terms given in the annex of Directive 93/13 and may be regarded as unfair, is incorporated almost word for word in the Regulation so that judges can

93. RG 13.06.2003, sy. 25137. On the control of standard terms under Turkish law, see Bozbel, *Allgemeine Geschäftsbedingungen im türkischen Recht*, RECHT DER INTERNATIONALEN WIRTSCHAFT [RIW] 2004, p. 183 ff.; Akdag-Güney, *Die Umsetzund der Verbraucherrichtlinien in der Türkei am Beispiel der missbraeuchlichen Klauseln*, 2009 ZEuP 109-37; *see also* Yeşim Atamer, *Genel İşlem Şartlarının Denetiminde Yeni Açılımlar: TKHK m.6, Tüketici Sözleşmelerindeki Haksız Şartlar Hakkında Yönetmelik ve Yeni Borçlar Kanunu Taslağı m.18 a-f [New perspectives regarding control of standard contract terms: Art. 6 CPL, UnfairTR and Art.18 a-f of the Draft Code of Obligations]*, *in* KOCAYUSUFPAŞAOĞLU IÇIN ARMAĞAN 291-331 (Seliçi et al. eds., 2004).

94. On the limits of contractual freedom in Turkish-Swiss law, *see* Yeşim Atamer, SÖZLEŞME ÖZGÜRLÜĞÜNÜN SINIRLANDIRILMASI SORUNU ÇERÇEVESINDE GENEL İŞLEM ŞARTLARININ DENETLENMESI [CONTROL OF STANDARD FORM CONTRACTS IN THE CONTEXT OF RESTRICTION OF FREEDOM OF CONTRACT] 143 et seq. (2001).

95. *See* Atamer, *supra* note 93, at 298-99.

refer to it when assessing the level of imbalance between the rights and obligations of the parties.[96]

Pursuant to Article 6 UnfairTR, in the evaluation of unfairness the same criteria are determinative as in Article 4 Directive 93/13. The nature of the goods or services for which the contract was concluded has to be taken into account as well as all circumstances attending the conclusion of the contract and all other terms of the contract or of another contract on which the main contract is dependent. But the contract terms regarding price/performance relationship are, in principle, exempt from any kind of judicial control. An exception is given only in case of transgression of the "principle of transparency": the duty to formulate the terms in plain, intelligible language (Art. 6(1) UnfairTR).[97] Where there is ambiguity as to the meaning of a clause, the interpretation most favourable to the consumer shall prevail.

If the unfairness of particular terms is established, they are void (Art. 7 UnfairTR). The contract itself remains valid, so long as this is possible with the remaining clauses. Under Turkish law the grounds of invalidity must be considered by a judge of its own motion, that is *ex officio*:[98] this is consistent with the case law of the ECJ in *Océano Grupo*, *Cofidis* and recently *Mostaza Claro*.[99]

A complaint with respect to the declaration of nullity of unfair terms in standard contracts can be lodged by consumers, consumer organisations and the Ministry[100] (Art. 23 CPL in connection with Art. 8 UnfairTR). The court can order the omission of these terms in the future or provide for other fitting legal remedies.

Taking the provisions together, Directive 93/13 has been implemented with only few changes into Turkish law and there is no need for reform. It is worth asking whether a reform would be necessary if the horizontal directive on consumer rights[101] is adopted. The draft directive not longer prescribes the judicial control of terms that have not

96. *See* Bozbel, *supra* note 93, at 183, 187.

97. *See* Atamer, *supra* note 93, at 317-18; *see also* Micklitz, *in* HANDBUCH DES EU-WIRTSCHAFTSRECHTS, 22. EL (Daueses ed., 2008), H V ¶¶ 223-28 (discussing the principle of transparency).

98. SEROZAN, MEDENI HUKUK, GENEL BÖLÜM [CIVIL LAW, GENERAL PART] ¶¶ II 16 et seq. (2005).

99. Case Nos. C-240/98 to C-244/98, Océano Grupo, 2000 E.C.R. I-4951; Case No. C-473/00, Cofidis, 2002 E.C.R. I-10875; Case No. C-168/05, Mostaza Claro, 2006 E.C.R. I-10421.

100. Consumer organisations are, pursuant to Article 3(p) CPL, "Associations, foundations or their umbrella organization founded with the aim of protecting consumer interests."

101. *See supra* note 15.

been "individually negotiated," but of those that are "pre-formulated."[102] This would signify a narrowing of the scope in comparison to 93/13 because clauses can be imposed even though they were not written up in advance. Article 3 of the present directive only prescribes that a contractual term cannot not be considered negotiated if it has been drafted in advance. But a prerequisite of pre-drafting is not sought for.[103]

VII. TIME-SHARE CONTRACTS

A. Overview

Time-share contracts are regulated in Article 6/B CPL. The mode of regulation is similar to that of the package-holiday contracts. In the law, only the basic contractual definitions are governed, the rules on duties to provide information, the right to withdrawal, as well as rules on the performance of the contract are all in the relevant Administrative Regulation on Time-Share ("Time-ShareR"). This mode of regulation begs the question whether or not the legal rule should, at the very least, define the basic requirements of the duty to inform and the right of withdrawal.

B. Definition and Scope

Article 6/B CPL or Article 4 Time-ShareR defines the time-share contract as a contract or group of contracts with a minimum duration of three years, which gives the contracting party the usage of an immovable for a minimum of a week annually. Thus Article 6/B is consistent with Article 2(1) of the Time-share Directive 94/47/EU. The user is given no proprietary right, but obviously only a claim in contract. Unlike Article 4(c) of the Directive, the Turkish law contains no legal definition of immovable.

The very narrow definition of Time-share contracts has led to a series of evasive strategies by insincere vendors, which cause many problems in practice.[104] The European Commission is, in the course of

102. Article 30 (1), *Proposal for a Directive of the European Parliament and of the Council on Consumer Rights*, at 32, COM (2008) 614 final (Oct. 8, 2008).

103. *See* GRABITZ, HILF & WOLF, *supra* note 59, A5 RL (EC) 93/13 Art. 3 ¶¶ 22 et seq.

104. *See* the report of the European Consumer Law Group, *available at* http://212.3.246.142/docs/1/OIMOOBLCHEFDNOKAPNLJMMCLPDBK9DW1T39DW3571KM/BEUC/docs/DLS/2004-01577-01-E.pdf; *see* ANALYSE VERBRAUCHERPOLITISCHER DEFIZITE BEIM ERWERB VON TEILNUTZUNGSRECHTEN, (Pfeiffer & Hess eds., 2006), SCHRIFTENREIHE DES BUNDESMINISTERIUMS FÜR ERNÄHRUNG, LANDWIRTSCHAFT UND CONSUMERSCHUTZ, ANGEWANDTE WISSENSCHAFT, Heft 515 (providing the German perspective).

its reform of consumer law,[105] trying to issue a new directive on Time-share Contracts along with the package-holiday contracts. One of the main points of the reform will be the extension of the material scope of the Directive 94/47/EC.[106]

The Time-ShareR defines, in Article 4 the personal scope. The parties are described as supplier and consumer. The Directive in turn uses expressly in Article 2(3) and 2(4) the terms vendor and purchaser. It is questionable whether a person counts as a purchaser, if professionally active in the real estate business, but acquires the time-share for private purposes. Since the Directive does not distinguish abstractly between private and business person, rather concentrates on the purpose of the contract, this type of contract must also fall within the personal scope of application.[107] To this extent, the term "purchaser" in the context of time-share contract is not entirely identical with that of "consumer."

C. *Information Duties, Form Requirements and Performance*

Article 10 Time-ShareR governs pre-contractual duties to provide information. The vendor must provide the consumer with a brochure, which, apart from a general description of the property, must provide minimum information. Though the Time-ShareR in (a)-(e) provides a list of duties, it is not complete and does not tally perfectly with the provisions of Article 3(1) of the Directive.[108]

On a natural reading of Article 10 TimeShareR, parties can later conclude a contract which deviates from the terms of the brochure. But pursuant to Article 3 Directive this possibility to make changes to the brochure rests on circumstances which are out of the control of the supplier. Article 10 of the Turkish Regulation mentions here a somewhat unfortunate translation of *force majeure*, which nevertheless gets to the

105. *Green Paper on the Review of the Consumer Acquis*, COM (2006) 744 final.

106. The Directive is currently under revision. The European Parliament approved the proposal for amendment on 22 October 2008, http://ec.europa.eu/consumers/rights/docs/timeshare_position_en.pdf. As the final version is not yet available, the paper uses the old Directive as a blueprint.

107. *See also* GRABITZ, HILF & WOLF, *supra* note 59, at A 13 RL (EC) 94/47 Art. 2 Rn.109 (explaining this result through a comparison with the *di Pinto* decision of the E.C.J. on door-to-door sales, Case No. C-361/89, 1991 E.C.R. I-1189)). As they explain, the court qualified a trader who concludes a transaction relating to his business (irrespective of its experience in that specific business) as a non-consumer. Therefore, traders, who are active in the time-share business but transact for private purposes, must in turn be treated as consumers, independent of their business experience.

108. *See* GRABITZ, HILF & WOLF, *supra* note 59, at A 13 RL (EC) 94/47 Art. 3 ¶ 110 et seq.; Micklitz, *in* REICH & MICKLITZ, EUROPÄISCHES CONSUMERRECHT § 19.14.-19.18 (2003).

heart of the matter. It is more problematic that, in Article 10 Time-ShareR there is no indication that the vendor has to communicate or point out these changes to the consumer. This subverts the aim of pre-contractual information, as the consumer would mostly not notice that the final contract terms are deviating from the brochure.

Article 5 Time-ShareR mandates written form and enjoins the supplier to provide the consumer with a contractual document. It is not clear, what written form means. In particular, it is not clear whether Article 5 requires a personal signature or whether an electronic signature and document will suffice.

In Article 5 the minimum content of the contract are set out, which again, do not tally with the far more detailed rules in the Time-share Directive. The rule of Article 4 Directive is not implemented, according to which, the purchaser has a choice of which language the contract and the brochure are written. If the Consumer has a residence in a member state of the EU, he can demand that the language of his member state is used.

D. Withdrawal and Ban on Advance Payments

Article 6(1) Time-ShareR grants the consumer a ten day right of withdrawal, calculated from the conclusion of the contract. The Time-ShareR makes no indication whether calendar or working days are intended or whether the consumer is bound to a particular form when exercising the right of withdrawal. Article 5(2)2 of the Directive is not implemented, pursuant to which the time period is respected if the consumer has dispatched the notification within the ten days. The proof can only be made if the letter is sent by registered post. The original draft by the Commission is still included this requirement.[109]

Article 6(2)1 Time-ShareR concerns itself with the difficult issues raised by the request made by the supplier for an advance payment. That provision forbids the supplier, consistent with Article 6 Directive to demand an advance payment within the ten day withdrawal period. This rule refers back to the circumstance that many vendors do not repay the advance payment to purchasers who exercise the right of withdrawal.[110] But this ban is relativized in the Time-SharingR. In Article 6(2)2 Time-ShareR an advance payment can be demanded if the contract is made directly on the piece of property concerned in the time-share. This

109. 1992 O.J. (C 222), 8.

110. On the parallel problem in distance contracts below K and the pending decision before the ECJ, *see* Case No. C-71/02, Gysebrecht; *see also* REICH & MICKLITZ, VOLLHARMONISIERUNG DURCH DIE HINTERTÜR - ZUR KRITIK DER SCHLUSSANTRÄGE DER GAIN TRESTENJAK VUR 348 et seq. (2008).

exception is based on the false conception, that the right of withdrawal only protects the consumer until he can take a look at the property and therefore contradicts with the provisions of the directive.

Article 7 Time-ShareR governs the legal consequences in the case of an inadequate provision of the information, which has to be conveyed to the consumer according to Article 5 Time-ShareR. Article 7 differentiates three situations: (1) the consumer demands the missing information but does not receive it (2) the consumer receives the missing information and (3) the consumer receives within three months no full information but does not ask for it. The rights of the consumer differ according to the situation. In situation 1, the consumer can withdraw from the contract within the ten day period. In (2), the right to withdraw is triggered from the time at which all the information is provided. In (3), the contract ends automatically after the elapse of three months. To this extent, but only to this extent, the Time-ShareR makes clear that the consumer must bear no costs and any payments can be recouped. It stands to reason that this consequence must also apply to the first variant, but this is not made clear in the wording.

The treatment of the right to withdraw in Article 7 Time-ShareR is not entirely consistent with the directive. It is partly more strict, at least in so far as the contract automatically ends after three months, if the supplier neglects his duty to provide information. It is however, narrower in the sense that the consumer, in the first variant, must take action. However, on close inspection, this strengthening of the provision does not burden the consumer, because he will always have the possibility to wait for the supplier to deliver the missing information within the three months period. The Directive follows a different model. The right of withdrawal is first limited to ten days, but is extended in the case of missing information to three months plus an additional ten days. The Directive does not prescribe an automatic cancellation of the contract.

E. Linked Transactions

Article 8 Time-ShareR concerns itself with financing through the supplier or through a third party. Consonant with Article 7 Directive, Article 8 Time-ShareR stipulates that the withdrawal of the time-share contract automatically dissolves the credit relationship. Nevertheless, the withdrawal must be communicated to the creditor. The Time-ShareR does not make clear whose responsibility it is to contact the creditor.

The Turkish consumer law rule is, in two ways, different from Article 7 of the time-share directive. First, the Time-ShareR covers only the complete financing whilst the Directive also covers partial financing.

Second, the Time-ShareR establishes an information duty about the exercise of the right of withdrawal. In fact, Article 7 leaves it to the member states to sort out the details of the dissolution of credit contracts in national law. However, these rules ought not to depart from the precepts of the Directive to the disadvantage of the consumer. This is the case with both situations, especially when one assumes that the consumer must inform the creditor.

VIII. PACKAGE-HOLIDAY CONTRACTS

A. Overview

The term, package-holiday contracts was introduced into the CPL in the 2003 revision. Although the draft revision included no such provision, in Parliament, at the last moment, Article 6/C (like Article 6/B on the time-share contract) was added, which also only provided a definition of the contract and left the regulation of other details to the Ministry. The latter reacted immediately, issuing the *Administrative Regulation on Package-holidays* ("Package-HolidayR") in June 2003.[111] Just like the Regulation on product liability, this Regulation has been criticized because it is contrary to the hierarchy of norms, since all questions of contractual liability are governed, without there being a corresponding provision in the CPL to that effect.[112]

B. Definition

The definition of the package-holiday contract is largely consistent with that of Article 2(1) of the Directive 90/314: it must have a combination of at least two services (transport/accommodation/other tourist services) for a period of longer than twenty-four hours or include an overnight stay in a package price sold or offered for sale.[113] Unlike the Directive, the CPL and the Regulation protect only consumers. The specific consumer definition of Article 2 Directive 90/314, which includes also persons buying a package tour for business purposes,[114] was not adopted. On the other hand the terms "organizer" and "retailer" are defined parallel to the Directive, covering both, the person who

111. *See supra* note 22.

112. For a suggestion on how a rule on the CPL could be drafted, *see* Yeşim Atamer, *Paket Tur Sözleşmelerine İlişkin TKHK m.6/C'nin Revizyonuna İlişkin Teklifler [Article 6/C of Consumer Protection Law on Package Tours – Proposals for Revision]*, *in* PROF. DR. UĞUR ALACAKAPTAN ARMAĞANI 87-101 (M. Inceoğlu ed., 2008).

113. *See* Yılmaz, *supra* note 63, at 516-17; ZEVKLILER & AYDOĞDU, *supra* note 19, at 204-07.

114. *See* GRABITZ, HILF & WOLF, *supra* 59, at A 12 RL (EC) 90/314 Art. 2 ¶ 18.

organizes package holidays and offers them to sale as well as the person just offering for sale packages put together by an organizer.[115]

C. *Information Duties, Form Requirements, Transfer and Alteration of the Contract*

Article 12 of the Package-HolidayR prescribes that the organizer has a duty to give a brochure to interested consumers, and lists the information it must contain. This tallies, for the most part, with the terms of Article 3 Directive 90/314. Article 5 Package-HolidayR on the other hand contains the information that must be communicated at the conclusion of a contract. But the legislature overshot, and introduced a contractual form, the absence of which will render the contract void. Differently, Article 4(2)b Directive 90/314 only prescribes that the information has to be communicated to the consumer in writing or made available in some other form—it is not a validity requirement.

Parallel to Article 4(3) Directive 90/314, Article 7 Package-HolidayR governs the possibility of a contract transfer in the event that the consumer is unable to travel. The prerequisite of a "reasonable notice" before the journey starts has been concretized by the Regulation as "7 days before the beginning of the journey," so that the consumer can, at this point, at the latest, inform the organizer of his intention to transfer. The transferee and the transferor are jointly liable to the organizer for the payment of the balance due and for any additional costs arising from the transfer.

Principally, when it comes to package-holidays, the contractually set prices may not be raised with the exception that the price hike is based on alterations in the duties or taxes on air- or sea ports or variations in the exchange rate (Art. 6 Package-HolidayR). The organizer or the provider must in this case notify the consumer immediately and give him the possibility to either cancel the contract, to accept the changes or to choose an alternative trip, if the organizer is in the position to offer one. The possibility to raise the price due to alterations in fuel costs is not provided for in the Package-HolidayR. Missing is also a term parallel to Article 4(4)b of the Directive which prohibits a price increase less than twenty days prior to the stipulated departure date, which is criticized in the literature.[116] But the general prohibition on the abuse of rights (Art. 2 Turkish Civil Code) could also improve matters here, after which a notification at too short notice would be denied any effect.

115. In order to avoid repetition, only the term "organizer" will be used in the text, but it should be understood to include the retailer.

116. ASLAN, *supra* note 63, at 592.

The question, how far contractual terms other than the price can be changed before departure, is not openly regulated in the current version of the Package-HolidayR.[117] Since Package-HolidayR prescribes written form, and Article 12 of the Turkish Code of Obligation also extends this to any alteration of the contract, one must conclude that every alteration, even minor ones can only be made with the agreement of the consumers.[118] The rule on price is an exception.

D. Cancellation of the Organizer Before Departure

Article 8 Package-HolidayR governs the option of the organizer to cancel the contract before the beginning of the trip. He can do so on the condition that he refunds the consumer the payment already made in less than ten days after his cancellation. The organizer also has a duty to pay damages to the consumer for any damages caused by his cancellation. This duty can be escaped only if he proves that the cancellation was made due to the failure to reach the minimum number of participants, or because of *force majeure*, and that the consequences could not have been avoided even if all due care had been exercised.

E. Remedies in Case of Non-Performance

Article 9(1) and (2) Package-HolidayR is almost an exact translation of Article 4(7) Directive 90/314 and give the consumer the right, in the case of non-performance, to avoid the contract. However, this is only allowed after the organizer is given the chance to cure the non-performance. If the alternative performance is worth less than what is promised in the contract, the difference must be paid to the consumer.

It is problematic that the Regulation regarding the consumer's duty to notify any non-performance to the organizer is based on a false concept. Article 11 Package-HolidayR prescribes (apparently inspired by provisions from the law of sale) that the consumer must inform the provider of the non-performance within thirty days from its discovery. Thus the right of the organizer to offer cure is jeopardized and Article 5(4) Directive 90/314 not implemented. However one could deduce a duty to notify at the earliest opportunity by reference to the general duty to mitigate the damage (Art. 44 Turkish Code of Obligations).[119]

In case no cure can be offered or this is not in the interests of the consumer, he can demand repayment and avoid the contract. In this

117. *See* GRABITZ, HILF & WOLF, *supra* note 59, at A 12 RL (EC) 90/314 Art. 4 ¶ 39 et seq.

118. In this sense, *see* ASLAN, *supra* note 63, at 541.

119. *Seealso id.* at 534.

case, the paid sum must be returned within ten days, and if damage can be proved, compensation must be paid too. Unlike the Directive the Regulation gives the organizer no possibility to demand an adequate compensation for the performance already made.

The Regulation contains no provision regarding a claim based on wasted holiday time. In the literature, it is debated, whether such a claim can only be raised in connection with a claim for injury to the person, or if it is indeed, independent thereof.[120] Since in Article 49 Turkish Code of Obligations a claim for non-material damage for the violation of the general right of personality is given irrespective of the gravity of the fault and the damage, there is often a claim according to both opinions. Even if the consumer is not injured itself but his/her child, and therefore it is impossible for him/her to enjoy the holiday—like in the *Leitner* case of the ECJ[121]—a claim for non-material damage will be given under Turkish law based on the violation of the right of personality.

F. Liability and its Exclusion

Pursuant to Article 9 Package-HolidayR, the organizer is liable for all possible kinds of non-performance. Whether this non-performance was caused by the organizer himself or by any third person, who was involved in the performance of one of the obligations arising out of the package-holiday contract is irrelevant. Also the nature of the relationship between the organizer and the third person, whom fulfils the contract is of no consequence. If the organizer has used a third person to perform its obligations he will be liable for any non-performance.[122] The organizer can only be exculpated in two circumstances, namely if the breach of contract was caused by the conduct of the consumer or *force majeure.*

Article 10 Package-HolidayR goes further than Article 5(2) Directive 90/314 in that a contractual exclusion of liability or a limitation of liability is entirely forbidden. Although the reference to the limitation of liability in international conventions is missing, this should be no

120. *See, e.g.*, GENÇ ARIDEMIR, SÖZLEŞMEYE AYKIRILIKTAN DOĞAN MANEVI TAZMINAT [NON-MATERIAL DAMAGE IN CASE OF NON-PERFORMANCE] 168-75 (2008); BÜYÜKSAĞIŞ, YENI SOSYO-EKONOMIK BOYUTU ILE MADDI ZARAR KAVRAMI [THE CONCEPT OF DAMAGE IN ITS NEW SOCIO-ECONOMIC DIMENSION] 402-09 (2007). In 2001, the High Senate of the Turkish Court of Cassation recognized a claim for non-material damage where the baggage of a married couple on a trip to Prague was lost and they were not able to attend the Opera and Ballet performances as intended. Cf. HGK 12.12.2001, E. 2001/11-1161, K. 2001/1052, printed in BÜYÜKSAĞIŞ, at 408-09.

121. Case No. C-168/00, Simone Leitner, 2002 E.C.R. 1-02631.

122. *See* ASLAN, *supra* note 63, at 521.

problem because these conventions rank higher than the provisions of the Directive in the normative hierarchy and therefore take priority.

G. *Guarantee in Case of Insolvency of the Organizer*

In the revision of 2003 no provision was included in the CPL or the Regulation regarding a guarantee to ensure the refunding of the paid sums in case the organizer goes insolvent. This neglect was changed in 2007 through an alteration to the *Law pertaining to travel agents and the association of travel agents*. Pursuant to Article 12 of this law, the tour organizer must conclude liability insurance. This policy must cover the liability of the organizer to the consumer for the case that the promised obligation cannot be performed or cannot be performed in its entirety. The reason for breach of contract can lie in illiquidity or the commencement of insolvency proceedings against the travel agent, but can also be another reason. Consequently, the insurance duty is far more comprehensive than that of Article 7 Directive 90/314. Nevertheless, the minimum level of insurance is set at the price of the package-holiday, which limits claims and contradicts the Directive. The consumer is given a direct claim against the insurer.

IX. DOOR-TO-DOOR SALES

A. *Overview*

Door-to-door sales produce a plethora of problems in Turkey. The comparatively comprehensive rules in Article 8 and 9 of the CPL and the Door-to-door Sales Administrative Regulation ("Door-to-doorR") testify to this.[123] It is not the case that large direct sale firms conduct themselves in a negative manner. Rather, the smaller, regional Turkish firms are the source of the problem. Two strategies always cause furor. The representatives wait until men go to work and then tempt women with gifts and/or they induce the consumer to sign a contract with lacking information about the product and the possible modes of payment. In the struggle against these means, the legislator does not restrict itself to the usage of civil law; rather it uses also public legal controls, in which the sales companies are obliged to fulfill registration requirements. Many rules can only be understood against the background of the fact that the traders try to evade the legally mandated withdrawal period by delivering the product during this period. In such case the only option remaining for the consumer is to send back the product, which requires different

123. The following information results from that put at the disposal of the authors by the Turkish Ministry of Industry and Trade.

legal precautions, in comparison to the exercise of a withdrawal before the delivery.

The EC has regulated door-to-door sales since 1985, although here, the transnational context, which is necessary for triggering the competence provision of Article 95 of the EC Treaty is not strongly manifested.[124] It was issued at a time when unanimous voting was needed and is, after the Product Liability Directive, the second oldest EC consumer directive. The cursory drafting of its provisions has spawned many preliminary hearings before the ECJ.[125] At the moment, like most other consumer contract directives, it is being examined. The suggested revision of the consumer-acquis is showing its first results. The draft horizontal regulation of consumer contracts includes also door-to-door sales.[126]

B. Definitions and Scope

Article 8(1) CPL contains a wide definition of door-to-door sales, comprising all contracts, which are concluded away from business premises, like exhibitions or trade fairs. Article 4 Door-to-doorR adds the conclusion of contracts at the place of work. In the Door-to-doorR, there is a legal definition too. Thus, the rule reaches far further than the Directive 85/577/EC. It does credit to the name of the directive, which extends to all contracts, which are negotiated "away from business premises." In fact, the directive contains a catalogue and gives the member states the option, to reduce the scope of application to circumstances, in which the consumer has not previously agreed to a visit at the house door.[127]

According to Article 14 Door-to-doorR particular products and services are not within its scope: (1) foodstuffs or beverages or other goods intended for daily consumption (nutrition supplements fall within the scope), (2) insurance contracts, (3) products or services, whose marketing outside business premises is recognized as a general trade practice. Only the first two exceptions are consonant with Article 3(2) Directive.[128] The last reaches far beyond and allows, given its very weak

124. Therefore, it is doubted whether the E.C. has the power to legislate in this area at all. *See* Roth, *Bürgschaftsverträge und EG-Directive über Haustürverträge,* ZIP, 1996, at 1285.

125. *See* Micklitz, *in* REICH & MICKLITZ, *supra* note 108, § 14. The *Heiniger*-Saga has led to further decisions. *See* Micklitz, *Rechtsprechung zum Europäischen Vebraucherrecht in den Jahren 2006-2008, Vertrags- und Deliktsrecht*, EWS 2008, at 353, 354 et seq.

126. *See Proposal for a Directive of the European Parliament and of the Council on Consumer Rights*, COM (2008) 614 final (Oct. 8, 2008), Chapter III Art. 8 et seq.

127. *See* Micklitz *in* REICH & MICKLITZ, *supra* note 108), § 14.11 et seq.

128. *See id.* § 14.17 et seq.

formulation, for a large proportion of relevant products to be taken out of the scope. A narrow interpretation is however possible when one takes into consideration the background of the norm: in regional areas of Turkey some goods and services are still offered only by travelling salesmen. The norm is actually reduced to these cases, which is clear from the practice of the courts.

The personal scope is wider than in the Directive.[129] Consumers are named in Article 3(h) next to natural persons, also legal persons, in so far as they do business outside of their professional activities. Such a wide formulation has been rejected by the ECJ in the *Di Pinto*[130] case. In so far, the rule of Turkish law is not consistent with the Directive.

The term, trader, corresponds with that of the Directive, but goes further to the extent that Article 3(f) also includes public undertakings. Conversely, neither the law nor Door-to-doorR contemplate the role of vicarious agents. However, Article 2 Directive equates everybody who is acting in the name or on behalf of the trader with the trader itself. This rule has, in the German version, played a central role with respect to the so-called Schrottimmobilien (*scrap immovables*). The ECJ has decided, contrary to the German Court, that the acts of the agent are imputed to the principal irrelevant of the fact whether the principal knew or could have known about marketing strategy the agent was applying.[131]

C. *Prerequisites of Business Practice*

According to Article 5 Door-to-doorR, the seller or supplier—the rule does not speak of the sales agent—requires proof that their capital amounts to a minimum of 25.000 new TL (which corresponds to about €13, 865). To get permission to do door-to-door sales, the applicant must present the following documents: an example contract, which adheres to the minimum criteria of Article 6 Door-to-doorR, an excerpt from the commercial register, a notary authentication of the proxy, as well as a report from the auditor. Pursuant to Article 7 Door-to-doorR, the certificate is valid only for a year and must be renewed thereafter. Certificates which are not renewed lose their validity three months after the expiry of their term. Article 8 Door-to-doorR gives the ministry the power to withdraw the trading permit of a trader, if the trader violates the rules of door-to-door trade. The Industry and Trade Ministry has issued about 15.000 of these permits. The not inconsiderable income from

129. *See supra* part II.B.1.

130. Case No. C-361/89, di Pinto, 1993 E.C.R. I-1206.

131. Case No. C-350/03, Schulte, 2005 E.C.R. I-9215; Case No. 229/04, Crailsheimer Volksbank, 2005 E.C.R. I-9273 Rdnr. 41-45.

these permits helps the intensification of the oversight activities of the Ministry.

This rule is not unproblematic in EC-law terms. Although the Directive 85/577/EC does not regulate the permit pre-requisites and seems to leave this area to the Member States, the Turkish provision could contradict the fundamental freedoms laid down in the EC Treaty. On the other hand, the freedoms are not unlimited. It could be argued that the numerous shortcomings necessitate a stricter stance on the part of the Turkish legislator. The ECJ has twice rejected similar attempts to overthrow by reference to the fundamental freedoms stricter national prerequisites for the practice of certain professions.[132] In both cases, a central role is played, by the fact that the potential effects are too marginal on the cross-border trade, and, as a result, could not be evidenced. This way the ECJ has increased the autonomy of the member states in the sensitive area of door-to-door contracts. However, the Draft Proposal on Consumer Rights would no longer leave any leeway for the Member States to adopt such type of rules.[133]

D. Information Duties, Form Requirements, Confirmation of Contract

Article 9 CPL and Article 6 Door-to-doorR mandate a written contract between consumer and trader. The consumer must be given a copy. Article 9(3) CPL and Article 6(3) Door-to-doorR demand that the consumer signs the contract and inserts the date in the contract by hand. This way, the aim is to prevent the trader from altering the date of the conclusion of the contract retrospectively. This rule is consistent with the Directive currently in force. However, it should be taken into account that the EC wants to reduce the formal requirements of contracts. That is true, at least for the electronic transfer of relevant contractual information.[134]

The Turkish rule is geared towards written form. As Article 9(1) does not lay it down expressly it can be argued in theory that the minimum requirements of the contract, as they are regulated in Article 6 Door-to-doorR can also be electronically sent. But the last half sentence of Article 9(1) seems to stand in the way of this interpretation, as it

132. Case No. C-20/03, Strafverfahren Burmanjer u.a., 2005 E.C.R. I-4133; Case No. C-441/04, A-Punkt Schmuckhandels GmbH v. Schmidt, 2006 E.C.R. I-2093.

133. *See Proposal for a Directive of the European Parliament and of the Council on Consumer Rights*, COM (2008) 614 final (Oct. 8, 2008) Chapter III.

134. The debates on the form of the contract played a decisive role in the work on the Directive on Consumer Credit 2008/48/EU. Finally, the Commission, together with the financial service providers managed to prevail with its more liberal standing. Contrary to the existing law in individual member states, consumer credit contracts are, in the future, also capable of electronic conclusion. *See also infra* part XI.C.

mandates, that, on the first side of the contract, in minimum 16-point font, there must be a legally pre-formulated notice about the consumer's right of withdrawal. Every other understanding would also run counter to the fact that the consumer must personally sign the contract.

E. Right of Withdrawal

The main statement is in Article 8(2) CPL. The ruling philosophy is also laid down there. The consumer is free to accept the wares or to reject them without giving reasons within seven days—without specification whether calendar or working days are intended. The withdrawal period commences according to Article 11 Door-to-doorR as follows: a) if delivery and contract conclusion fall together, from the date of the contract, b) if delivery occurs after conclusion of the contract, the withdrawal period begins with delivery, c) for service contract, the date of the contract is determinative. The Directive, in Article 5(1)1 on the other hand, takes account of the handing over of the written notice about the consumer's right of withdrawal.[135] In view of the shortcomings, such a regulation would be counterproductive. Since the Directive still formulates minimum standards, the stricter Turkish law is compatible with EC law.

The Turkish rule is lagging behind the provision of the Directive in that it does not expressly state that, the consumer will satisfy the withdrawal period (to give an example) by bringing the packet to the post, on the seventh day (Article 5(1)2). The Turkish rule can be read so that the returned wares must be with the vendor within seven days. In Article 8(2) CPL, the term used is "within seven days." Article 11 Door-to-doorR establishes that, the right of withdrawal is not bound to any form. If the consumer has made use of his right of withdrawal, he does not owe the vendor, pursuant to Article 8(3) CPL and Article 11 Door-to-doorR anything for the diminished value of the goods resulting from normal usage.[136]

Until the end of the seven-day term, the trader is forbidden to demand from the consumer payment or any written guarantee. It is noteworthy that such a detailed regulation has been codified in Article 8(2) CPL. The status of the established shortcomings could not find clearer expression. This is repeated once more in Article 11 Door-to-doorR.

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135. *See* Micklitz, *in* REICH & MICKLITZ, *supra* note 108, § 14.34.

136. The meaning of Article 8(2)3 CPL is not clear, according to which the trader is obliged to retrieve the goods within 20 days of the exercise of the right of withdrawal. It can be assumed that the return costs are to be borne by the trader.

It is the trader's responsibility to prove that a legally conforming contract was made and that this was sent together with the wares to the consumer. If this cannot be shown, the consumer is not bound to the seven-day term (Art. 9(4) CPL and Art. 11 Door-to-doorR)—the Turkish variant of the *Heininger*[137] jurisprudence of the ECJ. Such a rule would weigh all the heavier as the vendor must not only repay the purchase price but has no claim for loss of value on the goods.

F. Linked Transactions

Article 8(5) CPL explains the rules on installment contracts also for door-to door contracts applicable. These provisions are further enlarged upon in Article 9 Door-to-doorR. But accurately speaking, they are not concerned with joined transactions. Although the legislature had clear situations in mind, in which door-to-door sales are financed,—overwhelmingly by vendors of wares—Article 9 is aimed solely at the content of this credit relationship. Whether and how the right of withdrawal works on the linked credit transaction is not expressed in the law or the Directive.

Article 9 governs, in a detailed way, the minimum requirements of a credit contract, defines the upper limits for consumer payments, protects the consumer's early repayment right, and provides for when and under what conditions the vendor/creditor can claim early repayment and to what level.

G. Guarantee Certificates

To the extent that the consumer purchases goods in the frame of door-to-door sales, for which a guarantee is given, the relevant rules of the law of sale of goods are applicable.[138]

X. DISTANCE CONTRACTS

A. Overview

Article 9A CPL governs what a distance contract is, defines the information that must be provided by the trader, contains provisions about the execution of the contract and declares the rules of door-to-door sales applicable with few exceptions.

The details are found in DistanceCR, which supplements the CPL. Little is know about the practical meaning of the rule. This might have

137. Case No. C-481/99, Heininger, 2001 E.C.R. I-9945.
138. *See supra* part IV.F.

something to do with the fact that, unlike door-to-door sales, no special permit requirements are set up. It is precisely this that gives the Industry and Trade Ministry an overview of the actual problems of the consumer in door-to-door sales.

The backdrop to the rules are formed by Directive 97/7/EC on Distance Contracts,[139] which like the door-to-door sales Directive is subject to revision and redrafting on European level. In the horizontal directive proposal made public by the Commission on 8.10.2008, a formulation was suggested, which approximates the provisions regarding door-to-door and distance contracts.[140] Thus, the final step was taken to accomplish what was already inherent in the wording of the Directives. They are supplementary. The door-to-door Directive governs contracts, which are concluded outside of business premises in the simultaneous presence of both parties, the distance contract Directive concerns contracts, which are concluded outside of business premises in the simultaneous absence of both parties. According to that there are two connecting factors: the conclusion of the contract outside of business premises and the moment of contemporaneous absence/presence.

Directive 2002/65 on the distance marketing of consumer financial services to consumers has not yet been implemented into Turkish law.

B. Definitions and Scope

The terminology of consumer und trader are similar to those of the door-to-door sale. Here, like there, there are difficulties, as the Turkish law includes legal persons in the term consumer, to the extent that they are forming contracts outside of their field of trade.[141]

Article 9(1) provides a legal definition of the distance contract, which Article 4(i) DistanceCR repeats. In comparison to Art 2(1) or (4) of the Distance Contracts Directive there are some major variations. Although contracts are included, which are concluded by means of distance communication methods, without a physical contact between the parties, both provisions feature only few forms of distance communication. There is no exhaustive list in the sense of Article 2(4) Directive, nor is there an exemplary reference to the appendix. The Directive seems stricter than the Turkish rule, in the sense that it

139. *See also* Yeşim Atamer, *TKHK m.9/A ve Mesafeli Sözleşmelere İlişkin Uygulama Usul ve Esasları Hakkında Yönetmelik'in AB Mevzuatı İle Uyumuna İlişkin Görüş ve Değişiklik Önerileri [How to change Art.9/A of the Consumer Protection Act and the Statute Regarding Distance Contracts to Achieve Harmonisation with EU-Legislation]*, Batider 2005, Vol. XXIII/1, at 177-99.

140. *Proposal for a Directive of the European Parliament and of the Council on Consumer Rights*, COM (2008) 614 final (Oct. 8, 2008), Chapter III.

141. *See supra* part II.B.1.

demands that the contract is "exclusively" concluded with means of distance communication. Conversely, in the relevant provision of Turkish law, it is only stated that the parties must conclude the contact without coming into physical contact. Therefore the Turkish rule permits, mixed forms of communication in its scope, so long as the distance communication is dominant.[142] In the Directive, but missing from the Turkish rule is the necessary characteristic of the "organized distance sales or service provision scheme." This requirement leads in practice to difficulties, because for the consumer, it is not always apparent whether he is working with a professional or with a consumer who frequently uses the medium. Not least, since the consumer bears the burden of proof, the European Commission, in its draft horizontal regulation of consumer contract law, distances itself from this requirement.[143]

Article 11 DistanceCR takes a range of contracts out of the scope of the Directive, including: (1) financial services, which are the subject of Directive 2002/65/EU, (2) contracts which are concluded using vending machines or automated commercial premises, (3) contracts which come about with telecommunications operators through the use of public payphones (4) contracts which are concluded at an auction, (5) contracts for the supply of foodstuffs, beverages or other goods intended for everyday consumption, as well as contracts for the provision of services in the areas of accommodation, transport, catering and leisure services. It is not difficult to recognize Article 3 Directive in this provision. However, the rule is on one hand narrower, because the Turkish legislator does not use the full catalogue of exceptions in the Directive, and, on the other hand, entirely excludes the contracts under (4) and (5), whilst the Directive only declares inapplicable the provisions regarding pre-contractual information duties, written confirmation and the right of withdrawal.[144] The ECJ had only once to deal with this provision and to decide whether car lease contracts are contracts of transport. The Court answered this in the affirmative, contrary to the opinion of the Advocate General.[145] In the Draft Proposal on Consumer Rights leasing contracts are left out of the scope.

142. *See* Micklitz, *in* REICH & MICKLITZ, *supra* note 108, § 14.15 (addressing the important mixed forms in practice and the resulting difficulties for the interpretation of the characteristic "exclusive"); PÜTZHOVEN, EUROPÄISCHER VERBRAUCHERSCHUTZ IM FERNABSATZ 44 (2001).

143. Art. 2 (6), *Proposal for a Directive of the European Parliament and of the Council on Consumer Rights*, at 20, COM (2008) 614 final (Oct. 8, 2008).

144. For details regarding the very complex exceptions in the Directive, *see* Micklitz, *in* REICH & MICKLITZ, *supra* note 108, § 15.10 ff.; PÜTZHOVEN, *supra* note 142, at 84 ff.

145. Case No. C-336/03, easyCar v. Office for Fair Trading, 2005 E.C.R. I-1947.

C. *Pre- and Post-Contractual Information Duties and Formal Requirements*

Art 9/A (2) CPL marks the boundary. Consistently with the Directive, Article 9/A differentiates between information, which must be made available to the consumer before the conclusion of the contract, and the information, which must be received and confirmed at or after that time. Both types of information are interconnected so that the information that should be communicated at or after the conclusion of the contract is a pre-requisite for the conclusion of the contract. The differentiation and the connection are reiterated and further clarified in Articles 5 and 6 DistanceCR.

Article 5 DistanceCR governs the pre-contractual information. That is clear from the title, but not from the text of the provision itself. In the following lines details of the required information is listed. The rule does not correspond completely with the Directive's Article 4. That is valid for lit (h)-(j). It might have been serviceable, in the framework of the rule on pre-contractual information also to implement Article 4(2) and (3) which set out a general rule on transparency and special conditions for telephone communication.

Article 6 DistanceCR concerns the written confirmation of the pre-contractual information. According to the rule, all relevant information, set out in Article 5, must be communicated to the consumer in written form before the conclusion of the contract. Transfer through any durable medium also fulfils the requirement of writing. The rule goes beyond the Directive, because it generalizes the exception stated in Article 5 Directive that written confirmation is needed "unless the information has already been given to the consumer prior to conclusion of the contract in writing or another durable medium" in such way that written confirmation has become the rule. The provision is also problematic, because the consumer must in turn affirm the receipt of the information in writing. Only where the sale is electronic or by order, can the confirmation be in the form of electronic mail. The fulfillment of such a written requirement contradicts the nature of distance contracts and can work to the disadvantage of the consumer, because, pursuant to Article 6 DistanceCR, the contract cannot validly be concluded in the absence of such an affirmation.

Article 7 DistanceCR sets out the minimum contractual requirements that are necessary for every distance contract. The information must be communicated to the consumer in written or electronic form. It follows from Article 9(3) DistanceCR, that the trader carries the burden of proof, that he made all the information available to the consumer and received confirmation of that.

D. Right of Withdrawal

Astonishingly, Article 9/A CPL does not govern the right of withdrawal. This is only contained in the DistanceCR. Article 8(1) DistanceCR guarantees the consumer a seven-day right of withdrawal. The right of withdrawal is valid according to Article 8(2) of the DistanceCR, which has two exceptions obviously inspired by Article 6(3) Directive: no right of withdrawal is given in case of services if performance has started with the consumers consent before the end of the seven-day withdrawal period as well as in contracts about the delivery of audio- and video recordings or computer software, which were unsealed by the consumer. Excluded from the right of withdrawal are also, according to Article 8(4) DistanceCR contracts for the delivery of goods, which are made to consumer specification or which decompose rapidly and therefore would pass their date of expiry. These provisions were also modeled on Article 6(3) Directive. Included, unlike the Directive, Article 6(3), are contracts for the delivery of newspapers, periodicals and magazines as well as contracts for the provision of betting and lottery services.

The Turkish law equates door-to-door and distance contracts when it comes to the duration of the withdrawal period, which EC law does not. The distance contract Directive prescribes, in Article 6 a term of seven working days, the door-to-door contract Directive speaks, contrarily, of seven days. To this extent, Turkish law is not consonant with EC law. Already, Directive 97/7/EC obliges the Commission to point out the need to align the different periods in both types of contracts. Finally, in the draft of 8.10.2008 for a horizontal Directive on consumer contracts, this mandate is redeemed. In the draft, a term of fourteen days is prescribed.[146]

Pursuant to Article 8(1) DistanceCR the withdrawal right for sales contracts begins with the delivery of goods and for service contracts, with the conclusion of the contract. However, in case that the contract provides that the service may be performed before the end of the withdrawal period, the consumer has the right to withdraw up until the performance starts. Indeed, the service provider should not be able to undermine the consumer's withdrawal right by early performance. The background considerations originally stem from abusive practices of door-to-door sales.[147]

146. Art. 12 (1) of the draft, *Proposal for a Directive of the European Parliament and of the Council on Consumer Rights*, at 25, COM (2008) 614 final (Oct. 8, 2008).

147. *See supra* part IX.A.

Neither the law nor the Regulation contain provisions on the form of the withdrawal statement or its timeliness. Here, the express reference of Article 9/A to the laws on door-to-door sales are of no assistance. Admittedly, the Directive 97/7/EC is also silent on this point.[148]

The consumer needs not to give any grounds for his withdrawal. It has not legal consequences for the consumer. According to Article 8(1) DistanceCR, he is subject to no obligations or sanctions. This formulation is modeled on the wording of Article 5(1) Directive. It is contentious in the member states, whether the consumer must pay compensation for the usage of the item. A case for a preliminary hearing is pending in which exactly this question is to be determined. Thus far the Opinion of the Advocate General has not been made public.[149] Contrariwise, the trader is obliged to recompense the consumer for paid fees within ten days in case of withdrawal and to retrieve the goods within 20 days (Art. 9(2) DistanceCR).

If the consumer has not received the pre-contractual information pursuant to Articles 6 and 7 DistanceCR, the trader has the possibility to make up for this and send the information within a maximum of thirty days. Under such circumstances, the withdrawal period begins after the point at which the information is made available. This rule plays into the hands of a trader, who has not completely informed the consumer. After the expiration of thirty days, the consumer loses his right of withdrawal. The Turkish regulation is in conformity with the Directive on this point, but the absence of any form of sanction is, from the point of view of the consumer, problematic.

E. Linked Transactions

The Turkish law contains a single rule about joined transactions in distance contracts. It finds itself in Article 8(6) DistanceCR. Nonetheless, the rule is of remarkable clarity. If the distance contract transaction is fully financed the credit contract is also extinguished with the withdrawal. The withdrawal must be communicated to the creditor in written form. Just as in door-to-door sales, the rule does not make clear who must announce the withdrawal, the consumer, vendor or service provider.[150] EC law chooses a different construction. The consumer

148. Micklitz, *in* REICH & MICKLITZ, *supra* note 108, § 15.33; PÜTZHOVEN, *supra* note 142, at 76 et seq.

149. Case No. C-489/07, Messner v. Krüger.

150. *See supra* part IX.E.

must not withdraw the contract twice. Withdrawal from the distance contract against the trader is imputed also to the creditor. [151]

Much more precise and stricter than the Directive are the legal consequences of the withdrawal from the credit contract. Turkish law treats the distance contract and the credit contract in the same way. The consumer can release himself from both without obligation or repayment. This rule, at first blush, seems plausible, but is, so far unexampled. As is known, the unwinding of linked transactions has caused a whole series of preliminary rulings without any end to the discussion being foreseeable.[152]

F. Contract Performance and Payment Modalities

Rules on contractual performance and payment modalities are found exclusively in Article 9 and 10 DistanceCR. Article 9(1), (4), (5) set out a list of obligations on the trader. Pursuant to 9(1), the order must be fulfilled within thirty days after the day after which the consumer communicated the order to the deliverer. Thus far, the rule is basically consonant with Article 7(1) Directive. Pursuant to 7(1)2 DistanceCR, this period can be extended by ten days, provided that the trader informs the consumer in writing beforehand. This is a strange interpretation of the provisions of the Directive, according to which the parties can agree otherwise on the performance day and unnecessarily limits the contractual freedom of the parties.[153]

In so far as the trader cannot provide the wares, the consumer must be told and any payment must be repaid within ten days. This rule in Article 9 (5) DistanceCR corresponds broadly with Article 7(2) Directive. Article 9 (4) DistanceCR, in conformity with the Directive, grants the trader the right to offer the consumer a replacement article at the same price, where the replacement article must be similar yet not identical to the original object. This right to alter must be provided for in the contract. That alone is not enough to do justice to Community law. One would also have to demand that the trader points out to this right in a prominent place in the contract.[154]

Article 10 DistanceCR guarantees the consumer the right to cancel a payment and ask for compensation against the card provider, in case the price is charged to his debit or credit account without his permission or

151. *See* Reich, *Die neue Directive 97/7/EG über den Verbraucherschutz bei Vertragsabschlüssen im Fernabsatz*, EUZW 1997, at 581, 586; Micklitz, *in* REICH & MICKLITZ, *supra* note 108, § 15.39.

152. *See Heininger*, *supra* note 137; *Schulte* and *Crailshaimer*, *supra* note 131.

153. *See* Micklitz, *in* REICH & MICKLITZ, *supra* note 108, § 15.41; PÜTZHOVEN, *supra* note 142, at 58 et seq.

154. *See* Reich, *supra* note 151, at 586.

fraudulently.[155] Therewith, Article 8 Directive 97/7/EC was implemented, which only governs fraudulent usage. The Turkish rule goes further, because it covers usage without permission. It is noteworthy that the consumer has a direct claim against the card provider.[156] Article10 DistanceCR contains no rule on the burden of proof, which, in practice, is determinative of the claim.

G. *Limitations with Respect to the Use of Particular Means of Communication*

Neither the law nor DistanceCR take precautions for the implementation of Article 10 Directive, which restricts the use of certain long distance communication. In particular, feelings have run high in the debate, before and after the approval of the Directive, about the permission for so-called *cold calling*, where the consumer receives unsolicited phone calls.[157] The legal position in Europe is divided. Germany and Austria have stuck to the opt-in rule, according to which a consumer can be called, if he gives his agreement. Germany has enshrined this rule in section 7 (2)2 of its new Unfair Competition Act.

XI. CONSUMER CREDIT CONTRACT

A. *Overview*

Consumer credit contracts were first dealt with in the law of 1995 in Article 10 CPL and were subject to a revision in 2003. In the same year, the Administrative Regulation on Consumer Credit ("CreditR") was issued[158]. The rules are orientated towards the EU provisions, but they are only partly in conformity. With the coming into power of Directive 2008/48/EC in June 2008, the discrepancy was increased. In what follows, the Turkish rules are compared to the new version of the consumer credit Directive.

B. *Terminology and Scope*

The Turkish and EU law provisions are different from the offset—the definition. Pursuant to Article 10(1) CPL, a consumer credit is a loan that is paid to the consumer with the purpose of facilitating the purchase

155. *See* Atamer, *supra* note 139, at 194-95.

156. For the most complex German rules on reimbursement in the triangular relationship, *see* VOGT, DIE RÜCKABWICKLUNG VON KARTENZAHLUNGEN (2007).

157. *See, e.g.*, Leible, *in* MÜNCHENER KOMMENTAR ZUM LAUTERKEITSRECHT, Band 2: §§ 5-22 UWG, 2006, § 7 UWG ¶ 102 et seq.

158. Published in: RG 13.06.2003, sayı 25137.

of goods or services. Consequently, the law excludes from its scope all contracts in which the creditor offers a loan in the form of a deferred payment or other similar financial accommodation. Like the definition of credit, the definition of creditor is also limiting. In the sense of the CPL, these are only banks, special financing institutions, or companies, which are legally permitted to provide consumer credits (Art. 3(k) CPL).[159]

Although the scope in connection with the term, credit, is narrower than in the Directive, there is no catalogue of exceptions comparable to that given in Article 2(2) Directive 2008/48. Therefore also credits, which are designed to serve the procurement of immovable property, and credits, which are secured through immovable property, are covered by the CPL.[160] The amount of the credit, its repayment periods and the like are also of no importance in the determination of the applicability of the law as it is in the Directive.

C. Advertising, Information Duties and the Conclusion of the Contract

The Turkish consumer credit provisions include no duties similar to those of Article 4 Directive 2008/48 with respect to the content of advertisements. In fact, the AdvertR,[161] in Article 7(e) and (f),[162] prohibits misleading advertisements, but up to this date, no advertisement in which e.g., only the contractual interest rate was used without indicating the annual percentage rate of charge and the total cost of the credit to the consumer, has been found misleading by the Advertising Council. In practice, this is heavily exploited, with the result that the credit consumption is artificially driven to heights and a raising indebtedness in society is to be feared.[163]

Also a pre-contractual information duty is not established in Turkish consumer credit law.[164] Only with respect to the mandatory content of the contract there are provisions in Article 10(2) CPL. If this is compared to Article 10 of Directive 2008/48, one can see that especially the following information is not obligatory in Turkish law, making it inconsistent with EU law:

159. *But see* Art. 3(b) Directive 2008/48.

160. In the revision of the CPL in 2003, real estate, which serve as temporary or holiday accommodation were included in the term "goods." *See supra* part II.B.2. In 2007, a special regulation was introduced for mortgage loans (in Art. 10/B).

161. *See supra* note 22.

162. *See supra* part III.E.

163. For the statistics of the Turkish Banking Association, visit www.tbb.org.tr.

164. For mortgage credits, *see supra* note 160, such duty was introduced in the 2007 regulation.

- A statement about the annual percentage rate of charge, that is the total cost of the credit to the consumer, expressed as an annual percentage of the total amount of credit. This term is absent from the law, and is only mentioned in the CreditR. In spite of this omission, the CreditR mandates that the interest must be stated in the contract. Thus, there is another case in which the hierarchy of norms is not respected. In practice, there is no known case, where the credit contact was declared null, because it omitted this information.

- The right of withdrawal (no such right is prescribed in Turkish law for consumer credit agreements);

- Rights in a linked credit agreement;

- Termination;

According to Article 10(1) a credit contract must be in written form. Failure in this respect, nullifies the contract.[165] This will cause a problem under the Directive 2008/48 as it has given up the written form requirement and introduced in Article 10 the rule, that credit agreements may be drawn up on paper or on another durable medium (Art. 4 of the old Directive 87/102).

Unlike in the Directive, the Turkish legislature also provides that the contractual terms cannot, after conclusion of the contract, be changed to the detriment of the consumer. That means that in consumer credit contracts, only a fixed interest rate can be agreed upon which can only be reduced in favor of the consumer). The default interest rate is also fixed: it can be set at a maximum of 30% more than the contractual interest rate.

D. Applicability of Acceleration Clauses in Case of Default

An immediate collection of the entire loan and termination of contract, for the case that a consumer falls behind with payments is, pursuant to Article 10(3) CPL, only allowed under strict conditions: Such an acceleration clause must be contracted for, the creditor must have completely fulfilled his contractual duties; the consumer must be two successive payments in arrears and the creditor must give the consumer a one week period with the explanation that he will terminate

165. ZEVKLILER & AYDOĞDU, *supra* note 19, at 284.

the contract, after the expiration of the period. Although there is a similar regulation in many member states, this is not dealt with in the Directive.

E. Early Repayment

Article 10(4) CPL gives the consumer the right to discharge fully or partially his obligations under the credit agreement at any time. In both cases, the consumer, depending on the amount paid, is entitled to a reduction in the total cost of the credit. How the amount of reduction is to be calculated was set out by the Ministry in the CreditR. Appendix II Directive 87/102 served as a model for the drafting of the Regulation. A suitable compensation of the creditor for the case of early repayment is, unlike Article 16 (2) Directive 2008748 not provided under Turkish law.

F. Linked Credit Contracts

Pursuant to Article 10(5) CPL, a linked credit contract means a contract, where the consumer is given a credit on the condition that he purchases a particular product or service, or purchases from a particular vendor or service provider. Although this definition covers those types of linked credit agreements, which in practice most frequently occur, it will not meet the demands of the *Max Rampion* decision of the ECJ,[166] which gives a broader definition of linked agreements. This can be circumvented by interpreting Article 10(5) CPL as an exemplary list of linked agreements and not an exhaustive one as it is done in practice.[167]

In case of a breach of contract in a linked contract, the creditor is jointly liable to the consumer together with the vendor or the service provider. The consumer is at liberty to choose whom to sue. Since Article 15(3) Directive 2008/48, unlike Article 11(2)e Directive 87/102, leaves it up to the member states to introduce a direct claim against the creditor, this provision of Turkish law should be unproblematic.

G. Ban on the Issuing of Securities

Article 10(6) CPL contains the prohibition of securitization of the loan debt. If this prohibition is transgressed, the consumer can demand the return of the security papers at any time. Should the creditor meanwhile have endorsed them he will be liable for any damage, which the consumer suffers due to this endorsement. A rule on assignment of rights, which is comparable to Article 17 Directive 2008/48 is not to be

166. Case No. C-429/05, Max Rampion und Marie-Jeanne Godard gegen Franfinance SA und K par K SApp 2007 E.C.R. 1-8017 ff.

167. ASLAN, *supra* note 63, at 356.

found in the CPL. However pursuant to Article 167 Turkish Law of Obligations every debtor can in the event of assignment to a third party plead against the assignee any defense which was available to him against the original creditor, including set-off.

H. Topics not Dealt with Under Turkish Law

In a final comparison of the Turkish provisions regarding consumer credit contracts with the Directive 2008/48, one can ascertain that following issues need to be tackled in a possible reform: advertisement and pre-contractual information duties (Chapter II Directive), access to databases used for assessing consumer creditworthiness (Chapter III Directive), the right of withdrawal (Art. 14 Directive) and supervision of creditors and credit intermediaries (Chapter VI). The provisions with respect to the declaration of the annual percentage rate and about the mandatory content of credit contacts need to be of harmonized and supplemented. Another important lacuna in Turkish law is that no duty is imposed on credit institutes to control the creditworthiness of consumers.

XII. ACTIONS FOR AN INJUNCTION

A. Overview and Background

The discussion about the standing of actions for an injunction in the consumer law system can only be had against the background of the European discussion. The EC first imposed rules on the member states in Directive 84/450/EC on misleading adverts, mandating that either a state body, trade- or consumer organization have oversight and to stand in the way of infractions with an action for injunction. Since then, this instrument recurs in a flood of Directives, Directive 93/13/EC on unfair terms, Directive 97/7/EC on distance contracts, Directive 2002/65/EC on distance marketing of consumer financial services and Directive 2005/29/EC on unfair commercial practices. These directives have one thing in common, they are specific to particular areas and encompass, at their core, marketing and sales methods as well as unfair contract terms. According to common understanding, the member states have the choice of entrusting public authorities or consumer organizations, or in the area of advertisement also business organizations, with the enforcement. In

fact, this approach led mostly to the entitlement of consumer organizations beside or together with state authorities to file a lawsuit.[168]

This issue should be distinguished from Directive 98/27/EC on actions for an injunction. It concerns, as the name suggests, only injunctions and is purely procedural. It establishes actions for injunction as the central element of law enforcement in national and transnational domain. The considerable novelty lies in the structure of the reciprocal acknowledgement of a right to sue in the EC-transnational context. The EC Commission draws up a list of the qualified entities, to which member states can add their authorized institutions, be they public authorities or consumer organizations.[169] The Directive formulates only very modest minimum requirements for consumer organizations[170] and the competent authorities. The member state is left a wide discretion, so that the criteria differ considerably, in each member state, according to which the status consumer organization is conferred.

Thus far, this action has been used once, in a legal dispute of the Office of Fair Trading against a Belgian company, which distributed from Belgium, so-called *Sweepstakes* in England.[171] This might have been also the reason, why the Commission introduced the Regulation of 2006/2004[172] on cooperation between national authorities responsible for the enforcement of consumer protection laws. It demands of member states that they elect a single authority, which is entrusted with enforcement and can also proceed, where necessary by way of injunctions. But Germany and Austria have reserved the right to delegate the right of action to consumer organizations. Nevertheless, with the Regulation, the emphasis has been shifted away from private law enforcement to public enforcement.

For Turkey, given this background, there is a two-fold question: (1) who should be entrusted with the control of unfair contract terms and/or unfair and misleading advertisement—trade or consumer organizations and/or state authorities, and (2) how can the participation of Turkey in the transnational litigation of infringements of consumer law Directives via "qualified entities" be conceived? To this extent,

168. MICKLITZ, ROTT, DOCEKAL & KOLBA, VERBRAUCHERSCHUTZ DURCH UNTERLASSUNGSKLAGEN, RECHTLICHE UND PRAKTISCHE UMSETZUNG DER RICHTLINIE UNTERLASSUNGSKLAGEN 98/27/EG IN DEN MITGLIEDSTAATEN (2007).

169. Last published in 2008 O.J. (C 63/5).

170. GRABITZ, HILF & WOLF, DAS RECHT DER EUROPÄISCHEN UNION, Band IV, A 5 Art. 7 ¶ 16 et seq. zur Rechtslage nach der Richtlinie 93/13/EG über missbräuchliche Klauseln in Verbraucherverträgen.

171. *See* Micklitz, *Transborder Law Enforcement—Does it exist?*, *in* THE REGULATION OF UNFAIR COMMERCIAL PRACTICES UNDER EC DIRECTIVE, NEW RULES AND NEW TECHNIQUES 235-54 (Bernitz & Weatherill eds., 2006).

172. 2004 O.J. (L 364), 1.

Turkey is not autonomous. The Directive 98/27/EC does not prescribe, that non-member states are included in the reciprocal acknowledgement process regarding qualified entities. The legal position is more flexible when it comes to administrative cooperation. The Regulation of 2006/2004 on cross-border cooperation between national authorities responsible for the enforcement of consumer protection laws allows, in Article 14, for the possibility of the inclusion of non-member states in this process.

B. The Legal Position in Turkey

Turkey has found different solutions for the two main areas of general contract terms and the laws relating to fair advertisement. Against the use of unfair terms in general contract conditions, consumer organizations have been permitted to make claims (Art. 8 of the UnfairTR in connection with Art. 23(4) CPL. Conversely, the control of unfair and misleading marketing lies in the hands of an Advertising Council, a body, which is associated with the Ministry of Industry and Trade (Art. 17 CPL in connection with Art. 8 of the Advertising Council Regulation). Consumer organizations are not given standing in the law or in the Regulation. Nevertheless, they can call upon the Advertising Council to investigate a particular advertisement.

The significance of Article 23(4) CPL is an open question. The rule states as follows: "The ministry or consumer organizations have the permission to bring a claim to the consumer court, which is not an individual consumer problem but can be seen as having general implications for consumers, with the aim of avoiding possible infractions of the law."

On a first glance, the rule is in three ways very broad. It gives standing to the consumer organizations and the ministry, it encompasses not only the use of unfair terms and unfair trading but also infringements of the "collective interest of the consumers"—tending to reach far past the areas of the Unfair terms Directive and the Unfair trading Directive and extends itself, thirdly, beyond mere injunctions. Seen this way, Article 23(4) CPL would also include claims that the law has been infringed,[173] which, pursuant to Directive 98/27/EC, extends to all the Directives, so long as the collective interest of the consumer is injured.

173. Regarding the implementation of Directive 98/27/EC in Germany, consider the newly introduced § 2 Law on actions for Injunction.

XIII. REVISION ATTEMPTS SINCE 2003, THE TWINNING-PROJECT AND THE FUTURE

The above analysis reflects the state of the valid law, but does not say anything of the intra-Turkish, or more precisely, intra-ministerial discussion. Shortly after the issuance of the revised version of the Consumer Protection Code in 2003, the European Commission began new negotiations with Turkey on the conformity of the consumer law to the consumer *acquis*. In order to offer Turkish authorities legal assistance a usual call for tenders process was started and a consortium with the name of ECODES—Economic Development Services accepted the bid. The instructions had two components, (1) one legal, the critical appraisal of new Turkish consumer law in the version of 2003, as well as support in the updating; and (2) one political, the support for the professionalization of Turkish consumer organizations. In this phase, which lasted from Autumn 2003 until the end of 2004, the first critical examination of the new law from 2003 emerged, with concrete alternative suggestions, which also were the subject of internal counsel with the Turkish Industry and Trade Ministry and their collaborators. As usual, this report was not publicized. Nevertheless, it is available in the relevant expert circles.[174]

More or less directly thereafter the Twinning Project (financed by the European Commission) of the German Ministry for Food, Farming and Consumer Protection (MFFCP) with the Turkish Ministry of Industry and Trade began. The basic inspiration of the Twinning Project is, that a member state of the European Union can help a country with candidate status harmonize and implement an entire legal complex, here consumer law and consumer policy. This project encompassed a multitude of tasks, of which only the part relevant to Turkish consumer law will be introduced. The work was coordinated by a team of the MFFCP, which was integrated into the Turkish Trade and Industry Ministry. Since it was known, at the end of 2003, that Turkish consumer law did not yet correspond to the European *acquis*, the challenge lay therein, to find a way to work surgically on Turkish law, including the comprehensive administrative regulations. Starting from the EC-Directives, working groups were built around the individual themes. Nearly three years were taken to balance the various fields of door-to-door sales, distance contracts, consumer sales and product liability, credit and marketing, product safety and injunctions, with provisions of EC law. A large part of the work was done by one of the authors of this

174. The report was drafted by one of the authors of this article. *See* HANS MICKLITZ, FINAL REPORT ASSISTANCE FOR THE DIRECTORATE GENERAL FOR CONSUMER PROTECTION AND COMPETITION AND MINISTRY OF TRADE AND INDUSTRY (Nov. 30, 2003).

contribution, Hans-W. Micklitz. The concrete results, the necessary alterations of the law and the regulations should be executed by the Turkish authorities, or, more precisely, by the Turkish Ministry. The project accelerated only in October 2005, as the second author of this article, Yeşim Atamer, joined the MFFCP-led project. Yeşim Atamer, partly with the Ministry, partly in agreement with the Ministry, but actually single-handedly, made suggestions as to the renovation of the law and all the relevant regulations, which were then discussed intensively between the authors and the Ministry.

With the ending of the Twinning Project in 2007, the Turkish Ministry was presented with a fully reformulated law, with 99 articles (cf. the current 43) with an extensive explanatory memorandum, and 12 new administrative regulations. But contrary to the hopes of the authors, this law no longer made it into Parliament because of the unexpected early elections in Summer 2007, which hamstrung the EU-harmonization process. The newly appointed Minister for Industry and Trade did not stand with similar conviction behind the project, so that, instead of the issuing of a new law, new options for the revision of the existing CPL were sought. In May 2009, a shorter version of the proposals prepared by the authors was put up for public discussion.[175] It is not, at the present time, foreseeable how the discussion will develop.

A final personal remark from the authors:

Another article could be written about the political guidelines of the EC-led harmonization process of Turkish law and its practical implementation through tenders, the engagement of consultancy firms, later then the German Ministry as well as the army of (largely identical) experts, who were employed by the different contractors. Here only this much be said: Over the years a quite friendly relationship developed between authors and coworkers of the Ministry, which helped the project over difficult phases. In this respect, the authors remain personally attached to the Ministry and its collaborators independent of the awaited results of the project. For both authors, it was a fruitful period of their academic careers, which produced, not least of all, this article.

175. Available on the Ministry's website: www.sanayi.gov.tr.

Consumers and New Technologies: Information Requirements in E-Commerce and New Contracting Practices in the Internet

Immaculada Barral*

INTRODUCTION

This paper discusses the European Union's ("EU's") excessively narrow definition of the concept of "consumer" in the context of new e-commerce contracting types. Due to the fact that the concept of "consumer" is narrow, the consumer concept in EU regulation is not as useful in the domain of new contracting types born in e-commerce.

I discuss two examples of this loss of usefulness. First, I examine the extent and effects of the changes in information requirements for this new platform of e-commerce. Pre-contractual information is a central aspect of consumer protection. In e-commerce, such pre-contractual information must be extended to all parties, regardless of whether or not they are consumers. Therefore, the concept of "consumer" should include all parties that are weaker because they are not experts. This includes, for example, any contractor participating in a "clickwrap" agreement. Second, I discuss new e-commerce practices, specifically, online auctions. In this case, I try to find an integral solution for practices that are breaking down the traditional meaning of consumer and trader relations.

Parts one and two of this paper deal with the concept of the consumer as a non-expert in mass contracts and analyzes information requirements. I then focus in part three of this paper on the two main challenges to the narrow concept of the consumer: how information requirements are extended to non-consumers within e-commerce and how EU contract law advances a step beyond legal principles for information. In part four the question of whether e-commerce

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regulations constitute a special consumer law or whether there are already major problems with this new mode of action, is discussed.

I. MODERN RATIONALES OF CONSUMER CONTRACTS: MASS CONTRACTS AND THE INSTITUTIONALLY WEAKER PARTY

The nineteenth-century Spanish Civil Code is based on the liberal doctrine. In this Code, freedom of contract is the core scope of contract regulation; there are no limits to commercial transactions because there is no control by guilds or professional corporations. Only articles 1254 to 1260 of the Spanish Civil Code cover the general theory of contracts in a context in which the parties are assumed to have equal bargaining power and are free to discuss any aspect of the contract. The two main principles of traditional transactions include: equality between the two contracting parties;[1] and the freewill or autonomy of the parties.[2] Nevertheless, this approach and rationale do not reflect how contracts are formed in the modern context of consumer transactions.

The idea that one party in a contract is weaker than the other means that there is an imbalance which, to some extent, limits the freedom of contracts. This is particularly true of mass contracts. Such contracts are changing the bases of the traditional contracting process in which there was freedom of contracts and equality between parties. The liberal doctrine of equality between the parties assumes that transactions are carried out with a level of equality that does not exist today.

The weaker party in modern transactions is normally considered to be the consumer.[3] Therefore, the concept of consumer protection comes from the unequal bargaining power that breaks down the ancient dogma of equality. In this respect, as Ramsay states, consumer law faced the materialisation and differentiation of contract law in the twentieth century[4] "due to the breakdown of the formal system of contract law as an autonomous system of law that assumed a basis of formal equality between contracting parties." In the author's opinion, the EU consumer *acquis* applies a rather strict concept of the consumer as a natural person who is acting for purposes that are outside the scope of his/her trade, business or profession.[5]

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1. *See* Código Civil (C.C.) arts. 1254, 1256 (Spain).
2. *See id.* art. 1255.
3. *See* Ewoud Hondius, *The Protection of the Weak Party in a Harmonised European Contract Law: A Synthesis*, 27 J. CONSUMER POL'Y 245 (2004).
4. *See* IAIN RAMSAY, CONSUMER LAW AND POLICY: TEXT AND MATERIALS ON REGULATING CONSUMER MARKETS 166 (2d ed. 2007); *see also* FRANZ WIEACKER, HISTORIA DEL DERECHO PRIVADO EUROPEO 230 (1957).
5. This is the exact definition of Council Directive 97/7/EC, art. 1, 1997 O.J. (L 144) (EC) [hereinafter Distance Selling Directive]. One can find similar definitions in other main directives, including Council Directive 85/577/EEC, art. 2, 1985 O.J. (L 372)

However, I consider that the concept of "consumer" is broader than that of the non-professional as defined in EU law. If we want to protect the weaker party from unfair agreements, the consumer must be considered as any non-expert acting in what I will call "mass contracts."[6]

In my view, consumers must be protected not because they are non-professionals, but because they are non-experts. Consequently, consumers will always be considered the weaker party that needs special regulations. This idea is not highly compatible with the freedom of contract in Article 1255 of the Spanish Civil Code. The EU's narrow concept of a consumer cannot fulfill the expectations of subjects such as small enterprises or farmers. Therefore, the Study Group on a European Civil Code has suggested that small businesses should, at least in some cases, be included in the consumer definition.[7] This approach was supported by the Advocate-General in the *Pinto* case, but rejected by the European Court.[8] Nevertheless, it has been admitted in some national courts, for example in France, Italy,[9] and Spain.[10] I will focus on the Spanish case.

In all these cases, the courts stressed that enterprises can be treated as the weaker party in business transactions. Thus, small businesses can rely on existing consumer protection when they execute their normal business affairs. This extension of the consumer concept is justified by the fact that small businesses are non-experts in specific fields. For example, in the above-mentioned Spanish court case involved a hospital whose contract with an elevator service included unfair contract terms. The hospital was not an expert in this agreement, since elevator services were outside the scope of the hospital's normal trade, and the hospital was therefore in a weaker position as compared with the trader.

This broader concept of the consumer is based on the idea of protecting the weaker party, which is any party that can be considered a non-expert in a contract. In this respect, Weatherill—referring to the

(EC) [hereinafter Doorstep Selling Directive]; Council Directive 87/102/CEE, art. 1(2)(a), 1986 O.J. (L 042) (EC); and Council Directive 94/47/EC, 1994 O.J. (L 280) (EC) [hereinafter Timesharing Directive].

6. *See* Immaculada Barral Viñals, *Del Consumidor-Destinatari Final al Consumidor-No Expert en la Contractació En Massa*, 7 REVISTA CATALANA DE DRET PRIVAT 69 (2007).

7. *See* Johnny Herre, Ewoud Hondius & Guido Alpa, *The Notions of Consumer and Professional and Some Related Questions,* from the Task Force on Consumers and Professionals, Study Group on a European Civil Code, *available at* http://www.sgecc.net/media/downloads/consumers_and_professionals.pdf.

8. Case C-361/89, Republic v. De Pinto, 1991 E.C.R. I-1189.

9. *See* Herre et al., *supra* note 7, at 11 nn. 21, 22 (citing the French and Italian cases).

10. SAP de Burgos, Feb. 15, 2001 (R.A., No. 875).

scope of application of the Unfair Contract Terms Directive[11]—discusses what he calls an "irrational limitation" to consumers.[12] In fact, the remedies for contracts concluded between economically imbalanced parties can easily be applied to small business, as, Weatherill says, the power differential between such parties may be a great deal wider than that between the small trader and consumer.[13] Consequently, normal consumer remedies—such as pre-contractual information requirements—can be applied to non-consumers in the legal sense when the non-consumers are not experts,[14] for example, when the contract process is communicated electronically.

The second main character of the law that is assumed to protect consumers is related to mass contracts. Contracts are becoming standardized and offered to an unlimited range of possible contractors regardless of their individual condition or characteristics.[15] However, these mass contracts are coordinated by a class of experts who rely on technological knowledge. In this case, the imbalance between the parties and the concept of protecting the weaker party comes from the idea that only one party leads the bargaining process and has the information required to impose contractual conditions.[16] Consequently, control of the standard terms in a contract is limited to those terms that have not been individually negotiated, as there is a suspicion that "mass-produced" contracts cannot be fair to the other party.[17] In these cases, the imbalance between the parties and the opportunities to protect the weaker party generates a legal framework that interferes with the private autonomy that we conventionally call consumer law.[18]

II. INFORMATION REQUIREMENTS IN CONSUMER LAW

In this scenario, **contracts are offered to a mass of non-expert contractors**. Consumer law then must reduce free bargaining power to a formal principle and generate tools to control the bargaining process and the content of a transaction with a consumer. Obviously, the rules concerning consumer protection are changing contract regulations and

11. Council Directive 93/13/EEC, 1993 O.J. (L 95) (EC) [hereinafter Unfair Contract Terms Directive].

12. *See* STEPHEN WEATHERILL, EU CONSUMER LAW AND POLICY 117 (2005).

13. *See id.*

14. *See* Barral Viñals, *supra* note 6.

15. *See* LUIS DÍEZ-PICAZO, DERECHO Y MASIFICACIÓN SOCIAL, TECNOLOGÍA Y DERECHO (DOS ESBOZOS) 42, 50, 95 (1987).

16. For the rationales of these ideas, *see* Friedrich Kessler, *Contracts of Adhesion: Some Thoughts About Freedom of Contract*, 43 COLUM. L. REV. 629 (1943).

17. *See* WEATHERILL, *supra* note 12, at 118.

18. *See* HUGH COLLINS, REGULATING CONTRACTS 228-32 (Oxford Univ. Press 1999).

their interpretation in good faith.[19] Consumer law tends to avoid the imbalance between parties by focusing on two main aspects: lack of information and control of unfair terms. Both aspects deal with the concept of the consumer as an institutionally weaker party.[20]

There is an important difference between these two aspects. Information requirements are, in terms of legal remedies, a variety of clauses and information given to consumers before they accept a contract. It is generally understood that the law tries to re-establish the balance between parties by providing the consumer with information on characteristics of the goods or service for which he/she is contracting. The scheme is based on the idea that these information requirements will make consumer assent more reliable. Another interesting tool, the unfair contract terms regulation, allows the contract conditions to be reviewed and creates the possibility of having non-binding standard terms to redress any imbalance in a business-to-consumer contract ("B2C"). In the case of a business-to-business ("B2B") contract, there is an incorporation and interpretation test, but the law does not permit content reviews. Standard terms in a B2B contract only deal with the external problem, i.e., they tend to guarantee that the other party is aware that some of the contractual terms have been prefixed by the contractor, and because of this possibility of knowledge, the terms form part of the contract.[21] These terms are provisions that act at the same level as information requirements. However, in consumer transactions, the Unfair Contract Terms Directive[22] contains provisions on content reviews for consumer contracts when the terms are considered unfair. A test of unfairness is stated in the Standard Contract Terms Act.[23] However, the content of consumer contracts must be analysed in terms of good faith and checked to ensure there is no significant imbalance between the parties' duties or rights. In such cases, the court can analyze whether a contract is enforceable or not, depending on the fairness of the agreement or the clause. Thus, a material and substantive analysis can be carried out and the imbalance between the parties or the inequality of bargaining power can render the clause unenforceable.[24] The only

19. *See* Código Civil (C.C.) art. 1258 (Spain).

20. *See Consumer Police Strategy 2002-2006, A Communication from the Commission to the European Parliament, the Council, the Economic and Social Committee and the Committee of the Regions*, COM (2002) 208 final (May 7, 2002).

21. *See, i.e.*, art. 5 of the Act 7/1998 on the Condiciones Generales de la Contratación (B.O.E. 1998, 89) [hereinafter Standard Contract Terms Act].

22. *See* Unfair Contract Terms Directive *supra* note 11, art. 3.

23. *See* Standard Contract Terms Act, *supra* note 21.

24. About the relation between unfair contract terms and unconscionability, *see* Immaculada Barral Viñals, Unconscionability: Freedom of Contract, Unequal Bargaining Power and Consumer Law (draft paper presented at the Comparative Conference on

condition on contract terms is that the disputed term must be pre-formulated: the control of standard terms in a contract is limited to terms that have not been individually negotiated due to suspicion of "mass-produced" contracts. Nevertheless, this content review is not likely to differ in e-commerce transactions, except in aspects generated by the technical structure of the contract, which is a matter beyond the scope of the present paper. Therefore, I will focus on pre-contractual information requirements.

EU legislation highlights the idea that information requirements are the main focus of consumer protection.[25] In fact, information is aimed at complementing the market economy from the perspective of the weaker party. In other words, the function of information is to moderate the interaction between supply and demand in favor of demand. This re-establishes a certain degree of equilibrium between resources and the respective powers of companies and consumers. EU legislation has its own logic for information requirement regulations when one of the parties is legally defined as a consumer. This differential treatment is justified by evidence of the imbalance between the two parties, which leads to the need for specific solutions that only favor the "weak" party.

The application of these consumer protection regulations breaks the main principles of traditional transactions (according to a liberal economic doctrine), as stated in the Spanish Civil Code. EU legislation uses this process to redress the imbalance in transactions between company and consumer by means of information requirements involving three different tools: pre-contractual information requirements, advertisement as an integral part of the offer, and labeling prescriptions, especially for food products. It is generally understood that the law tries to re-establish a balance in order to provide consumers with information about the characteristics of contracted goods or services. Nonetheless, in these requirements, the singular claim of a consumer is normally linked to other substantive problems like contract fraud, pre-contractual liability, or voidable contracts due to misrepresentation or fraud. This brings us back to the Spanish Civil Code and its prescriptions on the elements of the contract.[26]

Contract Law in Financial Transactions in Europe: Protecting the Vulnerable in Financial Transactions: Conceptualising Unconscionability, University of Durham) (Sept. 8-9, 2008).

25. For the evolution of EU consumer law, see Paola Gozzo, *The Strategy and the Harmonization Process within the European Legal System: Party Autonomy and Information Requirements, in* INFORMATION RIGHTS AND OBLIGATIONS: A CHALLENGE FOR PARTY AUTONOMY AND TRANSACTIONAL FAIRNESS 21 (Howells Geraint, Andre Janssen, & Reiner Schulze eds., 2005).

26. *See e.g.*, Código Civil (C.C.) arts. 1261, 1300 (Spain).

The EU is questioning the effectiveness of information that is not properly given or understood by the consumer.[27] In addition to this important challenge, the question of how e-commerce is using the same tools to protect the non-expert (the weaker-party) and the effectiveness of these remedies in the new way of forming contracts, must also be addressed.[28]

III. E-COMMERCE AND NEW INFORMATION REQUIREMENTS

Information requirements are central to consumer protection and are used to regulate e-contracts. Such requirements try to empower the weaker party in the face of the complexity of the Internet. The aim of information requirements is to protect the consumer, as well as the professional or trader, who is defined as a non-expert for the first time.

The main effect of Directive 2000/31/EC[29] ("E-commerce Directive") is to create a single legal system of information requirements that is applied to both B2C and B2B transactions. The goal of the E-commerce Directive is to extend consumer protection to all kinds of contracts. Consequently, Article 10 of the E-commerce Directive (Art. 27 of the Spanish E-commerce Law, LSSICE[30]) prescribes some pre-contractual information requirements for the clickwrap agreement.[31] Instead of saying "yes," the contractor clicks a button on the PC to indicate his assent. In other words, as the will of the contractor is not *expressis verbis*, the legal system must confer security about the e-contract, especially to the contracting party. Pre-contractual information requirements in e-contracts are designed to build certainty about the e-contract and its terms.

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27. *See* Consultative Document of the Directorate-General for Health and Consumer Protection, *Labelling: Competitiveness, Consumer Information and Better Regulation for the EU* (Feb. 2006), *available at* http://ec.europa.eu/food/food/labellingnutrition/betterregulation/competitiveness_consumer_info.pdf; *see also* Gillian Hadfield, Robert Howse & Michael Trebilcock, *Information-Based Principles For Rethinking Consumer Protection Policy*, 21 J. CONSUMER POL'Y 131 (June 1998).

28. *See* Study Group on a European Civil Code and the Research Group on EC Private Law, *Principles, Definitions and Model Rules of European Private Law: Draft Common Frame of Reference (DCFR)* 16 (Christian von Bar, Eric Clive & Hans Schulte-Nölke eds,, 2008*), available at* http://webh01.ua.ac.be/storme/DCFRIntcrim.pdf.

29. Council Directive 2000/31/EC, 2000 O.J. (L 178) (EC) [hereinafter E-commerce Directive].

30. Act 34/2002 on Information Society and E-Commerce Services (B.O.E. 2002, 166) [hereinafter LSSICE].

31. We have focused on the information given before an offer is accepted. Therefore, we are not referring to Articles 5 or 6 of the E-commerce Directive, *supra* note 29, that include general information about the service provider and electronic communications.

The E-commerce Directive and the Spanish Law (Art. 27 LSSICE) validate the acceptance of an offer on the Internet if the service provider meets the information requirements. Two information requirements must be met in order to recognize acceptance of electronic contracts:[32]

1. Whether he/she is a consumer or not, the contractor must know how to accept the offer. Therefore the service provider must explain the different technical steps to follow to conclude the e-contract.[33] The service provider must also describe the technical means of identifying and correcting input errors prior to placing the order.[34] The law considers these two elements to be different. However, their aim is the same: to ensure that an offer is accepted correctly. The technical environment of the e-contract should be explained to the contractor to avoid divergence between the meaning of the party and what was finally "said" on the website with the click of a button. Such divergence may be due to problems in technical aspects, as Cavanillas Múgica[35] stresses. Moreover, Art. 11.2 of the E-commerce Directive deals with the duty of the service provider to provide security procedures to detect and revise errors, thus ensuring the effectiveness of the service provider's obligation to give the aforementioned information. The rule that silence is not binding because there is no intention to contract in such cases should be applied to e-contracts.[36]

2. The service provider must give information about whether or not the concluded e-contract will be filed by the service provider and whether it will be accessible to the contractor.[37] This information deals with the documentation of the e-contract. The contracting party must know how the e-contract is going to be stored so the e-contract can be reproduced at a later date. Thus, e-contracts must be filed in the service provider's electronic filing system. Mention of the languages used in the e-contract ensures the effectiveness of this obligation.[38] The same provision applies to the terms of the e-contract and general conditions

32. *See* E-commerce Directive, *supra* note 29, art. 10; LSSICE, *supra* note 30, art. 27.

33. *See* E-commerce Directive, *supra* note 29, art. 10(1)(a).

34. *See id.* art. 10(1)(c).

35. *See* Cavanillas Múgica, *Informática y Teoría del Contrato*, X AÑOS DE ENCUENTROS SOBRE INFORMÁTICA Y DERECHO, 1996-1997, at 270.

36. *See* E-commerce Directive, *supra* note 29, art. 7; *see also* Immaculada Barral Viñals, *La 'Contratación Por Aía Electrónica': Adaptación del Marco Jurídico Mediante Los Principios de Equivalencia Funcional*, *in* EUGENIO LLAMAS POMBO, 1 ESTUDIOS DE DERECHO DE OBLIGACIONES 107 (2006).

37. *See* E-commerce Directive, *supra* note 29, art. 10(b).

38. *See* E-commerce Directive, *supra* note 29, art. 10(1)(d); *see also* María Rosa LLacer Matacás, *Obligaciones Vinculadas a la Formación del Contrato y Codificación del Derecho de Consumo: Información y Documentación*, *in* EUGENIO LLAMAS POMBO, 2 ESTUDIOS DE DERECHO DE OBLIGACIONES 172 (2006).

provided to the recipient. These must be made available in a way that enables the consumer to store and reproduce them.

Therefore, when an e-contract is passed to a consumer it must include all the information prescriptions used in this special field, i.e., it must comply with Article 4 of the Distance Selling Directive.[39] Moreover, the e-contract must contain all the information requirements legally stated in the E-commerce Directive, particularly those stated in Article 10. If the contractor is not a consumer, only this second set of information is required. In this case, the regulations are related to the idea that contractors are not familiar with the new e-commerce platform and therefore need extra information about the contracting process, as well as proof of the e-contract, to reestablish the imbalance between the parties. It must be stressed that it is the service provider that brings the technology to the e-contract.

Thus, information requirements are not related to the e-contract itself but to the new method of drawing up contracts on the Internet. In my opinion, the information requirements stated in Article 10 of the E-commerce Directive were not drawn up specifically to protect the consumer, but instead were based on the specificity of the electronic contract method. In e-commerce, prior information requirements are a tool for consumer protection that have been extended to all contractors. This is because in an electronic exchange of offer and acceptance there is a weaker party that must be informed. The weaker party is any contractor, whether he/she is a consumer in a legal sense, or not. The imbalance between the electronic service provider and the contractor can be explained by the same legal reasoning applied to information requirements in a consumer contract: one party can be defined as a non-expert who needs legal tuition by means of prior information requirements, in this case, about the exact contracting process.[40]

However, when the weaker party is not a consumer information requirements can be excluded. Therefore, the consumer is presumed to be a non-expert in all cases, whilst a non-consumer can decide the exact level of information requirements he/she wants. For the same reason, information requirements are only applied to mass contracts. Information requirements are not applied to contracts that are concluded exclusively by exchange of e-mails or by equivalent individual

39. *See* Distance Selling Directive, *supra* note 5, art. 4.

40. These information requirements are highlighted in other international texts. *See* Convention on the Use of Electronic Communication in International Commerce, G.A. Res. 60/21, art. 14, U.N. Doc A/RES/60/21 (Dec. 9, 2005); UNIFORM ELECTRONIC TRANSACTIONS ACT art. 10 (UETA) (1999) (approved by the National Conference of Commissioners on Uniform State Laws).

communications (e.g. chats or videoconferences), as there is no imbalance between service provider and the contractor in such cases.[41]

In conclusion, we are starting to protect not only the consumer, who is a non-expert and therefore a weaker party (the consumer is an institutionally weaker party), but also the professional non-expert. Such protection is necessary because the contract is agreed by means of electronic communication which makes all contractors weaker parties. In this case, consumers have a double level of protection as a kind of "super weaker party."

IV. NEW CONTRACTING PRACTICES: ONLINE "AUCTIONS" AND THE CONSUMER CONCEPT

The extension of information requirements described above, which expands the concept of non-expert to include non-consumer, uses traditional consumer tools. As a result, the effect is rather limited. Another important change is expected in the near future, in relation to formal consumer to consumer ("C2C") contracts agreed on a service provider's website.[42] This change is linked to online "auctions," in which a website offers users the opportunity to buy and sell products using the technical infrastructure of the organizer in a wide range of legal processes.

In fact, even if we call these transactions "auctions" out of simplicity and because of the bidding process involved, it is difficult to compare online auctions with offline auctions. Not all the contract processes that occur on this kind of auction website involve bidding. In addition, there is no bidding at all when we contract the "buy-it-now" offer at a fixed price. Even when a bidding process does exist to fix the price, online auctions do not share most of the legal requisites of normal auctions, i.e., the service provider does not represent the seller, as occurs in offline auctions.[43] Therefore, as Riefa concludes, online auctions are

41. We are not referring to cases in which the service provider uses individual communication tools to avoid the legal obligations. In such cases, fraud can make the contract lose its validity.

42. On the rising importance of peer-to-peer platforms, *see* H. Schulte-Nolke, *EC Law on the Formation of Contract—From a Common Frame of Reference to the 'Blue Button,'* 3 EUR. REV. OF CONT. L. 332 (2007).

43. For the main characteristics of online auctions. *see* CHRISTINA RAMBERG, INTERNET MARKETPLACES: THE LAW OF AUCTIONS AND EXCHANGES ONLINE 44 (Oxford Univ. Press 2002). In reference to Spanish law, *see* Gemme Rubio Gimeno, *La Protezione del Consumatore in un Contratto Atipico: Le Aste Online Nell'ordinamento Spagnolo*, *in* G. CAVAZZONI, L. DI NELLA , L. MEZZASSOMA & V. RIZZO, IL DIRITTO DEI CONSUMI: REALTÀ E PROSPETTIVE 667 (2007).

not traditional auctions.[44] Consequently, their legal interpretation must be based on the exact extent of the relations among the parties, stressing the fact that some of these parties may be consumers. To sum up, online auctions can involve a variety of contracting processes and do not always include bidding. They are analyzed here because they are new Internet practices that generate new ways of contracting. Consequently, online auctions can lead to new contracting problems.

This paper focuses on some aspects of online auctions. However, its scope does not include defining the entire legal treatment for this type of contract. I only address the implications of these platforms being offered by a service provider and the application of the legal framework to the previously-defined e-contract. Some problems related to consumer protection in this new technological environment will be discussed, including the three-sided relations that these practices create and the way they modify the stated concept of consumer. First, I clarify why the current, narrow concept of the consumer does not protect consumers from the new contracting types found on the Internet, which suggests that a major challenge will arise in the future.

There are at least three different relationships in online auctions because the seller and buyer use a third party system. This generates legal relationships among the seller, the buyer and the third party at different levels: there is a contract between the users (the buyer and seller), and a contract between each user and the service provider. This latter contract between each user and the service provider is the only relationship that is clear in the application of the E-commerce Directive. Moreover, the relation between the buyer and seller in an online auction can generate a B2C or a C2C contract.

In this contractual triangle, the third party is considered an Internet Service Provider ("ISP") and is subject to all the obligations stated in the E-commerce Directive. From this perspective, the third party is not only considered as a hosting service that allows parties to contact one another, but an active part of this relation and liable for the services they offer, like any other party on the Internet.[45] This idea arises from the fact that

44. *See* Christine Riefa, *To Be Or Not To Be An Auctioneer? Some Thoughts on the Legal Nature of Online "eBay" Auctions and the Protection of Consumers*, 31 J. CONSUMER POL'Y. 167, 169 (2008) (concluding that it would be odd to deserve this second type of contract). A different legal framework from auctions, or rather offline auctions, are excluded from the scope of application of the Distance Selling Directive. The problem is less significant in Spain, where online auctions are included in the national law that transposes this Directive, *see* Act 7/1996 de Ordenación del Comercio Minorista, art. 38(3)(b) (B.O.E. 1996, 15). However, other problems can easily arise: defining these practices as auctions does not avoid the problems highlighted in this text.

45. *See* Gimeno, *supra* note 43, at 674.

the third party carries out an economic activity on the Internet by putting the other parties in contact with each other.

This brings us to a crucial point of the analysis, as some of these services are free to the user. However, even in these cases, it is hard to deny that the third party's activity involves doing business. In most online auctions, the buyers must pay the price fixed in a bidding process but the online system is free. Normally, the third party makes money by charging the seller a commission. In the case of file sharing systems, the service is usually free to users. However, some websites are starting to include some paying content on their platforms.[46] In these cases, the service provider does business through advertising related to the website or through the data industry.[47] Such websites make money by generating Internet traffic and selling publicity. In any of these circumstances, the new practices are related to economic activity, at least for the third party who leads the processes, even if the services are free for one or two of the users. We can also argue that free use does not make a significant difference in terms of the regulatory framework, as the E-commerce Directive applies to any service provided "normally with remuneration."[48] That is to say, even when there is no payment, these cases are within the scope of the application of the E-commerce Directive and related national laws. Therefore, ISP can be defined as offering both remunerated and free services and must therefore comply with all the information requirements of identification,[49] the legal duties in the case of electronic communication,[50] and information about the contract.[51] Regardless of the form of operation, a service provider in an online auction is a trader. Consequently, users benefit from the extension of consumer protection offered by the E-commerce Directive: all users of this kind of platform are considered non-experts in the mass contract services offered by online auctions. In other words, the restricted concept of consumer does not apply.

The general framework that defines the organizer of the online auction as an ISP is solid. However, the definition of the other parties in this three-sided scheme, that is to say, the relation between the users of

46. *See* RAFAEL SANCHEZ ARISTI, EL INTERCAMBIO DE OBRAS PROTEGIDAS A TRAVÉS DE PLATAFORMAS PEER-TO-PEER 84 (2007).

47. *See* Delores Gramunt Fombuena, *Dati Personali e Communicazione Ellecttroniche, in* IL CODICE DEL TRATTAMENTO DEI DATI PERSONALI 944 (Vincenzo Cuffaro, Roberto D'Orazio & Vencenzo Risciuto eds., 2006).

48. *See* E-commerce Directive, *supra* note 29, art. 2 (referring to Council Directive 98/34/CE, art. 1(2), 1998 O.J. (L 204) (EC), modified by Council Directive 98/48/CE, 1999 O.J. (L 217) (EC)).

49. *See* E-commerce Directive, *supra* note 29, art. 5.

50. *See id.* arts. 6, 7.

51. *See id.* arts. 10, 11.

this new Internet practice, is not so clear. In online auctions, one of the main problems in devising the legal framework is to realize who is acting as the user of the service. If buyer and seller can be considered consumers in the narrow legal sense of "acting for purposes outside of their trade," the Internet contract is a C2C contract, which is outside the scope of application of the Distance Selling Directive and other consumer protection laws. However, the figures reveal that a lot of the sellers on these online auctions are not consumers but retailers or even big corporations that use the platform to sell their products or as intermediaries. In addition, the buyers may not be consumers, as there is no restriction in the bidding process and anyone can be a buyer in these auctions. It is easy to conclude that if the seller is a consumer, the sale is C2C and should be excluded from consumer law because such tools are useless in this context. Nevertheless, if the buyer is a consumer *estricto sensu*, consumer law is applicable. Therefore, the real framework that is applicable to a contract formed in such circumstances cannot be known until we determine whether the buyer is a legal consumer according to EU regulations. This is only possible at the end of the contracting process, as this is the moment when we determine whether the buyer is a consumer or not. Consequently, neither legal security nor material justice is attained because our legal framework focuses on the concept of buyer and seller, whereas in these cases the correct approach stresses the special character of the contracting method; i.e. the use of a third party platform and no power of decision over the contracting process and online contracts. Only the aspects related to the transfer of property or execution of the contract—payment and delivery—should be treated as a normal sales contract.

For this reason, and focusing again on the three-sided scheme, the main problem of such practices is that the distinction between "consumer" and "trader" is turned upside-down. Traditionally, the consumer was the party who acted for purposes outside his/her trade, business or profession. In some cases, the buyer or seller are not consumers in the strict sense, even if they are as unaware of the contracting process as they would be if they were "real" consumers who needed the same extra information. In addition, traditionally, the supplier was the party who acted in his/her commercial or professional capacity, but this cannot be the case if the technical infrastructure of the online auctions is financed with funding from advertising. Therefore, the rationale of consumer law based on a strict concept cannot solve many of the problems that have arisen and the perspective of the legal framework is too narrow.

Nevertheless, the EU is addressing these new forms of exchange. For example, the Future Challenges Paper 2009-2014[52] focuses on these issues and requests different regulations for online consumer behavior, as it differs greatly from the usual offline practices. Do we need different regulations for consumers depending on the type of contract? Perhaps a more effective solution would be to develop a general understanding of e-commerce contractual practices in order to solve the problems that arise, rather than focusing on the current narrow consumer concept.

CONCLUSION

New technologies highlight the idea of the consumer as the weaker party due to the imbalance of bargaining power. In fact, the consumer concept and the legal framework it requires makes sense when we consider two key-factors: the contractor is a non-expert and acts in a mass contract environment. These are the rationales for consumer law. For this reason, laws related to new contract types on the Internet aim to extend consumer protection tools such as pre-contractual information requisites, as stated in the E-commerce Directive. But the real challenges are found in the field of brand new contract types, such as those used in online auctions, that both strengthen the feeling that the parties must be protected beyond the narrow concepts of supplier, buyer and seller and simultaneously, completely change the rationales of the consumer concept as interpreted by the EU in its regulations. Moreover, these practices demonstrate that new rationales are needed in the online context to obtain legal certainty and material justice for all the parties involved.

52. Directorate-General for Health & Consumer Protection, *Future Challenges Paper: 2009-2014*, *available at* http://ec.europa.eu/dgs/health_consumer/future_challenges/future_challenges_paper.pdf.

Legal Efficiency for Secured Transactions Reform: Bridging the Gap Between Economic Analysis and Legal Reasoning*

Frederique Dahan & John Simpson

INTRODUCTION

The case for the importance of law and institutions to boost investment and access to credit does not have to be made. Other chapters in this article have unambiguously demonstrated that secured transactions and creditors' rights are among the most influential measures. This need was acknowledged by the countries of Central and Eastern Europe and the former Soviet Union from the very beginning of the transition process. Since 1990 a huge effort has been made to transform their legal regimes. From the moment communism had collapsed it was urgent to introduce the changes that were necessary to develop modern market economies. The laws and institutions relating to commercial transactions (such as the laws of contracts, companies, property and insolvency) were hopelessly inadequate and economic reform had to be accompanied by major programmes for legal reform. Never before did so many legal systems have to change so much and in such a short period of time.

The European Bank for Reconstruction and Development (EBRD or the Bank) has engaged in many aspects of legal reform in the region. Its involvement in secured transactions reform began in 1992 and has continued every since. The objective of the Bank is to encourage countries to modernise their secured transactions laws[1] and it offers

* Published November 2008. SECURED TRANSACTIONS REFORM AND ACCESS TO CREDIT (Frederique Dahan & John Simpson eds., 2008). Reprinted with Permission from Edward Elgar Publishing Ltd. [Ed. Note: the citation format of the footnotes has been modified to conform with THE BLUEBOOK: A UNIFORM SYSTEM OF CITATION (Columbia Law Review Ass'n et al. eds., 18th ed. 2005).]

1. In this article we use the term "secured transactions" to embrace all transactions such as pledge and mortgage where the principal aim is to give security, not in the more limited sense (as given in the USA under article 9, Uniform Commercial Code—Secured Transactions) of relating only to security over movables.

assistance at all stages of the reform process to achieve an effective legal framework for secured transactions, building a consensus for those reforms and then assisting in the preparation of necessary legislation and the implementation of the law. To a large extent, this call has been heard in Central and Eastern Europe. When the EBRD Secured Transactions Regional Survey was published in 1999[2] most countries in the region had undertaken reform on this part of their legal framework. By 2004, all of the countries had done so. Yet, the assessment of their regimes is not consistently positive. In fact, in some cases, despite what seems to have been considerable efforts, users are still denouncing restrictions or problems in the legal and institutional framework for secured transactions. Why?

In this article we look at two questions that constantly arise and that we have been able to observe while engaged in this reform work:

1. How do you define the precise objectives of a law reform proposal and to ensure that they are adhered to throughout the reform process;

2. How do you assess whether a law reform is successful?

To address the first question we will draw in particular on our experiences of what happens in the transition countries of central and eastern Europe when a secured transactions law is proposed. We do not have the space for detailed case studies and we seek rather to give a broad overview of how the reform process works (or fails to work). Every reform project has its own list of successes and failures, and there is always scope for presenting critical analyses of specific cases. However when one takes the time to look back at what has been achieved it is more constructive to do so in a sense of learning and building on past experience. Our intention is not to draw attention to past failings and mistakes but to look at the lessons that can be learnt from the experiences of the past fifteen years. On the second question, surprisingly little has been done to develop methods for assessing whether a law reform is successful—or, to use other words, what makes a secured transactions system "legally efficient." We will describe the concept of "legal efficiency" and explain how we use that as the basis both for establishing the objectives of reform and for evaluating the result.

2. *See* EUR. BANK FOR RECONSTRUCTION AND DEV., LAW IN TRANSITION: SECURED TRANSACTIONS (2000), *available at* http://www.ebrd.com/pubs/legal/lit002.htm.

Of course, both questions are linked. During the first part of this article we will often refer to "efficient" laws and in the second part we will put forward the criteria that may be used to determine what makes a law "efficient." The primary reason for introducing a secured transactions law is economic. Secured transactions are encouraged because of the economic benefits that can be derived from them and the law is needed first and foremost to enable those economic benefits to be maximised. In spite of all the progress in collateral reform in recent years there has been a failure to create a coherent and constructive connection between the economic and the legal fundamentals and it is this issue that we will try to address.

THE PROCESS OF LAW REFORM

The typical law reform can be divided into four stages:

a) consultation and decision to reform
b) designing and passing of legislation
c) establishing the necessary institutions and implementing mechanisms
d) bringing the law into force.

Although these stages are interdependent, it is our experience that as the process develops the focus tends to become hazy, with the objectives somehow becoming lost and the gap between the economic and the legal analysis widening, sometimes alarmingly.

Decision to Reform

There has to be agreement at a political level that a new law is needed.[3] In the case of secured transactions this is likely to be based on a belief that a modern legal framework will boost the availability of credit and investment. The decision to reform should be taken because of the perceived benefits to the economy. If a finance ministry agrees to include a secured transactions law in the legislative programme mainly in order to placate a persistent international financial institution or other external influential organisation, the reform will be off to a bad start. There is a need for a broad consensus on the reasons for introducing the reform and what it is aiming to achieve. The breadth and depth of the decision-making process will often be critical for the reform's subsequent phases.

3. This does not exclude that the reform initiative may have come initially from the users and other stakeholders before being relayed to the executive (typically the government) or the legislative (parliament).

Usually one ministry or other agency (e.g. Central Bank) will assume the task of developing the reform proposal. The approach at this stage can vary greatly. Sometimes it is limited to taking the necessary steps to obtain a government decision to adopt the proposal in principle and to put the requisite legislation on the parliamentary agenda. However, much more can be done to put the reform on the right track and to increase the chances of a successful outcome. As with any project, early preparation and management is likely to be well rewarded. An understanding is required of the issues involved in the reform, the options that will be faced and the possible broader implications of what is proposed. Providing information to and seeking support from other ministries and organisations who may be involved is more than just part of the normal political process: it greatly facilitates subsequent work on transforming the proposal into reality.

The Ministry of Justice and other sectors of the legal community may merit special attention. Legal conservatism and a protectionist attitude towards "legal traditions" can, if not appropriately managed, become major obstacles to successful reform. Also at this stage external support and technical assistance may be sought but it is essential to understand that this assistance is precisely only technical: it cannot substitute for what is primarily a policy and political decision.

The most important outcome of this stage should be a broad consensus on what is to be achieved and the reasons for wanting to do so. Our experience is that a spineless reform project is unlikely to get strengthened at a later stage. A strong consensus at the outset on *all* of the key aspects of the reform will provide a powerful force for subsequently surmounting the many difficulties that will inevitably arise as the reform proposal proceeds.

Designing and Passing Legislation

Law reform is not just about writing and adopting laws the other stages are equally important. The process of preparing the necessary legal texts and steering them through the adoption process is often a lengthy and complex task and if it is badly managed the whole reform may be jeopardised. The outcome of this stage should be a law or legal provision that enable the desired reform to be implemented efficiently. We look later at how "efficiency" can be gauged but here it is appropriate to look at some of the factors that may impede this stage of the law reform process.

Losing Sight of the Objective

The lead players for preparing the legislation will most often be lawyers because drafting laws is essentially a legal role. If the decision-making process has been well prepared, the economic objectives of the future law should be well analysed and presented. However that may not be enough to ensure that the legal drafting team fully understand the economic objectives and actively assess the draft they produce against economic criteria. The Ministry of Finance and Economic Affairs or the Central Bank, or any other "champion" of the reform, needs not only to remain involved but continually to monitor the drafts that are produced against the economic rationale for the reform. Players from the financial markets can usefully be consulted (see comments under market resistance below). Secured transactions may not be rocket science, but there are any number of details which, if not properly understood, could steer the reform off track. Without good management of the drafting process the law presented is likely to fare badly when assessed against the legal efficiency criteria that we discuss below.

Legal Conservatism

The drafting of legislation is a difficult skill to acquire which is not given to just any lawyer who is practised in drafting the legal documents required by his clients. It requires a deep understanding of the purpose of the law, an ability to visualise the effect that the draft law may have on the existing body of laws and, most importantly, a capacity to relate the law proposed to existing and future market practice. It is this capacity to perceive the way in which the law will support (or fail to support) market transactions that is especially important and also quite rare. It should be possible to develop the requisite qualities within the drafting team, but the same cannot necessarily be expected for other lawyers who are consulted or who express views on the draft. Lawyers from their very training are likely to view with suspicion any departure from existing legal rules. The protection of legal tradition and the integrity of the legal system is to be encouraged but they have to be balanced against the need of markets to move forward. Regrettably it happens all too frequently that lawyers who contribute to the legislative debate make little attempt to achieve that balance, and indeed often have little understanding of the economic objectives of the law.

Market Resistance

It sometimes comes as a surprise that resistance to the introduction of an efficient secured transactions law comes from the persons who

could be expected to derive the most benefit from it. Banks, lenders and other creditors who give input at the drafting stage will not always be favourably disposed to the reform, or to some of the features that are precisely designed to make it efficient. They may require some persuading that from their perspective the proposed changes will be preferable to the existing market practice. The lure of increased credit activity may be tempered by fears of increased competition and lower margins. The problem may be compounded if the persons giving input are not the managers who are capable of understanding the broad economic picture but representatives from the legal department who are more concerned at how to document a transaction than its justification in a wider context. Even bankers may not understand all the reasons underpinning the reform. In one country recently, provisions in the draft pledge law designed to facilitate taking security for syndicated loans were struck out because of opposition from bankers who did not understand what a syndicated loan was, or assumed that it was undesirable or unnecessary in the local market.

The solution however is not to restrict consultation, rather to adapt the way in which it is carried out. If economists, bankers and investors, especially those who have been exposed to modern market practices, are not given a guardian role in the reform at the drafting stage it will be all the more difficult to keep the implementation on track later. The fact that the banking sector in Central and Eastern Europe has seen a large strategic participation of foreign investors should facilitate the introduction of modern market practices. Paradoxically, because the domestic markets in many Western European countries have been protected from external influences and thus slow to introduce modern techniques, resistance can sometimes come from those foreign dominated banks who do not understand why the transition country should need a "modern" secured transactions law and prefer to see replicated the system they are used to in their home country.

Incompatibility of Technical Assistance and Foreign Input

In transition countries considerable technical support has been given for secured transactions law reform from national and supra-national providers of technical assistance (of which EBRD is one). Although much of that assistance has been efficient and has contributed to the success of reform, it has also to be admitted that the nature of the assistance and the way it is provided sometimes falls short of what could be expected. The role of the technical assistance provider is a delicate one. It is there to provide expertise, practical advice and guidance using experience of reforms elsewhere, and to ensure that the original

objectives of the reform decision drive the process. It can also bring additional resources that would not otherwise be available. Its role is to assist, not to dictate or impose.

We put forward a few guidelines for assistance providers:

1) The drafting should be done by local lawyers. The law will have to fit in to the existing legal framework and someone who is not from the jurisdiction, however knowledgeable, is ill-placed to draft it. It is also desirable that local lawyers acquire a full understanding of all the issues and accept responsibility for the draft. A home-grown product, as opposed to a foreign implant, will engender a sense of achievement and with that should come a greater commitment to defend it and to see it properly implemented over time. A very good example of this is found in Bulgaria, where the 1998 Pledge Law was developed by Bulgarian lawyers, who understood very well the objectives of the reform and are still actively following up on how the system is faring.

2) The temptation to import foreign law concepts should be resisted. In a civil law country you cannot, for example, introduce a trust by sleight of hand. It may take longer but the drafters have to understand fully each aspect of the result desired from the reform and then work out how they can be achieved in the context of their own legal tradition and institutions. Foreign examples will certainly be a source of inspiration but will also be a source of confusion and inefficiency if imported without adaptation and reconstruction in order to fit to the local environment. Perhaps the worst sin is when assistance providers produce a draft in their own language substantially based on their own law and then present a translation of that draft as the law to be adopted. This caricature of technical assistance has for the most part now disappeared in Central and Eastern Europe but unfortunately the negative effects can still be felt. In fairness to technical assistance providers, the fault does not always lie with them. In some instances, a ready-made product is what the developing country will request and expect to be given.

3) Some understanding of the local legal tradition is essential. Ideally the assistance provider will mobilise experts who speak the local language and be well versed in the local law and practice. In practice that will not often be feasible but the assistance provider needs as a minimum to acquire a basic understanding of the approach of the local law and practice. Without that he will operate under a severe handicap.

4) The approach should be dispassionate and impartial. Once again the underlying philosophy is to encourage and support the local ownership of the project. The assistance provider is there to help develop a consensus on the reform objectives which is compatible with the original rationale and then to ensure that those objectives are translated into the legal system with maximum efficiency. The issues need to be presented in a manner which is balanced and conducive to rational decision. One of the more difficult aspects of the international expert's work is to detach himself from his legal roots, to present legal issues objectively. Every lawyer is conditioned by his legal training and may tend sub-consciously to believe that his own law is superior but that has to be resisted. It is sad to witness how often well-meaning lawyers working on law reform in transition countries press for solutions based on their own law, when with a little objective analysis it can be seen that the solution proposed is not appropriate for the local context or that other routes may be just as valid.[4]

Once finalised the draft law will pass through the parliamentary process. At this stage the drafting team needs to be vigilant to ensure that the draft does not fall victim to the uncertainties and excesses of the political process. One of the greatest dangers is amendments made at this stage by politicians who have their own agenda which may have

4. When the secured transactions project was set up at EBRD in 1992 a policy was introduced that there should always be in the team at least one lawyer from a common law background and one from a civil law background. The transition countries are civil law based but much of modern financial practice is inspired by common law solutions. That policy has been conscientiously pursued ever since and it has certainly had a considerable influence on all of EBRD's work in this field. If you have to discuss and agree issues across legal boundaries in-house, you are that much better prepared to adopt an open-minded approach when working in a local jurisdiction.

little to do with the issues covered by the law. However if the draft has been well prepared, objectives are clear, consultation process wide, and the presentation is persuasive, the chances are that political battles will not interfere with the adoption of the law.

Establishing the Necessary Institutions

Institutions will be established to enable the new law to operate. In the case of a secured transactions law a registration or "notice filing" system is needed and viable and efficient procedures have to be established to enable the security to be enforced. Often at this stage the people involved will change. Drafting a law is high profile, even more so if it involves amending the Civil Code, and may attract considerable high level interest. Setting up a pledge register is definitely not sexy work and may be left to administrators and IT experts. If they do not have a proper grasp of why the register is being established and the implications its use will have on market practice, there is a risk that inefficiencies will be introduced through superfluous or inappropriate requirements. The instinctive approach of a registrar towards pledge registration may be quite different to that intended by the law. If he is not properly briefed on the purpose and aims of the law he may, for example, build a title registration system modelled on a land register, which would definitely not be an efficient way of publicising pledges.

Similarly enforcement procedures often lose sight of the fundamental objective in the context of secured transactions, which is of achieving a rapid sale of the assets given as security at a high price. There are many opportunities for creating overly bureaucratic public auction and other procedures, which provide "protections" which are of little benefit to the debtor or creditor who are party to the enforcement. The gap between the economic analysis which underlays the original reform decision and the mindset of those developing the register or the enforcement procedure is sometimes alarmingly wide, especially when those responsible for the initial reform initiative have moved on to other things and fail to ensure effective follow through.

Bringing the Law into Force

Once the new law enters into force the task of making the new regime work in practice is entrusted to market players, institutional administrators and, in the final count, judges. How it works will be determined, to a large extent, by how the new regime is explained, and the support and guidance that is given to those to whom it is entrusted. Lawyers and bankers may be happier with the old system they were familiar with and slow to realise, or fearful of, the scope the reform gives

for new deals. As with any new product the way it is introduced into the market may be just as important as the quality of the product itself. Often those active in the reform process will have moved on to the next task and there are few resources available to analyse whether all the effort bears fruit. A common problem is the lack of a good understanding of the new law by those who will apply it at the moment when it is most needed: the courts. Unfortunately, it is rare for the judiciary to be closely involved in developing the reform from the outset. The danger is that the courts may then not grasp the effect (or intended effect) of the law and interpret it in a narrow or limitative way.

Much can be done to assist at this stage: education and awareness programmes, dissemination of promotional and explanatory material, training programmes, pioneer transactions sponsored by IFIs, and monitoring of the way the law is working (or not working) in practice against what was intended. The idea that the reform will be perfectly applied first time is a myth, especially in the fragile and fast-changing environment of a transition country. Reform is a continuing and gradual process and after any major step is taken, such as the introduction of a new law, careful monitoring is necessary to identify problems and find solutions. Inevitably the legal implementation of a law will not always correspond to the underlying economic rationale. If discrepancies are addressed rapidly solutions can most often be found relatively simply. If they are left to develop there is a danger that they can eventually jeopardise the success of the reform. In Poland the pledge law when introduced in 1996 was a good example of a modern pledge law but, in contrast to neighbouring countries that introduced similar laws, it has failed to deliver the expected benefits precisely because of the way it has been implemented.[5]

In order to be effective, the nature and purpose of the monitoring and evaluating task has to be clearly understood. It is not a policing task aimed at disciplining those that do not behave as intended, nor is it a kind of audit to enable the external assistance provider to verify the success of the project. It is more in the nature of an active after-sales service designed to ensure that the new product works, that its users derive maximum benefit from it and that the economic benefits that were assumed from the reform indeed materialise. It requires encouragement and support from the reform's champion since it can only be successful when it is underwritten by a commitment to carry it through effectively. It also requires sound methodology and benchmarking, and this leads us

5. *See* EUR. BANK FOR RECONSTRUCTION AND DEV., THE IMPACT OF THE LEGAL FRAMEWORK ON THE SECURED CREDIT MARKET IN POLAND (2005), *available at* http://www.ebrd.com/country/sector/law/st/facts/nbpeng.pdf.

to the second part of this article—the question of how a reform's success can be assessed.

ASSESSING THE SUCCESS OF REFORM: THE CONCEPT OF LEGAL EFFICIENCY

The process of reform is not an easy one. It is hampered in particular by an often inadequate analysis of what the reform is aiming to achieve and a lack of clear directions to guide the work as it progresses. Government proposes a law on secured transactions in order to facilitate access to credit. A team of local and foreign experts help the government prepare the necessary legislation, which is duly passed. A different set of government employees and external contractors establish a register or notice filing system and a public auction procedure. Everyone has done their job, the reform is complete and yet, the result in terms of facilitating access to credit may fall well short of what was intended. Or, as is most often the case, nobody has a clear idea of what the result of the reform actually is. What is missing are the constant and well-defined goals which determine the direction of the process and ensure that it leads to the desired result.

A lawyer who is drafting a pledge law or an administrator who is setting up a pledge registration system needs to be given a clear picture of the end objective, not just as a technical description of the law or register, but also by way of indication of the ways in which it should actually facilitate access to credit. In this way he gains an understanding of the broader issues involved, including the economic function of the law, and will realise that the outside world will be judging the law or register with these in mind. In practice surprisingly often that is not the case.

In order to address this gap we use the concept of legal efficiency. What do we mean by "legal efficiency"? We use it as indicating the extent to which a law and the way it is used provides the benefits that it was intended to achieve. We look at the concept against the background of secured transactions law because we prefer to link it to our direct experience in transition countries, but we believe it is capable of much wider application.

As mentioned before, the prime purpose of a law regulating pledge or mortgage is economic, since the secured credit market has essentially an economic function, (whilst recognising that it may also have important social functions and consequences); and it is essentially facilitative since a secured credit market is not a necessity, it being possible for any jurisdiction to function without it. We work on the premise that the basic legal framework should be *conducive* to a flexible

market for secured credit. There are also social issues, for example relating to consumer credit and housing, but the driving force behind the introduction of a law on secured transactions is the benefits that it is expected to bring to the economy.

A relatively simple indicator of the success of a secured transactions law reform (or primary motive for undertaking the secured transactions law reform) would be the subsequent increase in the *volume* of secured lending. This is a crude and narrow indicator, inadequate by itself. The intended function of the secured credit market may be more than just to boost the amount of credit granted against security. It may also include, for example, opening up credit to new sectors of society, encouraging new housing construction, or allowing privately-funded infrastructure projects.

The intended function of a law has to be looked at in the context within which it is to operate. Its ramifications have to be considered not just in economic terms but in social and cultural terms as well. An appropriate balance has to be found between fulfilling the law's economic purpose and ensuring that the effects of the law are acceptable in context. The purpose of the reform needs to be carefully analysed and agreed at the outset, failing which the potential achievements of the law in terms of legal efficiency may be curtailed. It sometimes happens that the goals of the reform are not clearly defined, or that they are not perceived in the same way by all persons involved. That can be fatal to the subsequent implementation. Without well-defined and accepted goals there cease to be unambiguous criteria against which the reform can be assessed. The boat is sailing with no sense of direction and it is unlikely it will reach port safely.

Legal Efficiency Criteria

We analyse legal efficiency by looking at the degree to which the legal framework enables secured transactions:

a) first, to achieve their basic function and

b) secondly, to operate in a way which maximises economic benefit.

And, as shown in the table, we break the second criterion into five separate headings: simplicity, cost, speed, certainty and fit-to-context.

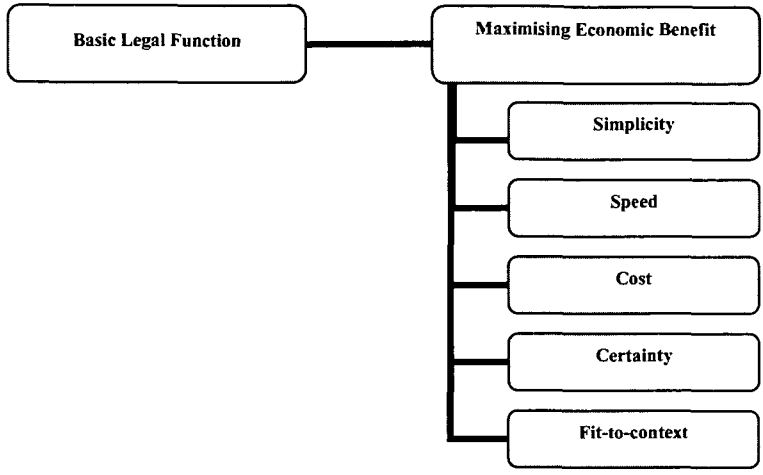

Table: Criteria for legal efficiency of secured transactions law

The basic legal function of a secured transactions law is to allow the creation of a security right over assets which, in the case of non-payment of a debt, entitles the creditor to have the assets realised and to have the proceeds applied towards satisfaction of his claim prior to claims of other creditors. If a secured transactions law only gives the creditor a personal right but no right in the assets, or if there is no right to enforcement, or no priority vis-à-vis other creditors, the law fails to achieve its basic legal function. An absolute priority for taxes and other state claims ahead of the secured creditor, or the right in insolvency of ordinary creditors to share in a portion of the proceeds, are more than inefficiencies in the secured transactions law, they are defects which prevent it from fully achieving its basic function. They may be intentional (a super-priority of the state usually is) but they reflect a compromise between two laws with conflicting purposes. Any such compromise inevitably inhibits the effective operation of the secured transactions law and introduces uncertainty into the minds of lenders.

If the legal framework for secured transactions is to operate in a way which ***maximises economic benefit,*** the system for creation and enforcement of pledge or mortgage should be simple, fast and inexpensive, there should be certainty as to what the law is and how it is applied, and it should function in a manner which fits to the local context.

Simplicity—Simple does not mean simplistic: it is necessary to strike a balance between simplicity and the sophistication required by the

market. In many countries complexities have developed and become entrenched over time as laws have been adapted to new circumstances, not because of the sophistication of these circumstances but rather from inherent limitations of the legal system. There exists in transition countries a huge opportunity to reduce down to the essential elements and to introduce laws which are directly adapted to modern market requirements. Part of simplicity comes from the lack of restrictions and barriers. If the law is to facilitate the use of secured credit it needs to provide a base which offers the necessary flexibility to adapt with the trends of the market.

Speed—For most aspects of the legal process, the less time it takes the more efficient it is. There are exceptions: a notice period or a cooling off period has to be of appropriate length, but for registration of a pledge or mortgage, for example, there can only be benefits if it takes only a few minutes rather a month, and a lender who knows that enforcement of the pledge or mortgage is likely to take several years will derive less comfort from his security.

Cost—Legal costs almost inevitably have an adverse impact on the economic benefit of a transaction. Delay, complexity and uncertainty all tend to add to costs so there is a close relation with the other aspects of legal efficiency. Some costs are, at least to an extent, within the control of the parties. Before taking legal advice on structuring a transaction the parties can assess the value of doing so. The cost of legal advice on a complicated transaction may be outweighed by the benefits, but the cost of legal advice incurred because of defects in the legal framework always reduces efficiency, as do fixed costs (for example registration, notary or court fees).

One does not have to be an economist to understand that if the legal procedures for creating and enforcing a pledge or mortgage are slow, expensive and complex, the cost of secured credit will be higher and the economic benefit of using pledge or mortgage reduced. There are however two other elements that need to be taken into account when assessing legal efficiency. They are sometimes overlooked by economists because they are more difficult to translate into quantifiable indicators but they are critical to the success of a legal system.

Certainty—Certainty is a critical element of any sound legal system. A grain of uncertainty in the legal position can have a pervasive and disproportionate effect. Once a banker hears that there is some doubt in the legal robustness of a transaction, he will fast become hesitant. The difficulty is one of measurement. If the legal uncertainty relating to a pledge or mortgage could be stated, for example, as a five per cent chance of proceeds on enforcement being reduced, with the amount of the reduction being on average twenty per cent, the risk would

be quantified and it would become easier to manage as there would be relative certainty. In reality legal opinions cannot be expressed in that way and the natural reaction to unquantifiable uncertainty is extreme caution. Transparency can often strengthen certainty: for instance, easy access for all to information in the land register allows potential mortgage lenders to find out about the property and any other mortgages that may be claimed.

Fit-to-context—The "fit-to-context" criterion is the most elusive but nonetheless important since it covers a number of facets. Simplicity, cost, speed and certainty are all concepts which are relatively easy to understand and to relate to economic benefit. The "fit-to-context" concept however merits more explanation. It is not enough to adopt a law which establishes clearly and unambiguously a simple, fast and inexpensive regime for pledge or mortgage security. The efficient functioning of the law will also depend on whether it is adapted to the economic, social and legal context within which it is to operate. It needs, for example:

a) To respond to the economic need: Markets are constantly changing, and the law has to be able to adapt to new products, as for example when loans are proposed with flexible interest rates;

b) b) To fit to the broader financial context within which the law operates: For example, the rules applicable to transfers and pledges of secured loans should not hamper the use of mortgage-backed securities and covered bonds and the secured transactions law should take into account the way in which pledge is used for securitisation transactions involving unsecured loans and other assets;

c) c) To fit with existing market practice: Whereas much can be learned from other markets, a law has to be compatible with existing market and legal practice and to give confidence to those who rely on it;

d) To achieve an appropriate balance between fulfilling the economic purpose and ensuring that the effects of the reform are acceptable in context: The rights of consumers and occupiers of property to appropriate protection cannot be eliminated to suit the economic needs of the secured transactions law, rather they have

to be framed in a way which enables borrowers and lenders to derive the benefits afforded by a flourishing secured credit market while at the same time ensuring the necessary protections to persons in a vulnerable position.

e) To achieve particular objectives of the law: For example, the law may aim to extend secured lending to a wide range of banks as opposed to creating a lending cartel, or to reduce constraints on the types of pledge and mortgage product that can be offered.

Legal Efficiency and the Functional Approach

An issue which can be used to illustrate the importance of the fit-to-context criterion is the functional approach to security interests over movable property. This was originally introduced under Article 9 of the Uniform Commercial Code in the USA. During the first half of the twentieth century there had developed a vast range of different rules and practices in the US that were applied for securing claims using movable property. In an attempt to introduce some order into what had become a somewhat chaotic and highly complex field of law, Article 9 provided for a unique set of rules, governing creation, notice filing, priority and enforcement, for *all transactions* whose function was to create a security interest in movable assets. Those rules apply irrespective of the form of the agreement between the parties if the substance of the transaction is to create a security interest. For example, an agreement between a buyer and seller of goods for title in the goods only to pass to the buyer upon full payment for the goods would not be effective as such, but would create a security interest over the goods with title passing to the buyer and the seller having a pledge in the goods.

In the context of the US in the 1950s the functional approach under Article 9 no doubt met the fit-to-context criterion. It was a key to providing a cure to the defects of the system that had prevailed until then and the sophisticated American market was able to understand it and apply it. In the very different context of transition countries the functional approach may be assessed otherwise. They have a lack, rather than a surfeit, of devices and practices for taking security. The introduction of a sophisticated concept of definition by reference to substance not form, and the recharacterisation of transactions that can result, does not fit easily with a civil law system and brings with it unnecessary complexity and uncertainty. Western European countries do not have a functional approach: England has recently rejected the

proposal that such system would be of benefit. Retention of title and financial leasing, fixed and floating charges, for example are used extensively. A country from central or eastern Europe thus needs to reflect carefully before adopting an approach which would bring considerable complexity and would touch on fundamental elements of its legal system such as freedom of contract[6] and ownership rights[7], whilst being diametrically different from the approach taken by its neighbours.

A few transition countries have adopted a functional approach (for example, Albania, Kosovo and Montenegro). No clear assessment has been made of the effect but anecdotal evidence suggests that the meaning of the relevant provisions has not been understood and that they are largely ignored in practice.

Measuring Legal Efficiency

Legal efficiency is thus relevant both when defining the general and detailed objectives for the reform and when subsequently measuring what has been achieved. A basic assessment whether a law maximises economic benefit may appear relatively simple. If the law enables a pledge or mortgage to be taken, and if necessary enforced, simply, quickly and cheaply the cost of security by way of pledge or mortgage is minimised and the benefit of the security is maximised. As we showed above, there are broader aspects that also have to be taken into account. Legal inefficiency may not merely reduce the economic benefit that might otherwise result from the law (for example a lower interest rate for a secured loan compared to that of an unsecured loan), it may also have a dissuasive effect. This is particularly pertinent to factors where the economic impact is difficult to measure. If the legal process is complex or takes a long time, or if there is uncertainty, potential players may never pass the decision threshold and not proceed with the transaction at all. If a few people take that line the impact may be multiplied as their conduct influences others.

Measuring legal efficiency is clearly challenging and any attempt to develop an accurate scientific basis is unlikely to be convincing. However, a close examination of a legal system against the legal efficiency criteria listed above can provide indicators of how efficient the system is. EBRD has done this for mortgage law in transition countries[8]

6. A contract for a financial lease or a credit sale or retention of title would be recharacterised as a pledge.

7. An agreement which purports to govern transfer of ownership has the effect of creating a pledge.

8. *See* EUR. BANK FOR RECONSTRUCTION AND DEV., MORTGAGES IN TRANSITION ECONOMIES (2008), *available at* www.ebrd.com/pubs/legal/mit.htm.

and it gives an interesting comparative insight into the strengths and weaknesses of existing legal regimes.

CONCLUSION

In most transition countries the basic reforms of the legal regimes for pledge and mortgage are well advanced, but there remains much work to do to assess those regimes and to fine-tune them to ensure that secured credit markets are supported by laws that are appropriate and conducive to the operation of the market for the mutual benefit of lenders and borrowers. We believe that the failure to define the general and detailed objectives of a reform and subsequently to measure what has been achieved against those objectives often prevents emerging markets from realising the advantages they should derive from legal reform programmes. The use of legal efficiency criteria provides a basis for bridging the gap between economic analysis and legal reasoning.

Achieving Optimal Use of Harmonization Techniques In an Increasingly Interrelated Twenty-First Century World of Consumer Sales: Moving the EU Harmonization Process to a Global Plane*

Louis F. Del Duca, Albert H. Kritzer & Daniel Nagel**

Synopsis

Robust and interesting scholarship generated in the last decade on the need, feasibility and content of a harmonized European Civil Code, the Common Frame of Reference "tool box" approach, the harmonization of European Contract law or the European Law of Obligations, and the decision of the Commission of the European Community to focus on harmonizing the existing Acquis Communitaire of the already promulgated consumer protection directives has been well documented.[1]

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* This article was originally published by Thomson Reuters in 41 UCC L.J. 51 (2008). It is included with the consent of Thomson Reuters in this symposium collection of papers presented at the 14th Biennial Conference of the International Academy of Commercial and Consumer Law held at the University of Bamberg in Bamberg, Germany on July 30-August 3, 2008.

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1. *See* Michael Joachim Bonell, *The CISG, European Contract Law and the Development of a World Contract Law*, 56 AM. J. COMP. L. 1, 9-15 (2008), *available at* http://cisgw3.law.pace.edu/cisg/biblio/bonell4.html; STUDY GROUP ON EUROPEAN CIVIL CODE AND THE RESEARCH GROUP ON EC PRIVATE LAW, PRINCIPLES, DEFINITIONS AND MODEL RULES OF EUROPEAN PRIVATE LAW: DRAFT COMMON FRAME OF REFERENCE (DCFR), 1-40 (Study Group on European Civil Code and the Research Group on EC Private Law,eds., Sellier 2008); Jan M. Smits, *The Draft-Common Frame of Reference (CFR) for a European Private Law: Fit for Its Purpose?*, 15 MASST. J. EUR. & COMP. L.

The paper entitled "Developing Global Transnational Harmonization Procedures for the Twenty First Century—The Accelerating Pace of Common Law and Civil Law Convergence"[2] *presented at the 13th Biennial Conference of the International Academy of Commercial and Consumer Law, reviewed the procedural options for addressing the new harmonization challenges and opportunities which the Twenty First century presents.*[3]

Noting the wide variation in consumer law in the domestic law of states around the world and the anticipated difficulties and probable inability to achieve broad based acceptance and enactment of any proposed harmonization of consumer law, organizations like UNCITRAL and UNIDROIT explicitly exclude consumer transactions from the International Sale of Goods Convention and the Principles of International Commercial Contracts.

Utilization of hard law harmonization techniques (i.e., conventions, model laws, regulations or directives by the European Community) would therefore not be broadly accepted for enactment or implementation. Exploration of procedures and methods for utilizing soft law techniques to be voluntarily incorporated by parties to consumer contracts is an alternative method for offering a harmonized approach to interested parties. The comments that follow provide initial observations regarding use of this approach to achieve benefits for consumer and business parties to consumer agreements.

I. INTRODUCTION—THE STATUS OF E-COMMERCE AND CONSUMER SALES AT THE OUTSET OF THE TWENTY-FIRST CENTURY

Just as the UNIDROIT Principles of International Commercial Contracts[4] is a valued aid to the global harmonization of commercial contract law, a comparable aid to the global harmonization of consumer contract law is beneficial.

The elevation of the European Union (EU) harmonization process to the global arena takes advantage of the enriched frame of reference offered by the EU harmonization process and related work underway elsewhere. Further, the EU harmonization process affords consumers

145 (2008); *see also* Norbert Reich, *Transnational Consumer Law—Reality or Fiction?*, 41 UCC L.J. 67 (2008).

2. Louis F. Del Duca, *Developing Global Transnational Harmonization Procedures for the Twenty First Century—The Accelerating Pace of Common Law and Civil Law Convergence*, 42 TEX. INT'L L.J. 625 (2007), *available at* http://tilj.org/docs/J42-625_Del_Duca.pdf.

3. *See id.*

4. UNIDROIT Principles of International Commercial Contracts, http://www.unidroit.org/english/principles/contracts/principles2004/blackletter2004.pdf.

and business groups in the world trade community the opportunity to interact to develop a fair, rational set of principles that parties are free to incorporate into their consumer agreements. The emergence of the Internet provides a special incentive for such work. Yet although the emphasis of this article is on the Internet and on international sales, it should be understood that the Global Principles of Consumer Contracts to be developed under this initiative are not to be limited to either Internet sales or international sales of consumer goods or services. It should also be understood that the principles under this initiative are to be fair and balanced and not one-sided in either direction: they are to be balanced principles, reflecting the needs of both businesses and consumers.

Five hundred years ago, Erasmus wrote "*Immortal God! What a century do I see beginning!*"[5] We who live at the dawn of the Information Age can also say, "*What a century do we see beginning!*"

The 21st century is the "Age of the Internet." The Internet has evolved from a medium only for scientists and scattered experts to a resource for all of us. In recent years, globalization and the growth of electronic networking have advanced at an incredibly fast pace. New companies are continually emerging and are already gaining prominence throughout the world. E-commerce has now arrived in the homes of families all over the globe.

As laptop users with Internet connections, we can replace tiresome shopping trips with enhanced experiences. A few clicks on a screen enable us to see more items than we'd ever dreamed of, from clothing and iPods to tropical fruit and exceptional design. The Internet has brought these items only a mouse-click away from our cozy armchair. It is no wonder that this "burgeoning area of commerce . . . promises to be the most rapidly growing type of retail distribution for years to come."[6]

Although e-commerce has a wide-ranging influence on our lives, it has been accompanied by drawbacks. Several stems are still lacking petals when it comes to cross-border consumer sales. Several factors explain this phenomenon. The first is that many consumers still consider the Internet a lawless frontier. Haunted by doubts, consumers can never be absolutely sure of the actual consequences of agreeing to online "terms and conditions." The price sounds good, but what happens if:

5. Erasmus to Guillaume Budé (1517), *quoted in* JACQUES BARZUN, FROM DAWN TO DECADENCE: 1500 TO THE PRESENT; 500 YEARS OF WESTERN CULTURAL LIFE 8 (Harper Collins Publishers) (2000).

6. Ronald J. Mann & Travis Siebeneicher, *Just One Click: The Reality of Internet Retail Contracting*, 108 COLUM. L. REV. 984, 1010-1011 (2008).

- The arrangement of wine bottles I ordered arrives in pieces; or
- The trousers do not match the color that I saw on the computer screen; or
- The label on the goods is a counterfeit; or
- No goods were sent at all even though I paid for them?

Were any of these circumstances to arise, the next question consumers ask is, where do I go for relief? Considerations include:

- Which court will provide justice?
- What law applies?
- Would I be subject to any limitations of service, although I did not explicitly agree to them?
- Would I have to spend more money on attorney fees than the actual value of my transaction to receive what I hoped to buy?

A second factor when considering e-commerce is whether there is a sufficient level of protection for the legitimate interests of businesses when conducting sales over the Internet. Arguably, different legal systems have made great achievements in consumer and business protection. However, the benefits of these achievements are only guaranteed so long as the jurisdictional sphere covers the contract. The Internet does not stop at national borders; legislation, unfortunately, does. For this reason, an international consumer legal regime is desirable.

A third and final factor to consider with e-commerce is that some truly great harmonization steps have been taken in the field of international contracting, such as the CISG[7] and the UNIDROIT Principles[8]. Nevertheless, these regulations either do not apply to consumer contracts or apply only to a certain region or to certain transactions.[9]

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7. U.N. Convention on Contracts for the International Sale of Goods (CISG), April 11, 1980, 19 I.L.M. 668, http://www.uncitral.org/pdf/english/texts/sales/cisg/CISG.pdf.

8. UNIDROIT Principles of International Commercial Contracts, http://www.unidroit.org/english/principles/contracts/principles2004/blackletter2004.pdf.

9. *See*, e.g., Commission on European Contract Law, *The Principles of European Contract Law* (1999), *available at* http://frontpage.cbs.dk/law/commission_on_european_contract_law/index.html (setting forth the Principles of European Contract law that were drafted for consideration by the European Community. Although these principles have not been designed to apply globally, they have a broader scope than the CISG or UNIDROIT Principles. Like the U.S. UCC, they apply to consumer sales as well as commercial sales).

There is a clear need for a regulatory scheme that can overcome these difficulties, help shield consumers from e-commerce predators,[10] and simultaneously help businesses boost e-commerce by enhancing consumer trust.[11]

II. A SOFT LAW PROPOSAL FOR OPTIONAL GLOBAL USE

For commercial sales, two global aids serve the international community: the United Nations Convention on Contracts for the International Sale of Goods (CISG);[12] and the UNIDROIT Principles of International Commercial Contracts.[13]

The CISG is a treaty (*hard law*) that has been adopted by countries accounting for more than three-quarters of all world trade. The UNIDROIT work product is a set of principles (*soft law*), a "Restatement" or model law that has proven to be of immense benefit.[14]

At the moment, global aid to Internet consumer sales does not exist. Although it would be helpful if an acceptable global Convention on Contracts for the International Sale of Goods to Consumers could be

10. *See* Craigslist – About Scams, http://www.craigslist.org/about/scams.html (last visited Nov. 5, 2008) (providing examples of guidance on avoiding Internet scam and fraud attempts).

11. *See* Press Release IP/08/980, Brussels European Council, Gap Between Domestic and Cross-Border E-Commerce Grows Wider, Says EU Report (June 20, 2008), http://ec.europa.eu/consumers/strategy/docs/i08_980_en.pdf. This European Council Press Release indicates that:

> EU Consumer Commissioner Meglena Kuneva today announced the results of a new EU wide survey on e-commerce and cross border trade. The figures show that even though e-commerce is taking off at national level, cross-border e-commerce is failing to keep pace. From 2006 to 2008, the share of all EU consumers that have bought at least one item over the internet has increased significantly (from 27% to 33%) whilst cross border e-commerce is stable (6% to 7%). The pattern is similar for those with internet access at home—56% of consumers with internet at home have made a purchase (in any country including their own) by e-commerce compared to 50% in 2006, while only 13% (of those with internet access at home) made a cross-border e-commerce purchase compared to 12% in 2006.
>
> "These figures underline how much work we still have to do to boost confidence in the online internet market" said European Consumer Affairs Commissioner Meglena Kuvena. "Consumers and retailers are beginning to embrace e-commerce at a national level but internal market barriers still persist online. The potential of the online internal market to deliver greater choice and lower price to consumers and new markets for retailers is considerable. We need to redouble our efforts to tackle the remaining borders."
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> . . .
>
> Data gathering was carried out in February-March 2008 amongst more than 26,000 consumers and 7,200 businesses in the 27 EU-countries and Norway. *Id.*

12. *Supra* note 7.

13. *Supra* note 8.

14. *See* Bonell, *supra* note 1.

devised, that is not realistic at the present time.[15] However, a global soft law or set of Principles *is* realistic and we should aim to set one in place. It would be a consumer counterpart to the UNIDROIT Principles of International Commercial Contracts.[16]

Comparable to the case today under the UNIDROIT Principles,[17] an appropriate set of Consumer Principles could serve the world trade community as follows:

- The Global Consumer Principles as a model for national and international legislators;
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- The Choice of the Global Consumer Principles as the law governing the contract; and
-
- The Global Consumer Principles applied in dispute resolution.[18]

A shield can be a symbol of these Consumer Principles; for example, "consumershield.org" is a website domain name that has been registered on the Internet for this purpose.[19] The set of Consumer Principles, with its own website, could be presented as a voluntary code[20] for consumer contracts for cross-border Internet sales. Such a set of soft law principles would contain provisions relevant to concluding contracts for the sale of goods and services from e-merchants to consumers. The Consumer Principles very well could be a global tool to avoid and resolve disputes between contracting parties.

The applicability of these soft law principles would depend solely on the intent of the parties. Participation would be completely voluntary

15. *See* Hans Schulte-Nölke, Christian Twigg-Flesner & Martin Ebers, EC Consumer Law Compendium: Comparative Analysis (April 2007), *available at* http://ec.europa.eu/consumers/cons_int/safe_shop/acquis/comp_analysis_en.pdf (setting forth an 845 page report on challenges associated with efforts to devise a single, simple set of consumer contract laws for the European Community). *See also* EUROPEAN COMMISSION, DIRECTORATE—GENERAL FOR HEALTH AND CONSUMERS, EC CONSUMER LAW COMPENDIUM: THE CONSUMER ACQUIS AND ITS TRANSPOSITION IN THE MEMBER STATES 570 (Schulte-Nölke, Twigg-Flesner & Ebers eds., Sellier 2008).

16. *See supra* note 8.

17. *See id.*

18. *See supra* note 14 (referencing these applications of the UNIDROIT Principles of International Commercial Contracts).

19. *See* www.consumershield.org (last visited Nov. 7, 2008).

20. An example of the positive influence that voluntarism can exert can be found in the Sullivan Principles, the firms that have subscribed to them, and the impact they have had. *See* Global Sullivan Principles of Social Responsibility, http://www.thesullivanfoundation.org/gsp/about/governance/default.asp (last visited Nov. 7, 2008).

and would be effected via an explicit opt-in. E-merchants interested in participating could apply for a registration, which could be awarded to e-merchants subject to requirements, such as posting a bond, or providing a letter of credit from a reputable bank or a statement from a national registering authority. The register would be compiled, maintained and updated by "consumershield.org." Upon successful registration, the program would award a seal to e-merchants which they could present on their homepages with a link to "consumershield.org" thereby documenting their adherence to the relevant soft law principles of responsible e-commerce.

Consumers wishing to buy goods from registered e-merchants and to participate in complying with the Consumer Principles would be able to choose the applicability of the soft-law code by opting-in during their Internet purchase.

There could be a grievance procedure to enable consumers to comment on e-merchants and transactions.[21] This feedback would be reviewed by "consumershield.org," translated into statistics, and made readily accessible on the Internet to any consumer interested in doing business with a registered e-merchant.[22]

III. BENEFITS

The general benefits of such a program are obvious.

(1) The global soft-law code would be easily accessible since it would be available to e-merchants and consumers on a public website.

(2) The legal provisions applicable to e-commerce through the Consumer Principles would be available in different languages so users of many countries could access and understand them. The intent is to draft them carefully so the Consumer Principles would be easily understood.

(3) Consumer participation in the program would be free of charge and thus affordable for consumers around the world.

21. *See* RocketLawyer.com, http://www.rocketlawyer.com/documents/legal-form-Complaint+Letter+to+a+BBB+or+attorney+General.aspx?partner=111&HelpTopic=BBB+Info (last visited Nov. 7, 2008) (displaying an effective complaint mechanism involving the Better Business Bureau used in the United States and Canada). For other recommended approaches to grievance procedures, *see* also EBay.com—What steps can I take to protect when purchasing items on EBay, http://pages.ebay.com/help/tp/questions/avoid-fraud.html (last visited Nov. 7, 2008) (providing available approaches to grievance procedures); EBay.com—About Our Buyer Protection Programs, http://pages.ebay.com/help/tp/isgw-buyer-protection-steps.html (last visited Nov. 7, 2008) (providing information on buyer protection through PayPal transactions).

22. *See* the procedure along these lines offered by EBay, *id.*

(4) The approach is simple and quick because no lengthy discussions or ratification processes is necessary since the Consumer Principles would be soft law.

(5) The program would encourage mediation, which represents a potential way to resolve disputes usually recognized to be cheaper and more efficient than court proceedings.

(6) The approach mirrors the idea of contractual freedom because the parties voluntarily agree to have the Consumer Principles govern their contractual relationship.

Furthermore, there are several specific advantages to both the consumer and the e-merchant.

For the e-merchant: The added demonstration of credibility attained through registering for participation in the program should help e-merchants attract consumers from all over the world.[23] The e-merchant would also benefit from protective features applicable to its goods, services and transactions.

For consumers:

(1) Consumers, on the other hand, would not face legal insecurity with respect to hidden terms that contradict the principles recited in the program because they would be shielded from such terms.

(2) The shield would provide a powerful additional resource for consumers, namely, the complaint mechanism.[24]

(3) Consumers would have more confidence in purchasing goods that meet their special needs but that are not regularly sold without having to pay for intermediaries.[25]

(4) Finally, transactions would be conducted on a more level playing field because purchases would be subject to more evenly balanced contract terms rather than pre-drafted, one-sided terms.

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23. To be noted is the fact that the program may not be as important to the large firm with an established world-wide reputation. However, for other firms—businesses that can offer much value to consumers—a suitable program can be of considerable interest. Moreover, larger firms would benefit from added protections offered against counterfeits of their products.

24. *See supra* note 21 for description of such a complaint mechanism.

25. An added step to bolster consumer confidence in the integrity of businesses displaying the Consumershield could be to require a satisfactory independent evaluation report prior to granting the business the authorization to display the shield. For examples of such evaluations, *see* the reports provided pursuant to the International Company Profile service of the U.S. Department of Commerce. The U.S. Commerce Department profile reports provide considerable data on the business and include an assessment of the business' reputation. For a fee, the Consumershield Program could obtain profile reports of this nature from independent evaluation firms retained for this purpose. A global contract would reduce the costs of the reports. Businesses that wish to include the Consumershield logo in their advertisements would pay a fee for this privilege. The fees would defray the costs of the evaluation reports.

IV. ANTICIPATING DIFFICULTIES

The Consumershield approach will, of course, face some criticism. Its first deficiency is that it is *only* soft law. The main point here is that it is simply impossible to regulate every matter with hard law.[26] A prominent example is the Internet: no state or legal entity has succeeded so far in effectively regulating Internet activities. In addition, the approach is applicable internationally, whereas the political borders of a particular state that passes hard law also restrict it.

Additionally, people may question the authority of the program because it lacks the official approval of state authorities. Nevertheless, a uniform global law of consumer sales is not realistic at the present time. The Principles approach is much more flexible and universal so long as the interests of the parties, rather than national interests, give it life.[27]

Furthermore, doubt may be cast upon the necessity of such an approach because international choice-of-law rules or conflict-of-law rules already exist. Such rules, however, do not guarantee a result that is foreseeable, as a court might have to interpret an unfamiliar foreign provision, or, as Cardozo said, these rules are "more remorseless, more blind to the final cause than in other fields."

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26. Soft law offers the following advantages over hard law. Comparing a soft law such as Incoterms or the UNIDROIT Principles with a hard law such as the CISG:

- After a hard law has been enacted, if one sees a cavity, how can it be filled? How do you rectify errors you may detect? How do you implement improvements that you want to make? How do you implement improvements that you did not previously consider or that could not have been considered.
- As of July 2008, the CISG has been enacted by seventy-one separate national legislatures. Needs such as the above can be satisfied by hard law either by national re-enactments or by accommodating interpretations (or re-interpretations) of the hard law terms, neither of which provides a simple solution. It is much easier to devise soft law solutions. Take, for example, the realization some years ago of the growing importance of containerization. It was much easier for the ICC to implement an appropriate soft law accommodation. The ICC simply issued a new set of Incoterms that took proper cognizance of this development.

For related comments, *see* Kenneth W. Abbot & Duncan Snidal, *Hard Law and Soft Law in International Governance*, 54 INT'L ORG. 421 (2000), and Sandeep Gopalan, *A Demaneur-Centric Approach to Regime Design in Transnational Commercial Law*, 39 GEO. J. INT'L L. 327 (2008).

Devising the proper Consumer Sales Code for global use presents many challenges. Commencing on a soft law basis is the primary recommendation of this presentation. This permits us to take advantage of current wisdom in the field (wisdom coming out of Europe and elsewhere) and gives us the opportunity to readily adjust the principles we set forth to take advantage of future wisdom as it emerges.

27. Moreover, where contracting parties adopt the Consumer Principles, state-backed enforcement mechanisms *are* available—to the extent that the principle of freedom of contract is an integral part of the applicable governing law.

Finally, the approach's opponents might see it as a blunt tool because enforcing one's legal remedies might result in difficulties. Arguably, an approach that is based on the voluntary opt-in of parties depends to a large extent on their integrity and honesty. Trusting someone who is across the ocean from you is less promising. Cross-border enforcement always presents difficulties irrespective of the legal background on which it is based. In addition, a soft-law scheme has the characteristic feature of firing rifle shots and not shotgun blasts, simply because in the latter case nobody would opt-in.

In conclusion, even though the Consumershield approach would not offer perfect solutions, in many cases it can surely provide better ones.[28] As we saw with the UNIDROIT Principles, the global soft law for international commercial sales transactions whose future some doubted at the outset, has become a universally acclaimed success.[29]

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28. *See, e.g.,* Doreen Carvajal, *EBay Ordered to Pay 61 Million in Sale of Counterfeit Goods*, N.Y. TIMES, July 1, 2008, at 1, *available at* http://www.nytimes.com/2008/07/01/technology/01ebay.html?_r=1&sq=ebay&st=nyt&oref=slogin (highlighting a scam that led to a huge judgment against EBay. The scam was the sale of counterfeit Luis Vuitton bags and Dior perfumes by businesses utilizing EBay.com). The Consumershield program could not prevent scams such as this; however, it could shorten their duration. As currently visualized, e-commerce purchasers who click the Consumershield emblem presented on the homepage of participating businesses would obtain the following types of information:

- The consumershield.org Consumer contract provisions to which each participating business has agreed to abide;
- Information on how long the business has been a consumershield.org participant; and
- A report on unresolved complaints. *See supra* note 21 for data on a manner in which complaint mechanisms have been applied. Use of the Internet would help assure timely and current information on this subject.

Where there is a procedure such as this and a scam of the type reported in the *The New York Times*, consumers aware of the misrepresentation would have an opportunity to report it immediately to the program administrator. The business would be requested to respond. If the consumer's report is determined to be valid, notice to that effect could be posted; the business could be de-registered from the program, and, if a bond had been required to participate in the program, the bond could be forfeited.

The amount that owners of brands lose due to counterfeit goods is enormous. It may be that, because a properly devised Consumershield program can be a helpful response to such scams, owners of vulnerable brand names could be looked to for donations of funds to cover expenses associated with the meetings of the Working Groups referred to in Phase Three of the Action Plan described below. To achieve balance business representatives as well as consumer representatives will participate on the Working Groups formulating the specifics of the Consumershield program.

29. *See supra* note 14 for comments on the benefits being derived from these Consumer Principles.

V. A CAVEAT

Subject to one exception, none of the Consumershield proposals presented in this paper should be regarded as final-final. The one exception in which the proposals should be final is in the recognition of the desirability of a global set of Principles for Consumer Sales Contracts, a counterpart to the UNIDROIT Principles of International Commercial Contracts. Development of such a set of Principles should be resolved as a move-forward objective. All other observations and proposals presented in this paper should be regarded as tentative and subject to further refinement.[30]

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30. A possible Action Plan follows. It is patterned after the development of the CISG. The Working Groups that helped develop that Convention on Contracts for the International Sale of Goods commenced with texts that were primarily European accomplishments: the 1964 Hague Formation and Sales Conventions. After much deliberation over the course of many meetings, the Working Groups devised refinements that, in their judgment, were best suited to the global audience they served. The Consumershield Working Groups will have an opportunity to proceed in a similar manner. The Consumershield Working Groups can build upon the harmonization work underway in the European Community.

There are many aspects to the harmonization work underway in the European Community. In addition to the Principles of European Contract Law (PECL), whose Chapter 2 on Obligations of the Seller is very relevant, Viola Heutger classifies some of the related European aproaches to harmonizing private law into three channels: the Accademia dei Giusprivatisti Europei, the Acquis Group, and the Study Group on a European Civil Code. She introduces her helpful elaboration on these activities with the statement that:

> [The Academia] concentrates on an already existing codification and aims to create a whole civil code. [The Acquis Group] deduces some principles for European use from the already existing *acquis communautaire*. [The Study Group] is drafting principles on various fields of law on the basis of national legislation, the *acquis communautaire* and international instruments and will later combine these principles in a Civil Code. All three groups consist of international scholars and are all busy drafting principles on European Sales Law, as well as other parts of contract and patrimonial law.
>
> All of these academic groups have specific ideas on how their own results will later be used on a European level. The principles seek to serve different purposes. On the one hand, they will be an academic answer to the ongoing process relating to the EU-wide harmonization of contract law and will therefore offer their own dogmatic system. On the other hand, they could also be a model law for further comparative and legislative activities within European contract law. The principles may offer a solid basis for a common frame of reference as requested in the Commission's Action Plan on a more coherent European Contract Law. The Principles may serve as an optional instrument in cross-border transactions, allowing the parties simply to refer to this instrument as the applicable law. In addition, the principles may provide a solution when it proves impossible to establish the relevant rules of the applicable law. Like the PECL and the UNIDROIT Principles, the principles may be used to interpret or supplement international or European uniform law instruments and customs. (citations omitted).

VI. AN ACTION PLAN

Speaking in the context of the European Union, EU Consumer Commissioner Meglena Kuneva said:

> In the world we live in, we are not obliged to shop in the supermarkets and stores of our postal codes. We are not constrained to buy in our municipalities. We should also not be forced to shop within our national borders. . . . [T]here is no place . . . for artificial geographical restrictions which hold consumers back within national borders.[31]

While these comments are on target, they have a broader application than the European Union. We need a *global* set of Principles that takes cognizance of the fine work underway in Europe and also underway elsewhere.[32] The global set of Principles would be designed to benefit consumers and businesses of all countries.

The following is a four-phase Action Plan for the development and oversight of the requisite Consumer Principles and aid to consumers and businesses engaged in e-commerce.

Phase One: A Preliminary Articulation of Goals and Objectives

This paper has been prepared as a Phase One response.

Phase Two: The Refinement of these Goals and Objectives

A Dialogue Planning Group has been set in place to refine the goals and objectives of this endeavor and to review the Business Plan requisite to accomplishing them. The dialogues will be online and in print. The

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Viola Heutger, *Do We Need a European Sales Law?*, 4 GLOBAL JURIST Art. 1, 5-6 (2004), *available at* http://viola.heutger.de/artikelen/saleslaw.pdf.

All of this is relevant to and should be considered by those who wish to look at the subject on a broader global plane. The subjects Europe is focusing on merit consideration not only for that region, but also for markets of Asia, the Americas, Africa, the Middle East and Oceana. That is the primary thesis of this paper: these subjects merit examination on a global plane.

31. *See supra* note 11.

32. *See, e.g.*, AMERICAN LAW INSTITUTE - PRINCIPLES OF THE LAW OF SOFTWARE CONTRACTS, http://www.ali.org/index.cfm?fuseaction=projects.proj_ip&projectid=9 (last visited Nov. 7, 2008) (providing an overview of the Principles submitted for discussion at the Eighty-fifth Annual Meeting of the American Law Institute on may 19, 20 and 21, 2008). *See also* International Consumer Protection and Enforcement Network—homepage, http://www.icpen.org (last visited Nov. 7, 2008) (providing information about the Network, aimed at sharing information about cross-border commercial activities that may affect consumer activities, and to encourage cooperation amongst international law enforcement agencies); International Consumer Protection and Enforcement Network—Related Sites, http://www.icpen.org/related.htm (last visited Nov. 7, 2008) (listing other organizations concerned with consumer issues or e-commerce).

current participants in the Dialogue Planning Group are the following members of the International Academy of Commercial and Consumer Law: Yesimar Atamer, Immaculada Barral Viñals, Michael Joachim Bonell, Neil Cohen, Ross Cranston, Louis F. Del Duca, Mary Hiscock, Eva-Maria Kieninger, Donald B. King, Albert H. Kritzer, Hans Micklitz, Norbert Reich, Alex Schuster, Takis Tridimas, Kazuaki Sono, and Jay Westbrook. They are being joined by Margaret F. Moses, Dean for Faculty Research and Development at Loyola University, Chicago. The Secretary pro tem of the Dialogue Planning Group is Daniel Nagel of Heidelberg University.

A Consumershield blog will be set in place to facilitate the further sharing of insights on a global basis. In addition, the Internet website on uniform and harmonized international law of the Pace University School of Law,[33] and the popular LexMercatoria site[34] can serve as "bully pulpits" for sharing information on the program. A promotion of this initiative on the Pace Law School site[35] and on the LexMercatoria[36] site can bring the Consumershield program to the attention of an enormous global audience.[37]

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33. *See* Pace Law School Institute of International Commercial Law, http://cisgw3.law.pace.edu (last visited Nov. 7, 2008).

34. *See* LexMercatoria—homepage, http://lexmercatoria.net (last visited Nov. 7, 2008). A July 13, 2008 entry of "International Commercial Law" into a Yahoo Internet search form lists the Pace Law School site *First*, the LexMercatoria site *Second* and the Pace Law School site *Third* out of 444 million sites listed under this subject heading. A similar entry on a Google Internet search form lists the Pace Law School site *First* and *Second* and the LexMercatoria site *Fourth* out of 17.8 million sites listed under this subject heading. The third most prominent source for Internet searches, Microsoft's MSN, lists the Pace Law School site *Second*, *Third* and *Sixth* and the LexMercatoria site *Seventh* and *Eighth* out of 77.5 million sites listed there under this heading.

35. *See supra* note 33.

36. *See supra* note 34.

37. During the first six months of 2008, the Pace Law School site received 10 million Internet "hits," an average of over 50,000 per day. The "hits" have come from the following jurisdictions: Albania, Algeria, Andorra, Angola, Antigua & Barbuda, Argentina, Armenia, Aruba, Australia, Austria, Azerbaidjan, Bahamas, Bahrain, Bangladesh, Barbados, Belarus, Belgium, Bermuda, Bhutan, Bolivia, Bosnia-Herzgovina, Brazil, Brunei, Bulgaria, Burkina Faso, Cambodia, Cameroon, Canada, Chile, China, Colombia, Cook Islands, Costa Rica, Croatia, Cuba, Cyprus, Czech Republic, Denmark, Dominica, Dominican Republic, Ecuador, Egypt, El Salvador, Estonia, Ethiopia, Faroe Islands, Finland, France, Fiji, Gabon, Gambia, Georgia, Germany, Ghana, Gibralter, Greece, Greenland, Guatemala, Guinea, Guinea Bissau, Honduras, Hong Kong, Hungary, Iceland, India, Indonesia, Iran, Ireland, Israel, Italy, Jamaica, Japan, Jordan, Kazakhstan, Kenya, Republic of Korea, Kuwait, Kyrgyzstan, Laos, Latvia, Lebanon, Lesotho, Libya, Liechtenstein, Lithuania, Luxembourg, Macau, Macedonia, Maldives, Malaysia, Mali, Malta, Mauritius, Mexico, Micronesia, Moldova, Monaco, Mongolia, Morocco, Mozambique, Myanmar, Namibia, Nepal, Netherlands, Netherlands Antilles, New Caledonia, New Zealand, Nicaragua, Niger, Nigeria, Norway, Palestine Territories, Panama, Papua New Guinea, Paraguay, Peru, Philippines, Poland, Polynesia, Portugal, Qatar, Romania, Russian Federation, Saint Kitts & Nevis Anuilla, Saint Lucia, San Tome

Phase Three can begin when the goals and objectives of the endeavor have been sufficiently developed.

Phase Three: Formation of Working Groups to Promulgate the Principles and Methodology to be Followed in the Design of elated Aids to Consumers and Business

We seek to develop global principles. Representation on the Working Groups should therefore be global. We also seek balanced principles. The Working Groups should therefore represent business interests as well as consumer interests.

The activities of the Working Groups could be sponsored by an academy, an institution accustomed to managing such work, or a consortium of universities dedicated to the advancement of world trade on a fair and equitable basis.

Phase Four: Formation of an Oversight Committee

Following approval of the Working Groups' recommendations, an Oversight Committee should be created. Incoterms work well—extremely well—and remain current, among other reasons, because they are revisited on a decennial basis. Once adopted, the Consumershield Principles should be revisited on an appropriate cycle.

VII. CONCLUSION

Moving the EU Consumer Law harmonization process to a global plane makes sense. A suitable Consumershield program can safeguard consumers' and merchants' interests. Further, the dialogues associated with the process can enhance domestic and global relations. The time to begin working on the process is now.

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and Principe, Saudi Arabia, Senegal, Singapore, Slovak Republic, Slovenia, Solomon Islands, South Africa, Spain, Sri Lanka, Sudan, Sweden, Switzerland, Syria, Taiwan, Tanzania, Thailand, Togo, Trindidad & Tobago, Tunisia, Turkomenistan, Turkey, Turks & Caicos Islands, Uganda, Ukraine, United Arab Emirates, United Kingdom, United States, Uruguay, Uzbekistan, Vanuatu, Venezuela, Viet Nam, Yugoslavia, Zambia and Zimbabwe.

An extremely high rate of usage can also be reported for the Lex Mercatoria site.

Personal Property Security Law Reform in Australia and New Zealand: The Impetus for Change

Anthony Duggan & Michael Gedye*

Assume a period some time in the early part of the twentieth century. Country A introduced a telephone system some years back. Country B's government is now proposing to do likewise. A consortium of stakeholders, led by postal workers and stationery manufacturers, oppose the initiative on the ground that Country B has a postal service that works perfectly well. They point out that the postal service in Country A was always problematic because vast distances and harsh winters made deliveries unreliable but they say Country B does not have the same problems because it is much smaller and the climate is better. They concede that Country B's communications system could be improved, but they argue that only modest changes are needed: for example, the government might consider centralizing postal operations, which are currently run on a regional basis, and it might consider allowing postmen (no post-women in those days) to ride bicycles. They are ambivalent about a proposal to offer additional services, in particular, a telegram service, because they fear that telegram-writing might corrupt proper letter-writing. They argue that introducing telephones would be a bad idea because some people may have trouble learning to use them. There may be other adverse implications that have not occurred to anyone yet, and at least we know where we stand with the postal service. Question: how should Country B's government respond?[1]

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1. Anthony Duggan, Submission to the Australian Commonwealth Attorney General's Department on Review of the Law on Personal Property Securities: *Discussion Paper 1—Registration and Search Issues*, ¶ 2 (May 2007) (on file with author).

I. INTRODUCTION

Australian and New Zealand secured transactions laws share a common history. But they took different paths, at least temporarily, in 1999 when New Zealand enacted a Personal Property Securities Act[2] based on the Canadian version of Article 9 of the United States Uniform Commercial Code. Australian personal property security law reform lagged behind, but there has been renewed activity over the past two years or so, culminating in the release of a draft Personal Property Securities Bill a few months ago.

An interesting feature of the Australian and New Zealand experiences is the relative ease with which New Zealand managed the reform process and the equanimity, if not enthusiasm, with which the legal profession and other stakeholders greeted the proposals.[3] In Australia, by contrast, personal property security law reform at least until recently has been dogged by a lack of political will, at best lukewarm support from the banks and other financial institutions and strong opposition from within the legal profession. This difference is curious given the close cultural, economic and political similarities between the two countries, their geographical proximity and their commitment to the harmonization of Australasian business laws *via* the Australia and New Zealand Closer Economic Relations Trade Agreement.

Our aims in this paper are to: (1) explain why lawyers tend to oppose Article 9-type personal property security law reform; (2) critically analyze the reform opponents' main arguments; and (3) identify the key factors behind the impetus for change in Australia and New Zealand. We also comment briefly on the Australian Draft Bill and the New Zealand PPSA, with emphasis on the dangers of re-inventing the wheel. This is a lesson which the New Zealanders, to their credit, for the most part have taken to heart but which, to the potential prejudice of a successful legislative outcome, the Australians continue to ignore.[4]

In Part II, below we provide a short historical account of the reform movements in the two countries. In Part III, we compare and contrast the legal profession's reactions to the reforms in Australia and New Zealand. In Part IV, we identify the factors that provided the impetus for change, looking first at Australia and then New Zealand. In Part V, we make

2. *See* Personal Property Securities Act 1999 (N.Z.) [hereinafter NZPPSA 1999].

3. Although there was a considerable time lag between the date when the proposals for Article 9-type reforms were first floated in New Zealand and the enactment of the legislation. *See* Part II B, below.

4. Although the New Zealand legislation does depart from the Canadian model in a number of respects. *See* Part V B, below.

some brief remarks about the recently released Australian Draft Bill, followed by some observations about the New Zealand PPSA. Part VI concludes.

II. HISTORICAL BACKGROUND

A. Australia

The defects in the Australian personal property security laws have been well documented.[5] The history of proposals for law reform has been long and tortured and this, too, has been well documented.[6] But for David Allan's unflagging efforts, the cause may well have been lost for good in 1993, following the Australian Law Reform Commission's ill-considered recommendations for a home-grown PPSA.[7] Professor Allan almost single-handedly managed to keep the issue alive, by convening stakeholder workshops at Bond University in 1995 and 2002,[8] by exploiting his connections with the Banking Law Association and, generally, by taking every available opportunity to prod reluctant governments into action.

The current chapter in the saga was sparked by a truly Pythonesque episode. The then Commonwealth Attorney-General, Philip Ruddock, was to be the keynote speaker at a combined Queensland Law Society/Queensland Bar Association symposium in 2005. He arrived early and, to kill time, decided to sit in on one of the presentations currently under way. By chance, the presentation he walked in on was Professor Allan making the case, again, for personal property security law reform. Allan's remarks captured Ruddock's attention and, at the end of the session, in an actualization of every academic's dream, Ruddock introduced himself, congratulated Allan on his presentation and

5. *See* AUSTRALIAN LAW REFORM COMM'N, REPORT NO.64, PERSONAL PROPERTY SECURITIES (1993), *available at* http://www.austlii.edu.au/au/other/alrc/publications/reports/64/Report_64.txt; *see also* Anthony Duggan & Simon Begg, Victoria Law Reform Commission & Queensland Law Reform Commission, *Personal Property Securities Law: A Blueprint for Reform* (QLRC DP, No.39 & VLRC DP No. 28) (1992); David E. Allan, Patrick Quirk & Nicole Martin, *Final Report-Workshop on Personal Property Security Law Reform*, 14 BOND L. REV. 8 (2002); Standing Comm. of Attorneys-General, *Review of the Law on Personal Property Securities—Options Paper* (Austl.) (2006), *available at* http://www.ag.gov.au/www/agd/agd.nsf/Page/ConsultationsreformsandreviewspersonalpropertysecuritiesreformPPSDownloads; Anthony Duggan, *Globalization of Secured Lending Law: Australian Developments*, 34 INT'L LAW. 1107 (2000); Anthony Duggan, *Personal Property Security Law Reform: The Australian Experience to Date*, 27 CAN. BUS. L.J. 17 (1996).

6. *See id.*

7. *See id.*; *see also infra* text accompanying note 15.

8. The proceedings of the 2002 workshop were published in a special issue of the *Bond Law Review*. *See* 14 BOND L. REV. (2002).

invited him to address the Standing Committee of State and Commonwealth Attorneys-General ("SCAG") at its next meeting.

Following this meeting, the attorneys formed a working group to examine the possibilities for reform and to develop proposals for further consideration.[9] This led to the publication by SCAG in April 2006 of a paper canvassing a range of reform options based on the New Zealand Personal Property Securities Act 1999 and an Allan-sponsored draft Bill.[10] In April 2007, the Council of Australian Governments agreed in principle to establish a national system for the registration of personal property security interests coupled with Commonwealth legislation to be supported by a referral of legislative power by the States to the Commonwealth.[11] Between November 2006 and April 2007 the Commonwealth Attorney-General's Department published three detailed Discussion Papers which signified a clear commitment in principle to Article 9-type reforms,[12] while in the May 2007 federal budget, the Australian government allocated $113.3 million over five years to fund the enactment of legislation and the development of a national on-line register.[13]

The most recent development was the release, on May 16, 2008, of a draft Bill for public comment with a submission deadline of August 15, 2008.[14] Sadly, Professor Allan died before these latest developments took place and so he will not see the fruits of his labours. On the other hand, he must have known that the signs were promising following the 2005 SCAG Meeting and the prospect of movement at last would have given him considerable satisfaction. Ironically, Philip Ruddock has also been denied the opportunity of seeing the project through to completion.

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9. *See* Australian Government Attorney-General's Department, *available at* http://www.ag.gov.au/pps [hereinafter AGA-GD].

10. *See supra* note 5.

11. *See* Personal Property Securities Reform, *supra* note 9.

12. *See* AGA-GD, *Discussion Paper 1: Registration and Search Issues* (2006), *available at* http://www.ag.gov.au/pps (follow "PPS Downloads" hyperlink; then follow "Registration and Search Issues" hyperlink); *see also* AGA-GD, *Discussion Paper 2: Extinguishment, Priorities, Conflict of Laws, Enforcement, Insolvency* (2007), *available at* http://www.ag.gov.au/pps (follow "PPS Downloads" hyperlink; then follow "Extinguishment, Priorities" hyperlink); AGA-GD, *Discussion Paper 3: Possessory Security Interests* (2007), *available at* http://www.ag.gov.au/pps (follow "PPS Downloads" hyperlink; then follow "Possessory Security Interest" hyperlink). For purposes of clarity, hereinafter we refer to these collectively as "Discussion Papers."

13. AGA-GD, *Media Release: Personal Property Securities Reform* (2007), *available at* http://www.ag.gov.au/pps (follow "PPS Downloads" hyperlink; then follow "Media Releases" hyperlink; then follow "Personal Property Securities Reform" hyperlink).

14. *See* Personal Property Securities Bill 2008 (Austl.) (Consultation Draft), *available at* www.ag.gov.au/pps (follow "PPS Downloads" hyperlink; then follow "Exposure Draft Personal Property Securities Bill 2008" hyperlink).

His party was voted out of office in the November 2007 federal election and his opposition counterpart, who is now in the driver's seat, will probably end up getting the credit for the initiative assuming it succeeds.[15]

B. *New Zealand*

The New Zealand reform history is almost as long but somewhat less tortured than in Australia. Defects in New Zealand's prior secured transactions law were documented from as early as the 1950's.[16] In 1967 the Legal Research Foundation, a highly regarded private law reform body that draws its membership from the legal profession, the judiciary and academia, commenced research into the possibility of reforming the New Zealand law by enacting a secured transactions statute based on Article 9, as was then occurring in Ontario. Around the same time, Professor Riesenfeld, a North American academic who was visiting New Zealand, famously described the then New Zealand law as a "quagmire," a metaphor that proved to be enduring.[17] Further calls for reform were made in 1973, 1982 and 1984.[18] But the most important initiatives came from the New Zealand Law Commission in 1988 and 1989 with the publication of its Preliminary Paper No. 6, *Reform of Personal Property Security Law,* and Report No. 8, *A Personal Property Securities Act for New Zealand*, both publications strongly endorsing the enactment of an Article 9 type regime. The authors of the initial report described the problem in the following terms:

> The law relating to security over chattels and intangibles in New Zealand is in a mess.... The principal reason for the mess is that New Zealand inherited the English Bills of Sale legislation (itself a

15. The new Attorney-General is Robert McLelland. In an address to the Institute for Factors and Discounters on 6 March 2008, he gave credit to a previous Labor government for initiating personal property security law reform in the 1990s and went on to give his own government credit for "injecting renewed vigour into the regulatory reform agenda." Robert McLelland, Australia Attorney General, Institute for Factors and Discounters (IFD) Annual Luncheon Speech (Mar. 6, 2008), *available at* http://www.ag.gov.au/pps (follow "PPS Downloads" then follow "Media Releases" hyperlink; then follow "IFD Annual Luncheon" hyperlink).

16. *See generally* Cain, *The Chattels Transfer Act: Oddities and Oddments,* 35 NZLJ 86 (1959).

17. *See* S. Reisenfeld, *The Quagmire of Chattels Security in New Zealand* (Auckland: New Zealand, Legal Research Found. 1970). The metaphor was frequently repeated over the years. For example, *see* The New Zealand Law Commission's Preliminary Paper 6, *Reform of Personal Property Security Law,* at 10 (1988).

18. *See* The Contract and Commercial Law Reform Committee 1973 Chattels Securities Report to the Minister of Justice; Mr. D. F. Dugdale's 1982 report on Australian developments; *and* a 1984 Ministerial Working Party review of registration of company charges.

> mess) and the relevant provisions of the companies legislation (an incomplete security system) and adapted them to local needs, sometimes in a desultory way.[19]

Farrar and O'Regan identified the main reasons for the then unsatisfactory state of the New Zealand law as being.

> (a) the lack of any functional basis for the law;
>
> (b) conceptual difficulty and confusion;
>
> (c) the incompleteness and incoherence of the statutory registration schemes.[20]

These reasons are as applicable in Australia and the United Kingdom (and indeed elsewhere) as they then were in New Zealand.

Although the New Zealand Law Commission and its advisers saw an urgent need for reform,[21] another 10 years passed before the New Zealand Personal Property Securities Act was finally enacted in 1999. The delay was not due to any significant stakeholder opposition; in contrast to Australia and the United Kingdom, affected groups either actively supported the reforms or at least did not oppose them. The delay was due in part to the priority given to company law reform at large, in part to the absence of a particular champion within government to promote the reforms and in part to a desire to await the outcome of Australian reform initiatives. However, when by 1993 there still seemed to be no immediate prospect of Australia adopting a similar secured transactions regime, New Zealand decided to go it alone. In March 1993, the Minister of Justice gave the green light to the Law Commission's recommendations. There was no change to this position when later in 1993 the Australian Law Reform Commission produced what New Zealand regarded as unsatisfactory proposals for Australia. But it was not until the commercial law reform responsibilities of the Ministry of Justice were transferred to the Ministry of Economic Development, which doubtless saw the potential economic benefits of the reform more clearly than the Justice Ministry, that real progress was

19. Preliminary Paper No. 6, *Reform of Personal Property Security Law*, at 10 (1988) (reporting by Professor John Farrar and Mark O'Regan to the New Zealand Law Commission).

20. *Id.*

21. "We believe that the time has come to stop talking about the inadequacies of the current law relating to personal property securities which have been recognised for over 20 years, and to take immediate action to reform the law to overcome those inadequacies." *Id.*

made. The Ministry of Economic Development reviewed and endorsed the Law Commission's proposals and the legislation was finally enacted in 1999.

III. THE LEGAL PROFESSION'S REACTIONS

A. Australia

It is probably fair to say that, up until the most recent events described above, the legal profession in Australia was, by and large, at worst hostile and at best indifferent to Article 9-type reform of the personal property securities laws. There were at least five inter-related factors to which this essentially negative response can be attributed.

1. The Difficulty of the Subject-Matter

The law of secured credit is not easy. It comprises elements of corporate law, sale of goods and hire-purchase law, mortgage law, property law and the law of contracts as well as numerous registration statutes, many of them technical and arcane. Lack of sufficient expertise across all these subject areas almost certainly left many lawyers incapable of properly assessing the case for reform. For those uncertain about change, the *status quo* will often be the most comfortable option. In other words, uncertainty promotes a "better the devil you know" kind of response: see, further, *(No.5)*, below.

2. The Nature of the Legislation and the Unfamiliarity of Key Concepts

Compounding the difficulty of the basic subject-matter is the opaqueness of the Article 9 model and the unfamiliarity of its key concepts. Unlike the ordinary run of statutes, it is not possible to read Article 9 or a Canadian PPSA from cover to cover and come away with a working knowledge of what it is about. Article 9 has its own internal logic which requires mastery before the secrets of the statute can be unlocked.

The key concepts of attachment and perfection and the relationship between them are part of this internal logic. Attachment and perfection are simply old wine in new bottles, in other words, they are no more than new and economical means of expressing well-established common law principles. However, there is a tendency for the novelty of the expressions to mask the familiarity of the ideas they represent and this can make newcomers to the legislation nervous. The Article 9/PPSA priority rules and the relationship between them are another source of

anxiety. The rules are for the most part easy to apply in practice, but they can be hard to understand in the abstract and it is in the nature of things that the newcomer to the legislation is likely first to encounter the rules in the abstract.

3. Distrust of American Law

At least until recently, the Australian legal tradition was a strongly Anglo-centric one. There was a heavy emphasis in law schools on English cases; far more graduate students went to Oxford or Cambridge than to Harvard or Yale. Courts regularly cited English authorities and much less frequently relied on case law from other jurisdictions and much Australian statute law, particularly in the commercial area, was English in origin (the Companies Acts, the Bills of Exchange Act, the sale of goods legislation, the bills of sale statutes and the hire-purchase laws are a few examples that come readily to mind). In summary, if the need arose for law teachers, courts and legislatures to borrow, the tendency was to look to England. The tendency is somewhat less pronounced these days (for example, Australian courts now quite regularly cite Canadian cases and even, occasionally, American ones, while, on the legislative front, the States have replaced their English model money-lending and hire-purchase laws with American style truth-in-lending and consumer credit laws). On the other hand, old habits die hard and the bias persists. American law and legal institutions are more alien than English ones and, therefore, are liable to be treated with suspicion. Article 9 is doubly cursed in this regard: not only is it American, but also it is markedly different in style and approach from the English model laws Australian practitioners are used to.

4. The Irresistible Urge to Reinvent the Wheel

Perhaps partly on account of the factors identified in *(No.2)* and *(No.3)*, above, law reformers who support the basic Article 9/PPSA philosophy have nevertheless proved reluctant to copy the Article 9/PPSA drafting. There is a tendency to think we can do it better ourselves and also to assume, without proper inquiry, that differences in Australian economic conditions, financial transactions and legal practice justify departure from the North American model. The Australian Law Reform Commission's 1993 report on personal property securities is the most prominent example of this way of thinking. One problem with taking a radically different drafting approach is that it increases the risk of error. Article 9 and the PPSAs have been tried and tested and they are the product of careful and extensive deliberation. New legislation, drafted in haste, might not work as well—or at all. A decision to

reinvent the wheel puts a premium on knowing what you are doing and why.[22] The Australian Law Reform Commission's view was that the Article 9/PPSA model was unsuitable for adoption in Australia because it was too radically different in substance and drafting style from current Australian laws. The ALRC preferred to reinvent the wheel, producing a draft bill which looked nothing like Article 9 or the PPSAs. The bill was roundly criticized by the ALRC's North American consultants and, while this was a justified reaction, it had the effect of fuelling stakeholders' doubts about the wisdom of reforming the law at all.[23]

5. Better the Devil You Know

The factors identified in 1-4, above, all contributed to a "better the devil you know" attitude: law reform may make things worse and, to avoid the risk, we should stick with the tried and true. What we have may not be optimal, but at least we know where we stand. The concern with transition costs, including the costs to lenders and their legal advisors of becoming familiar with the new legislation and adapting documents and systems, is a variation on the same theme. There is no denying that Article 9-type reforms involve transition costs but, as the Canadian experience demonstrates, these costs are substantially outweighed by the benefits over the longer term. A fixation on transition costs can easily develop into the "better the devil you know" attitude described above and this, in turn, tends to stultification.[24]

Times have changed and there is more support now for the reforms within the legal profession than there used to be. Nevertheless, there is still some significant opposition, particularly from a number of the larger law firms. The Law Council of Australia's submissions on the 2006-2007 Discussion Papers[25] reveal a sharp division of opinion. The submissions endorse "efforts to reform this area of law" and acknowledge that "the existing system is unnecessarily complex, with gaps, inconsistencies and out-dated formal requirements." However, they go on to say:

> members of the Committee have not been able to reach a consensus as to whether some aspects of the reform should be supported. These include:

22. *See* Jacob S. Ziegel, *Canadian Perspectives on Chattel Security Law Reform in the United Kingdom*, 54 CAMBRIDGE L.J. 430, 441 (1995).

23. *See Personal Property Security Law Reform*, *supra* note 5, at 181-84.

24. The new Attorney-General acknowledged this point in his address to the Institute of Factors and Discounters: "The reforms have encountered several road blocks along the way. For many, it was easier to live with the existing complex and expensive system than to change it." *See* McLelland, *supra* note 15.

25. *See* Discussion Papers, *supra* note 12.

- codification of the general law relating to security interests or otherwise altering the existing substantive law except where a specific need exists;

- enshrining the "in substance" or "functional" approach as a key feature of the reforms; and

- re-characterising interests that are not formally security interests as security interests for the purpose of registration or otherwise.

While some members of the Committee support these reforms, others oppose them.[26]

Contrary to what the opening words imply, these points of disagreement go to more than matters of detail. They are fundamental to the entire Article 9 endeavour. As such, they are inconsistent with the broad statements of support for the reforms which appear in the submissions' opening paragraph.

The reform opponents' main objections can be summarized as follows:

- the Article 9/PPSA model is too complex;

- Article 9 is not relevant to Australia; and

- Article 9's functional approach to secured transactions confuses ownership with security interests.

These are similar to the objections raised by professional organizations[27] to the Law Commission's 2004 proposals[28] for Article 9-type reforms in England and Wales.[29] The following is a short critical account of the points listed above.

26. Financial Services Committee, Business Law Section, Law Council of Australia, *Review of the Law on Personal Property Securities: Submission in Response to Discussion Paper 1: Registration and Search Issues* (June 2007), ¶¶ 1, 2. These statements were repeated in the submissions on Discussion Papers 2 and 3.

27. The main opposition came from the Financial Committee of the City of London Law Society, *see* LAW COMM'N, CO. SEC. INTERESTS, 2005, CM. 6654, and the Association of Business Recovery Professionals.

28. *See* LAW COMM'N, CO. SEC. INTERESTS: A CONSULTATIVE REPORT, 2004, Consultation Paper No. 176.

29. *See* Jacob Zeigel, *The Travails of English Chattel Security Law Reform—A Transatlantic View*, 2006 LLOYD'S MAR. & COM. L.Q. 110 (2006) (providing a critical account of both submissions); *see also* Hugh Beale, *The Exportability of North American*

a. The complexity of Article 9

According to the Law Council of Australia's submissions, the main reason for opposition to the proposed reforms is "the significant increase in complexity of the laws" the reforms would entail" and this is "a compelling reason" not to adopt them.[30] The following is a fuller statement of this concern:

> [t]he proposed priorities regime . . . is significantly more complex than the existing rules applying under Australian law. . . . Although there will be a new registration system, covering a broader range of security interests, registration will not determine priority in all cases. The outcome of any particular priority dispute may depend on the order of registration of security interests, the 'category' of personal property over which the competing security interests are held and the way in which both the grantor of the security interest and the holders of the competing security interests held the property.
>
> The complexity of the NZ priority regime is evidenced by the manner in which the legislation classifies personal property. There are seven primary categories of personal property including chattel paper, documents of title, goods, intangibles, investment securities, money and negotiable instruments. The definition of goods alone contains nine sub-classifications, including consumer goods, equipment and inventory.
>
> Under the NZ regime there are approximately 70 priority rules. There is no need to adopt such a complex set of priority rules. This complexity undermines the certainty that a single register system is intended to provide.[31]

Chattel Security Regimes: The Fate of the English Law Commission's Proposals, 43 CAN. BUS. L.J. 178 (2006).

30. *See* Financial Services Committee, *supra* note 26. *See* Financial Services Committee, Business Law Section, Law Council of Australia, *Review of the Law on Personal Property Securities: Submission in Response to Discussion Paper 2*, at 1 (2007). The committee repeats its opposition in its submission on Discussion Paper 3. *See* Financial Services Committee, Business Law Section, Law Council of Australia, *Review of the Law on Personal Property Securities: Submission in Response to Discussion Paper 3*, at 1 (2007).

31. Angela Flannery & Greta Burkett, *Personal Property Securities Reform in Australia*, 23 AUSTL. BANKING & FIN. LAW BULL. 23, 24 (2007). The authors are both with Clayton Utz, a leading law firm. The passage is not a fair or accurate reflection of the New Zealand legislation. We are unsure how Flannery and Burkett arrived at the figures they quote. There are three subcategories of goods: consumer goods, equipment, and inventory. Other types of goods, such as crops, are mentioned out of an abundance of caution to preclude any possible argument they are not goods. Motor vehicles and aircraft are subject to serial number registration requirements, but it is no more accurate

The complaint that there are too many rules calls to mind the Austrian Emperor Joseph II's reputed gripe to Mozart that *Don Giovanni* had too many notes, and it is hardly less fatuous. The key question, of course, is too many compared to what? According to the Attorney-General's Department's reckoning, there are currently "at least 77 separate Acts governing PPS in Australia, administered by 30 separate Commonwealth, State, and Territory government departments and agencies."[32] Moreover, as Discussion Paper 1 points out:

> registration and search vary according to jurisdiction, the nature of the collateral, the kind of security interest or whether the debtor is a natural person or a company. Some interests are required to be registered on more than one register to gain protection while for others there is no available register at all.[33]

It is hard to accept the assertion that the proposed legislation is more complex than the current laws, and it is ironic that the number of priority rules the critics say the proposed legislation contains almost exactly matches the number of registration statutes the new law will replace. Moreover, as Ziegel points out in the context of the English debate on personal property security law reform, the implication that the current laws are "clear, flexible and predictable" relative to the Article 9/PPSA model is belied by the volume of secured lending transactions that are "successfully concluded each year in Canada and the U.S."[34]

b. The Irrelevance of Article 9

A partner in one of the leading Australian law firms was reported in the *Australian Financial Review* 12 months ago as saying that Article 9 was introduced in the United States "in 1951 and in the context of a legal system which didn't recognize equity."[35] The revelation that there was no equity in the United States will no doubt come as a posthumous shock to the likes of James Kent, John Pomeroy, and Joseph Story, and it is

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to refer to them as a subcategory than it would be for any other type of goods. We have never counted the number of priority rules—there seems little point—but the prudent secured creditor who registers need be concerned with only a few.

32. AGA-GD, *Review of Personal Property Securities Information Sheet* (Nov. 2006), *available at* http://www.ag.gov.au/pps (follow "PPS Downloads" hyperlink; then follow "Additional Downloads" hyperlink; then select "PPS reform information sheet"). The legislation is listed in Attachment D of the Department's *Options Paper*. *See* Standing Comm. of Attorneys-General, *supra* note 5, at 24-25.

33. *See Discussion Paper 1: Registration & Search Issues*, *supra* note 12, at 1.

34. *See* Zeigel, *supra* note 29, at 118.

35. *See* Marcus Priest, *Need for Federal Plan Questioned*, AUSTL. FIN. REV., June 1, 2007, at 63.

unclear whether the speaker was being deliberately mischievous or was simply uninformed.

A third, and perhaps more likely, possibility is that the speaker was misquoted, and what she meant to say was that United States law did not recognize the floating charge and Article 9 was enacted to cure this deficiency. The implication is that, because the floating charge is part of Australian law, there is no need for Article 9-type reforms in Australia. The argument overlooks the fact that the floating charge *was* part of pre-PPSA law in Canada and New Zealand, but this did not stop the Canadians or New Zealanders from going down the Article 9 road.

The truth, of course, is that the need to reverse *Benedict v. Ratner*[36] was only one reason for the enactment of Article 9. Aside from the lack of the floating charge, pre-Article 9 secured lending law in the United States had many of the same features as the current Australian law, including "a multiplicity of legal, equitable and statutory security devices each with its own rules, many of them quite unsuited to modern financing requirements and leading to equally uncommercial results."[37] The need to reduce the number of registers is reason enough for reform, but, as most law reformers have discovered, it turns out to be hard to achieve this objective without also introducing substantive rules that are uniform across the different forms of transaction.

c. The Heresy of Article 9

The third commonly voiced objection to the Article 9 model is that "hire-purchase agreements, conditional sale agreements and other quasi-securities are not true security interests and should not be governed by the same principles as apply to mortgages and charges. To merge the two . . . is to confuse what 'I owe' with what 'I own.'"[38] The argument goes to the heart of Article 9's functional approach to the treatment of secured transactions and, at least as commonly presented, implies that a registration requirement is warranted for mortgages and charges, but not for hire-purchase agreements, conditional sales, and the like. This, of course, amounts to a defence of the *status quo* as represented by the system for registration of company charges.

By way of justification for discriminating between forms of transaction, Flannery and Burkett argue that extending the registration

36. Benedict v. Ratner, 268 U.S. 353 (1925) (determining that debtor could not use proceeds from accounts because using the proceeds would preclude the effective creation of a lien).

37. *See* Ziegel, *supra* note 29, at 115.

38. This is how Ziegel states the argument before dismantling it. *See id.* at 116. For a statement of the argument in the Australian context, see Flannery & Burkett, *supra* note 31.

requirement to title retention arrangements may lead to parties being taken unfairly by surprise:

> the consequences of non-registration are severe. If a security interest is not registered it may be defeated by other secured creditors of an insolvent debtor. For lessors, suppliers and consignors, this will mean that they may lose title to their goods if they inadvertently fail to register their interests on the new register.[39]

As it happens, the first two cases decided under the New Zealand PPSA, *Graham v. Portacom NZ Ltd*[40] and *Waller v. New Zealand Bloodstock*[41] involved this very scenario of lessors failing to register, and, at least in Australia, both cases have become rallying points for opponents of the new law.[42]

However, any concerns these cases have prompted are misconceived. The potential for unfair surprise in the new laws is no more than an aspect of the transition costs parties face in adapting to the new regime.[43] These transition costs are justifiable on the assumption that they will be outweighed by the benefits of the new law in the longer-term. Moreover, if there is a problem, it will likely prove to be self-correcting. It should take only one or two cases like *Portacom* and *New Zealand Bloodstock* for lessors, suppliers and consignors to get the message that the new law applies to them and that they need to register financing statements.[44] It can safely be predicted that there will not be too many more cases like this in New Zealand and that the courts will be free to turn their attention to more interesting questions.

B. New Zealand

As mentioned earlier, stakeholder groups in New Zealand, including lawyers, either actively supported the proposed personal property

39. *See* Flannery & Burkett, *supra* note 31, at 23-24.

40. Graham v. Portacom N.Z. Ltd., [2004] 2 NZLR 528 (H.C.).

41. Waller v. N.Z. Bloodstock Ltd., [2004] 2 NZLR 549 (H.C.).

42. The Australian government was sufficiently persuaded by these arguments to include in the draft Personal Properties Securities Bill 2008 a provision aimed at protecting the holder of an unperfected security interest pursuant to a true lease or consignment from the consequences of the rule that an unperfected security interest is invalid in the debtor's bankruptcy or liquidation. *See infra* app. pt. t (k). The provision is arguably misguided for the reasons stated in the text and Appendix.

43. The real surprise in *Portacom* and *New Zealand Bloodstock* is that the lessors failed to register, despite extensive campaigns by government and professional bodies aimed at informing affected persons of the need to do so. *See Portacom*, 2 NZLR ¶ 6; *N.Z. Bloodstock*, 2 NZLR ¶ 7. What is more, in *Portacom* it was clear that the lessor had taken proper legal advice about the new law and, apparently, chose to ignore it. *See Portacom*, 2 NZLR ¶ 5.

44. *See* discussion *supra* note 43.

security law reforms, or at least did not oppose them.[45] How did New Zealand overcome the "better the devil you know" response which dominated the Australian scene for so long? The supportive attitude of the New Zealand legal profession, and the neutrality of New Zealand's financial institutions (to suggest that financial institutions actively supported the reforms may be to put it too highly) represented significant differences from the Australian and British experiences with secured transactions law reform.

But perhaps the defining difference was the grass-roots involvement of the legal profession in New Zealand. Senior members of the profession, who had daily experience of the deficiencies of the old secured transactions regime, often led the reform initiatives. The Legal Research Foundation, one of the early promoters of reform, was a joint venture between practitioners and academics. The Contracts and Commercial Law Reform Committee, which in its 1973 report to the Minister of Justice endorsed the reform proposals, had practitioner membership. The Government commissioned reports from leading practitioners in 1982 and 1984. And, perhaps most significantly, when the Law Commission was tasked with reviewing the law on the registration of company charges, it initially engaged John Farrar and Mark O'Regan (then a senior commercial lawyer) to prepare a preliminary report and subsequently established an advisory committee of specialists comprising five senior practitioners (two of whom were later appointed judges and now sit in the Supreme Court and Court of Appeal) who were partners in five out of the eight largest national law firms, together with Farrar, David McLauchlan and Bob Dugan.[46] The seniority and calibre of the Advisory Committee's members ensured that it had immediate credibility.

Although there was no orchestrated promotion of the reform proposals, the Advisory Committee widely circulated a draft of its report and was encouraged by the support received from stakeholders. The Advisory Committee received no opposing submissions. Prior to this, the recommendation in the Farrar and O'Regan report to adopt an Article 9 regime was presented "and generally applauded"[47] at a series of insolvency law seminars across New Zealand.

The New Zealand reformers not only resisted the urge to reinvent the wheel, but also actively discouraged it. No doubt this was in part due

45. *See supra* text accompanying note 3.

46. At that the time, Professor Farrar was on the Faculty of Law at University of Canterbury, Christchurch, while Professor MacLauchlan and Mr. Dugan (not to be confused with the co-author of the present paper) were both on the Faculty of Law at Victoria University, Wellington.

47. *See* Preliminary Paper No. 6, *supra* note 19.

to an unrealistic time frame given to the Advisory Committee to submit its recommendations. After Farrar and O'Regan's preliminary report recommending the adoption of an Article 9 regime, the Advisory Committee was given a bare 6 months to come up with a final recommendation and draft legislation. The Committee, working on a *pro bono* basis, essentially met this deadline by working weekends and by basing the draft legislation on the British Columbia model. However, officials could not resist the urge to reinvent the wheel. The New Zealand Ministry of Economic Development's first draft bill departed radically from the North American model. For example, it based priority on the time of perfection (rather than the time of registration) and it required the registration of particulars of individual security agreements rather than merely details of the prospective collateral. A subcommittee of the New Zealand Law Society (the New Zealand practitioner body) spent many hours in meetings with Ministry officials endeavouring to convince the Ministry to return to the tried and tested Canadian model and in the end they substantially succeeded in doing so.[48]

New Zealand's history is characterised by a lack of opposition from financial institutions and industry groups. This is perhaps surprising given that all of the major New Zealand banks are Australian owned and some of the Australian parent banks at least initially opposed similar reforms in Australia. Some of the Australian bankers' opposition was engendered by Dr. William Gough, an expert on company floating charges, who was opposed to the reforms and who advised Australian banks. Gough also made his views known in New Zealand.[49] Perhaps, however, Australian institutional opposition did not take root cross the Tasman, because the financial institutions' local legal advisers were

48. Michael Gedye was a member of the New Zealand Law Society subcommittee. Nevertheless, the Law Society subcommittee was not wholly successful in convincing New Zealand officials to adopt the Canadian model. Officials insisted on following New Zealand drafting conventions as well as adopting some other home grown amendments against the subcommittee's advice. For example, the New Zealand Act lacks any provisions dealing with fixtures. Furthermore, for no good reason, only first ranking secured parties were given the right to enforce security interests. This latter anomaly has subsequently been rectified. *See* Personal Property Securities Act 1999 (N.Z.), 1999/126, s. 109. On the other hand, perversely the subcommittee was responsible for one notable omission from the New Zealand Act. The draft bill included provisions that were equivalent to the Canadian provisions dealing with competing priorities when collateral disposed of by the debtor was subsequently returned to the debtor. For unconvincing reasons, the subcommittee persuaded officials to delete these provisions from the New Zealand Act.

49. *See, e.g.*, William J. Gough, *The Law Relating to Chattel Security III: Toward a New System of Business Security Law*, N.Z. COMPANY DIRECTOR AND PROF'L ADMIN., Nov. 1979, at 72-79.

already on board with the proposed reforms and were able to steer their clients away from the Australian point of view.

It is also possible that New Zealand's experience with partial reforms to its secured transactions laws may have smoothed the way for more fundamental reform. For example in 1974 some relatively insignificant amendments to New Zealand's Chattels Transfer Act introduced New Zealand practitioners to the concept of the functional security interest.[50] Moreover, the 1989 Motor Vehicle Securities Act furthered the partial reforms through the creation of a national computerised registry and the transparent adoption of the time of registration as a priority point.[51] In this connection, Farrar and O'Regan's assessment of the Chattels Transfer Act is instructive:

> There is a core of good sense in the New Zealand Chattels Transfer Act. This is largely the result of indigenous reforms—the assimilation of bailment and hire purchase, the recognition to some extent of purchase money security interests, flexible agricultural securities, facilitation of stock in trade financing, the protection of the bona fide purchaser.[52]

In other words, New Zealand had already begun to reform their secured transaction laws and so the proposal for a fully-fledged Article-9 type regime may not have seemed such a big step.

IV. THE IMPETUS FOR CHANGE

A. Australia

There are perhaps three main reasons why the Australian proposals are now on the verge of success. The first, and most significant, is Philip Ruddock's conversion to the cause. The lesson the Australasian experience teaches is that good ideas are not enough and that reforms of this nature require broad support from within senior levels of government and from key stakeholders such as the legal profession (as seen in New Zealand). In Australia, Ruddock's arrival on the scene dramatically affected the course of events. The long years beforehand were characterized by a lack of leadership and commitment. The responsible government departments assumed a passive role, being prepared to enact legislation, but only after there were sufficient signs of support from the

50. *See* s.18A(3) of the now-repealed Chattels Transfer Act, 1924 (N.Z.)

51. Before this, time of registration could affect priorities under the Chattels Transfer Act, but the subject provision was undermined by subsequent provisions where knowledge was relevant.

52. Preliminary Paper No. 6, *supra* note 19, at 50.

banks and other key stakeholders. This was a recipe for inertia, given the prevalence of the "better the devil you know" attitude, and academics, for all their efforts, proved powerless to achieve the necessary momentum. Ruddock put together a team within the Attorney-General's Department to take control of the agenda. This group has been remarkably proactive in championing the case for reform and it appears to have succeeded in brokering a significant measure of stakeholder consensus. In summary, successful law reform requires a coalition of governments, stakeholders and reformers. Australia now seems to have achieved this coalition whereas England clearly has not.[53]

The second factor shaping the Australian developments has been the apparent success of the New Zealand PPSA. The fully electronic remote access New Zealand register has proven to be a significant drawcard with Australian stakeholder audiences and the Australian reformers have taken every opportunity to arrange for demonstrations. The observable efficiency of the New Zealand register as compared to the current Australian registration arrangements speaks more eloquently to the case for reform than any law reform report or law review article ever could. Aside from cases like *Portacom* and *New Zealand Bloodstock*, a related consideration is that financial institutions and legal practitioners in New Zealand appear to have managed the transition to the new regime without undue dislocation. The New Zealanders learned quickly to draw on Canadian secondary materials as an aid to understanding the new law and this lesson will not have been lost on Australian stakeholders.[54] In sum, the New Zealand developments have played an important part in reducing the levels of distrust and anxiety that Article 9-type reforms tend to provoke.

53. It is also noteworthy that personal property security law reform in Australia achieved a high level of bi-partisan support. Without this development, the project may have died following the change of government in 2007. Furthermore, the success of a national scheme depended on the cooperation of the States and Territories, all of which have had Labor governments since 2005. On the other hand, the Labor Party was not actively pushing for reform in the pre-Ruddock years and it is open to speculation whether it would have taken an interest at all had Ruddock not already put the issue on the political agenda.

54. For example, Mike Gedye teamed with Ron Cuming and Rod Wood to produce a New Zealand version of Cuming and Wood's very successful PPSA Handbook series. *See generally* MICHAEL GEDYE, RONALD C.C. CUMING & RODERICK J. WOOD, PERSONAL PROPERTY SECURITIES IN NEW ZEALAND (2002); *see also* LINDA WIDDUP & LAURIE MAYNE, *PERSONAL PROPERTY SECURITIES ACT: A CONCEPTUAL APPROACH* (2d ed. 2002). Linda Widdup is a Canadian legal practitioner, based in Edmonton and Laurie Mayne is a New Zealand lawyer. Linda Widdup has also collaborated with Tom Telfer on the PPSA sections of MORISON'S COMPANY AND SECURITY LAW (2004). Tom Telfer is a Canadian legal academic who taught for some years at the University of Auckland Faculty of Law.

The third key factor has been the involvement in the Australian reform process of lawyers, such as Craig Wappett and David Krasnostein, who have studied or practiced law in the United States and Canada and are familiar with the Article 9 and PPSA regimes. Wappett is a long-serving member of the Financial Services Committee of the Law Council of Australia's Business Law section, while Krasnostein was until recently Chief General Counsel at the National Australia Bank. Both have been strong supporters of the case for reform and they have proven to be influential in converting some, if not all, of their colleagues to the Article 9 cause.

B. New Zealand

The commitment to reform the companies' legislation including, but not limited to, the companies' charges provisions was a factor in the drive for personal property security law reform in New Zealand. This commitment to reform, however, was just the catalyst that got the proposals moving in the wake of many years' criticism of the old secured transactions regime. The Law Commission put it this way:

> The Commission's involvement in reform of this area of the law stems primarily from the Minister of Justice's request for a review of the Companies Act 1955 (Part IV of which deals with security interests created by companies). The need for our involvement has been reinforced by the weight of comments and submissions made to the Commission seeking comprehensive reform of chattel securities law.[55]

Even then, it is likely the reform initiative would have stalled if it were not for the dedication of the Commission's unpaid Advisory Committee comprised of senior practitioners and academics. A cynic might suggest that the Committee was given an unrealistic timeframe to formulate its recommendations and draft legislation in the expectation that it would not succeed. However, it took barely six months to produce a detailed analysis and a draft Act. In its report to the Minister of Justice, the Law Commission noted:

> All members of the [Advisory] Committee are widely experienced and expert in their professions with great demands upon their time. . . . The commitment of the Advisory Committee to the project is in part indicative of the need for reform in this area, and of current circumstances favourable to comprehensive and coherent reform. Prominent among those circumstances are advances in information

55. New Zealand Law Commission, Report No. 8, *A Personal Property Securities Act for New Zealand* (NZLC R8), at 1 (1989).

> technology, experience with reform regimes in various Canadian jurisdictions, and the opportunity provided by a comprehensive review of the Companies Act 1955.

Nevertheless, the Law Commission's plea for urgency was not enough to ensure prompt action. Although the Law Commission envisaged that a Personal Property Securities Act would be "enacted together with our virtually contemporaneous proposals for a new Companies Act,"[56] this did not occur. Instead, when the Companies Act was passed in 1993, it was necessary to bring forward, on a temporary basis, the registration of company charges provisions from the 1955 Companies Act.

While one can assume the Law Commission continued to stir the pot, the final impetus for reform came from the Ministry of Economic Development ("MED"). The MED took over responsibility for commercial law reform from the Ministry of Justice. No doubt mindful of the need to enact a permanent replacement for the temporary registration of company charges provisions, the MED would have been keen to demonstrate its commitment to its new responsibilities, and see an important reform through to a successful conclusion. After reviewing the Law Commission's recommendations, the MED advised the Government to proceed. A bill was drafted in 1998 and the legislation enacted in 1999.[57]

V. THE LEGISLATIVE OUTCOMES

A. Australia

The battle is not yet over and the most recent developments raise the fear that Australia may yet succeed in snatching defeat from the jaws of victory. The May 2008 draft Bill reveals, once again, the Australian lawmakers' propensity for reinventing the wheel. While the Bill takes the Canadian and New Zealand PPSAs as its starting point, it departs significantly from the model in terms of organization, terminology and general style. This is in contrast to the approach the New Zealanders took, which was for the most part to follow the text of the Saskatchewan PPSA,[58] and incorporate legislative cross-references to the corresponding Saskatchewan PPSA provisions.

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56. *Id.* at 4.

57. For the Law Commission's draft Act and commentary, see *id.* *See generally* NZPPSA 1999, *supra* note 2.

58. Some of the New Zealand departures from the Saskatchewan model are noted in section 5(b) below.

As discussed in Part III, the New Zealand approach has substantial benefits. The Canadian model is a tried and tested one.[59] It is the product of lengthy and careful deliberations by leading commercial lawyers and it has stood the test of time. The Canadian model, in turn, is based on Article 9 which itself was the product of an exhaustive drafting process involving some of the finest minds in United States commercial law. Close adherence to the North American models makes sense because it enables the local lawmaker to freely utilize Canada's and the United States' learning and experience. By contrast, departure from the model creates uncertainty and increases the risk of error. These concerns are exacerbated if the drafting is done under time constraints and without access to the kind of expertise the Canadians and Americans had at their disposal when drafting their laws.

The Australian decision not to follow the North American model is explained in the commentary which accompanies the Bill as follows:

> The differences between the Bill and its international counterparts reflect issues raised by stakeholders, differences in the Australian consumer and commercial environment, advances in information technology, and drafting styles adopted to improve legal certainty and consistency with Australian drafting practices.[60]

The commentary does not specify what the relevant issues, differences and advances are, and so it is impossible to test the strength of this assertion. Moreover, while the Bill may improve legal certainty at one level, it increases uncertainty at another level; the statement in the commentary fails to acknowledge this trade-off. The Bill reflects a strong commitment to drafting precision with a view to ensuring that the legislation provides for every possible contingency. It is in this sense that the claim to improved legal certainty is presumably to be understood. However, a commitment to precision is not cost-free. The inevitable by-product is longer, more complex legislation. The Australian Bill is at least twice as long as the New Zealand and Canadian PPSAs, it contains numerous definition provisions not found in these other statutes, and it relies on an elaborate system of forward and back referencing which means that the reader is constantly having to look at two or more parts of the legislation at once to get the overall sense of

59. *See* Saskatchewan Personal Property Act, 1993 (Can.), *available at* http://www.qp.justice.gov.sk.ca/orphan/legislation/P6-2.htm; *see also* New Brunswick Personal Property Security Act, 1993 (Can.), *available at* http://www.gov.nb.ca/acts/acts/p-07-1.htm.

60. Personal Property Securities Bill 2008 Commentary ¶ 1.16, *available at* www.ag.gov.au/pps (follow "PPS Downloads" hyperlink; then follow "Personal Property Securities Bill 2008 Commentary" hyperlink).

particular provisions. Furthermore, in the absence of cross-references to corresponding provisions in the other jurisdictions, readers who want to know the origins of particular provisions in the Australian Bill are forced to do their own research.[61]

In summary, while the greater precision of the Australian Bill may save litigation costs by providing answers to questions that might otherwise have been left to the courts, it increases the costs of comprehension and it is not at all clear that the gains exceed the losses. A relevant question to ask in this connection is how much litigation has resulted from the perceived lack of precision in the Canadian and New Zealand PPSAs; particularly in relation to the issues on which the Australian drafters have thought it necessary to elaborate. The answer is "surprisingly little" and this at least suggests that the benefits of greater drafting precision may not be worth the cost.

The complexity of the Australian Bill is itself a source of uncertainty, but this is compounded by the factors identified above. In particular, the failure to adhere closely to the North American model will substantially reduce the usefulness of Canadian case law and secondary sources as a guide to interpretation, and it will make projects like the New Zealand/Canadian academic collaboration much less feasible.[62] In short, Australia may be forced to develop its own body of case law and literature and, in the meantime, parties and their legal advisers will be left to their own resources in determining what the legislation means. Again, the question that needs to be addressed is whether these costs are worth the benefits that flow from the approach the Australian drafters have taken. There is also the very real concern that the costs of the Australian approach may erode stakeholder support for the new legislation by refueling the concerns identified in Part III, and, if that happens, the costs will end up being political as well as economic.

B. New Zealand

The New Zealand PPSA is closely modelled after the tried and tested second generation legislation of the Canadian province of Saskatchewan. Many of the New Zealand sections are worded substantially the same as the corresponding Canadian provisions. But the New Zealand Act does not slavishly follow the Canadian model; it differs in structure and in several matters of substance. Some of the variations represent considered policy choices but others simply reflect

61. The minutia are likely to be of little interest to an international audience, but see the Appendix *infra* for a critical discussion of some of the respects in which the Australian Bill departs from the New Zealand and Canadian models.

62. *See supra* text accompanying note 54.

the local New Zealand drafting style and may result in unintended consequences. Anecdotal evidence suggests that uncertainty is more likely to arise where New Zealand has, for stylistic reasons, departed from the Canadian wording. Conversely, it is clear from the New Zealand cases that the New Zealand court's ability to rely on Canadian case law has allowed New Zealand law to become settled more quickly than would otherwise have been the case.

Ultimately, the concepts underpinning the New Zealand Act, as with its Canadian parent, are derived from Article 9 of the American UCC. The American functional definition of security interest and the key concepts of attachment, perfection, and the reliance on the time of registration as a priority point are all replicated in the New Zealand Act.

Two of the more significant New Zealand departures from the North American approach are:

1. Greater emphasis is placed on the time of registration as a priority point. Various North American priority rules that turn on the giving of notice or the absence of knowledge of a competing interest have not been adopted in New Zealand.[63] The New Zealand approach is less nuanced than the North American one, but it has the advantage of greater simplicity and certainty and avoids evidential difficulties over the giving of notice and the existence of knowledge;
2. In New Zealand, an unperfected security interest is effective against a trustee in bankruptcy. This departure from the North American position is the most controversial aspect of the New Zealand Act. It probably came about in part because of the tight deadline imposed on the Law Commission's Advisory Committee. In the time available, the Committee was unable to reach consensus on the subject and noted that it was almost evenly divided on the issue. The pros and cons of the New Zealand approach have been set out elsewhere,[64] but the most visible (or perhaps more accurately, invisible) consequence is a reduction in the amount of PPSA litigation. The plethora of North American cases where a trustee in bankruptcy has challenged a defective registration cannot arise in New Zealand.

63. Under s.74 of the NZ Act, in order to take priority, the holder of a purchase money security interest is **not** required to give notice to the holder of a prior security interest. Under s.52 of the NZ Act, a buyer takes free of a prior unperfected security interest whether or not the buyer knew of the earlier interest.

64. *See* GEDYE, CUMING & WOOD, *supra* note 54, at 5.

One useful feature of the New Zealand Act is the cross-referencing of each section to the equivalent Canadian provision on which the New Zealand section is based. A standard text on the New Zealand Act[65] has taken this a step further by cross-referencing the New Zealand sections to multiple Canadian jurisdictions as well as to both the pre and post 1999 versions of Article 9. This allows New Zealand practitioners and judges easy access to relevant North American legislation and cases.

VI. CONCLUSION

The Australian and New Zealand experiences tell a similar story about the recipe for successful personal property security law reform. Sound policy arguments alone are not enough. Successful law reform requires a coalition of government, stakeholders and reformers. In Australia, there had been support for reform from within academic circles for many years, but the impetus for change did not come until the Commonwealth Attorney-General enthusiastically adopted the cause in 2005. His intervention provided the political leadership necessary to win over stakeholders and neutralize the anti-reform lobby.

In New Zealand, the sequence of events was slightly different, but the end result was the same. There, the impetus for reform came from within the legal profession itself, and this came about at least in part because leading commercial law practitioners were involved in developing the proposals from the outset. In other words, the profession had an ownership stake in the reform agenda and so they did not have to be sold on the reform, as was the case in Australia and England. The government commitment came later through the agency of the Ministry of Economic Development which had its own reasons for wanting the enterprise to succeed.

In both countries, reformers have had to grapple with the urge within government circles to reinvent the wheel. It is not at all clear what basis the local Parliamentary Counsel and their advisers had for thinking that they could do better than the tried and tested model; particularly when they were working under tight time constraints and without access to the range of expertise the American and Canadian drafters had at their disposal. In any event, the New Zealanders by and large managed in the end to overcome the temptation and are now reaping the benefits. On the other hand, the Australians have not, and may, as a consequence, end up reaping the whirlwind.

65. *See id.*

POSTSCRIPT

The Australian government has announced that, following public consultation, it is likely that there will be "some refinement" to various aspects of the [draft Personal Property Securities Bill]."[66] The redrafted Bill was not available at the time of writing, but it was released not long before this article went to press.[67] The Bill has been referred to the Senate Standing Committee on Legal and Constitutional Affairs for review and the committee is due to report by February 24, 2009. The revised draft does not address the concerns raised in this article.

66. Property Securities Bill 2008, *supra* note 14,
67. Personal Property Securities Bill 2008: Exposure Draft (10 November 2008).

APPENDIX

EXTRACT FROM ANTHONY DUGGAN, *SUBMISSION TO THE AUSTRALIAN ATTORNEY-GENERAL'S DEPARTMENT ON PERSONAL PROPERTY SECURITIES BILL 2008* (MAY, 2008).

(a) Introduction

The following are some selective comments on particular provisions in the Bill. I cannot claim to have undertaken a comprehensive review of the legislation. A comprehensive review would require careful comparison of the Bill with the New Zealand and Canadian PPSAs and . . . it would involve asking the following questions of each provision: (1) is there a corresponding provision in the other jurisdictions and, if so, is the wording the same? (2) If the wording is different, is the meaning the same? (3) If the meaning is different, was this an intended or unintended consequence and is it justifiable? This kind of analysis would take months and far more resources than I, and I suspect most stakeholders, have at my disposal. The problem is that without this kind of analysis, it is impossible to be sure that the Australian Bill is an improvement on the other models. The best I can do in the time available to me is focus on a few issues I have identified with a view to demonstrating the main point, which is the danger of departing from a tried and true model, particularly when drafting under time constraints and without the opportunity for careful deliberation and consultation.

(b) Changes in taxonomy

The Canadian and New Zealand PPSAs, following Article 9, divide personal property into 7 categories (chattel paper, documents of title, goods, intangibles, investment securities, money and negotiable instruments) and they further subdivide goods into consumer goods, equipment and inventory. This taxonomy serves an important function in the overall scheme of the legislation.

The Australian Bill adopts a different taxonomy. It divides personal property into: (1) intangible property, (2) tangible property and (3) chattel paper, documents of title, investment instruments, currency and negotiable instruments. It further divides personal property into "consumer property," "equipment" and "inventory." "Tangible property" is essentially, goods including fixtures and the like.

These changes were presumably made with specific policy objectives in mind, and they may or may not be an improvement on the

Canadian and New Zealand models. The problem is that this can only be determined by a painstaking analysis of the Bill as a whole read in conjunction with the New Zealand and Canadian model. In other words, while there may be benefits in attempting to improve on the established model, there are also costs and the drafters of the Bill appear to have discounted the costs. The costs are increased uncertainty (because we cannot be sure that the outcomes of the new taxonomy are the same as the outcomes of the old one) and increased risk (because we cannot be sure that the shift to the new taxonomy will not have undesirable commercial implications). The drafters themselves may be confident on both these fronts, but that is little consolation to parties and their legal advisers confronted with the choice of either doing their own research to be on the safe side or, alternatively, running the risk.

(c) Definitions

The substitution of "tangible property" for "goods" is open to question. The justification, presumably, was that it is misleading to define goods as including fixtures and the like. On the other hand, referring to goods as "tangible property" throughout the legislation is a potential source of confusion because the reader is constantly required to remind herself what the expression means.

The New Zealand and Canadian PPSAs use the expressions "secured party" and "debtor" to describe the parties to a security agreement and they define "debtor" to include a third party who provides security in support of the loan. The Australian Bill substitutes "grantor" for "debtor" and it defines grantor to include both the debtor and a third party who provides security in support of the loan. The thinking, presumably, was that it is misleading to define "debtor" as including a third party. On the other hand, referring to the debtor as the grantor throughout the legislation is a potential source of confusion because the reader must constantly remind herself what the expression means. Perhaps more importantly, the expression "grantor" is inappropriate for title retention transactions and it is an additional source of confusion and potential misunderstanding for this reason. It is not hard to envisage counsel making the argument that, notwithstanding the functional definition of "security interest" in s.21, the repeated references in the legislation to "the grantor" signify an intention to limit the scope to the traditional forms of security.

The Bill defines "registered" by reference to registration of the collateral, rather than the security interest and it follows through with this approach in other provisions, such as s.60(2), which refers to "registration of the collateral" and s.194(1) which refers to "registration

of personal property as collateral." By contrast, the New Zealand and Canadian PPSAs refer to registration of the security interest. It is unclear why the Australian drafters took a different approach and the Commentary provides no clues.

Registration is one method of perfection. The legislation refers to perfection of the "security interest." To speak of perfecting "the collateral" would be nonsensical. Given that registration is a method of perfection and that the subject-matter of perfection is the security interest, it is conceptually odd to speak of registration of the collateral instead. Perhaps another way of making the same point is to say that what searchers of the register are looking for is not collateral but, rather, security interests.

There is a similar confusion between the security interest and the collateral in other parts of the Bill. For example, s.24(3) provides that:

> If a security interest secures both purchase money collateral and collateral that is not purchase money collateral, the security interest is a purchase money security interest only to the extent that it secures the purchase money collateral.

What it should say is that:

> A security interest in both purchase money collateral and collateral that is not purchase money collateral is a purchase money security interest only to the extent that it is in the purchase money collateral.

The New Zealand and Canadian PPSAs use the expression "financing statement" to describe the instrument for registering a security interest. The Australian Bill uses the expression "registration" instead. It is unclear why the drafters made this change and the Commentary offers no clues. One problem with the Australian approach is that the Bill uses "registration" in two different senses: first to describe a method of perfection and second, to describe the registration instrument. This is, at best, a potential source of confusion and, at worst, a potential source of unintended consequences.

(d) Conflict of laws

The conflict of laws provisions in Part 2, Div.7 of the Australian Bill differ substantially in form and, I suspect, also in substance from the New Zealand and Canadian PPSAs. The Canadians have been unable to achieve uniform provincial PPSAs, much less national legislation, but they have at least managed to achieve uniform conflict of laws rules and a high level of harmonization with the conflict of laws rules in Article 9. Uniform conflict of laws rules are important to ensure that the outcomes

of choice of law disputes do not vary depending on the jurisdiction in which the litigation takes place.

Australia will avoid conflicts problems at the inter-state level, given that its proposed PPSA is a national one, but there is still the potential for conflict of laws issues to arise at the international level (for example, between Australia and New Zealand). Closer Economic Relations between Australia and New Zealand was an early impetus for personal property security law reform in Australia, and the CER agenda dictates harmonization of laws. In the absence of uniform conflict of laws rules between Australia and New Zealand, there is a risk of different choice of law outcomes depending on whether the case is litigated in Australia or New Zealand. This prospect is hardly in the spirit of CER.

(e) Investment entitlements

The Canadian provinces are in the process of enacting uniform securities transfer legislation, modeled on Article 8 of the United States Uniform Commercial Code. The new legislation contains detailed rules governing the transfer of both directly and indirectly held securities. The legislation refers to the investor's interest in indirectly held securities as a "security entitlement" and it goes on to specify that the investor has a proportionate proprietary interest in the intermediary's holding of the securities in question. It also gives the investor a set of personal rights exercisable against the intermediary for breach of the duties the intermediary owes investors. These rights in combination, make up the "security entitlement" and they are what the investor gets in return for her investment. Cognate reforms to the PPSAs are aimed at facilitating security interests in investment property. The PPSA definition of "investment property" expressly includes a security entitlement. Other parts of the Act spell out the rules for attachment of a security interest in a security entitlement and other kinds of investment property. They also stipulate what the secured party should do to perfect its security interest in investment property and they enact special priority rules for disputes between the holder of a security interest in investment property and competing claims.

"Investment entitlement" is defined in s.50(7) of the Australian Bill to mean, in effect, an investment held by an investor in the indirect holding system. The provision refers to "an interest" in a financial product evidenced by registering the owner on books maintained by a securities intermediary. However, it fails to specify what the interest is and there is no equivalent to Article 8 of the Uniform Commercial Code or the Canadian Securities Transfer Acts to fill the gap. Perhaps such

legislation is under consideration in Australia, but the Commentary makes no mention of it and, in the meantime, the question is at large.

Moreover, the Bill contains no provisions equivalent to the new Canadian PPSA provisions mentioned above. In other words, there are no special provisions for the attachment or perfection of security interests in an investment entitlement or for dealing with priority disputes involving investment entitlements. The Bill does make special provision for security interests in an investment instrument, including provision for perfection by control and priority rules giving precedence to security interests perfected by control over security interests perfected by other methods. However, the definition of "investment instrument" does not include an investment entitlement and so none of these provisions apply.

So far as I have been able to discover, the only provision in the Bill relating specifically to investment entitlements is the conflict of laws rule in s.50. Given, this, what is the Bill's impact on security interests in an investment entitlement? An investment entitlement would fall within the definition of "intangible property" and so, presumably, it would be subject to the legislation on that basis and all the ordinary rules relating to a security interest in intangible property would apply. One consequence is that it would be possible to perfect the security interest by registration, but not control and so the advantages of perfection by control would not be available to the secured party. As a matter of policy it does not make sense to discriminate in this way between security interests in directly and indirectly held investments. Another concern is that the failure to specify the nature of the investor's interest in an indirectly held investment means that a prospective secured party cannot be sure of what it is getting and this, too, may act as a disincentive to security interests in indirectly held investments. It is unclear from either the Bill or the Commentary whether the drafters were aware of these concerns and, if so, what plans, if any, are in train to address them.

(f) Acquiring personal property free of security interests

Part 5 of the Bill combines provisions modeled on the New Zealand and Canadian PPSAs and provisions drawn from the Australian state REVs legislation without proper regard to the potential for overlap and inconsistencies. For example, s.86(1), which derives from the REVs laws, overlaps substantially with s.81, which derives from the New Zealand and Canadian PPSAs. Likewise, s. 86(2), imported from the REVs laws, overlaps with s.82 (the sales in ordinary course provision). Both sets of provisions are directed to the same questions and enacting them both smacks of overkill as well as adding unnecessarily to the

length and complexity of the legislation. The drafters may have taken the view that the PPSA-based provisions do not sufficiently protect the consumer—and there are grounds for that concern (particularly in the case where the end purchaser does not buy the goods directly from the debtor). However, a simpler response would have been to make appropriate adjustments to the PPSA-derived provisions, rather than to enact a new layer of provisions on top.

The provisions in Part 5 switch between references to the transferee's knowledge of the security interest and the transferee's knowledge that the transfer is in breach of the security agreement but without any clear indication as to why. In the case of the buyer in ordinary course provision (s.82), the appropriate question is whether the buyer knew that the transfer constituted a breach of the security agreement. This is because the provision typically applies to the case where the subject-matter of the transaction is inventory. In these circumstances, the buyer's knowledge of the security interest is neither here nor there because, provided the sale is in the ordinary course of the transferor's business, the buyer will reasonably expect to take free of the security interest in any event. What does matter in this context is whether the transfer is in breach of the authority the secured party has given the debtor-transferor to sell its inventory and the purpose of the provision is to prevent the buyer from being prejudiced by unpublicized restrictions on the transferor's authority to sell. Section 82 accurately reflects these considerations.

However, the considerations behind the other provisions in Part 5 of the Bill are different. The other provisions are directed to the case where, for one reason or another, the buyer has no means of discovering the security interest (for example, because the security interest is unperfected, or because the registration has omitted the serial number or because in the circumstances it would be unreasonable to expect the buyer to conduct a register search). In these cases, the relevant question is whether the buyer knew about the security interest anyway. On this basis, the references in ss 80, 81, 83, 84, 85, 86 and 87 should all be to the transferee's knowledge of the security interest and, as presently drafted, ss 83-87 have it right, but ss 80 and 81 do not. Incidentally, there is a similar error in s.28(5) of the Ontario PPSA and this may be the source of the confusion in the Australian Bill.

Section 81 provides for cases where the secured party omits the serial number from the registration, or gets it wrong. If the regulations follow the Canadian and New Zealand model, inclusion of the serial number will be mandatory for consumer goods but optional for equipment and inventory. On this basis, s.81 should be limited to cases where the collateral is equipment. If the collateral is consumer goods,

omission or misdescription of the serial number will invalidate the registration. This means the security interest is unperfected, s.80 applies and s.81 is not needed. If the collateral is inventory, the transferee will typically take free of the security interest even if it is perfected and so, again, s.81 is not needed. The corresponding provision in the Canadian PPSAs is directed to the case where the security interest is in equipment and the secured party knows the serial number at the time of registration. The purpose of the provision is to give the secured party an incentive to include the serial number even though failure to include it does not invalidate the registration. The drafting of the provision should reflect this objective.

(g) Fixtures, accessions and commingled goods

Part 8, Div.2 contains provisions governing competing claims to fixtures. All the PPSAs except New Zealand have corresponding provisions. The New Zealand PPSA's failure to provide for fixtures means that in cases involving a priority dispute between the holder of a security interest in a fixture and the holder of an interest in the land, the court will have to revert to the common law rules. By contrast, in Canada, the rules are codified in the statute, they are clear and accessible and they give effect to the parties' likely commercial expectations. The rules vary depending on whether: (1) the security interest attaches before or after the goods become a fixture; and (2) the competing party acquired its interest in the land before or after the goods became a fixture.

For example, if the security interest attached before the goods became a fixture and the competing party had already acquired its interest in the land before the goods became a fixture, the security interest has priority. The rationale is that otherwise the competing party would get a windfall at the secured party's expense because the competing party would not have had the fixture in mind at the time it acquired its interest in the land. Note that in this case, the secured party's priority does not depend on perfection: attachment is sufficient. On the other hand, if the goods become a fixture before the competing party acquires its interest in the land and the security interest has already attached at that point, the competing party has priority unless the secured party filed a notice of its interest in the Land Registry Office before the competing party's acquisition. The rationale is that, in the absence of notice, the competing party is likely to assume that its acquisition includes the fixture. Note that in this case, the secured party's priority depends on registration, not in the PPS register, but in the Land Registry Office. This is the place where a prospective purchaser of the land is

most likely to search and it avoids the need for prospective land purchasers to search twice.

The fixtures provisions in the Australian Bill are worded quite differently from the Canadian model. It is unclear whether the drafters changed the wording simply to improve the clarity, whether the change in wording was intended to change the meaning and, whether or not the drafters intended to change the meaning, they have done so anyway. The Canadian provisions have been tried and tested and it makes no sense to adopt a different model unless there are clear policy reasons for doing so. Neither the Bill nor the Commentary suggests any such reason. Paragraph 12 of the Commentary asks whether the Bill should include fixtures provisions along the lines of those included in the draft Bill. The answer is, yes, the Bill should include fixtures provisions (for the reasons stated above) but, no, not along the lines of the provisions in the Bill.

The same observations apply to the provisions in Part 8, Div. 3 of the Bill governing competing claims to accessions and to the provisions in Div.4 relating to commingled goods. (The priority rules for competing security interests in commingled goods (ss 150-152) are significantly different from the Canadian and New Zealand PPSAs and decidedly more complex).

Section 146 limits the secured party's rights in the product or mass to "the value of the obligation" immediately before the commingling. The reference should be to the value of the secured party's collateral immediately before the commingling. As presently drafted, the provision gives a windfall to the secured party who is under-secured.

In a departure from the New Zealand and Canadian PPSAs, s.147 requires the secured party to reperfect its security interest following the commingling within a prescribed grace period. As the Commentary explains, the rationale is to ensure consistency with the perfection requirements for security interests in proceeds. The s.147 grace period is "5 business days after the secured party acquires the knowledge required to perfect [or reperfect]" and s.148 defines "knowledge" to mean information the secured party could have acquired through making reasonable inquiries." There is substantial uncertainty in these provisions, particularly in relation to what amounts to "reasonable inquiries." For example, monitoring of the debtor's operations may enable the secured party to discover the commingling. Do ss 147 and 148 require monitoring and, if so, to what degree? The answers to these questions may vary from case to case, depending on the secured party's level of sophistication and resources. In advance of litigation, the secured party may have no way of predicting the status of its security interest in the end product and this uncertainty is likely to affect both its willingness to give the debtor credit and the amount of its charges. Of

course, there is an offsetting consideration which is that, in the absence of a reperfection requirement, other prospective secured lenders may have no way of discovering the secured party's interest in the product or mass and this may affect both the prospective secured lender's willingness to deal with the debtor and the amount of its charges.

Paragraph 8.47 of the Commentary asks whether it is appropriate to confer temporary perfection on commingled goods. The answer is that it is impossible to know, without reliable empirical evidence as to the costs of doing so relative to the costs of not doing so. It can at least be said, though, that the absence of a reperfection requirement for commingled goods does not appear to have caused undue commercial disruption in Canada and, in the absence of better evidence, the safest course is probably to follow the Canadian lead.

(h) Notice requirements

Section 154 applies where there is a security interest in a fixture or accession and the secured party proposes to remove the collateral. The provision requires the secured party to give notice to various persons. In the case of a fixture, the secured party must give notice to the landowner. The Canadian PPSA requirement is broader: the secured party must notify not just the landowner, but any party with an interest in the land and this would include, for example, a mortgagee or tenant. There are obvious reasons why such parties should be entitled to notice and it is unclear why the Australian Bill overlooks them.

In the case of an accession, s.154 requires the secured party to give notice to "any person who has a registration describing the [host goods]." The Canadian PPSA requirement is broader: the secured party must also notify any person the secured party knows to have an interest in the host goods and this would include, for example, the owner or a lessee. Again, there are obvious reasons why such parties should be entitled to notice and it is unclear why the Australian Bill overlooks them.

Section 163 of the Bill permits contracting out of the s.154 notice requirements, but the contract would presumably have to be between the secured party and the person who would otherwise be entitled to the notice, rather than between the secured party and the debtor. Contrast s.96 (subordination agreements), which makes it clear that a subordination provision in the security agreement is enforceable by the intended beneficiary.

(i) Remedies

Section 163 allows for contracting out of the enforcement provisions in non-consumer transactions. This distinction makes sense in relation to provisions that benefit the debtor. However, some of the provisions s.163 lists are for the benefit of third parties, not the debtor: for example, s.154, which requires notice to the landowner before removal of a fixture, and s. 169, which requires notice to higher priority parties. Whether or not the security agreement is a consumer transaction has no obvious bearing on these third party rights.

Section 164 provides that the remedies provisions do not apply to receivers. The intention, apparently, is to avoid overlap with the provisions governing receivers in the Corporations Act. However, a receiver who is appointed to enforce a secured party's security interest should be under the same obligations as the secured party itself. Otherwise, receivership may be used simply as a device for avoiding the PPSA enforcement provisions. The PPSA would be a better location than the Corporations Act for the provisions governing receivers first, because the power to appoint a receiver is not limited to cases where the debtor is a corporation and secondly, for the sake of a complete PPSA.

Section 168 deals with the enforcement of a security interest in liquid assets, accounts, chattel paper and the like and it provides that the secured party may "give a written notice to any person obligated on the collateral requiring the person to discharge the secured obligation." There is a corresponding provision in the New Zealand and Canadian PPSAs, but the wording is different. What the provision should say, as it does in the other PPSAs, is that the secured party may require the obligor to pay the amount of the obligation to the secured party. In other words, the reference should be to the obligation the obligor owes to the debtor, not the obligation the debtor owes to the secured party.

Sections 181-185 deal with the secured party's right of foreclosure. There are corresponding provisions in the New Zealand and Canadian PPSAs. However, in contrast to the other PPSAs, the Bill fails to state that foreclosure extinguishes the debt obligation: in other words, the secured party takes the collateral in full satisfaction of the secured obligation. The secured party's right of foreclosure is subject to objection by the debtor and other interested parties but, in contrast to the Canadian PPSAs, the Bill gives the secured party no right to challenge an objection. The secured party can request the objector to provide evidence of his interest, but if the objector complies, that is the end of the matter. The Canadian PPSAs allow the secured party to dispute an objection on the ground that it is frivolous or vexatious, or that the value of the collateral is less than the outstanding amount of the debt.

(j) Registration

Section 228 provides for register searches against the secured party's name, the debtor's name, the debtor's ABN, the collateral serial number and any other criteria the regulations specify. This is more generous to searchers than the Canadian PPSAs, which provide for search only against the debtor's name and the collateral serial number. The problem with providing for multiple search options is that, while it no doubt benefits searchers, it also increases the burden on the secured party at the time of registration. A mistake in any of the search criteria is a seriously misleading error and it will invalidate the financing statement. It follows that the more search criteria the legislation allows for, the greater the risk of error for the secured party. With these concerns in mind, the wisdom of providing for searches against the ABN and the secured party's name is questionable.

In my submission on Discussion Paper 3, I said the following:

> "In my submission on Discussion Paper 1, Registration and Search Issues, I argued in favour of a debtor's name index, coupled with a serial number index, along the lines of the Canadian and New Zealand models. I have since come round to Simon Begg's thinking, namely that, the first of these indexes should be based on the ABN rather than the debtor's name. The implication is that security interests in consumer goods would not be registrable unless the goods are serial-numbered goods, in which case the security interest would be registrable against the serial number. In the case of a dispute between the holder of an unregistrable security interest and a subsequent purchaser, the purchaser would win provided she purchased the goods for value, in good faith and without knowledge of the security interest and provided also that the security interest was not perfected by possession at the time of the purchase. However, this rule would be subject to a cut-off figure of, say, $30,000: if the purchaser paid more than the cut-off figure, she would take the goods subject to the security interest: compare Chattel Securities Act 1987 (Vic.), s 7(1) and (5). In the likely rare case of a dispute between two or more unregistrable security interests, priority would depend in the first place on whether any of the competing security interests is perfected by possession or temporarily perfected. Otherwise, priority would turn on the order of attachment. If one of the competing security interests is a purchase-money security interest, it would have priority. An unregistrable security interest would have priority over execution creditors and it would not be ineffective in the debtor's bankruptcy.

> One advantage of providing for registration against the ABN, rather than the debtor's name, is that it avoids the need for elaborate rules identifying the correct name for registration and search purposes. It also avoids the privacy concerns which have been raised at various points in the Discussion Papers. The main disadvantage, as indicated above, is that it would result in security interests given by a non-business debtor being unregistrable, unless the collateral is serial-numbered goods. However, the importance of this consideration should not be over-stated. The consideration matters most if the collateral is valuable, because then the disputing parties have more to lose. However, motor vehicles are by far and away the most common form of high value collateral given by non-business debtors and security interests in motor vehicles would be registrable in the serial-number index. A second disadvantage is that there would need to be special extinguishment and priority rules for disputes involving unregistrable security interests and there is no precedent for such provisions in any of the current PPSAs. However, again as noted above, there is a partial precedent for such provisions in the Victorian and Western Australian Chattel Securities Acts, and this legislation provides a useful model to build on. In this connection, it might be worthwhile asking banking and finance industry representatives whether, based on their experience with the Chattel Securities Acts over the past twenty years, they would be comfortable with the idea of making security interests in consumer goods other than serial-numbered goods unregistrable, assuming a set of priority rules along the lines outlined above.

I still hold these views, but the Bill does not reflect them. My proposal is for registration and search against the debtor's ABN *instead of* registration and search against the debtor's name. By contrast, the Bill provides for both.

(k) Miscellaneous

In common with Article 9 and the Canadian PPSAs, but in contrast to New Zealand, the Bill invalidates an unperfected security interest in the debtor's bankruptcy or liquidation. The policy justification for this is to make sure that the entitlements of execution creditors relative to the holder of an unperfected security interest are the same inside and outside bankruptcy and to prevent the holder of an unperfected security interest from using the bankruptcy laws opportunistically as a means of obtaining a priority position it does not have outside bankruptcy: *Re Giffen* [1998] 1 SCR 91 (SCC). In contrast to all the other PPSAs, the Bill also provides that a security interest is void if the debtor is a company and goes into liquidation or administration or executes a deed of

arrangement, unless the security interest was continuously perfected during the preceding 6 months. The Commentary does not explain the policy behind this provision, except to say that it comes from the Corporations Act. Nor does it explain why the rule only applies if the debtor is a company.

Section 238 applies to non-security leases and consignments. Section 238(2) provides that if the lessor's or consignor's interest is void under s.237, the lessor or consignor is taken to have suffered loss or damage and may recover compensation. However, the provision does not indicate who the prospective defendant might be. Typically, if s.237 applies, the lessor or consignor will have only themselves to blame for failing to perfect their security interest and it is hard to see who else should bear the responsibility. Perhaps the section means that the lessor or consignor has a claim in the debtor's bankruptcy or liquidation for the amount of its loss, but the language does not seem appropriate for this purpose and, besides, it is hard to see any reason in principle why the lessor or consignor should have such a claim. Section 238(3) provides that "despite section 237, the leased or consigned property remains the property of the lessor or consignor." This is tantamount to saying that s.237 does not apply at all to the transactions in question: if the property still belongs to the lessor or consignor, it follows that they may recover it from the debtor's liquidator or trustee in bankruptcy. In that event, of course, the lessor or consignor will have suffered no loss and so there will be no basis for any compensation claim under s.238(2).

The reasons for this excess of kindness towards lessors and consignors are unclear, but the provision may have been drafted to allay concerns about unfair surprise arising from *NDG Pine Ltd (in Receivership) v. Portacom NZ Ltd* [2004]2 NZLR 528 and *Agnew & Waller v. New Zealand Bloodstock* [2005] 2 NZLR 549. However, the concerns these cases have prompted are misconceived. The potential for unfair surprise in the new laws is no more than an aspect of the transition costs parties face in adapting to the new regime. These transition costs are justifiable on the assumption that they will be outweighed by the benefits of the new law in the longer-term. Moreover, the problem will likely prove to be self-correcting. It should take only one or two cases like *Portacom* and *New Zealand Bloodstock* for lessors, suppliers and consignors to get the message that the new law applies to them and that they need to register financing statements. It can safely be predicted that there will not be too many more cases like this in New Zealand and that the courts will be free to turn their attention to more interesting questions. The same goes for Australia.

Current Approaches Towards Harmonization of Consumer Private International Law in the Americas

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I. INTRODUCTION

Since 2003, the Organization of American States[1] ("OAS") has concentrated most of its efforts and focused on the harmonization of international consumer law. It has become the current focal point of the legal harmonization process undertaken by the Inter-American Specialized Conference on Private International Law ("CIDIP").[2] As its name indicates, the CIDIP is concerned with conflict issues and therefore with private international law rules understood in a broad sense (i.e. choice of law, jurisdiction, judicial cooperation and international arbitration).[3] However, the CIDIP VI, in 2002, has changed this "paradigm" of codification, enlarging the scope of the inter-American unification even more.[4] Thus, the Inter-American Model Law on Secured Transactions deals with both domestic and international relationships, and by consequence most of its provisions are substantive rules. The current state of affairs of the treatment of the subject matter of consumer protection offers a mix of proposals made by Brazil, Canada and the United States ("U.S."), reaffirming the change operated in 2002.

Namely, Brazil presented a Draft Convention on the Law Applicable to International Consumer Contracts and Transactions, Canada proposed a Model Law on Jurisdiction and Choice of Law to Consumer Contracts, and the U.S. submitted a Draft of Legislative Guidelines on Availability of Consumer Dispute Resolution and Redress for Consumers. The U.S. Guidelines included three annexes that provide a) a Model Law on Small Claims; b) Model Rules for Cross-border Arbitration; and c) a Model Law on Government Redress.[5]

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1. OAS includes 35 American States from Argentina in the south to Canada in the north; only 34 are effective because Cuba has been suspended since 1962. *See* http://www.oas.org.

2. *See* Organization of American States [OAS], Private Int'l Law, *available at* http://www.oas.org/dil/privateintlaw_interamericanconferences.htm. There is also another issue which is actually the continuation of the main subject-matter of CIDIP VI: security interests. *See* OAS, CIDIP VI, Washington, D.C., Feb. 4-8, 2002, Final Act, *available at* http://www.oas.org/dil/CIDIP-VI-finalact-Eng.htm. Current developments in this field address the electronic registry implementation of the Inter-American Model Law on Secured Transactions—an instrument adopted at CIDIP VI. *Id.* The OAS General Assembly adopted the agenda topics for CIDIP VII. OAS, CIDIP VII, June 6, 2006, *Convocation*, AG/RES. 2065 (XXXV-O/05), *available at* http://www.oas.org/dil/CIDIP-VII_res.2065.htm.

3. *See generally* GONZALO PARRA-ARANGUREN, CODIFICACIÓN DEL DERECHO INTERNACIONAL PRIVADO EN AMÉRICA (vol. I 1982, vol. II 1998); Didier Opertti Badán, *L'oeuvre de la CIDIP Dans le Contexte du Droit International Privé Actuel*, *in* E PLURIBUS UNUM: LIBER AMICORUM GEORGES A.L. DROZ 269 (1996).

4. *See* Diego P. Fernández Arroyo, *La CIDIP VI: ¿Cambio de Paradigma en la Codificación Interamericana del Derecho Internacional Privado?*, XXIX CURSO DE DERECHO INTERNACIONAL – 2002, at 465 (2003).

5. Collectively, the "Draft Model Laws."

In the inter-American harmonisation process, as well as in other similar processes undertaken by different international organisations, it is uncommon to be confronted with three different proposals relating to the same topic. What usually happens in other international organisations, as well as in the CIDIP, is a discussion based on one project and its different versions. It is perhaps just a consequence of the characteristics of the CIDIP as a codification body, which functions essentially with the assistance of member states activity, because of the absence of a permanent secretariat specifically dedicated to private international law codification. Regardless, the existence of different available options and various approaches should not be seen as a negative figure; quite the opposite.

In addition to the interest of the subject matter itself, current efforts in the Americas give a great opportunity to test the different possible techniques to achieve international legal harmonization within a regional organisation and to analyze the compatibility between them. At the same time, chance is given to observe and compare the different approaches proposed to offer to consumers a way to solve appropriately their cross-border disputes with suppliers.[6] This paper will address these issues, as well as with the policies embodied by them.

II. DIFFERENT INSTRUMENTS (FROM HARD TO SOFT LAW)

Besides its practical relevance to solve real disputes, that the current movement takes place in the Americas within the OAS is interesting from both a theoretical and a technical point of view. Indeed, three approaches have been adopted by the initiators of these three projects. The choice of the best approach—i.e. the most efficient in terms of harmonization of consumer law—should only be made after an in depth analysis of each instrument.

6. *See* J.M. Velázquez Gardeta, La Protección del Consumidor Online en el Derecho Internacional Privado Interamericano, Análisis Sistemático de las P Presentadas para la CIDIP VII (2008) (Ph.D. thesis), *passim*.

A. *Brazilian Draft Convention on the Law Applicable to International Consumer Contracts and Transactions*[7]

At first sight, the instrument proposed by Brazil is a classical conflict-of-laws convention. In fact its single goal is to establish which law applies to a certain kind of private international relationship. Nevertheless, a more detailed scrutiny shows that it is all but classical, at least within the very context of rules on international consumer contracts. The key of the Brazilian draft is a combination between limited party autonomy on the one hand and the principle of the most favourable law to the consumer on the other hand.[8] Namely, parties may choose the law of the consumer's domicile, the law of the place of conclusion of the contract, the law of the place of performance, or the law of the provider's[9] domicile or seat.[10] For passive consumers (i.e., for contracts and transactions made while the consumer was in her or his country of domicile[11]), chosen law shall apply to the extent that it is the most

7. OAS, Dep't of Int'l Law, Proposal of Brasil for the CIDIP Convention on Consumer Protection, CP/CAJP-2094/03 add. 3-a (Dec. 17, 2004), *available at* http://oas.org/dil/CIDIP-VII_topics_cidip_vii_proposal_brasil_applicablelaw.htm [hereinafter Brazilian Draft Convention]. The Brazilian Draft Convention was born from a particular initiative of Professor Claudia Lima Marques, who proposed it in the 2000 Session of the OAS Course on International Law. *See* Claudia Lima Marques, *A Proteção do Consumidor: Aspectos de Direito Privado Regional e Geral*, XXVII CURSO DE DERECHO INTERNACIONAL - 2000, at 657 (2001). *See also* Claudia Lima Marques, *Consumer Protection in Private International Law Rules: The Need for an Inter-American Convention on the Law Applicable to Some Consumer Contracts and Consumer Transactions*, *in* REGARDS CROISES SUR LES ENJEUX CONTEMPORAINS DU DROIT DE LA CONSOMMATION 145 (T. Bourgoignie ed., 2006). For that reason the proposal is also known as the "Lima Marques Draft" (*Projeto Lima Marques*).

8. A favorable opinion on this option can be found in Erik Jayme, Speech Given at the Inauguration of the New Building of the Hague Academy of International Law: La Vocation Universelle du Droit International Privé—Tendances Actuelles (Jan. 23, 2007), *available at* http://www.vredespaleis.nl/shownews.asp?ac=view&nws_id=109.

9. The term "provider" is used in these paragraphs because it is the term used in the English version presented by the Brazilian delegation. In its Draft Model Laws, the U.S. delegation mainly uses the term "business" instead.

10. Brazilian Draft Convention, *supra* note 7, art. 2.1. Parties are only entitled to choice "a law of a state or nation." Thus, no "transnational" or "not national" set of rules or principles on consumer transactions could be chosen by the parties. *See* GRALF-PETER CALLIESS, GRENZÜBERSCHREITENDE VERBRAUCHERVERTRÄGE, RECHTSSICHERHEIT UND GERECHTIGKEIT AUF DEM ELEKTRONISCHEN WELTMARKPLATZ 375-485 (2006) (giving a heterogeneous list of "not national" texts, including some EU instruments).

11. The subjacent idea is that a consumer deserves more protection when it is the business who "goes" to the consumer's residence to offer him a good or a service. On the contrary, if the consumer "goes" across the boundaries to buy something he should be perfectly conscious of the internationality of that relationship and accept its legal consequences. *See* Paul Lagarde, *Heurs et Malheurs de la Protection Internationale du Consommateur dans l'Union Européenne*, *in* ETUDES JACQUES GHESTIN, 511 (2001); A. Sinay-Cytermann, *La Protection de la Partie Faible en Droit International Privé*, *in*

favourable to the consumer.[12] If there is no valid choice of law by the parties, the applicable law will be the law of the consumer's domicile (for passive consumers) or the law of the place of contracting (for active consumers).

This draft provides that the choice of law "must be express and in writing, known and agreed in each case."[13] It also introduces the duty of the provider to give clear information either about the law chosen as applicable in standard terms of reference or about the possible options between different laws available to the consumer. Other provisions of this draft may modify the law applicable in principle. Thus, the court may exceptionally apply a different law from the one indicated in the convention, provided that this law is both more closely related with the contract and more favourable to the consumer. In addition, internationally mandatory rules[14] of the forum shall apply in any case,[15] while internationally mandatory rules of the consumer's domicile only apply whenever the conclusion of the contract was preceded by any negotiations or marketing activities by the provider or its representatives in that country.[16] Finally, the Brazilian draft also includes specific rules for travel and tourism contracts and for timesharing contracts.[17]

MÉLANGES PAUL LAGARDE 737 (2005) (describing the different treatment pursuant to this distinction within the European private international law).

12. Brazilian Draft Convention, *supra* note 7, art. 2.1.

13. In the light of the current works accomplished in UNCITRAL, the agreement "in writing" can appear in various forms and is likely to raise difficulties of construction. *See* P. Perales Viscasillas, *¿Forma Escrita del Convenio Arbitral?: Nuevas Disposiciones de la CNUDMI/UNCITRAL*, DERECHO DE LOS NEGOCIOS, Feb. 2007, at 5; *see also* Toby Landau, *The Requirement of a Written Form for an Arbitration Agreement: When "Written" Means "Oral," in* ICCA International Arbitration Congress Series 11, INTERNATIONAL COMMERCIAL ARBITRATION: IMPORTANT CONTEMPORARY QUESTIONS 19 (2003).

14. *See* Commission Regulation 593/2008, On the Law Applicable to Contractual Obligations (Rome I), art. 9(1), 2008 O.J. (L 177) 6 (EC) on law applicable to contractual obligations [hereinafter *Regulation*] (not yet in force) ("Overriding mandatory provisions are provisions the respect for which is regarded as crucial by a country for safeguarding its public interests, such as its political, social or economic organisation, to such an extent that they are applicable to any situation falling within their scope, irrespective of the law otherwise applicable to the contract under this Regulation.").

15. Brazilian Draft Convention, *supra* note 7, art. 3.1.

16. *Id.* art. 3.2.

17. *Id.* arts. 6, 7.

B. *Canadian Draft Model Law on Jurisdiction and Choice of Law*[18]

From the very beginning of the CIDIP VII process, Canada asserted that the way to achieve harmonization of international consumer law in the Americas consisted of elaborating a model law dealing only with jurisdiction. However, some days before the Porto Alegre (Brazil) meeting of experts in December 2006—which has been the most important event within the process of preparation of the CIDIP VII—Canada added to its Draft Model Law on Jurisdiction one provision on applicable law.[19] In any event, beyond the very content of the proposal, it is worth underlining Canada's constructive attitude in this venture, despite traditionally being sceptical about the regional process of codification in the Americas.

For the determination of both issues of jurisdiction and applicable law, similar to the Brazilian Draft Convention, the Canadian proposal is also based on party autonomy but in a very different way. Essentially, a choice of forum clause is invalid for contracts involving passive consumers if the agreement was made before the commencement of the proceedings,[20] and if the chosen jurisdiction is not the jurisdiction in which the consumer is a resident. In the same vein, a choice of law clause is invalid for contracts involving passive consumers if the clause deprives the consumer of the protection to which he or she is entitled pursuant to the laws of the state of his or her habitual residence.[21] In the absence of a valid choice of forum or of the submission of the defendant, the court in the defendant's state of residence has jurisdiction.[22] A court also has jurisdiction if there is a real and substantial connection between the state of the court and the facts on which the consumer contract case is based.[23] Every claimant may prove that such a connection exists, but this connection is presumed to exist in the case of passive consumers who bring a case before the courts of their country of residence against a provider who resides in another state.[24] In the field of the applicable law, the subsidiary rule for passive consumers is, in absence of a valid choice-

18. OAS, Revised Draft of Proposal For a Model Law on Jurisdiction and Applicable Law for Consumer Contracts appended to Proposal of Canada for the Seventh Inter-American Specialized Conference on Private International Law (CIDIP-VII), CP/CAJP-2652/08 (Aug. 21, 2008), *available at* http://scm.oas.org/pdfs/2008/CP20891E02.pdf [hereinafter Canadian Draft Model Law].

19. *See* the proposal sent by Canada (Jan. 20, 2004), *available at* http://www.oas.org/dil/proposalcanada.pdf.

20. Canadian Draft Model Law, *supra* note 18, art. 5(1)(a).

21. *See id.* art. 7.

22. *See id.* art. 3(a).

23. *See id.* art. 3(b).

24. *See id.* art. 4.

of-law clause, the application of the law of the consumer's state of residence.

One of the scenarios of passive consummation arises when the origin of the contract was a solicitation of business in the consumer's state by the provider, and the consumer and the provider were not in the presence of one another in the provider's state when the contract was concluded. The Canadian Draft Model Law presumes that a solicitation by the provider existed, but the provider may demonstrate that he or she took reasonable steps to avoid concluding consumer contracts with consumers residing in the consumer's state.[25]

Canadian rules on jurisdiction allow Canadian courts to decline jurisdiction using the well known common law device of *forum non conveniens*.[26] In order to decide the declination of the exercise of its jurisdiction, this draft provides the court with a non exhaustive list of circumstances to take into account,[27] including the law to be applied and the fairness and efficiency of the legal system as a whole. In other words, the Canadian proposal also provides for a comparative evaluation of the law applicable.

C. *U.S. Draft Legislative Guidelines (with Three Annexes Providing Model Laws and Model Rules)*[28]

In the beginning of the CIDIP VII process, when the OAS called on Member States to propose topics to compose the working agenda, the U. S. showed a concern for electronic commerce. The U.S. presented two subjects claiming that in both cases "rules should be formulated in the form of an Inter-American treaty, although a model law would alas be

25. *See* Canadian Draft Model Law, *supra* note 18, arts. 5(2) and 7(3); *see also* note 11 *supra*.

26. *See* Canadian Draft Model Law, *supra* note 18, art. 6. As reflected in the final act of the Meeting of Experts of Porto Alegre, several delegations expressed concerns about this inclusion, which is controversial in general but even more so when it comes to consumer relationships.

27. *See id.* art. 6(2).

28. OAS, Committee on Juridical and Political Affaire, Legislative Guidelines appended to Proposal of the United Status for the Seventh Inter-American Specialized Conference on Private Internacional Law (CIDIP-VII), CP/CAJP-2652/08 add.1 (Sept. 18, 2008), *available at* http://scm.oas.org/pdfs/2008/CP21008E.pdf [hereinafter U.S. Legislative Guidelines]; U.S. Legislative Guidelines, annex A. An English version of this document is available at http://scm.oas.org/pdfs/2008/CP21008E-A.pdf [hereinafter Annex A]; U.S. Legislative Guidelines, annex B. An English version of this document is available at http://scm.oas.org/pdfs/2008/CP21008E-B.pdf [hereinafter Annex B]; U.S. Legislative Guidelines, annex C. An English version of this document is available at http://scm.oas.org/pdfs/2008/CP21008E-C.pdf [hereinafter Annex C].

acceptable."[29] The proposed subjects were a) new uniform rules on cross-border investment securities transactions, covering the electronic creation of investment securities (stocks, bonds, etc.), their registration, pledge, clearance and settlement of transactions and related transaction rights, as well as the rights and responsibilities of securities intermediaries and of other holders of rights in these securities; and b) rules to provide for electronic filings, searches and certifications in connection with local or regional electronic commercial registries. In addition, the U.S. proposed that the draft Inter-American Rules on Electronic Documents and Signatures,[30] which had been already presented at the CIDIP VI but not adopted on that occasion, "be again reviewed and finalized as model rules."[31] Although the two main subjects proposed by the U.S. were supported by Chile and Peru, only the second subject was included in the agenda of the CIDIP VII.[32]

There was nothing on consumer issues in the letter from the U.S. Nevertheless, the U.S. expressed its broad support to this topic,[33] which had been suggested by Brazil, Canada, Mexico and Uruguay. Once the Member States reached an agreement in the Committee on Juridical and Political Affairs of the Permanent Council of the OAS, including consumer protection in the agenda and its adoption by the General Assembly, the U.S. presented, on 24 October 2006, its Draft Proposal for a Model Inter-American Law on Availability of Consumer Dispute Resolution and Redress for Consumers.[34] The document submitted, however, had not the structure of a model law, being rather a list of goals and guidelines that national legislatures should take into account to develop consumer protection.[35] After discussion at the Meeting of Experts held in Porto Alegre in December 2006, the U.S. revised the

29. *See* the North-American letter to the OAS, (Feb. 24, 2004), *available at* http://www.oas.org/dil/CIDIP-VII_home_topics_proposals_unitedstates.htm.

30. OAS, United States proposed Uniform Inter-American Rules for Electronic Documents and Signatures Recitals (Oct. 3, 2001), *available at* http://www.oas.org/dil/CIDIP-VII_topics_futures_cidips_electroniccommerce_signatures_3oct2001.htm.

31. *See* North American letter, *supra* note 29. CIDIP VI was entirely accomplished in a single week. There was not even time to analyze the Uniform Inter-American Rules for Electronic Documents and Signatures Recitals.

32. *See* Diego P. Fernández Arroyo, *La Contribución de la OEA al Derecho Internacional Privado*, XXXII CURSO DE DERECHO INTERNACIONAL 189, 205-08 (2006).

33. *See* http://www.oas.org/dil/CIDIP-VII_topics_cidip_vii_proposal_consumer protection_monetaryrestitution_unitedstates.htm.

34. OAS, Committee on Juridical and Poitical Affairs, Draft of United States Proposal for a Model Inter-American Law on Availability of Consumer Dispute Resolution and Redress for Consumers for CIDIP-VII, CP/CAJP-2424/06 (Nov. 2, 2006), *available at* http://oas.org/dil/CP-CAJP_2424_06_eng.pdf [hereinafter U.S. 2006 Draft Proposal].

35. The same document recognizes that "this proposal is drafted as a 'conceptual' model law." *See id.* at n.1.

original proposal and asked the experts for additional comments. Comments and suggestions were made. According to the U.S. delegate, all of the responding delegations commented that the U.S. proposal was more in the nature of a legislative guide. Hence, the nature of the U.S. proposal was changed and became a (general) legislative guide with three (specific) model laws.

Seen as a whole, the U.S. Draft Legislative Guidelines is too long an instrument to be summarized in a few words. The nature of the proposal does not help. The same document eloquently says that "these Guidelines offer a flexible common framework of *general principles* to enable OAS members to improve access to redress for consumers, rather than a single model law for all member states."[36] Notwithstanding this confession, several points of the U.S. proposal deserve attention.

Annex A provides sample legislative language for implementing a domestic small claims procedure for those states with no such procedure in place. The characteristics of a specific procedure for resolving small claims are clearly set forth at the beginning of the draft: it should be simple, expeditious, economical, and fair.

- Simple: The scope of the Model Law is broad and does not distinguish between civil or commercial claims; as long as the damage is suffered by a consumer as defined in the legislative guidelines, the Model Law should be applied.[37]

- Expeditious: The procedure should be in writing (but an oral hearing may be granted on an exceptional basis) and the time periods to respond to a claim and to notify a claim to render the judgment are short.[38] Moreover, "the tribunal may hold a hearing through an audio, video or email conference or other communications technology if the technical means are available and both parties agree."[39]

- Economical: "Representation by an attorney in a small claims tribunal shall not be mandatory[;] a party may be represented by a friend or relative if the representative is familiar with the facts of the case, consistent with the procedural law of the State."[40]

36. U.S. Legislative Guidelines, *supra* note 28, § 1(4) (emphasis added).
37. Annex A, *supra* note 28, art. 3.1. Damage is defined broadly.
38. *Id.* arts. 6 and 7.
39. *Id.* art. 6.8.
40. *Id.* arts. 5.1 and 5.3.

- Fair: It is reminded that "the tribunal shall respect the right to a fair trial and the principle of an adversarial process."[41] However, the right to appeal the decision rendered by the tribunal of small claims is subject to the procedural law of the forum.[42]

Annex C is a model law on government authority to provide redress and cooperate across borders against fraudulent and deceptive commercial practices; it is based on the experience of the U.S. Federal Trade Commission. Its aim is twofold. First, it provides for the designation or creation of a consumer protection authority in each member state that is vested with the authority to obtain redress for consumers and is able to cooperate with their foreign counterparts. Secondly, the law also purposes to "facilitate the enforcement of certain judgments for consumer redress across borders." The draft proposes that the authority "shall have the investigation and enforcement powers necessary for the application of this Law and shall exercise them in conformity with national law."[43] Procedure remains then in the domestic arena. "The competent authorities are . . . authorized to take action and obtain remedies, including, but not limited to monetary redress, for or on behalf of consumers 'who have suffered economic harm as a result of fraudulent or deceptive commercial practices.'" Once again, a broad definition of damage as suffered by the consumer appears in this draft.[44] On the international level, the interesting points are the cooperation between authorities[45] and the specific procedure for recognition of foreign civil judgments for consumer redress.[46] This last issue is particularly worth noting as the draft departs from its traditional view not to interfere in the national procedural law. Here, it is proposed that

> when a foreign competent authority obtains a civil monetary judgment for redress to consumers [. . .] and such authority seeks to have that judgment or order recognized and enforced in [member state], the judicial authorities may treat that judgment as equivalent to such a judgment in the name of a private party or parties, and shall not disqualify such a monetary judgment from recognition or

41. *Id.* art. 6. 2.
42. *See* Annex A, art. 8.1. This particular point deserves more discussion and it is at least debatable that the possibility to lodge an appeal should be excluded from the harmonization approach.
43. Annex C, *supra* note 28, art. 3.2.
44. *Id.* art. 4.1.
45. *See id.* art. 5.
46. *See id.* art. 6.

> enforcement as penal or revenue in nature, or based on the public nature of the law enforced, due solely to the governmental status of the plaintiff pursuing the redress claim.[47]

Both Annex A and Annex B are proposed as complementary to each other, and "both proposals are meant to work as alternatives for providing meaningful redress to consumers."[48]

Finally, Annex B refers to model rules for electronic arbitration of cross-border consumer claims. This annex is treated here as the last one as it plays a complementary role to the other two. Indeed, Annex B provides draft model rules for electronic arbitration of consumer claims. Unlike Annexes A and C, Annex B is only conceived for cross-border relations. Hence, it is possible to deduce from this precise scope that arbitration is not seen as an option for domestic consumer claims. Indeed, this feature seems rather odd, especially in the context of the U.S. proposal. The claim cannot exceed US$ 1,000.[49] The arbitration procedure is qualified as simple, economical, fast, and fair; as a result it should be effective.[50] Notwithstanding that, rules seem quite similar to rules in commercial arbitration but they are drafted in a more vague and incomplete fashion.[51] Moreover, U.S. and Canadian experiences with online arbitration is not particularly promising for other countries.[52]

D. The Nature of the Proposals and the Issue of Their Compatibility

Only the Draft Convention proposed by Brazil would be binding on member states. For that reason, it is also the most difficult instrument to negotiate and the most complicated to enter into force, due to the need for ratification by state parties. Advantages and disadvantages of concluding an international convention are well known. On the one hand, due to its legal nature, a convention lacks flexibility. Even if a convention provides for the possibility to ratify it with reserves, the text is, and must be, taken as a whole. On the other hand, the fact that the

47. Annex C, *supra* note 28, art. 6.1.

48. *See* Annex A, *supra* note 28, at n.1; Annex C, *supra* note 28, at n.1.

49. Annex B, *supra* note 28, art. 3.a.

50. Provided that consumers continue to have access to theirs own courts, the option for an international arbitration proceeding should be attractive for them; in particular, from an economical point of view.

51. *See* Velázquez Gardeta, *supra* note 6, at 598-608, 612-15.

52. *See id.* at 577 (citing relevant case law); Dell Computer Corp. v. Union des consommateurs, [2007] 2 S.C.R. 801, 2007 SCC 34 (Can.). *See also* Richard Alderman, *The Future of Consumer Law in the United States—Hello Arbitration, Bye-Bye Courts, So Long Consumer Protection* (University of Houston Law Center: Public Law and Legal Theory Series 2008-A-09, 2007), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1015517. *Cf* the North-American judicial approach with that of Europe in CJCE, October 26, 2006, case C-168/05, *Claro*.

text would be adopted as such, without being adapted according to the peculiarities of each state, could enable a true harmonization of consumer law. Moreover, a convention may also serve as a model law, as a number of conventions have already shown, particularly conventions adopted within the OAS.[53] This possibility could be particularly useful in the regulation of international consumer contracts, given that most of the national legal systems in the Americas have no rules for these contracts—neither on applicable law nor on jurisdiction.[54]

However, soft law is likely to be a faster way to achieve harmonization of consumer law. Indeed, model laws and legislative guides offer a degree of flexibility and adaptability in accordance with the needs and wishes of each state that facilitates negotiation. Nonetheless, it can be feared with good reason that the ultimate aim of harmonization of consumer law would not be successfully fulfilled with such an instrument whose version varies from country to country.

Instead of betting all the chances of harmonization on one instrument, a combination of different types could be chosen. For instance, the adoption of a convention regarding choice of law matters and a model law on international jurisdiction, as long as both were compatible (adopting the same fundamental policies), is an option which could be in principle feasible. However, in the concrete CIDIP VII scenario, proposals from Brazil and from Canada seem to be incompatible because of their departing philosophies. Nevertheless a convention such as the one proposed by Brazil could coexist with a model law on jurisdiction (or even with a convention on jurisdiction) other than that proposed by Canada.[55]

Regarding the U.S. proposal, its compatibility with both other texts is clear as far as they deal with different aspects of the same reality. U.S. (general) Draft Legislative Guidelines and U.S. (particular) drafts model laws aim at reforming the national legal systems in three particular aspects: first, the introduction of a procedure for resolving small claims in consumer contracts; second, the introduction of a procedure for the

53. *See* D.P. FERNÁNDEZ ARROYO, DERECHO INTERNACIONAL PRIVADO INTERAMERICANO 64-65 (2d ed., Universidad Anahuac del Sur 2003).

54. *See* C. Lima Marques, *As Lições da Reunião Preparatória de Porto Alegre da Conferência Especializada e Direito Internacional Privado—CIDIP VII—de Proteção dos Consumidores e das Negociações Posteriores, in* PROTECCIÓN DE LOS CONSUMIDORES EN AMÉRICA. TRABAJOS DE LA CIDIP VIII 79, 204-05 (D.P. Fernández Arroyo & J.A. Moreno Rodríguez eds., 2007).

55. *See* E. Tellechea Bergman, *Hacia una Regulación Interamericana Sobre Jurisdicción en Materia de Relaciones Internacionales de Consumo—Esbozo de Bases a Partir de Algunos Desarrollos del MERCOSUR, in* PROTECCIÓN DE LOS CONSUMIDORES EN AMÉRICA. TRABAJOS DE LA CIDIP VIII 79, 204-05 (D.P. Fernández Arroyo & J.A. Moreno Rodríguez eds., Asunción 2007).

electronic arbitration of the most common cross-border consumer claims; and, third, the establishment of competent consumer protection authorities vested with the power to obtain redress for consumers and to cooperate with their foreign counterparts. Obviously, none of these goals is contradictory with the adoption of a common set of rules to determine the law applicable to international consumer contracts.[56] The U.S. delegation has openly recognized that "these Guidelines are not intended to provide details of procedures for all attempts by individual businesses and consumers to resolve disputes directly and informally"[57]; on the contrary, they "are intended to complement existing . . . rules regulating or affecting business-to-consumer transactions."[58]

Already in 2005, delegations assembled in the Committee of Juridical and Political Affairs of the OAS had agreed that the CIDIP VII would produce both a convention on applicable law and a model law on monetary redress. The OAS legal advisor in charge of the CIDIP at the OAS Department of International Law explained the agreement in the following words: "the convention would create a system to determinate the applicable rules to consumer litigation, whilst the model law would complement the convention with mechanisms for the redress whenever there are no more effective solutions."[59]

III. DIFFERENT ASPECTS OF CONSUMER (PRIVATE INTERNATIONAL) LAW

A. The Options: From Law Applicable to ADR/ODR

The difference of approach is also reflected in the issues covered by the three projects. The Brazilian Draft Convention is the most limited and the most concrete; it restricts itself to the issue of the applicable law. This limitation is motivated by a very good reason: the narrower the ambit of a convention, the easier it is to negotiate that convention and to bring debates to a satisfactory and promptly solution.[60]

56. As it is expressly established in the final document of the Experts Meeting of Porto Alegre ('Explanatory Introduction to the Experts Meeting carried out by the OAS—Porto Alegre, December 2-4, 2006'), "delegations agreed that the US proposal and the Brazilian proposal were complementary and not mutually exclusive."

57. U.S. Legislative Guidelines, *supra* note 28, art. 2.2.

58. *Id.* art. 2.1 (emphasis added).

59. *See See* J.M. Wilson Molina, *CIDIP VII: trabajos preparatorios para la Séptima Conferencia Especializada Interamericana sobre Derecho Internacional Privado, in* INTERNET, COMÉRCIO ELETRÔNICO E SOCIEDADE DA INFORMAÇÃO—DECITA, REVISTA DE DIREITO DO COMÉRCIO INTERNACIONAL NO. 5/6, at 600-01 (Adriana Dreyzin de Klor & D.P. Fernández Arroyo eds., 2006).

60. *See* Lima Marques, *supra* note 54, at 190, 205.

However, it is here submitted that harmonization should be first achieved on the jurisdiction issue.[61] As consumer law contains many mandatory provisions, their application depends heavily on the jurisdiction seized. Notwithstanding, the negotiation of *fora* and other jurisdictional issues are the most difficult to compromise as jurisdiction is intrinsically linked with national legal orders and often seen as a question of sovereignty. That is the reason why, in spite of the fact that before the beginning of the official discussions in the cyber-forum of the CIDIP, several voices called informally for the inclusion of jurisdictional issues within the scope of the draft. The idea that prevailed, however, was to reserve jurisdictional matters for the near future.[62] Failed experiences from other organisations also played a role in making the decision not to introduce those matters in the Brazilian Draft.[63]

The Canadian Draft Model Law encompasses both issues of applicable law and jurisdiction. Nevertheless, only the latter was primarily identified by Canada as an issue to be treated by the CIDIP VII.[64] Treatment of the applicable law issue was added later, and it consists of only one article.[65] Although more inclined to address jurisdictional issues, Canada walks side by side with Brazil on the traditional conflicts road. Both countries, as well as almost all the states represented in the CIDIP VII debate, find that there is still room to regulate private international law for "classical" issues in consumer matters.[66]

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61. *See* Tellechea Bergman, *supra* note 57, at 213.

62. *Id.* at 213-17.

63. *See* Lima Marques, *supra* note 54, at 202 (underlining specially the problems arisen from the discussions on a global judgment convention at the Hague Conference on Private International Law, and from the lack of the effectiveness of the MERCOSUR Santa Maria Protocol on jurisdiction on consumer contracts, adopted in 1996 and not yet entered in force).

64. *See* Canadian Draft Model Law, *supra* note 18, at 2. "In recognition of the exponentially increasing cross-border electronic transactions involving consumers, Canada notes the need to develop jurisdictional practicable and reasonably predictable rules for cross-border business and consumer transactions on the Internet."

65. Given its declared preference for a model law rather than a convention, this addition seems an attempt to offer an option to the Brazilian proposal. *See id.*

66. This view is also shared in Europe. Indeed, the European Union has included specific rules for international consumer contracts in the Regulation 44/2001 ("Brussels I" Regulation, on jurisdiction and recognition and enforcement of judicial resolutions; *see also* Michael WILDERSPIN, *Le règlement (CE) 44/2001 du Conseil: conséquences pour les ontrats conclus par les consommateurs*, REV. EUR. DROIT CONSOMMATION, 2002 no. 1, at 5), and recently in "Rome I" Regulation (law applicable), modernizing the old rules on the same subject already present, respectively, in the 1968 Brussels Convention and in the 1980 Rome Convention. Also the recent updating of 1988 Lugano Convention (a "parallel convention to the 1968 Brussels Convention, linking EU states with EFTA states) has touched consumer provisions. *See also* Andrea Bonomi, *Les Contrats Conclus par les Consommateurs dans la Convention de Lugano Révisée*, *in* LA

The U.S. Draft Legislative Guidelines intend to go further in the direction of a treatment of consumer law as a whole because they propose new remedies to settle disputes arising between consumers and professionals. As mentioned above, the Guidelines propose to build a system of legal cooperation between State authorities. The project is ambitious as it also creates a common system for alternative dispute resolution that is generalized to almost all consumer disputes. The implicit idea is that conflict rules (both on applicable law and jurisdiction) are not effective (and then not necessary) to deal with consumer contracts.[67] In the opinion of the U.S., what all of the OAS member states need is a set of rules on small claims, authorities protecting consumers, and online arbitration. Such a proposition hides at least two serious flaws. First, a good part of the proposed rules proposed apply to internal cases rather than international ones. Secondly, in order to operate at an international level, some of the rules require either complementing rules or concluding agreements with other states. For example, according to article 4.1 of the U.S. Draft Model Law on small claims (Annex A), the claimant shall submit a claim form "to the relevant tribunal." Thus, for this rule to be workable in the international scenario, jurisdictional rules are necessary to know which court could take the case, i.e. which is the relevant tribunal. If the U.S. drafters considered only purely domestic cases, then the proposal has nothing to do with the Brazilian Draft and the issue of mutual compatibility is complete solved.

B. Need of Choice of Law Rules

Due to the fact that there are no inconsistencies between the proposals from Brazil and from the U.S. (or, in other words, accepting the compatibility between different instruments dealing with different aspects of the same matter), one can still evaluate the need and the opportunity of each one. U.S. delegates have expressed the idea that, to the extent that consumer disputes are usually of a small monetary value, litigation in "ordinary" courts does not make sense because proceedings will be very expensive and long and, by consequence, unaffordable for consumers.[68] According to this perspective, rules on applicable law would be worthless because consumer disputes should not be solved

CONVENTION DE LUGANO. PASSÉ, PRÉSENT ET DEVENIR 65 (A. Bonomi, E. Cashin Ritaine & G.P. Romano eds., 2007).

67. *See also* CALLIESS, *supra* note 10, at 134-36.

68. *See* M.J. Dennis, *Diseño de una Agenda Práctica para la Protección de los Consumidores en las Américas*, *in* PROTECCIÓN DE LOS CONSUMIDORES EN AMÉRICA: TRABAJOS DE LA CIDIP VII 219-21 (D.P. Fernández Arroyo & J.A. Moreno Rodríguez eds., 2007).

before the courts. Besides, the very determination of the applicable law would be expensive in comparison with the amount of the disputes.[69]

Even if it is admitted that most of consumer disputes involve small amounts of money, it is hardly possible to share the U.S. vision about "classical" consumer protection methods. There is no logical connection between these two assertions. The fact that alternative remedies might be useful does not necessarily mean that any other method is worthless. Even the International Chamber of Commerce ("ICC"), which does not show much sympathy towards "classical" conflicts approaches, agrees with its necessity. The "ICC believes that the greatest majority of consumer complaints will be resolved either by a company's internal customer service or similar mechanism, or through ADR. However, *this does not preclude the need for a predictable legal framework* in which to address the few disputes that persist."[70] The same has been said in the European context, in relation to the Regulation establishing a European small claims procedure.[71]

There is still another reason to adopt conflicts rules in matters of consumer law. Almost all American countries have rules more or less developed on consumer law. Some Latin American states maintain a high standard of protection. On the contrary, almost no national legal system in the Americas has specific rules for international consumer relationships.[72] For these reasons, despite the attraction of the Draft model laws, Latin American states have demonstrated their interest in the Brazilian Draft Convention.[73]

IV. POLICIES

Other than the different choices for the most appropriate instrument or combination of instruments used to achieve harmonization of consumer law, the success of the enterprise depends largely on the policies adopted by the states and by the OAS. Consumer protection

69. *Id.* at 232.

70. ICC: Electronic Commerce Project's Ad hoc Task Force, Policy statement: Jurisdiction and applicable law in electronic commerce, June 6, 2001, *available at* http://iccwbo.org/id478/index.html (emphasis added). Surprisingly, although M. J. Dennis, *supra* note 68, at 224, cites this document, he does not mention this statement.

71. *See* Council Regulation 861/2007, 2007 O.J. (L 199), 2. *See also* Ewoud Hondius, *Towards a European Small Claims Procedure?*, *in* LIBER AMICORUM BERND STAUDER 131, 142 (2006) ("A small claims procedure should not replace the consumer complaints tribunals. A competition between the two systems cannot be harmful.").

72. *See* Paula M. All, *El Diseño y la Pprogresiva Construcción de un Sistema de Protección del Consumidor a Escala Americana. Avances y Desafíos Pendientes*, *in* PROTECCIÓN DE LOS CONSUMIDORES EN AMÉRICA: TRABAJOS DE LA CIDIP VII 273, 277-78 (Diego P. Fernández Arroyo & J. A. Moreno Rodríguez eds., 2007).

73. *See* Lima Marques, *supra* note 54, at 204.

needs more than an adequate system of rules and proceedings. Education, advertising, and promotion of good conduct are among the long list of activities that public powers may develop to promote consumer protection at every level (local, national, supranational or regional). Notwithstanding the foregoing the policies embedded in the different proposals need to be evaluated.

Subject to some conditions, the Brazlian Draft Convention foresees that the most favourable law to the consumer should be applied. This principle reflects one policy, which is clearly focused on the protection of the consumer. Of course, this policy needs to be counterbalanced by the option to choose the law and the consequent legal certainty that the Convention would offer to providers.[74] Such an option should be analyzed in the context of the current state of affairs in the Americas, which shows that national legal systems are very heterogeneous and that the courts usually apply the *lex fori* to solve international consumer contracts.

This policy is not always the one pursued by all the states negotiating in the working group of the OAS. Some OAS member states—specifically Canada and the U.S., as well as two members of the Inter-American Juridical Committee ("IJC"),[75]—have criticized the use of the most favourable law principle. According to those delegations, this principle would be difficult to apply in practice.[76] Therefore applicable law would hardly be predictable. As an answer to these critics, the Brazilian delegation has proposed a rule containing several subsidiary criteria that determine which law should be reputed as the most favourable to the consumer. The first law most favourable to the consumer is the law of consumer's domicile; the second is the law of the common residence of the consumer and one of the branches of the provider, and so on.[77] It is here submitted that the introduction of these criteria is not a good answer since it might result in the loss of the key point of the Brazilian Draft Convention. On the one hand, in most cases, it will come back to the expanded idea that the better law for consumers

74. *See* Brazilian Draft Convention, *supra* note 7, pmbl. ("[H]aving in mind . . . the need to provide for an adequate protection to the consumer . . . and to give greater juridical security to all the parties intervening in consumer transactions.").

75. *See* the documents OAS/Ser.Q, CJI/doc.230/06 corr. 1, 18 August 2006 (Antonio F. Pérez and J.G. Rodas); OEA/Ser.Q, CJI/doc.227/06, 9 August 2006 (Antonio F. Pérez).

76. The U.S. delegation sent the experts a list of hypothetical cases aimed at demonstrating the difficulties of applying the most favorable law test. However, cases included in the US document do not seem hard to solve. According to Claudia Lima Marques, students of the XXXIV OAS Course on International Law (2007) who faced this matter for the first time could resolve them in less than ten minutes. *See* Lima Marques, *supra* note 54, at 180-81.

77. *See* Brazilian Draft Convention, *supra* note 7, art. 6(2).

is the law of their own domicile.[78] Since this law is the one provided by the Brazilian Draft Convention for cases in which there is no valid choice of law, the Convention would give only one solution—and the typical one—for contracts concluded by passive consumers. On the other hand, many critics are opposed to following the principle of the most favourable law to the consumer itself. Therefore, no change in its application will serve to satisfy those critics.

The U.S.[79] and the members of IJC mentioned above[80] have also argued that the Brazilian proposal could be discriminatory because "exporters might be subject to the laws of the exporting country or to those of the importing country, depending upon which ones are most favourable to the consumer . . . [but] a business within the importing country would only be subject to the rules of that country, since the draft convention only applies to a cross-border international consumer contract."[81]

All these questions deserve further discussion. Nevertheless, it is possible to ascertain that the introduction of a substantial policy in a conflicts convention is not new within the CIDIP process. As a matter of fact, the 1989 Inter-American Convention on Support Obligations (CIDIP IV), in force in twelve Latin-American states, establishes in its article 6 that "support obligations, as well as the definition of support creditor and debtor, shall be governed by whichever of the following laws the competent authority finds the most favourable to the creditor: a. that of the state of domicile or habitual residence of the creditor; b. that of the state of domicile or habitual residence of the debtor."[82]

In the same vein, the very principle of the existence of a consumer's right to the access to justice and its concrete scope are controversial issues. Again, such a principle is defended by some OAS member states,

78. This idea that is present in the European private international law system in the 1980 Rome Convention (article 5) and in Regulation 'Rome I' (article 6) is particularly useful when all the member states have a good level of consumer protection. In fact, the EU is revising all its consumer acquis in order to achieve a complete harmonization on the matter. *See, e.g.*, *Commission Green Paper on the Review of the Consumer Acquis*, COM (2006) 744 final (Aug. 2, 2007). This EU feature provokes doubts and criticism as it is reflected in T. Whilhelmsson, *Full Harmonization of Consumer Contract Law?*, Z. EUR. PRIV., 2008 no. 2, at 225; Norbert Reich, *Die Stellung des Verbraucherrechts im 'Gemeinsamen Referenzrahmen' und im 'optionellen Instrument' – Trojanisches Pferd oder Kinderschreck?*, *in* LIBER AMICORUM BERND STAUDER 364-69 (2006).

79. Document sent to the experts of OAS member states.

80. *See* sources cited *supra* note 75.

81. Generally discrimination is understood as the unequal treatment of the same (or comparable) situations, which is not the case in this example.

82. *See generally* R. Herbert & C. Fresnedo de Aguirre, *Flexibilización teleológica del derecho internacional privado latinoamericano*, *in* LIBER AMICORUM JÜRGEN SAMTLEBEN 55 (2002).

but others do not proclaim it as a right. A common position on this issue should be taken before adopting specific provisions regarding either jurisdiction or ADR. Furthermore, online dispute resolution ("ODR") mechanisms already exist in several parts of the world and in diverse ways for both consumer disputes and other kinds of controversies.[83] The existence of these mechanisms has not eliminated the use of (and, therefore, the need for) other mechanisms and tools for conflicts resolutions.

All in all, the remaining question is what would be the consequence of leaving the Brazilian proposal aside. As mentioned above, Latin American countries have no specific conflicts rules on consumer contracts. Whenever a court in a Latin American state faces international consumer contracts, the general attitude is to deny party autonomy and apply the *lex fori*. In some situations, courts seem not to be aware of the internationality of cases.[84] Even where party autonomy is accepted in general, without distinctions, rules on consumer contracts are usually seen as mandatory provisions and are, therefore, excluded from the scope of party autonomy.[85] Thus, although consumer contracts are not explicitly excluded from the scope of the 1994 Mexico City Convention on the law applicable to international contracts (CIDIP V), the prevailing opinion is that consumer contracts are not covered by that Convention.[86] In addition, current national projects on private international law (Argentina, Uruguay) do not allow choice of law clauses (or choice of forum clauses) in consumer contracts.

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83. Inter alia, the Electronic Consumer Dispute Resolution (ECODIR, www.ecodir.org) for consumer transactions; the Cibertribunal Peruano (www.cibertribunalperuano.org/portalcibertribunal/principal.aspx) for domain names, etc.

84. *See* N. de Araujo, *Contratos Internacionais e Consumidores nas Américas e no MERCOSUR: Análise da Proposta Brasileira para uma Convenção Interamericana na CIDIP VII*, *in* CADERNOS DO PROGRAMA DE PÓS GRADUAÇÃO EM DIREITO—PPGDIR./UFRGS 5, at 107, 119 (2006) (citing the *Panasonic* case, *Superior Tribunal de Justiça*, Resp 63.981, Aug. 13, 2001, *RSTJ*, No. 137, 12 (Jan. 2001), 387).

85. *See* C.D. Iud, *Los Acuerdos de Prórroga de Jurisdicción Concluidos por Consumidores en el Derecho Argentino*, *in* PROTECCIÓN DE LOS CONSUMIDORES EN AMÉRICA. TRABAJOS DE LA CIDIP VII1 421, 436 (D.P. Fernández Arroyo & J.A. Moreno Rodríguez eds., 2007) (citing the decision of the Argentinean National Court of Appeal, Chamber B, of 22 June 2005, *Volpi c/ UBS AG*, applying article 16 of the Argentinean Constitution to void a clause which submitted the contract to the jurisdiction and to the laws of Switzerland); *see also* D.P. Fernández Arroyo, *Chronique de jurisprudence argentine*, JDI, at 199, 204-05 (2008). *Cf* Sinay-Cytermann, *supra* note 11 (discussing the French decision, Cass. 1ere civ., 23 mai 2006 *JDI* (2007) 537).

86. *See* The Declaración de Córdoba, *available at* www.oas.org. *See also* J.A. Moreno Rodríguez, *La Convención de México sobre el Derecho Aplicable a la Contratación Internacional*, *in* PROTECCIÓN DE LOS CONSUMIDORES EN AMÉRICA. TRABAJOS DE LA CIDIP VII1 107, 140-41 (D.P. Fernández Arroyo & J.A. Moreno Rodríguez eds., 2007).

V. FINAL REMARKS

Three final conclusions can be drawn from the current approaches towards harmonization of consumer laws in the Americas.

First, consumer law needs an integral treatment. A single model law or convention is not enough to solve the problems caused by consumer transactions; a good combination of several instruments—and policies—would be preferable. The adoption of the Brazilian proposal, which is ready to be submitted for approval in a diplomatic conference, must not (and will not) preclude the implementation of others consumer protection mechanisms.

Second, given that most international consumer transactions are made by electronic means, any instrument adopted with the goal of harmonization should be suited to dealing with e-commerce. Nonetheless, even if online consumers become increasingly significant, the Internet does not constitute the only way to conclude consumer contracts. Consumer relationships still survive outside the net. Therefore, the best regulation on consumer law requires a complete treatment of the matter, online and offline.

Third, it should be taken into consideration that some instruments can require high investments unaffordable for some Latin American countries. Therefore, much information should be taken into account.

Payment Transactions under the EU Payment Services Directive: A U.S. Comparative Perspective

Benjamin Geva*

I. INTRODUCTION

Implementing a Proposal[1] of the Commission of the European Communities ("the Commission"), the Directive on payment services in the internal market, often colloquially referred to as "the payment services Directive" ("Directive"),[2] provides for "a harmonised legal framework" designed to create "a Single Payment Market where improved economies of scale and competition would help to reduce cost of the payment system." Focusing on electronic payments, the Proposal purported to "only harmonise what is necessary to overcome legal barriers to a Single Market, avoiding regulating issues which would go beyond this matter."[3]

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1. *Commission Proposal for a Directive of the European Parliament and of the Council on Payment Services in the Internal Market*, COM (2005) 603 final (Dec. 1, 2005), *available at* http://ec.europa.eu/internal_market/payments/framework/index_en.htm. Quotations in the text are from the Explanatory Memorandum, under "Context of the Proposal," which further cites Articles 47(2) and 95(1) of the EC Treaty as the legal basis for the proposal. The proposal was discussed by this author in Benjamin Geva, *Recent International Developments in the Law of Negotiable Instruments and Payment and Settlement Systems*, 42 TEX. INT'L. L.J. 685, 712-25 (2007).

2. Council Directive 2007/64/EC, On Payment Services in the Internal Market, 2007 O.J. (L 319) 1 (EC) [hereinafter Directive]. This amended several previous Directives—Directives 97/7/EC, 2002/65/EC, 2005/60/EC and 2006/48/EC—and repealed Directive 97/5/EC of the European Parliament and of the Council of 27 January 1997 on cross-border credit transfers. [SHERRY: can you fix this extra, blank line?]

3. *Commission Proposal*, *supra* note 1, at 7 (under "Legal Elements of the Proposal").

Title I of the Directive provides for subject matter, scope and definitions. It is followed by three substantive components. Title II covers payment service providers. Title III deals with transparency of conditions and information requirements for payment services. Title IV governs rights and obligations in relation to the provision and use of payment services. Under Directive Article 2, both Titles III and IV apply only where both the payer's and payee's payment service providers are located in the Community. In a major departure from the Proposal, Titles III and IV are not limited to payment transactions of up to EUR 50,000;[4] there is no amount ceiling whatsoever for payment transactions governed by them. The three substantive components are followed by Title V, dealing with implementing measures and Payment Committee, and Title VI, consisting of final provisions. Particularly, implementing measures may be adopted by the Commission with the view of (i) amending "non-essential elements of [the] Directive, relating to" the adaptation of the list of activities that constitute "payment services" under the Annex, as well as (ii) updating amounts specified in a few provisions "in order to take account of inflation and significant market developments."[5]

This article endeavours to analyse the provisions of Title IV governing rights and obligations in relation to the provision and use of payment services. Analysis is particularly from a US comparative perspective.[6] Attention will be given to Uniform Commercial Code ("UCC") Article 4A, which governs U.S. wire and other credit transfers as well as federal laws governing consumer retail payment systems. A broader but related objective of the article is the assessment of the contribution of Title IV to the harmonization of funds transfer and payment law, not only by comparison to the U.S., but also by reference to a few aspects of a national law of an EU Member State. Scope does not allow a comprehensive treatment to either aspect, particularly the latter; yet, salient issues will be addressed. The ultimate conclusion is

4. The applicable Proposal provision setting this ceiling for Titles III and IV is Article 2(1). Note that about 70% of all TARGET2 (for which *see* note 42 *infra*) payments are below 50,000 EURO. *See* EUROPEAN CENTRAL BANK-EUROSYSTEM, TARGET ANNUAL REPORT 2008 at 18 chart 9; BENJAMIN GEVA, LAW OF ELECTRONIC FUNDS TRANSFERS § 4.04[7] 4-139 n.180 (2008) (1992).

5. Directive art. 84. Another matter that can be so changed is "the definition of micro enterprise within the meaning of Article 4(26) . . .," *id.*, which may be important should a Member State move to apply to micro enterprises prohibitions against disclaimer clauses as set out in Title III and IV.

6. For a discussion of the entire Directive, albeit in a context of a significantly less extensive comparative analysis, *see* Benjamin Geva, *The EU Payment Services Directive: An Outsider's View*, *in* 28 YEARBOOK OF EUROPEAN LAW 2009 (Eeckhout & Tridimas eds., forthcoming).

that the Directive is a positive but inadequate step towards global and European harmonization.

II. SCOPE

The scope of the Directive is stated in Article 2(1) to "apply to payment services provided within the Community," both national and cross-border.[7] It governs the business activity of carrying out payment through the services of one or two payment services providers, each acting for a "payment service user";[8] the latter being either the payer (that is, "payor" in American English) or the payee, who may be either a natural or legal person.[9] The payment service may be carried out for either a consumer or business transactions, and may be for any amount.

Payment services providers[10] consist of: credit institutions (commercial banks and electronic money institutions), post office giro institutions, central banks, Member States or their regional or local authorities, as well as "payment institutions" established under the Directive—primarily, money transmitters.[11]

Effectively, a payment service is performed in the form of carrying out a payment transaction: namely, a transfer of funds from a payor to a payee. The scope of the Directive, in comparison to legislation in the U.S. covering payment transactions, is thus to be assessed by reference to an overall framework explaining and classifying funds transfers.

Conceptually, a payment mechanism denotes a payment transaction; it can broadly be described as any machinery facilitating a non-cash payment in monetary value. While authorizing or conferring on the payee the right to claim the sum of payment from a third party, it enables the payor (i) to avoid the transportation of money and its physical delivery to the payee, and (ii) where applicable, to obtain in the process a discharge of a debt owed by the payor to the payee.[12] A payment mechanism carried out through the banking system may be described as

7. Directive art. 2(1). This is in departure from European Parliament and Council Directive 97/5/EC, On Cross-Border Credit Transfers, 1997 O.J. (L 43) 25 (EC) (known as "the Transparency Directive"), that was superseded by Title III and repealed by the Payment Service Directive.

8. Directive art. 4(10) (defining "payment service user" to mean "a natural or legal person making use of a payment service in the capacity of either payer or payee, or both"). "Payer" and "payor" are used in this article interchangeably.

9. *See* definitions of "payer" and "payee" in Directive Article 4(7) and (8), respectively.

10. Defined in Directive Article 4(9) by reference to Directive Article 1(1).

11. On the whole, they are mostly banks or deposit-taking institutions, so that hereafter, "payment service providers" and "banks" are used interchangeably.

12. This is designed to improve on, for example, Benjamin Geva, *International Funds Transfers: Mechanisms and Laws*, *in* CROSS-BORDER ELECTRONIC BANKING: CHALLENGES AND OPPORTUNITIES 1-2 (C. Reed, I. Walden & L. Edgar eds., 2d ed. 2000).

a "funds transfer";[13] thereunder, funds "move" from one bank account to another, whether at the same or two different banks. It involves a process under which the debt owed to the payor by the payor's bank is ultimately replaced by a new debt owed to the payee by the payee's bank.

A funds transfer is initiated by payment instructions given by the payor or under the payor's authority and issued directly or indirectly to the payor's bank. It is the manner of communicating these instructions to the payor's bank and the resulting sequence of the ensuing banking operations that determine the classification of each mechanism. Thus, depending on how these instructions are communicated to the payor's bank, funds transfers are either debit or credit transfers. As a rule, the communication flow and the movement of funds are in opposite directions in a debit transfer but in the same direction in a credit transfer.

In a debit transfer, the payor's instructions are communicated to the payor's bank by the payee through the payee's bank. Such instructions are issued by the payee under the payor's authority, given in the form of either a specific check or general authority to initiate pre-authorized debits to the payor's account (as, for example, in connection with recurring mortgage or insurance premium payments). When the instructions are communicated by the payee to the payee's bank, the payee's account may be credited. The payee's bank passes these instructions onto the payor's bank, either directly or through an intermediary bank or banks. When the instructions ultimately reach the payor's bank, the payor's account is debited. Funds are thus collected or "pulled" from the payor's account to the payee's account. By definition, in a debit transfer any credit to the payee's account precedes the debit to the payor's account; credit to the payee's account is thus provisional; it may not necessarily be available for immediate use, and is subject to reversal if the payor's bank dishonors the payor's instructions (e.g., for lack of funds) and communicates its rejection to the payee's bank. Such communication may be direct or through the same banking channels by which the instructions were communicated to the payor in the first place. Credit to the payor's account becomes final only as of the time the payor's bank becomes accountable, or makes a "final payment," for the amount, irreversibly debited or to be debited to the payor's account.

In contrast, in a credit transfer (such as a direct deposit of payroll, benefit, interest, pension, or dividend, as well as a wire payment) the payor's instructions are communicated to the payor's bank directly by

13. Unfortunately, however, the drafters of the Uniform Commercial Code reserved the term to denote exclusively a credit transfer. *See* U.C.C. art. 4A, Prefatory Note (2008).

the payor or the payor's agent without the meditation of a credit to the payee's account at the payee's bank. In terms of the banking operation, when the instructions are communicated to the payor's bank, the payor's account is debited. Thus, in a credit transfer, unlike in a debit transfer, the first impact of the payor's instructions on the banking system is a debit to the payor's account with the payor's bank. Having received the payor's instructions and debited the payor's account, the payor's bank forwards the instructions, directly or through intermediary bank(s), to the payee's bank, which ultimately credits the payee's account. Hence, in a credit transfer, the debit to the payor's bank precedes the credit to the payee's account and is not subject to reversal for lack of funds. Stated otherwise, in a credit transfer, funds debited to the payor's account are "pushed" and paid into the payee's account.

"Payment services" to which the Directive applies under Article 2(1) are defined in Article 4(3) to mean business activities listed in the Annex. "Payment services" listed in the Annex[14] consist of: cash deposits in, and withdrawals from, payment accounts;[15] execution of payment transactions[16] in funds[17] held on deposit in a payment account; execution of direct debits; execution of payment transactions through a payment card (or a similar device); execution of credit transfers (including standing orders); execution of payment transactions in funds covered by a credit line; execution of direct debits (including one-off direct debits):[18] issuing of payment cards; execution of payment

14. The list is, however, quite disorganized and repetitive; for example, three items (card payments, direct debits and credit transfers) are enumerated separately according to whether they are used in connection with a "payment account" or credit line.

15. *See* Directive art. 4(14) (defining "payment account" to mean "an account held in the name of one or more payment service users which is used for the execution of payment transactions"). The Proposal required the account to be used "exclusively" for the execution of payment transactions, which was unnecessarily restrictive.

16. "Payment transaction" is defined in Directive Article 4(5) to mean "an act, initiated by the payer or by the payee, of placing, transferring or withdrawing funds, irrespective of any underlying obligations between the payer and payee."

17. "Funds" are defined in Directive Article 4(15) to mean "banknotes and coins, scriptural money and electronic money as defined in Article 1(3)(b) of Directive 2000/46/EC."

18. "Direct debit" is defined in Directive Article 4(28) to mean "a payment service for debiting a payer's payment account, where a payment transaction is initiated by the payee on the basis of the payer's consent given to the payee, to the payee's payment service provider or to the payer's own payment service provider." Unfortunately, "credit transfers" and "payment card" are not defined. *Cf.* Directive art. 4(23) (defining "payment instrument" to mean "any personalised device(s) and/or set of procedures agreed between the payment service user and the payment service provider and used by the payment service user in order to initiate a payment order"); *see also id.* art. 4(16) (defining "payment order" as "any instruction by a payer or payee to his payment service provider requesting the execution of a payment transaction").

transactions in e-money;[19] money remittance services in funds accepted for the sole purpose of carrying out the payment transaction:[20] and execution of certain payment transactions by means of any telecommunication, digital or IT device.

Directive Article 3 deals with the outer limits of the Directive. Thereunder, cash payments, professional physical transport of banknotes and coins; payment transactions consisting of the non-professional cash collection and delivery within the framework of a non-profit or charitable activity; payment transactions through a commercial agent authorized to negotiate or conclude the sale or purchase of goods or services on behalf of the payer or the payee; as well as certain cash refunds are specifically excluded. Also excluded from the coverage of the Directive are currency exchange transactions in the form of cash-to-cash operations; paper checks, drafts (i.e., bills of exchange), vouchers, traveller's checks and postal money orders; payment transactions carried out within a payment or securities clearing and settlement system; payments transactions related to securities asset servicing; payment processing services; payment by instruments which are not redeemable within a limited network or affiliated service providers; certain payment transactions executed by means of a mobile telephone or any other digital or IT device;[21] payment transactions carried out between payment service providers for their own account as well as between entities belonging to the same corporate group such as subsidiaries; and "services by providers to withdraw cash by means of automated teller machine acting on behalf of one or more card issuers, which are not a party to the framework contract with the customer withdrawing money from a payment account, on condition that these providers do not conduct other payment services as listed in the Annex."[22]

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19. *See* Council Directive 2000/46/EC, On the Taking Up, Pursuit of and Prudential Supervision of the Business of Electronic Money Institutions, art. 1(3)(b), 2000 O.J. (L 275) 39 (EC) (defining "electronic money" to mean "monetary value as represented by a claim on the issuer which is: (i) stored on an electronic device; (ii) issued on receipt of funds of an amount not less in value than the monetary value issued; (iii) accepted as means of payment by undertakings other than the issuer").

20. Directive Article 4(13) defines "money remittance" to mean "a payment service where funds are received from a payer, without any payment accounts being created in the name of the payer or the payee, for the sole purpose of transferring a corresponding amount to a payee or to another payment service provider acting on behalf of the payee, and/or where such funds are received on behalf of and made available to a payee."

21. Effectively excluded are "payment transactions executed by means of any telecommunication, digital, or IT device" made to "a telecommunication, digital or IT operator" acting as a supplier for "goods and services . . . delivered" and designed "to be used through a telecommunication, digital or IT device" and not "only as an intermediary between the [payer] and the supplier of the goods and services." *See* Directive art. 3(*l*).

22. *See id.* art. 3(o). This language is grammatically obscure and hence its meaning is not immediately discernable.

In the U.S., electronic funds transfers out of and into consumer asset accounts are governed by the federal Electronic Fund Transfer Act ("EFTA")[23]—subchapter VI of the Consumer Credit Protection Act ("CCPA")[24]—and Regulation E,[25] which implements the EFTA. Regulation E section 205.3(b) defines "electronic fund transfer" to mean "any transfer of funds that is initiated through an electronic terminal, telephone, computer or magnetic tape for the purpose of ordering, instructing or authorizing a financial institution[26] to debit or credit an account."[27] The provision goes on to state that the term:

> includes, but is not limited to, (i) Point-of-sale transfers; (ii) Automated teller machine transfers; (iii) Direct deposits or withdrawals of funds; (iv) Transfers initiated by telephone; and (v) Transfers resulting from debit card transactions, whether or not initiated through an electronic terminal.[28]

Regulation E section 205.3(c) excludes checks, drafts or similar paper instruments, check guarantee or authorization service, transfers through Fedwire or similar wire transfer systems used primarily for business transactions, certain securities or commodities transfers, certain automatic transfers, certain telephone-initiated transfers, and pre-authorized transfers to small financial institutions.[29]

At the same time, while EFTA and Regulation E govern access to a consumer asset account, the federal Consumer Credit Cost Disclosure Act ("CCCDA")[30]—Subchapter 1 of the CCPA—implemented by section 226.12 of Regulation Z Truth in Lending[31] governs a card accessing a credit plan, namely a credit card. "Credit card" is defined as "any card, plate, coupon book, or other single credit device that may be used from time to time to obtain credit."[32] This definition focuses on the credit facility provided by the card, and does not address the means of authenticating the payment by it. Nevertheless, the need for an

23. Electronic Fund Transfer Act, 15 U.S.C. §§ 1693-1700 (1978).
24. Consumer Credit Protection Act, 15 U.S.C. §§ 1601-1700 (1978).
25. Regulation E, 12 C.F.R. § 205 (amended 1981).
26. For our purposes, "financial institution" under EFTA is interchangeable with both "bank" under U.C.C. Article 4A and "payment service provider" under the Directive.
27. *See* Regulation E, 12 C.F.R. § 205, 205.2(b)(1) (defining "account" as a consumer asset account). Since 2006, the definition includes "payroll card account" as defined in Section 205.2(b)(2).
28. Regulation E, 12 C.F.R. § 205, 205.3(b)(1) (2006).
29. *Id.* §§ 205, 205.3(c).
30. 15 U.S.C. § 1631 (2006).
31. Regulation Z, 12 C.F.R. §226, as amended.
32. *Id.* § 226.2(a)(15), which goes on to define "charge card" to mean "a credit card on an account for which no periodic rate is used to compute a finance charge."

authorized user's identification under the third condition for liability for unauthorized use, set out above, was interpreted to cover manual signature, photograph or fingerprint on the card, as well as magnetic stripe used in conjunction with a code.[33]

Interestingly, under EFTA and Regulation E, neither "debit card" nor "debit card transaction" is defined; terminology must be in reference to a payment card facilitating the transfer of funds from or into a consumer asset account.[34] Thus, the dividing line between the credit card covered by Reg. Z and the debit card covered by Reg. E, is not the method of authentication, but rather the type of account to be accessed with the card; the former accesses a credit plan while the latter accesses an asset account.[35] Stated another way, both a debit card and credit card transaction, respectively covered by Reg. E and Reg. Z, could be authenticated either electronically or otherwise, including by means of a manual signature. What matters is the type of account accessed; it is an asset account for the debit card and a credit plan for the credit card.

The transaction covered in the U.S. by U.C.C. Article 4A is a credit transfer, called a "funds transfer."[36] It consists of a "series of transactions, beginning with the originator's payment order, made for the purpose of making payment to the beneficiary of the order . . . [which] is completed by acceptance by the beneficiary's bank of a payment order for the benefit of the beneficiary of the originator's payment order."[37] However, a funds transfer "any part of which is governed by [EFTA]" is specifically excluded.[38] Each of the "series of transactions" of which the "funds transfer" consists, involves a "payment order," meaning an instruction of a sender to a receiving bank, transmitted orally, in writing, or electronically (whether online or offline), to pay, or cause another

33. Regulation Z Official Staff Interpretations to § 226.12, 12 C.F.R. § 226, ¶ 12(b)(2)(iii)(1)-(2) (Supp. I 1999).

34. *See* Regulation E Official Staff Interpretations to § 205.3(b), 12 C.F.R. § 205, ¶ 3(b)(1)(1)(iv) (Supp. I 1999) (which covers "[a] transfer from the consumer's account resulting from a debit-card transaction at a merchant location, even if no electronic terminal is involved at the time of the transaction, if the consumer's asset account is subsequently debited for the amount of the transfer").

35. Obviously, delineation is not always straightforward. A card accessing an asset account tied to an overdraft line as well as a card that accesses both a credit and asset account could be a credit card governed by Reg. Z. *See* Regulation Z Official Staff Interpretations to § 226.2(a)(15), 12 C.F.R. § 226, 2(a)(2) ¶ 1(i)(A) and (B). Presumably, Reg. Z will apply to activities in the credit line and Reg. E to the asset account activity. Details are outside the scope of this study. *See* Reg. E § 205.12(a) and Official Staff Commentary on Reg. E 205.12(a); *see also* Reg. Z § 226.12(g).

36. U.C.C. § 4A-104 (2008). So far as terminology is concerned, no distinction is to be made between a "funds transfer" per U.C.C. Article 4A and "fund transfer" per EFTA and Reg. E.

37. *Id.* § 4A-104(a). Pertinent terms are defined in Sections 4A-103 to 105.

38. *Id.* § 4A-108.

bank to pay, a fixed or determinable amount of money to a beneficiary.[39] Accordingly, for each payment order, the parties are the sender and the receiving bank. In connection with an interbank transfer, other than solely between accounts in correspondent banks, the parties to a funds transfer are the originator, the originator's bank, one or more intermediary banks, the beneficiary's bank and the beneficiary.

In the terminology of the Directive, the originator under U.C.C. Article 4A is the payer; the beneficiary under U.C.C. Article 4A is the payee; the originator's bank under U.C.C. Article 4A is the Directive payer's payment service provider; and the beneficiary's bank under U.C.C. Article 4A is the Directive payee's payment service provider.

Unlike U.C.C. Article 4A, the Directive is not limited to credit transfers and does not exclude consumer transactions.[40] Its coverage extends to both credit and debit transfers as well as to consumer and business payment transactions. Unfortunately however, this achievement is mitigated by two factors. First, the Directive is not as comprehensive as U.C.C. Article 4A in terms of the range of issues covered. Second, the provisions outlining the scope of the Directive, set out above, are not entirely clear. They do not focus on the conceptual framework covering both credit and debit transfers but rather are saddled with unnecessarily long details, some of which are obscure. In the final analysis, in endeavoring to ascertain the underlying framework determining the scope of the Directive, one may get lost in a maze and not see the forest from the trees.

In turn, federal legislation in the U.S. governing consumer retail payment systems does not address the classification between debit and credit transfers; rather, scope of each relevant statute hinges on the type of consumer account accessed by consumers. In addition, federal legislation in the U.S. focuses on disclosures and misuse of payment devices; it does not purport to provide for a comprehensive scheme governing rights and obligations in connection with carrying out payment transactions. In short, consumer payment law in the U.S. is more of consumer protection law, with no parallel to U.C.C. Article 4A providing for a comprehensive scheme governing rights and obligations in connection with payment transactions governed by it.

39. *Id.* § 4A-103(a)(1).

40. *See* GEVA, *supra* note 4, § 2.02[3](c) (discussing the scope of U.C.C. Article 4A).

III. TITLE IV: RIGHTS AND OBLIGATIONS: OVERVIEW

Directive Title IV consists of:

- common provisions (Chapter 1 consisting of Articles 51-53);
- the authorization of payment transactions (Chapter 2 consisting of Articles 54-63);
- the execution of payment transactions (Chapter 3 consisting of Articles 64-78);
- data protection (Chapter 4 consisting of Article 79); and
- out-of-court complaint and redress procedures for the settlement disputes (Chapter 5 consisting of Articles 80-83).

The present article discusses the provisions of Chapters 1-3 by reference to parallel provisions in legislation in the U.S.

For the provisions of Title IV to apply, other than Directive Article 73 as discussed below, both the payer's and payee's payment service providers must be located in the Community.[41] Stated otherwise, the Directive will not apply to payments coming from or going out of the Community, even when they are denominated in euro. As for the payment as it is carried out between two payment service providers located in the Community, transfer need not necessarily be over TARGET2;[42] nor need it necessarily be in euro.

Other than in consumer[43] payment transactions, Directive Article 51 provides for the ability of parties to contract out of or vary some of the provisions of Title IV.[44] Directive Article 51 also allows Member States

41. Directive art. 2(1).

42. TARGET2 is the transfer system of the European Union for large-value and urgent payments. *See e.g.*, *TARGET2- The New Payment System for Europe*, MONTHLY REP. OF DEUTSCHE BUNDESBANK, Oct. 2007, at 69; Nicolas de Sèze, *TARGET2: From Concept to Reality*, 149 BANQUE DE FRANCE BULLETIN DIGEST 1 (2006). For a comprehensive discussion on the legal framework, *see* Kestutis Laurinavičius, Klaus M. Löber & Hans Weenink, *Legal Aspects of Target2*, 23 J. INT'L BANKING L. & REG. 15 (2008). *See* numerous reports and informational brochures of the European Central Bank. *See also* Benjamin Geva, *TARGET2 Transfer of Funds and Harmonization of EU Payment Law*, 41 UCC L.J. 113 (2008).

43. *See* Directive art. 4(11) (defining "consumer" to mean "a natural person who, in payment service contracts covered by this Directive, is acting for purposes other than his trade, business or profession").

44. *See id.* art. 51(1) ("Where the payment service user is not a consumer, the parties may agree . . . [that various provisions] shall not apply in whole or in part.").

to exempt consumers from Directive Article 83 requirements covering out-of-court redress.[45] It further allows Member States to provide that Title IV applies to micro-enterprises[46] "in the same way as to consumers."

Specifically, Directive Article 51 provides for the power of parties to contract out of or vary some provisions other than in connection with a consumer payment service user.[47] Thus, in non-consumer payment transactions, parties may contract out of: provisions dealing with allocation of charges;[48] authorization by consent by means of an agreement;[49] time for notifying an unauthorized or incorrectly executed payment transaction;[50] onus of proof in connection with an alleged unauthorized payment transaction;[51] allocation for losses for unauthorized payments;[52] refund for debit transfers;[53] irrevocability of a payment order;[54] and loss allocation in connection with non-execution or defective execution.[55]

By comparison, variation by agreement is recognized in principle by U.C.C. Section 4A-501.[56] Serious limitations nonetheless exist; for example, limitations exist in connection with unauthorized payment orders, receiving bank's liability for improper or late execution, refund upon non-execution, and some beneficiary's rights against beneficiary's bank.[57] In line with the Directive, waiver of rights is precluded in the U.S. for consumer payment systems for both credit cards[58] and electronic fund transfers.[59]

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45. *Id.* art. 51(2).

46. Defined in Directive Article 4(26) to mean "an enterprise, which at the time of conclusion of the payment service contract, is an enterprise defined in Article 1 and Article 2(1) and (3) of the Annex to Recommendation 2003/361/EC [2003 O.J. (L 124) 36]." In principle, this is an enterprise (namely an entity engaged in economic activity irrespective of its legal form) which employs fewer than 10 persons and whose annual turnover and/or annual balance sheet total does not exceed EUR 2 million.

47. *See* Directive art. 51(1) (requiring that the specified provisions of the Directive "shall not apply in whole or in part").

48. *Id.* art. 52(1).

49. *Id.* art. 54(2).

50. *Id.* art. 58.

51. *Id.* art. 59.

52. Directive art. 61.

53. *Id.* arts. 61, 62.

54. *Id.* art. 66.

55. *Id.* art. 75.

56. U.C.C. § 4A-501 (2008). Provisions of Article 4A may also be varied by Federal Reserve regulations and circulars and to some extent by funds-transfer system rules. *See id.* §§ 4A-107, 4A-501(b).

57. *See id.* §§ 4A-202 to 204, 4A-305(f), 4A-402(f), 4A-404(c). For a discussion, *see* GEVA, *supra* note 4, § 2.02[6].

58. CCCDA, 15 U.S.C. §§ 1631, 1643(c), (d) (2006).

59. EFTA, 15 U.S.C. § 1693*l* (2006).

In principle, the different treatment for consumer and business payments, which is common to both the Directive and U.S. legislation, is understandable. Moreover, policy grounds support the ability of business parties to contract out provisions that are suitable for consumer retail payments. However, unlike U.C.C. Article 4A in the U.S., the Directive does not contain a solid threshold—namely, a meaningful standard from which even non-consumers ought not to be released. The point will be demonstrated further below in the discussion on unauthorized payment orders.

Another common provision is Directive Article 53 dealing with derogation for low value payment instruments and electronic money. It applies to payment instruments that "solely concern individual payment transactions not exceeding EUR 30 or which either have a spending limit of EUR 150 or store funds which do not exceed EUR 150 at any time."[60]

Finally, a common provision, although not enumerated as such, is Directive Article 78, located at the end of Chapter 3. Directive Article 78 provides for a defense to liability under the liability provisions of Title IV. Thus, under Directive Article 78, "[l]iability under Chapter 2 and 3 [liability in connection with either the authentication or the execution of payment transactions] shall not apply in cases of abnormal and unforeseeable circumstances beyond the control of the party pleading for the application of those circumstances, the consequences of which would have been unavoidable despite all efforts to the contrary, or where a payment service provider is bound by other legal obligations covered by national or Community legislation."[61] Similarly, under EFTA § 1693h(b), a financial institution is exempted from liability where its action or failure to act resulted from "an act of God or other circumstances beyond its control"[62] or technical malfunction known to the consumer.[63]

IV. AUTHORIZATION OF PAYMENT TRANSACTIONS.

Authorization of payment transactions is governed by the Directive in Chapter 2 consisting of Directive Articles 54-63. The provisions cover authorization in general and electronic authorization in particular,

60. *See* Directive art. 53(1). However, under Directive Article 53(2), for national payment transactions, "Member States . . . may reduce or double [these] amounts. . . . They may increase them for prepaid payment instruments up to EUR 500." "Prepaid payment instruments" are undefined.

61. *Id.* art. 78.

62. 15 U.S.C. §§ 1693, 1693h(b)(1).

63. *Id.*

onus of proof, liability for losses, as well as reversal of authorized debit transfers.[64]

"Authorization" in the form of "consent" is to be given for the execution of a "payment transaction."[65] Directive Article 54 treats authorization only in terms of the payer's consent, which is obviously required also for "debit-pull" withdrawals by the payee from the payer's account.[66] Directive Article 54 makes no reference to the payee's authorization given to the payee's service provider for carrying out a debit transfer from the payer's account.[67]

Authorization in the form of payer's consent may be given under Directive Article 54 "prior to or, if agreed between the payer and the payment service provider, after the execution of the payment transaction" and "in the form" as well as under "[t]he procedure" agreed between them.[68] While in departure from the Proposal, consent is not necessarily required to be "explicit."[69] The reference to an agreement, as well as a procedure, weakens the possibility of an implied authority and may be read to eliminate altogether the possibility of an apparent authority,[70] such as when a cardholder voluntarily delivered the card and shared the associated code with a friend or relative.[71]

Where it is required, authorization is not given for indefinite duration; nor is authorization irrevocable. Therefore, under Directive Article 54, consent "may be withdrawn by the payer at any time, but no later than the point in time of irrevocability" of the payment order under Directive Article 66.[72] "Consent to execute a series of payment transactions" may also be withdrawn with the effect that "any future payment transaction is to be considered as unauthorised."[73]

The Directive contemplates authorization to be given either in an electronic form or some other form.[74] An electronic authorization is defined as authorization given by means of a payment instrument.

64. *See* Directive arts. 54-63.
65. *See id.* art. 54.
66. *See id.*
67. *See id.*
68. *Id.*
69. As in Article 41 of the Proposal.
70. As a matter of agency law, authority can be actual or apparent. Actual authority may be express or implied. *See* BLACK'S LAW DICTIONARY 142 (8th ed. 2004).
71. In which case, liability may nevertheless be fastened on the cardholder under Directive Article 61(2), discussed *infra*.
72. *See* Directive art. 54.
73. The withdrawal of consent to a single future payment transaction (rather than to a series of them) falls under the previous sentence.
74. Stated otherwise, a payment transaction falling under the Directive need not be electronic from end to end; rather, authorization can be given in writing. In fact, even an oral authorization is not precluded.

Important aspects of such authorization are governed by Directive Articles 55 - 57. "Payment instrument" is defined in Directive Article 4(23) as "any personalised device(s) and/or set of procedures agreed between the payment service user and the payment service provider and used by the payment service user in order to initiate a payment order."[75] A card, used with or without a personal code, will satisfy this definition. Moreover, any agreed upon security procedure will be a "payment instrument."

Limits on the ability to initiate a payment transaction by means of a payment instrument are provided for in Directive Article 55.[76] Under Article 55(1), where a "specific payment instrument is used for the purposes of giving consent, authorization may be given within agreed "spending limits for payment transactions executed through that payment instrument." According to Article 55(2), under the "framework contract," "the payment service provider may reserve the right to block the payment instrument for objectively justified reasons related to the security of the payment instrument, the suspicion of unauthorised or fraudulent use of the payment instrument" or for similar reasons.

Reciprocal obligations of payment service user and provider in relation to payment instruments are governed by Articles 56 and 57 of the Directive. Under Article 56, the payment service user is required "to use the payment instrument in accordance with the terms governing the issue and use of the payment instrument," and, in particular, to take all reasonable steps to keep safe the personalized security payment instrument. He[77] is further required to notify the payment service provider "without undue delay on becoming aware of loss, theft or misappropriation of the payment instrument or its unauthorised use."[78]

In turn, the payment service provider issuing a payment instrument is required under Directive Article 57(1):

(a) to make sure that the personalized security features of the payment instrument are not accessible to third parties;

(b) to refrain from sending an unsolicited payment instrument other than as a replacement to an existing one;

75. Directive art. 4.

76. *See id.* art. 55.

77. I follow the language of the Directive which uses "he" and "him" to include "she" or "her" as well as "it." In contrast, American legislation is gender-neutral. Any inconsistency in this article reflects my objective to adhere to the language of provisions discussed.

78. Per Directive Article 53(1)(a), this requirement does not apply to a low-value payment instrument that "does not allow its blocking or prevention of its further use."

(c) to ensure that appropriate means are available at all time to enable the payment service user to make required notifications such as upon the loss, theft, or misappropriation of the payment instrument;[79] and

(d) to prevent the use of the payment instrument once such notification has been made.

Directive Article 57(2) allocates to the payment service provider "the risk of sending a payment instrument to the payer or of sending any personalised security features of it." No reciprocal broad general duties of care to prevent and detect unauthorized use are fastened on the payment service user and provider.

Under Directive Article 59, where a purported payer denies authorization for a payment transaction as debited to his account, it is for his payment service provider "to prove that the payment transaction was authenticated, accurately recorded, entered in the accounts and not affected by a technical breakdown or some other deficiency." "Authenticated" is however defined by reference to the verification of the authorization by means of a payment instrument.[80] Furthermore, Directive Article 59 states that "the use of a payment instrument recorded by the payment service provider shall in itself not necessarily be sufficient to prove either that the payment transaction was authorised by the payer or that the payer acted fraudulently or failed with intent or gross negligence to fulfil one or more of his obligations under Article 56."[81] Stated otherwise, evidence regarding the use of a payment instrument recorded by the service provider is an important element in meeting the required standard of proof for fastening civil liability for authorized use; yet, standing on its own, such evidence creates neither an unrebuttable presumption,[82] nor even a rebuttable presumption that

79. *Id.*

80. Directive Article 4(19) defines "authentication" to mean "a procedure which allows the payment service provider to verify the use of a specific payment instrument, including its personalised security features." There is no requirement, comparable to U.C.C. Section 4A-202(b), for a "security procedure," which is "a commercially reasonable method of providing security against unauthorized payment orders."

81. Per Directive Article 51(1), where the service user is not a consumer, the parties may agree that Directive Article 59 shall not apply "in whole or in part." Also, under Directive Article 53(1)(b), which covers low-value payments, states that Directive Article 59 does not apply "if the payment instrument is used anonymously or the payment service provider is not in a position for other reasons which are intrinsic to the payment instrument to prove that a payment transaction was authorised."

82. *Cf.* Judd v. Citibank, 435 N.Y.S.2d 210, 212 (N.Y.C. Civ. Ct. 1980), where the court stated that it was "not prepared to go so far as to rule that when a credible witness is faced with the adverse 'testimony' of a machine, he is as a matter of law faced also with an unmeetable burden of proof."

reverses the onus of proof, as to whether use was authorized.[83] Rather, some corroboration is required.[84]

Allocation of losses for unauthorized payments is governed in the Directive by Article 58, 60 and 61. First, under Directive Article 58, unless the payment service provider failed to make disclosures required under Title III, the payment service user is entitled to obtain rectification from his service provider, only if the user notifies the provider "without undue delay on becoming aware of any unauthorised or incorrectly executed payment transactions giving rise to a claim[85] . . . and no later than 13 months after the debit date." Under Directive Article 60, refund by the payer's payment service provider to the payer is to be made immediately, for the amount of the unauthorized payment transaction. "Further financial compensation may be determined in accordance with the law applicable to the contract concluded between the payer and his payment service provider."[86] Presumably, such loss will also be for wrongful dishonour for items that lacked cover because of the debit for the unauthorized payment.

Second, Directive Article 61 provides for the liability of the payer for unauthorized payment transactions. However, under Directive Article 51(1), parties can contract out of Article 61 "where the payment service user is not a consumer." Purported payer's exposure under Article 61 varies. The starting point, under Article 61(1), is that "the payer[87] shall bear the losses relating to any unauthorised payment transactions, up to a maximum of EUR 150, resulting from the use of a lost or stolen payment instrument or, if the payer has failed to keep the personalised security features safe, from misappropriation of a payment instrument." It is noteworthy that this limited liability runs irrespective of fault and irrespective of lack of knowledge of the loss, theft or misappropriation. While under Directive Article 56(1)(b) the payment service user is to advise the payment service provider "without undue delay on becoming aware of loss, theft or misappropriation of the payment instrument or of its unauthorised use," exposure to unauthorized

83. *See* GEVA, *supra* note 4, § 2.05[4] (discussing U.C.C. Section 4A-203).

84. Such as lack of credibility or some support to user's version.

85. The notification requirement in Directive Article 58 applies also to a claim for an incorrectly executed payment transaction governed by Directive Article 75.

86. Directive Article 53(1)(b), regarding low-value payments, provides that Directive Article 60 does not apply "if the payment instrument is used anonymously or the payment service provider is not in a position for other reasons which are intrinsic to the payment instrument to prove that a payment transaction was authorised."

87. The reference in Article 61(1) to the "payer" should have been to the "purported payer" because he did not "allow . . . a payment order from [the] payment account" nor gave a payment order, which is required to meet the definition for a "payer" under Directive Article 4(7).

payment transaction losses begins to run irrespective of whether the purported payer was in a position to give the required notice.

Under Directive Article 61(2), a payer's liability is unlimited when the payer incurred losses "by acting fraudulently or by failing to fulfil one or more of his obligations under Directive Article 56 with intent or gross negligence." For their part, obligations under Directive Article 56 refer to "the terms governing the issue and use of the payment instrument" as well as the duty to notify of a known incident of loss, theft or misappropriation. They also specifically cover the obligation to "take all reasonable steps to keep [the payment instrument's] personalised security features safe." However, not any breach of such term results in an unlimited liability; rather, per the language of Directive Article 61(2), the failure to fulfil an obligation under Directive Article 56 must have been made "with intent or gross negligence."[88] Arguably, unlimited liability for gross negligence may be fastened in cases that would have otherwise been treated as those of apparent authority as, for example, where the payment service user delivers the payment instrument to someone he considers to be a trusted agent who nevertheless betrays him.

And yet, the amount of exposure may vary where notice is given to the payment service provider. Thus, under Directive Article 61(4), having not acted fraudulently, the payer "shall not bear any financial consequences resulting from the use of the lost, stolen or misappropriated payment instrument after notification in accordance with Directive Article 56(1)(b)." The latter provision requires the payment service user to notify the payment service provider "without undue delay on becoming aware of loss, theft or misappropriation of the payment instrument or of its unauthorised use." Similarly, under Directive Article 61(5), the payer who has not acted fraudulently and who was not furnished with "appropriate means for the notification" by the payment service provider, is excused altogether from all financial consequences resulting from the unauthorized use of the payment instrument.[89]

In the final analysis, in the absence of fraud, or intentional or grossly negligent failure to fulfil the obligations under Directive Article

88. Under Directive Article 53(1)(b), limitations to liability under Directive Article 61(1) and (2)—that is, limitations to both to the ceiling and the conditions of incurring liability (namely, fraud or gross negligence)—do not apply "if the payment instrument is used anonymously or the payment service provider is not in a position for other reasons which are intrinsic to the payment instrument to prove that a payment transaction was authorised." Purported payer's liability is then unlimited.

89. Per Directive Article 53(1)(a), these two exemptions do not apply in the case of a low-value payment instrument that "does not allow its blocking or prevention of its further use."

56, the purported payer incurs liability up to a ceiling of EUR 150. This liability exists even where he is faultless and unaware of the circumstances requiring him to give notice under Directive Article 56(1)(b). At the same time, except where he acted fraudulently, he incurs no further liability for losses occurring after notification. Moreover, regardless of lack of knowledge of the loss, theft or misappropriation, in the absence of notification and unless it is excused, liability is unlimited where the purported payer has either acted fraudulently or failed to fulfil an obligation under Directive Article 56 with either intent or gross negligence.

It seems that the proper interpretation of Directive Article 61(1) and (4) is that unlimited liability for losses occurring after notification hinges only on fraud by the purported payer and not on his intentional or gross negligent breach. In addition, arguably, undue delay in notifying the service provider of the loss, theft or misappropriation may constitute gross negligence on the part of the purported payer to fulfil the notification obligation under Directive Article 56(1)(b), which under Directive Article 61(2) exposes him to unlimited liability prior to the notification.[90] Finally as for the interpretation of Directive Article 61, the EUR 150 liability ceiling applies only in the absence of fraud or intentional or gross negligent breach; thus, for example, gross negligence in keeping of the personalised security feature safe, in breach of the specific obligation under Directive Article 56(2), arguably exposes the purported payer to unlimited liability under Directive Article 61(2), notwithstanding the fact that the mere failure to keep personalized security features safe, unaccompanied by gross negligence, is a case stated in Directive Article 61(1) to trigger the EUR 150 ceiling to liability.

Under Article 61(3), Member States may reduce both the EUR 150 ceiling and the unlimited liability by "taking into account, in particular, the nature of the personalised security features of the payment instrument and the circumstances under which it was lost, stolen or misappropriated."

Directive Articles 62 and 63 deal with a limited right for refund in connection with authorized debit transfers.[91] Specifically, Article 62 provides for a refund to which a payer is entitled from his payment service provider for an authorized completed debit transfer; that is, a

90. *Cf.* Minskoff v. American Express Travel Related Services, 98 F.3d 703 (2d Cir. 1996) (holding that receipt of a statement reasonably putting the customer on notice that one more fraudulent charges has been made precludes an argument based on lack of knowledge of these charges).

91. Per Directive Article 51(1), where the service user is not a consumer the parties may agree that Directive Articles 62 and 63 "shall not apply in whole or in part."

"payment transaction initiated by or through the payee which has already been executed." Such a right is available to the payer where the authorization did not specify an exact amount for the payment transaction and its amount "exceeded the amount the payer could reasonably have expected taking into account his previous spending pattern, the conditions in his framework contract and relevant circumstances of the case."[92] Such conditions may be waived in a framework contract[93] governing a direct debit. At the same time, a framework contract may provide that "the payer has no right to a refund where he has given his consent to execute the payment transaction directly to his payment service provider and, where applicable, information on the future payment transaction was provided or made available in an agreed manner to the payer for at least four weeks before the due date. . . ." Per Article 63, a request for a refund governed by Article 62 is to be made within eight weeks of the debit to the payer's account. The payer's service provider is to comply or respond within ten days.[94]

In the U.S., under U.C.C. Article 4A, to bind a sender, the payment order must be an authorized payment order for which the sender is bound under the law of agency. Alternatively, unless it proves that the payment order was not caused directly or indirectly by a person under its control, a customer is bound by any payment order whose authenticity was verified by the bank according to a commercially reasonable security procedure agreed upon between the customer and the bank.[95] Under Section 4A-201, "[a] security procedure may require the use of algorithms or other codes, identifying words or numbers, encryption, callback procedures, or similar security devices. Comparison of a signature of a payment order with an authorized specimen signature of the customer is not by itself a security procedure."

Under U.C.C. Section 4A-204, "a receiving bank accept[ing] a payment order issued in the name of its customer" which is neither authorized nor effectively verified is required to refund any payment

92. However, under Directive Article 62(2), "the payer may not rely on currency exchange reasons if the reference exchange rate agreed with his payment service provider . . . was applied."

93. A "framework contract" is defined in Directive Article 4(12) to mean "a payment service contract which governs the future execution of individual and successive payment transactions and which may contain the obligation and conditions for setting up a payment account."

94. According to Directive Article 63(2), a negative response must include a "justification for refusing the refund" accompanied by an indication of "the bodies to which the payer may refer the matter in accordance with Articles 80 to 83 if he does not accept the justification provided."

95. *See* U.C.C. §§ 4A-201 to 203 (2008).

made by the customer for that payment order. The receiving bank is further liable to pay interest for the refundable amount. However, liability to pay interest is excused upon the customer's failure to exercise ordinary care to determine lack of authority and notify the bank with respect to it "within a reasonable time not exceeding 90 days after the date the customer received notification from the bank." Furthermore, under U.C.C. Section 4A-505, having failed to challenge a debit for an unauthorized or unverified payment order posted to the customer's account within one year of receipt of notification from the bank, the customer is precluded altogether from contesting it.

A different regime altogether applies in the U.S. for a consumer's liability in connection with unauthorized credit card payments and electronic funds transfers.[96] Thus, the liability of a credit card holder for the unauthorized use of the card is governed by § 1643 of the federal CCCDA[97] and § 226.12 of Regulation Z.[98] Consumer liability for unauthorized electronic fund transfers is governed by the § 909 of the federal EFTA[99] and Regulation E.[100] In both cases, that of the unauthorized credit card payment and the unauthorized electronic fund transfer, there is a ceiling for the consumer's exposure for unauthorized payments In addition, the consumer's fault is irrelevant, other than in connection with the failure to promptly advise. The two schemes are however not identical.

Under Reg. Z § 226.12(b)(1), unless greater protection to the cardholder is afforded either by other applicable law or an agreement,[101] "[t]he liability of a cardholder for unauthorized use of a credit card shall not exceed the lesser of $50 or the amount of money, property, labor, or services obtained by the unauthorized use before notification to the card issuer." This limit was interpreted to be set in conjunction with a "series of unauthorized uses";[102] such uses are not necessarily related.[103] No increased liability is provided for the failure to promptly advise the financial institution; in fact, the incentive for prompt notification is lost after $50 unauthorized use loss has been incurred.[104] Notification to the

96. *See* Benjamin Geva, *Consumer Liability in Unauthorized Electronic Funds Transfers*, 38 CAN. BUS. L.J. 207 (2003).

97. *See* 15 U.S.C. § 1643 (2006).

98. *See* 12 C.F.R. § 226 (2008).

99. *See* 15 U.S.C. § 1693(g) (2006).

100. *See* 12 C.F.R. § 205 (2008).

101. *Id.* § 228.12(b)(4).

102. Regulation Z Official Staff Interpretations to § 226.12, *supra* note 33, ¶ 12(b)(2)(iii)(2).

103. Compare with the requirements of Reg. E, discussed below, under which the limit applies to a series of related unauthorized transfers.

104. Except that settling a balance on a periodic statement containing unauthorized transfers, can be viewed as the adoption of the unauthorized transfers, for which the

card issuer of the loss or theft may be given, at the option of the person giving it, "in person, by telephone, or in writing."[105] For the purpose of this provision, "cardholder" means any person, not necessarily natural, to whom a credit card is issued, for any purpose, including business, commercial, or agricultural use, "or a person who has agreed with the card issuer to pay obligations . . . arising from the issuance of [such] a credit card to another . . . person."[106] "Unauthorized use" is defined as "the use of a credit card by a person, other than the cardholder, who does not have actual, implied, or apparent authority for such use, and from which the cardholder receives no benefit."[107]

Three conditions are stated[108] to apply in order to fasten liability on a cardholder for the unauthorized use of the credit card. First, the card must be an accepted credit card, that is, either a "credit card that the cardholder has requested or applied for and received, or has signed, used, or authorized another person to use or obtain credit," or a credit card "issued as a renewal or substitute in accordance with this paragraph."[109] Second, "the card issuer has provided adequate notice[110] of the cardholder's maximum potential liability and of means by which the card issuer may be notified of loss or theft of the card." Third, the card issuer must have provided "a means to identify the cardholder on the account or the authorized user of the card." Where any of these conditions is not satisfied, the cardholder is not responsible for any unauthorized use of the card.

The approach for regulating unauthorized consumer electronic fund transfers under Reg. E is entirely different from that of UCC Article 4A for unauthorized business funds transfers. As well, the approach taken is not identical to that under Reg. Z for the unauthorized use of a credit card. The point of departure for both Regulations is quite similar; yet, the scheme of Reg. E appears to be an improvement on that of Reg. Z. Yet, no effort has been made to harmonize the two Regulations;

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customer becomes liable under agency law, specifically when payment is made with knowledge of such unauthorized transfers.

105. Regulation Z, 12 C.F.R. § 226.12(b)(3) (2008).

106. *Id.* § 226.2(a)(8); *see also id.* § 226.12(a); *id.* § 226.12(b)(5) (explaining that an issuer can contract out of the limited liability rule only where at least 10 cards are issued for the use of employees of an organization, provided liability of the employees remains governed by the provision).

107. *Id.* § 226.12(b)(1) n.22. This definition effectively reproduces of "unauthorized use" found in the CCCDA, 15 U.S.C. § 1602(o) (2006).

108. 12 C.F.R. § 226.12(b)(2).

109. *Id.* § 226.12(a)(2) n. 21; *see also* CCCDA, 15 U.S.C. § 1602(*l*) (2006).

110. "Adequate notice" is defined as " a printed notice to a cardholder that sets forth clearly the pertinent facts so that the cardholder may reasonable be expected to have noticed it and understood its meaning. The notice may be given by any means reasonably assuring receipt by the cardholder." § 226.12(b)(2)(ii) n.23.

particularly in connection with electronic authentication, the distinction does not appear to be justified.

The underlying principle of Reg. E is that a consumer is liable for authorized transfers, as well as, upon the failure to promptly advise the bank, for a limited amount of unauthorized transfers, up to the time of notification to the bank. Where such a notification is not given by a designated deadline, the customer is liable for the entire amount after the expiry of the notification period. The consumer's negligence contributing to an unauthorized transaction, other than in failing to give a timely notification, is not a factor in determining the consumer's exposure.

Reg. E §205.2(m) defines "[u]nauthorized electronic fund transfer" to mean:

> an electronic fund transfer from a consumer's account initiated by a person other than the consumer[111] without actual authority to initiate the transfer and from which the consumer receives no benefit. The term does not include an electronic fund transfer initiated:
>
> (1) by a person who was furnished the access device[112] to the consumer's account by the consumer,[113] unless the consumer has notified the financial institution that transfers by that person are no longer authorized;
>
> (2) with fraudulent intent by the consumer or any person acting in concert with the consumer; or
>
> (3) by the financial institution or its employee.

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111. This includes an erroneous or fraudulent transfer initiated by an employee of the financial institution as well as by the consumer himself or herself where "the consumer has been induced by force to initiate the transfer." *See* Regulation E Official Staff Interpretations on § 205.2(m), 12 C.F.R. § 205.17, 146 ¶¶ (1), (4) (2002).

112. Defined in Reg. E § 205.2(a)(1) to mean "a card, code, or other means of access to a consumer's account, or any combination thereof, that may be used by the consumer to initiate electronic fund transfer."

113. In furnishing the access device, the consumer must have acted voluntarily. Accordingly, where control of the access device is surrendered by the consumer as a result of robbery or fraud, the fund transfer initiated by the robber or the defrauding person is "unauthorized." In contrast, the exception applies so that the transfer is not "unauthorized" where "a consumer furnishes an access device and grants authority to make transfers to a person (such as a family member or co-worker) who exceeds the authority given." *See* 12 C.F.R. § 205.17, 146. Prior to this interpretation by the Federal Reserve Board, there was some judicial disagreement on the first point (that of *voluntarily* furnishing the access device). *See e.g.*, Feldman v. Citibank, 443 N.Y.S.2d 43 (N.Y. Civ. Ct. 1981); Ognibene v. Citibank, 446 N.Y.S.2d 845, 847 (N.Y. Civ. Ct. 1981); State v. Citibank, 537 F. Supp. 1192, 1194 (S.D.N.Y. 1982). In effect, the latter point may be regarded as dealing with apparent authority.

Transfers thus excluded are evidently deemed authorized to which the consumer is fully responsible.

In connection with debit card electronic authentication, it was held that "[i]n an action involving a consumer's liability for an electronic fund transfer . . . the burden of going forward to show an 'unauthorized' transfer . . . is on the consumer." However, "[t]o establish full liability on the part of the consumer, the bank must prove that the transfer was authorized."[114] These two statements can be reconciled as follows: to succeed in its action, the bank must initially make a prima facie case that the transfer was authorized. To that end, it is adequate for the bank to prove that the transfer was initiated by means of the access device it had issued to the consumer. At that point, the burden of proof shifts to the consumer alleging an unauthorized transfer. Proof of loss or theft of the access device, put forward by the consumer, is adequate to meet this burden. Obviously, notice of loss or theft given by the consumer to the bank is no more than prima facie evidence of loss or theft.

Ultimately, however, where loss or theft of the access device is not claimed, in determining the question of authorized or unauthorized transfer, the court may be forced to choose between the consumer's testimony and the bank's computer printout, often backed by some evidence as to the reliability of its security procedure. A review of case law reveals that a credible witness, usually where his or her testimony is corroborated, typically by some system malfunction, has consistently overcome the machine.[115] Nevertheless, witness credibility may differ from one case to another. Furthermore, relevant case law is from the first half of the 1980s; it is quite possible that with time, confidence in the reliability of computer systems increases, so that greater weight may be given to evidence generated by them.

In the final analysis, an unauthorized transfer may be caused by computer fraud or even an internal fraud at the financial institution. Both causes do not necessarily manifest machine malfunction and are outside the ability of the consumer to prove. To that end, existing case law, as described above, is inadequate.

The extent of consumer liability for "an unauthorized electronic fund transfer or a series of related unauthorized transfers" is governed by Reg. E §205.6. To be entitled to the amounts specified in the provision, the bank must have provided the consumer with certain disclosures as to the extent of the consumer's liability, the telephone number and address for providing notices to the bank, and the bank's business days. As well,

114. *Ognibene*, 446 N.Y.S.2d at 847.

115. *See e.g.*, Judd v. Citibank, 435 N.Y.S.2d 210 (N.Y.C. Civ. Ct. 1980); *Feldman*, 443 N.Y.S.2d 43; Porter v. Citibank, 472 N.Y.S.2d 582 (N.Y. Civ. Ct. 1984).

"[i]f the unauthorized transfer involved an access device, it must be an accepted access device and the financial institution must have provided a means to identify the consumer to whom it was issued."[116]

Thus, when these conditions are met, under the aforesaid Reg. E § 205.6, and subject to specified ceilings, liability is limited to unauthorized transfers occurring before the consumer advises the bank either of the loss or theft of the access device or of an unauthorized transfer that appears on a periodic statement. Where the consumer is not aware of the loss or theft of the access device, for unauthorized transactions occurring up to 60 days after the transmittal of a periodic statement containing an unauthorized transfer,[117] the consumer is not liable. However, for such transfers, the consumer is liable up to a $50 ceiling where he or she learns of the loss or theft of the access device and advises the bank of it within two business days. The $50 ceiling does not apply where the consumer learns before the expiration of that 60-day period of the loss or theft of the access device but fails to advise the bank of the loss or theft within two business days. In such a case, the $50 ceiling applies only until the close of two business days after learning of the loss or theft, and the overall liability for the period ending at the close of the 60-day period will not exceed $500. Liability beyond the 60-day period is unlimited, until notice is given to the bank. To be entitled to the $500 as well as the unlimited ceilings, the bank must establish that the consumer's timely notification would have prevented the loss.

Under Reg. E § 205.6(4), time periods for notification may be extended "to a reasonable period" where the consumer delayed notifying the bank "due to extenuating circumstances." However, in *Kruser v. Bank of America NT&SA*,[118] this provision did not assist a consumer who admitted that "she received . . . bank statements during her recuperation."[119] In one such a statement, she failed to notice and advise the bank of a $20 unauthorized ATM withdrawal. Almost a year later, the consumer received statements containing close to $10,000 in unauthorized ATM withdrawals. The consumer then promptly advised

116. *See* 12 C.F.R. § 205.6(a). An "accepted access device" is generally defined (in section 205.2(a)(2)) as an access device requested and received or used by the consumer. In order to be entitled to *any* amount of unauthorized transfers, the bank must establish the existence of these conditions. *See Ognibene*, 446 N.Y.S.2d at 847.

117. For an account to or from which electronic fund transfers can be made, a financial institution is required, under Reg. E § 205.9(b), to send a periodic statement for each monthly cycle in which an electronic fund transfer has occurred. Such requirement is not dispensed with for passbook accounts updated upon presentation, except where the accounts may be accessed "only by preauthorized transfers to the account." *See* 12 C.F.R. § 205.9(c)(1)(i).

118. 281 Cal. Rptr. 463 (Cal. Ct. App. 1991).

119. *Id.* at 467.

the bank of all unauthorized withdrawals, including the one that was almost a year old. In the Court's view, the consumer failed to show the required "extenuating circumstances." Having delayed the notice for the first $20 unauthorized transaction, the consumer was thus held liable for the entire amount of the unauthorized transfers.

V. EXECUTION OF PAYMENT TRANSACTIONS: OVERVIEW

Directive Articles 64-78 deal with the execution of payment transactions. "Execution" is not defined in the Directive. From the heading to the chapter containing these provisions, referring to the execution of the payment transaction, as well from the context elsewhere in the Directive,[120] the term denotes the performance of the entire payment transaction, rather than carrying out the instruction contained in the "payment order," as it is under U.C.C. Article 4A.[121] However, elsewhere in the Directive, reference is made to the "execution" of a "payment order";[122] hence, the use of the term is inconsistent.

Chapter 3 is divided into three Sections. Section 1, consisting of Articles 64-67, deals with payment orders and amount transferred. Section 2, consisting of Articles 68-73, deals with execution time and value date. Section 3, consisting of Articles 74-78, deals with liability.

VI. EXECUTION OF PAYMENT TRANSACTIONS: PAYMENT ORDERS AND AMOUNTS TRANSFERRED

Section 1, consisting of Articles 64-67, deals with payment orders and amount transferred. It deals with the receipt of payment orders, refusal of payment orders, the irrevocability of a payment order, and the relationship between amounts sent and received.

Directive Article 64(1) identifies "the point in time of receipt" with "the time when the payment order . . . is received by the payer's payment service provider." It goes on to state that if the point of time of receipt is not on a business day for the payer's payment service provider, receipt is deemed to occur on the following business day. As well, and on this point in the footsteps of U.C.C. Section 4A-106, the payer's service provider may establish a cut-off time, though only near the end of the business day, beyond which receipt will be deemed to occur the following business day.

Directive Article 64(1) applies to a payment order transmitted to the payer's payment service provider (i) directly by the payer, (ii) indirectly

120. For example, *see* the definition of "payment order" *infra*.

121. U.C.C. § 4A-301(a) (2008).

122. For example, Directive Article 65 deals with the refusal of payment orders and discussed further below. *See also* Directive art. 64(2).

by the payee through the payee's payment service provider, or (iii) indirectly through the payee, whether or not via the payee's payment service provider. The first two instances are respectively those of a credit and debit transfer. The third instance is that of a payment order issued by the payer to the payee who then transmits it either to his own service provider, in which case it results in a debit transfer, or to the payer's payment service provider, in which case it results in a credit transfer.

Under U.C.C. Article 4A, each payment order is a request by the sender to the receiving bank which can be accepted or rejected. Notice of rejection is required to avoid liability for interest, and may preclude acceptance by a beneficiary's bank holding adequate funds as cover. Otherwise, there is no acceptance by inaction or mere passage of time; an unaccepted payment order expires after five days.[123] Suspension of payment by a receiving bank is tantamount to rejection by operation of law. In general, the occurrence of either acceptance or rejection is irreversible.[124]

U.C.C. Article 4A is quite specific about the manner and contractual effect of acceptance, as well as the law applicable to an accepted contract. First, as its manner, acceptance of a payment order by the beneficiary's bank is accomplished either by paying (or advising) the beneficiary, or where the beneficiary has an account at the beneficiary's bank, also by obtaining cover for such a payment. Acceptance by a receiving bank other than the beneficiary's bank is by the *execution* of the payment order, that is, by issuing a corresponding payment order, intended to carry out the payment order received by the bank.[125] The executing bank must issue a payment order that strictly conforms to that received by the bank with respect to the amount, the ultimate destination of the funds, and the identity of any specifically designated intermediary bank. Otherwise, the executing bank's duties as to speed, the means of communication, the use of a funds-transfer system, and the selection of an intermediary bank where none is designated by the sender, are to be carried out with reasonable care and skill.[126] Nothing short of execution serves as acceptance by a receiving bank other than that of the beneficiary.

Second, as to its legal implications, acceptance of a payment order by a receiving bank obliges the sender to pay the amount of the order.[127]

123. U.C.C. § 4A-211(d).
124. Rejection of payment order is governed by U.C.C. Section 4A-210.
125. *Id.* §§ 4A-209, 4A-301.
126. *Id.* § 4A-302.
127. *Id.* § 4A-402.

The sender's payment is carried out usually by means[128] of: (i) an interbank final settlement over a funds-transfer system; (ii) a credit by the sending bank to the receiving bank's account, in which case payment occurs at the midnight of the day on which the credit is withdrawable and the receiving bank learns of this fact, unless credit was withdrawn earlier, in which case payment occurred at the time of withdrawal, or (iii) a debit by the receiving bank to the sender's account, provided funds are actually available in the account. Where the receiving bank is that of the beneficiary, payment by means of a debit to the sender's account containing adequate cover, in fact, even by means of the availability of cover for a debit in such an account, will constitute acceptance only at the opening of the next funds-transfer system day, provided the payment order was not rejected until one hour thereafter.[129]

As well, the acceptance by the beneficiary's bank of a payment order for the benefit of the originator's payment order denotes the completion of the funds transfer.[130] Acceptance by the beneficiary's bank further constitutes payment by the originator to the beneficiary, namely a discharge of the originator's obligation on the underlying transaction, that is, of the debt paid by means of the funds transfer.[131] It fastens on the beneficiary's bank an obligation to pay the beneficiary;[132] in principle, payment by the beneficiary's bank to the beneficiary is "final" and cannot be made provisional or conditional on the receipt of funds from the sender.[133]

Finally as to contractual implications, acceptance by a receiving bank other than the beneficiary's bank inures to the benefit of the sender; acceptance by the beneficiary's bank inures to the benefit of the beneficiary.[134] Unless displaced by a bilateral agreement or a funds-transfer system rule,[135] the law applicable to each payment order is that of the jurisdiction in which the receiving bank is located. Similarly, the law of the jurisdiction in which the beneficiary's bank branch is located governs the relationship between the beneficiary's bank and the beneficiary, as well as the discharge of the originator's debt to the beneficiary.[136]

128. *Id.* § 4A-403.
129. U.C.C. § 4A-209(b)(3).
130. *Id.* § 4A-104(a).
131. *Id.* § 4A-406.
132. *Id.* § 4A-404.
133. *Id.* § 4A-405(c).
134. *See generally* U.C.C. § 4A-212 (and Official Comment); *id.* § 4A-209 Official Comment 1.
135. As provided in U.C.C. Sections 4A-501 and 507.
136. Choice of law is governed by U.C.C. Section 4A-507.

No conflict of law rules are provided for in the Directive. This however is not an accident; as indicated, per Article 2(1), "with the exception of Article 73, Title . . . IV shall apply only where both the payer's payment service provider and the payee's payment service provider are . . . located in the Community." Furthermore, under Article 3(2), Title IV "shall apply only to payment services made in euro or the currency of a Member State outside the euro area." This unduly restricts the scope of the Directive; practically, this eliminates its application to both inbound and outbound Community payments and, unfortunately, renders academic the topic of conflicts of law in international (other than inter-Community) or foreign currency payments.

Nor does the Directive provide for acceptance. At the same time, refusal of payment orders is governed by Directive Article 65. Article 65(1) fastens on a payment service provider who refuses to execute a payment order a duty to advise the user of the refusal and if possible, the reason for it and the procedure for correction. Per the framework contract, the user may be charged for the notification of an objectively justified refusal.[137] On its part, the right to refuse is not entirely discretionary to the payment service provider. According to Article 65(2), and "irrespective of whether the payment order is initiated by a payer or through the payee," namely, both in a credit and debit transfer,[138] "where all the conditions set out in the payer's framework contract are met, the payer's payment service provider shall not refuse to execute an authorized payment order."

The position under U.C.C. Article 4A of an originator's bank that rejects a payment order is more favorable. Thus, under U.C.C. Section 4A-212, "[i]f a receiving bank fails to accept a payment order that it is obliged by express agreement to accept, the bank is liable for breach of the agreement to the extent provided in the agreement or in this Article [4A]." Otherwise, and "except as provided in this Article or by express agreement," a receiving bank "does not . . . have any duty to accept a payment order or, before acceptance, to take any action or refrain from taking action, with respect to a payment order. . . ." Thus, although

137. This is in fact enumerated in Directive Article 52(1) as one of the "information obligations" for which the payment service provider may charge the payment service user. Under Article 65(1), notification is to be made "in an agreed manner and at the earliest opportunity. . . ." In addition, the duty under Directive Article 65(1) is to be complied with "unless prohibited by other relevant Community or national legislation" *Id.*

138. As well, in the absence of a prohibition by Community or national legislation. *Id.*

under the Directive liability is based on contract,[139] the scope of liability is stated to be narrower under the U.C.C. Stated otherwise, unlike U.C.C. Section 4A-212, Directive Article 65 does not restrict liability by reference to its own provisions or the express agreement of the parties. In fact, liability provided under Article 4A is only for the failure to advise of rejection of a payment order which is only for lost interest.[140]

Directive Article 66(1) precludes the revocation of a payment order "once it has been received by the payer's payment service provider." For credit transfers, this is a noteworthy departure from U.C.C. Article 4A under which revocation is permitted until acceptance by the originator's bank.[141] This will also reverse the current position under German law.[142] Thereunder, as against the originator's bank, revocation is available to the originator as long as the originator's bank has not acted on the payment order. But even if the originator's bank acted on the payment order, it is obliged to transmit the originator's revocation order onward; unlike under the U.C.C.,[143] the bank has no discretion in the matter. Ultimately, the revocation is effective if it reaches the beneficiary's bank prior to the latter crediting the beneficiary's account.

In any event, under the Directive, the framework governing the ability of parties to provide for revocability is unclear. Thus, under Directive Article 51(1), irrevocability may be contracted out only "[w]here the payment service user is not a consumer." At the same time, under Directive Article 66(5), and irrespective as to whether the payment transaction is a consumer or business transaction, revocability beyond points of time specified in Directive Article 66 may be a matter of an agreement between the payment service user and his payment service

139. Unlike U.C.C. Section 4A-212, the Directive lacks the emphasis on "express" agreement; so even on this point it is less favorable to the payor's payment service provider (that is, the originator's bank).

140. *See* U.C.C. § 4A-210(b) (which is specifically referred to (together with U.C.C. Section 4A-209(b)(3) that does not apply to the originator's bank) in the Official Comment to U.C.C. Section 4A-212).

141. Until acceptance, injunction and creditor process by the originator's creditors can also prevent the originator's bank from initiating a funds transfer. Likewise, an injunction and creditor process by the beneficiary's creditors can prevent the beneficiary from receiving the benefit of payment once the funds transfer has been completed. A funds transfer cannot, however, be intercepted by third parties between acceptance by the originator's bank and by the beneficiary's bank. *See* U.C.C. §§ 4A-502, 4A-503.

142. For the position under German law, see, for example, BENJAMIN GEVA, BANK COLLECTIONS AND PAYMENT TRANSACTIONS: COMPARATIVE STUDY OF LEGAL ASPECTS 222 (2001).

143. *See* U.C.C. § 4A-211.

provider, for which the payment service provider may charge the payment service user if so agreed in their framework contract.[144]

Aside from an agreement as above, for a payment transaction initiated by or through the payee, revocability is denied even prior to receipt under Directive Article 66(1). Thus, according to Directive Article 66(2), a payment order issued by the payer through the payee is irrevocable as soon as it is transmitted. A payment transaction initiated by the payee becomes irrevocable as soon as the payer's consent is given; that is, as early as upon the authorization given by the payer to the payee to initiate the debit transfer.

However, under Directive Article 66(4), revocability is available for payment orders instructing payment in the future, though "at the latest by the end of the business day preceding the agreed day." For "a direct debit[145] and without prejudice to refund rights" the same rule is specifically provided in Directive Article 66(3).

Directive Article 67 deals with the amount of a payment transaction. Similar to U.C.C. Article 4A-302 (d),[146] the basic principle of Directive Article 67(1), is that the full amount instructed is to be transferred, so that no charges are to be deducted by the payer's as well as the payee's service provider and by any intermediary. Fees are to be charged to the account as such and are not to be deducted from the amount transferred. Thus, under Directive Article 67(2), an agreed charge may be debited separately to the payee's account by his payment service provider, rather than made as a deduction to the amount credited. Per Directive Article 67(3), it is up to the service provider of the party initiating the payment transaction to ensure that the payee receives the full amount of the payment transaction.

VII. EXECUTION OF PAYMENT TRANSACTIONS: EXECUTION TIME AND VALUE DATE

Section 2, consisting of Directive Articles 68-73, deals with execution time and value date. It covers three distinct concepts: execution, value dating, and funds availability. Execution is used in the

144. This is in fact enumerated in Directive Article 52(1) as one of the "corrective and preventive measures" for which the payment service provider may charge the payment service user.

145. That is, per Directive Article 4(28), a debit transfer (i.e., "a payment transaction . . . initiated by the payee on the basis of the payer's consent") carried out as part of "a payment service," namely, a "business activity listed in the Annex" (Directive Article 4(3)). This is, presumably, as distinguished from an isolated debit transfer.

146. U.C.C. Section 4A-302(d) precludes the receiving bank, "[u]nless instructed by the sender," to obtain or instruct a subsequent receiving bank to obtain charges and expenses by deducting them from the sender's payment order. *See also* U.C.C. § 4A-404(c).

context of the completion of the payment transaction. Such completion is addressed by reference either to the receipt of funds by the payee's payment service provider in the form of credit to its account, or to crediting the payee's account by its payment service provider. In this context, it is not clear why receipt of funds by the payee's service provider is necessarily limited to the situation where funds are so received by means of credit posted to the account of the payee's payment service provider. Certainly funds can be received by other ways, for example, debit to the account of the payer's payment service provider.[147]

"Value date" is defined in Directive Article 4(17) to be "a reference time used by a payment service provider for the calculation of interest on the funds debited or credited to a payment account." "Funds Availability" is undefined; it must be taken to refer to the unconditional availability to the payee's unrestricted use of the amount of the payment transaction. In theory, each of such events, namely, receipt by having the amount credited to an account, eligibility for earning interest on the amount,[148] and having the use of it as it is cash in the payee's pocket, are distinct and separate and hence they do not necessarily happen simultaneously.[149]

Under Directive Article 69(1), the payer's payment service provider is required to ensure that after "receipt" of a payment order,[150] the amount of the payment transaction is credited "to the payee's payment service provider's account," namely to the account of the payment service provider, "at the latest by the end of the next business day." Such an account need not necessarily be held by the payer's payment service provider; rather, it could be held by a central counterparty such as a central bank. Until January 1, 2012 a payer and his service provider may agree "on a period no longer than three business days." All such periods "may be extended by a further business day for paper-initiated payment transactions." According to Directive Article 72, for national (domestic) payment transactions, Member States may shorten all execution periods under the Section.

Directive Article 69(1) appears to apply to both debit and credit transfers. It does not provide a remedy to the payee against a breach by

147. *See e.g., id.* § 4A-403 (enumerating several methods of interbank payment *viz.*, through a funds transfer system, by crediting the receiving bank's account, by having the receiving bank debiting the sending bank account as well as netting and any other means).

148. Presumably, the actual earning of interest, as opposed to the eligibility to earn interest, may well depend on the type of account into which the amount in question is credited.

149. *But see* A/S Awilco v. Fulvia S.p.A. Di Navigazione (the "Chikuma"), [1981] Lloyd's Rep. 371 (H.L.) (effectively identifying all three points).

150. As defined in Directive Article 64.

the payer's payment service provider. Presumably, the theory is that in case of delay the payee is to sue the payer who can turn around and seek reimbursement from his payment service provider.

Indeed, the payee is accorded a right against his own payment service provider. However, this right is for the failure to value date the credit to the account and make it available once funds have been received by the payee's payment service provider. Receipt of funds is in the form of credit *actually made* to the account of the payee's payment service provider. The payee's right is by reference to the time credit is made, rather than the time credit *should have been made,* to the account of the payee's payment service provider. Thus under Directive Article 69(2), in conjunction with Directive Article 73(1), towards the payee, the payee's payment service provider is obligated to value date the credit to the payee's account "no later than the business day on which the amount . . . is credited to the payee's payment service provider's account." Directive Article 73(1) goes on to require the payee's payment service provider to ensure "that the amount of the payment transaction is at the payee's disposal immediately after that amount is credited to the payee's payment service provider's account." Under Directive Article 70, this time frame for funds availability by reference to the credit to the account of the payee's payment service provider equally applies where the payee does not have an account with the payment service provider. All this however, does not permit the payee any remedy for a delay in posting credit to the account of his payment service provider in contravention of Directive Article 69(1).

Being more general in its nature so as to accommodate an infinite number of banking linkages, U.C.C. Article 4A is in no position to time payment to the beneficiary by reference to the acceptance of the originator's payment order by the originator's bank. Rather, U.C.C. Article 4A times the obligation of the beneficiary's bank to pay the beneficiary to coincide with the day of acceptance by the beneficiary's bank.[151] However, on this point, Article 4A is preempted by US federal law. The latter effectively provides that the beneficiary's bank must make funds available to the beneficiary no later than at the start of the next business day after the banking day of acceptance by means of receiving a sender's payment.[152]

Directive Article 73, dealing with value date and funds availability, is not limited to an intra-Community payment. Rather, it is the sole provision in Title IV, which applies also when only one of the parties'

151. U.C.C. § 4A-404(a) (2008).

152. Availability of Funds and Collection of Checks (Regulation CC), 12 C.F.R. § 229.10(b)(1) (1988).

payment service provider, that is, either of the payer or that of the payee, is located in the Community.[153]

VIII. EXECUTION OF PAYMENT TRANSACTIONS: LIABILITY

Section 3, consisting of Articles 74-78, addresses liability. The central provision as to liability is Directive Article 75, which contains rules allocating responsibility in cases of non-execution or defective execution.[154] Under Directive Article 51(1), "[w]here the payment service user is not a consumer, the parties may agree that Article . . . 75 shall not apply in whole or in part."

Each of the rules set out in Directive Article 75 is stated to be "without prejudice to Directive Article 58, Directive Article 74(2) and (3), and Directive Article 78."[155] Directive Article 58 provides for the payment service user's right to obtain rectification form the payment service provider upon notifying to him "without undue delay on becoming aware of any unauthorised or incorrectly executed payment transactions." Directive Article 78 exempts from liability a party successfully pleading "abnormal and unforeseeable circumstances beyond [his] control."

Directive Article 74 protects a payment service provider that acted in reliance on an incorrect unique identifier. Under Directive Article 4(21), "unique identifier" is defined to mean "a combination of letters, numbers or symbols specified to the payment service user by the payment service provider and to be provided by the payment service user to identify unambiguously the other payment service user and/or his payment account for a payment transaction." The simplest example is an account number. Directive Article 74(1) deals with a payment order executed in accordance with a unique identifier. It authorizes a payment service provider to rely on the unique identifier so that "the payment order shall be deemed to have been executed correctly with regard to the payee specified by the unique identifier." It follows, and it is so provided in Directive Article 74(2), that the payment service provider that acted on the basis of the incorrect unique identifier provided by the user "shall not be liable . . . for non-execution or defective execution of the payment transaction." Moreover, under Directive Article 74(3), where the user furnishes the payment service provider with information in addition to the unique identifier, "the payment service provider shall

153. Directive art. 2(1).

154. *See generally* R. Steennot, *Erroneous Execution of Payment Transactions According to the New Payment Services Directive*, 6 INT'L. J. TECH. TRANSFER AND COMMERCIALISATION 145 (2007).

155. Both in Directive Article 75(1) and (2).

be liable only for the execution of the payment transaction in accordance with the unique identifier provided by the payment service user." Under Directive Article 74(2), having acted on the basis of the incorrect unique identifier, the payment service provider bears liability limited only to the making of "reasonable efforts to recover the funds involved in the payment transaction," an effort for which the payment service provider may charge the payment service user if so agreed in the framework contract.[156]

One effect of Directive Article 74, therefore, is that a payment service provider, which receives a payment order identifying a user by name and number, is free to act on the number alone. This goes, unnecessarily, further than U.C.C. Article 4A, that does not protect a payment service provider acting on the basis of the incorrect unique identifier with knowledge of the error or discrepancy.[157] In addition, under U.C.C. Section 4A-207(a), a payment order for a nonexistent or unidentifiable beneficiary cannot be accepted by the beneficiary's bank.[158] There is no parallel to that provision in the Directive.

Thus, and as indicated, "without prejudice to Article 58, Article 74(2) and (3) and Article 78," Directive Article 75(1) allocates liability for the non-execution or defective execution of a payment order initiated by the payer, as follows:

1. To begin with, the payer's "payment service provider shall . . . be liable to the payer for correct execution of the payment transaction." Effectively, this means that the payer's payment service provider is discharged at the point of time in which "the payee's payment service provider [timely] receive[s] the amount of the payment transaction. . . ."[159]

2. At the point in which the payer's payment service provider discharged its liability to the payer, "the payee's payment service provider shall be liable to the payee for the correct execution of the payment transaction."

3. The liability of the payee's payment service provider to the payee is discharged by immediately placing the amount of

156. This is in fact enumerated in Directive Article 52(1) as one of the "corrective and preventive measures" for which the payment service provider may charge the payment service user.

157. *See* U.C.C. § 4A-207(b) (2008).

158. *Id.* § 4A-207(a).

159. As specified in Directive Article 69(1).

the payment transaction at the payee's disposal and, where applicable, crediting the corresponding amount to the payee's payment account.

4. A payer's payment service provider in breach with its obligation as in #1 above "shall without undue delay refund to the payer the amount of the non-executed or defective payment transaction and, where applicable, restore the debited payment amount to the state in which it would have been had the defective payment transaction not taken place."

5. Regardless of breach or defense to liability, in the case of non-execution of defective execution, and on request, the payer's payment service provider shall "make immediate efforts to trace the payment transaction and notify the payee of the outcome."

This overall scheme for credit transfers is in the footsteps of U.C.C. Article 4A in two major respects. First, the Directive fastens responsibility on the payee's payment service provider as of the time of receiving funds.[160] Second, it entitles the payer to a "money-back guarantee" from the payer's payment service provider in case funds do not reach the payee's payment service provider.[161] At the same time, the Directive does not follow UCC Article 4A[162] and does not specify that the arrival of funds to the payee's payment service provider marks the occurrence of payment by the payer to the payee. Rather, it leaves this to national laws.

Furthermore, the Directive does not take a position on who bears the responsibility for an erroneous payment order transmitted by the payer. By way of comparison, in principle, under U.C.C. Article 4A, the sender is responsible for the contents of its own payment order. The sender is also responsible for any discrepancy arising in the course of the transmittal of a payment order through a third party communication system (e.g. SWIFT). This means that such an intermediary system is

160. Thus under U.C.C. Section 4A-104(a), a credit transfer is completed by the "acceptance" of a payment order by the beneficiary's bank, which under Section 4A-209(b)(2) could be in the form of receipt of funds. Upon "acceptance" under Section 4A-404, the beneficiary's bank becomes obligated to pay to the beneficiary (as provided for in Section 4A-405).

161. *See* U.C.C. § 4A-402(c); *id.* § 4A-402 Official Comment 2. Nonetheless, under U.C.C. Article 4A an originator that selected a failed intermediary bank is responsible for the amount prepaid by the sender to that bank.

162. *Id.* § 4A-406 (in conjunction with Section 4A-209(b)(2)).

deemed to be an agent of the sender who is bound by the contents of the payment order as sent to the receiving bank by that communication system.[163] A sender can nevertheless shift the loss arising from the transmittal of an erroneous payment order (whether by itself or by a communication system acting as its agent) where the receiving bank has failed to comply with an *agreed-upon* security procedure which would have detected the error. Such a procedure may require a unique code for each payment order (so as to alert the receiving bank in the case of a duplicate payment), different codes for different levels of amounts, or identification of regular beneficiaries.[164] In order to benefit the sender, the security procedure, with which the receiving bank failed to comply, must have been agreed upon in advance.

Also troublesome on the coverage of the Directive is the lack of definition of defective execution and lack of adjustment of remedies, or the provision of a comprehensive scheme, in cases such as underpayment, overpayment, and payment to the wrong payee. In contrast, the provisions of U.C.C. Article 4A are more detailed. Thereunder, the sender is not responsible for the erroneous execution of its payment order by the issue of a nonconforming payment order by the receiving bank. A receiving bank executing the sender's order is required to issue a conforming payment order of its own.[165] Effectively, this means that the risk of an erroneous execution is placed on the erring receiving bank.[166] For example, in case of overpayment resulting from the issue by the erring bank of a payment order in a larger amount than indicated in the payment order it received, the erring bank is required to pay the (larger) amount of its own payment order but is entitled to be paid only the (smaller) amount of the payment order it received. Recovery of an erroneous payment, resulting either from an erroneous payment order[167] or from erroneous execution,[168] can be made, but only to the extent allowed under the law of mistake and restitution. Such recovery is available to the erring bank only directly from the actual beneficiary, irrespective whether the two are in privity.

163. *Id.* § 4A-206.
164. *Id.* § 4A-205.
165. *Id.* § 4A-302.
166. U.C.C. § 4A-303 (dealing with erroneous execution leading to overpayment, underpayment or payment to a wrong beneficiary). The receiving bank is effectively exonerated where its nonconformance is in the selection of an intermediary bank other than that selected by the sender but the funds transfer is nevertheless completed without exception (so that in fact no loss occurred).
167. *Id.* § 4A-205(a).
168. *Id.* § 4A-303.

Certainly, the money-back guarantee under Directive Article 75(1) provides for only one aspect in such cases. And yet, this is the only remedy specifically provided for in all cases of defective execution.

Indeed, the Directive deals with the amount of liability, though not in a comprehensive manner. Thus, according to Directive Article 75(3), "payment service providers shall be liable to their respective payment service users for any charges for which [the payment service providers] are responsible, and for any interest to which the payment service user is subject as a consequence of non-execution or defective execution of the payment transaction." Under Directive Article 76, any additional financial compensation "may be determined in accordance with the law applicable to the contract concluded between the payment service user and his payment service provider." As well, under Directive Article 77(1), where a liability of a payment service provider under Directive Article 75 is attributed to another payment service provider or to an intermediary, "that payment service provider or intermediary shall compensate the . . . payment service provider [liable under Directive Article 75] for any losses incurred or paid under Article 75." Along the same lines as Directive Article 76, Directive Article 77(2) goes on to provide that "[f]urther financial compensation may be determined in accordance with agreements between payment service providers and/or intermediaries and the law applicable to the agreements concluded between them."

That is, additional compensation to charges is not rejected altogether, but its determination is to be made by reference to the law applicable to the relevant contract. This is in departure from both EFTA and U.C.C. Article 4A. Thus, under EFTA §169h(a), in principle, a financial institution is liable to a consumer "for all damages proximately caused by . . . the financial institution's failure to make an electronic fund transfer" as instructed and per the terms of the agreement with the consumer. Conversely, under U.C.C. Section 4A-305, the liability of a receiving bank for late or improper execution, as well as for nonexecution in breach of contract, is limited to interest losses, expenses,[169] and in some circumstances, reasonable attorney fees. There is no liability under U.C.C. Section 4A-305 for consequential loss, even foreseeable, including exchange losses, or loss of a profitable contract due to the failure to meet a contractual payment deadline,[170] except by

169. Expenses may not be recovered in the case of mere delay. *See id.* § 4A-305(a).

170. This is an obvious departure from the common law rule of *Evra* v. *Swiss Bank*, 673 F.2d 951 (7th Cir. 1982).

express written contract. In the view of the drafters,[171] this rule is rationalized on the need "to effect payment at low cost and great speed."

Excluding altogether liability for consequential loss under U.C.C. Section 4A-305 is not beyond criticism; and yet, the distinction between business and consumer transactions, as between U.C.C. Article 4A and EFTA in the U.S., can simply be rationalized on the extent of damages, as well as on the greater tightness of retail payment systems compared to the some looser interbank links in wholesale payments. Conversely, avoiding the issue altogether, as was done in the Directive, is certain not to contribute to harmonization.

Moreover, the combination between "money-back guarantee" under the Directive and additional damages that may be recovered under national law may not always be harmonious. Similar disharmony with national laws can be produced by the lack of a comprehensive treatment in the Directive with regard to the completion of the payment transaction and the discharge of the debt paid by it. Two examples taken from German law may be noted.[172]

First, by way of background, historically, the "money-back guarantee" rule was introduced in the U.S. under U.C.C. Section 4A-402(c) to "compensate" the originator for the loss of the right to recover consequential losses from a bank for a bank's default in carrying out its part in the credit transfer.[173] That is, instead of a right to recover unlimited amount of foreseeable losses caused by the fault of a bank,[174] the originator was accorded an automatic right to recover from the originator's bank, loss caused at the originator's or intermediary bank, regardless of any fault, though in principle,[175] only in the amount to be paid to the beneficiary.[176] Later, in the footsteps of this development, the German Credit Transfer Law purported to strike a balance. The law did not affect the originator's right to obtain damages for consequential

171. U.C.C. § 4A-305 Official Comment 2.

172. Fundamentals of German law are set out in GEVA, *supra* note 142, at 218-26.

173. *See* U.C.C. § 4A- 212 (strict privity requirements and hence no vicarious liability); *id.* § 4A- 305 (in principle, no bank liability for consequential losses).

174. Prior to U.C.C. Article 4A, such a right was recognized in principle in *Evra*, *supra* note 171.

175. Exceptions cover incidental losses such as for interest and expenses; additional damages are recoverable only if so provided in an express written agreement. *See* U.C.C. § 4A-305.

176. *See id.* § 4A-305 Official Comment 2. Damages for the loss of a profitable contract such as in *Evra* are not recoverable then under the "money-back guarantee" rule. In *Evra* consequential damages were for $2.1 million while the amount of the transfer, recoverable under a "money-back guarantee" rule, would have been a mere $27,000.

losses,[177] but further provided for the vicarious liability of the originator's bank for consequential losses caused by the fault of an intermediary bank not selected by the originator.[178] At the same time, it provided the originator with only a limited "money-back guarantee" from the originator's bank,[179] which was an innovation under German law.[180]

This balance, that is, entitlement to *unlimited* damages for consequential losses caused by fault, and yet only to a *limited* amount under a "non-fault" "money back-guarantee" rule, is to be upset by the Directive, which provides for a "money-back guarantee" for the entire amount and yet does not affect remedies for consequential losses. Certainly, an entitlement to both a "money-back guarantee" and damages for consequential losses are not logically mutually exclusive; however, the exposure of banks to losses incurred in the course of carrying out credit transfers are to be dealt with comprehensively and not be the result of patching together different pieces of legislation which are not necessarily harmonious.

Second, under the German civil code, while a monetary debt is discharged upon the arrival of the money to the debtor, in the absence of special circumstances, a debtor performs a monetary obligation by *sending* the money and not *delivering* it or *bringing* it to the creditor.[181] Stated otherwise, while the debtor bears the risk of loss in transit, it is the creditor who bears the risk of delay. In connection with payment into a bank account by means of a credit transfer, the prevailing view is that money is sent when the debtor-originator issues to the originator's bank the payment order directing payment to the creditor-beneficiary; from then on, unless the underlying contract on which the debt is paid specifically requires arrival of funds by a designated date, risk of delay is borne by the creditor-beneficiary. This means the debtor-originator does not incur interest charges for late payment as long as the debtor-originator sends payment, namely, instructed the originator's bank, no later than the due date. At the same time, the risk of loss is borne by the

177. Pursuant to section 611 of the German Civil Code ("BGB"), the contract underlying the credit transfer is a contract for service, also governed by most provisions relating to the mandate (BGB § 675). *See* GEVA, *supra* note 142, at 218-19.

178. BGB § 676c (under the Credit Transfer Law 1999, Überwiesungsgesetz vom 21.7.1999, BGBl. I 1999, s. 1624 ff) (using an unofficial translation of the statute).

179. BGB § 676b.

180. The German Credit Transfer Law implemented Directive 97/5/EC on cross-border credit transfers, *see supra* notes 2 and 7, and expanded its scope to cover domestic credit transfers.

181. BGB §§ 269-270. *See* THE GERMAN CIVIL CODE (as am. to 1 Jan. 1975) (I.S. Forrester, S.L. Goren & H.M. Ilgen trans., 1975) (supp. trans. by S.L. Goren, 1981). A more recent, updated English translation is available online at http://www.gesetze-im-internet.de/englisch_bgb/index.html.

debtor-originator; no discharge occurs until funds are credited to the account of the creditor-beneficiary by the beneficiary's bank.[182]

However, under Article 3(1)(c) of the EU Directive on combating late payment in commercial transactions[183] (hereafter "late payment Directive"), a creditor is entitled to interest for late payment "to the extent that (i) he has fulfilled his contractual and legal obligations; and (ii) he has not received the amount due on time." This is so unless "the debtor is not responsible for the delay." According to Article 3(1)(a) of that late payment Directive, "interest . . . shall become payable from the day following the date or the end of the period for payment fixed in the contract." Dealing with an obligation to make payment to be credited into an designated bank account by due date, the European Court of Justice interpreted this provision to entitle the creditor, whose account has not been credited by due date, to receive interest payment as of due date.[184]

Prima facie, the case appears to have dealt with a contract that specifically required arrival of funds to the designated account by due date. Nevertheless, the case is regarded in Germany as upsetting altogether the traditional distinction between the risks of loss (borne by the debtor-originator) and delay (borne by the creditor-beneficiary), and fastening them both on the debtor-originator. But even so, a question arises as to whether, in light of the payment services Directive, the cutoff point both for the discharge of the underlying debt and avoidance of interest is the liability of the beneficiary's bank (payee's payment service provider) to the beneficiary (payee), rather than the actual crediting of the funds to the payee's account. Certainly, the beneficiary's bank becomes liable to the beneficiary already upon receiving funds for the payment order directing payment to the beneficiary. As indicated, Article 75(1) of the payment service Directive fastens responsibility on the payee's payment service provider as of the time it receives funds. As under U.C.C. Article 4A, this would have been a logical point for discharging the originator altogether, as if the originator delivered funds to an agent appointed by the beneficiary-creditor. Lack of a comprehensive treatment in the Directive as to the completion of the payment transaction and the discharge of the debt paid by it thus leads to an unfortunate uncertainty.

As for non-execution or defective execution of a payment order initiated by or through the payee, and as indicated, "without prejudice to

182. *See* GEVA, *supra* note 142, at 218-26.

183. Council Directive 2000/35/EC, 2000 O.J. (L 200) 35 (EC).

184. Case C-306/06, Telecom v. Deutsche Telekom, 2008 E.C.R. I-01051, *available at* http://curia.euuropa.eu/content/juris/index.htm.

Article 58, Article 74(2) and (3) and Article 78," payment services Directive Article 75(2) allocates liability, as follows:

1. To begin with, the payee's payment service provider "shall . . . be liable to the payee for correct transmission of the payment order to the payment service provider of the payer in accordance with Article 69(3)," that is, "within the time limits agreed between the payee and his payment service provider, enabling settlement, as far as direct debit is concerned, on the agreed due date."

2. Upon becoming liable under #1, the payee's payment service provider "shall immediately re-transmit the payment order in question to the payment service provider of the payer." In addition it "shall . . . be liable to the payee for handling the payment transaction in accordance with its obligations under Article 73" and "ensure that the amount of the payment transaction is at the payee's disposal immediately after that amount is credited to the payee's payment service provider's account." Directive Article 73 requires that credit to the payee's payment service provider be value-dated "no later than the business day on which the amount of the payment transaction is credited to the payee's payment service provider's account" and that the payee's payment service provider ensure that funds become available to the payee immediately. As in connection with Directive Article 73, the assumption is that payment to the payee's payment service account is necessarily by posting credit to its account.

3. Where the payee's payment service provider is not liable as above, "the payer's payment service provider shall become liable to the payer." The implicit but unstated assumption is of course that the non-execution is not attributed to insufficient funds or any other breach by the payer.

4. Where the payer's payment service provider is liable under #3, it shall "as appropriate and without undue delay, refund to the payer the amount of the non-executed or defective payment transaction and restore the debited

payment account to the state in which it would have been had the defective payment transaction not taken place."

5. Regardless of breach or defense to liability, in the case of non-execution of defective execution, and on request, the payee payment service provider shall "make immediate efforts to trace the payment transaction and notify the payee of the outcome."

In principle, Directive Article 75(1) covers credit transfers while Directive Article 75(2) covers debit transfers. And yet, Directive Article 75(2) is stated to also cover credit transfers initiated by the payer through the payee. Indeed, depending on the architecture of a system, payment transactions initiated through the payee could be either debit or credit transfers. Thus, when they are routed through the payee's payment service providers they are debit transfers. At the same time, when they are routed from the payee to the payer's payment service provider, whether directly, through a switch, or even through the payee's payment service provider acting merely as a communication channel, they are credit transfers. As credit transfers, such payment transactions initiated through the payee ought however to be covered by Directive Article 75(1) and not 75(2).

IX. CONCLUSION

The Directive provides for a harmonized legal framework, focusing on electronic payments. It is designed to create conditions for integration and rationalization of national payment systems, and thereby, the establishment of a common framework for the Community payments market. Intended to leave maximum room for self-regulation of industry, the Directive purports to harmonize only what is necessary to overcome legal barriers to a Single Euro Payment Area, or "SEPA."

Thus, the Directive is not a comprehensive payment law. A narrow range of selected topics, primarily focusing on the payer-bank and payee-bank relationships, resulted in a scheme whose scope and contents, at least so far as credit transfers are concerned, cannot be compared to, for example, those of U.C.C. Article 4A.

Moreover, as the few examples from Germany demonstrate, for gaining what may be called *horizontal harmonization* among the various legal systems in the area of payments, cost has been incurred in the form of loss of *vertical harmonization*, between the provisions of the Directive, and provisions of general laws.

As well, in a globalized environment, it is regrettable that the terminology of U.C.C. Article 4A was not followed. Indeed, in adopting its Model Law on International Credit Transfers,[185] the United Nations Commission for International Trade Law (known as "UNCITRAL") followed both the terminology and conceptual framework of U.C.C. Article 4A. Thus a measure of international consensus had been achieved that regrettably was not adhered to in the Directive.

Nevertheless, as a follow-up to the Euro/single currency project, in bridging differences among established legal systems of sovereign nations, some of which of major financial centres, the payment services Directive made a giant leap forward, towards harmonization and even uniformity of payment laws. Moreover, in providing for one statutory framework to apply to both debit and credit transfers, as well as for business and consumer payments, the Directive may have done better than the more compartmentalized and incomplete statutory scheme in the U.S.; the latter deals with consumer and business payments in various pieces of legislation and has no comprehensive statute for a debit transfer. In the final analysis, and notwithstanding valid criticism and room for significant improvements, the Directive is a noteworthy milestone in the march to a comprehensive payment law.

185. G.A. Res. 47/34, art. 6(b), U.N. Doc. A/RES/47/34 (Feb. 9, 1993).

Secured Transactions in a Country of Transition: The Hungarian Experience

Attila Harmathy

I. PERIOD PRIOR TO WORLD WAR II

Over several centuries, the lack of capital has been one of the serious problems of the Hungarian economy. Consequently, credit was an important element of economic life. Until the second half of the 19th century, the conditions under the still-prevailing feudal system were unfavourable for establishing a credit system. In the second part of the 19th century, however, an economic boom changed the conditions. As a result of the new economic situation, new legal rules were needed. In 1875, a Commercial Code was enacted and the drafting of a new Civil Code started. For historical and economic reasons, Austrian and German law was influential. Several drafts of a Civil Code were produced and presented to the Parliament, but none of them were voted on until 1959. In other words, until World War II the Civil Law as a whole remained uncodified and a special kind of judge-made law prevailed. Nevertheless, some Acts of Parliament regulated specific fields of social and economic life.[1]

One of the fields that needed specific rules was credit and credit securities. For example, Act XXXV of 1927 specified rules for mortgages. The basic concept underlying the credit rules was similar to that of the law of most European countries: mortgages covered immovable items and lien, pledge addressed movable goods. An exception to this system was created by Act XXI of 1928, which regulated a special security on industrial enterprises as a going concern without possession by the creditor and a system of special registration.

1. *See generally* INTRODUCTION TO HUNGARIAN LAW 11-14 (Attila Harmathy ed., 1998) (providing a historical overview).

The exceptional security was, to some extent, similar to the floating charge, otherwise unknown in the Hungarian law.[2]

II. PERIOD OF PLANNED ECONOMY

After World War II a democratic government was established in Hungary but, as a result of the pressure of the Soviet army, a slow change of the economy started. It was accelerated from 1948 when the Communist Party came to power. A new political and economic system was introduced. The characteristic features of the new economic system were the nationalisation of the overwhelming majority of the means of production, replacement of the market system by a centrally-directed system of economy, central allocation of resources, and state monopoly of a much of the economy. In this system, credit was also the monopoly of the state. Banks were functioning as a special type of state authorities by administering the centrally allocated financial resources. Contracts in general, and secured transactions specifically, had a different meaning and regulation than in a market economy, although some traditional legal forms were maintained in civil law rules.[3]

The system mentioned above determined the rules of the Hungarian Civil Code of 1959. By the time of the enactment of the Civil Code, the strict system of plan instructions had changed. Nevertheless, the state monopolies (including the monopoly of crediting) prevailed and state ownership played a decisive role in the economy. Likewise, the banking system was different from that of a market economy. The drafters of the Civil Code managed, however, to maintain in the framework of the Code the most important rules of the pre-World War II Hungarian Civil Law. This included the rules on secured transactions, although they were practically not applied.

At the end of 1960s economic reform occurred and a form of market economy emerged. Hidden forms of private economy were slowly permitted. Thus, there was a slow transformation of the economic system but it was restricted by the political system.

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2. *See* Attila Harmathy, *Ungarischer Länderbericht, Das Recht der Mobiliarsicherheiten*, *in* MOBILIARSICHERHEITEN, VIELFALT ODER EINHEIT 75-78 (K.F. Kreuzer ed., 1999).

3. *See generally* Attila Harmathy, *Kreditsicherheiten im sozialistischen System*, *in* SYSTEMTRANSFORMATION IN MITTEL—UND OSTEUROPA UND IHRE FOLGEN FÜR BANKEN, BÖRSEN UND KREDITSCHERHEITEN 306-14 (U. Drobnig, K. J. Hopt, H. Kötz & E.-J. Mestmäcker eds., 1998).

III. PERIOD SINCE THE POLITICAL CHANGES

A. New Regulation of Secured Transactions

After the elections of May 1990, a new Parliament and a new government started to transform the political and the economic system. The market economy was re-established. After the planned economy, accumulating a great amount of foreign debts capital was badly needed. Many poorly-run state enterprises carried huge debts and the creditors were usually banks. As a result, the banking system was to be reorganised. Debts were covered from State budget, which deteriorated the budgetary situation. It was clear that credits played a crucial role for the economy and the regulation of secured transactions received a significant attention.

The elaboration of the new rules for secured transactions followed a few years after the transformation of the political system. At that time the legislature was very busy—the whole legal system had to be changed. This task has not facilitated fast development in the rather complicated field of credit securities. The rules on mortgage, liens, and pledges were incorporated into the Civil Code, but many rules connected with them were to be remained in other Acts—such as the Acts on land registration or enforcement of claims—or appropriate rules were practically missing. For example, no rules existed to regulate insolvency or the winding up of companies. The task of drafting a coherent new efficient system was, therefore, not an easy one. The new rules were developed in co-operation with the European Bank for Reconstruction and Development and in consultation with German, French, English, Swiss, and American experts. The new rules were promulgated by Act XXVI of 1996 on the amendment of the Civil Code.[4]

The new rules have changed some of the traditional basic concepts. Thus, the distinction of mortgage (concerning immovable) and pledge, resp. lien (on movable) has been replaced by the distinction of the charge with possession and without possession. This takes into consideration the importance of movables and intangibles in the modern economy and the fact that it is the interest of both of the creditor and of the debtor that the debtor can use the object of the security remaining in its possession. According to another new solution, a part of the property can be the object of the charge as a going concern specifying its value but not each item belonging to the charged property (resembling to the floating

4. Attila Harmathy, *The EBRD Model Law and the Hungarian Law*, *in* EMERGING FINANCIAL MARKETS AND SECURED TRANSACTIONS 197-209 (Joseph Jude Norton & Mads Andenas eds., 1998) (discussing the transformation and the new rules).

charge). A third element of the changed conceptual basis was the reintroduction of the so-called abstract charge, which is not connected with the contract on crediting (in contrast with the charge having accessory character). The aim was to connect the abstract charge with some kind of securitisation; however, this link has not yet been achieved. A vital condition of the realisation of the new system was the establishing of a new registration system for charges without possession by the creditor. After long negotiations, the notary publics have established a computer network of registration, but the existing land registry system continues.

A serious problem of the new regulation was the necessary modification of the regulation of insolvency and the winding up of companies. Furthermore, enforcement of claims could not be achieved and inconsistencies remain in the complex system of regulation. Additional steps were made by Act CXXXVII of 2000 on the amendment of the Civil Code and some other Acts. The basic concept of the regulation of the Civil Code was not changed, but the rules on registration and enforcement were brought into harmony with the new system.

B. Court Practice

During the planned economy, the rules on secured transactions were in force but they were not applied because the economic conditions were not favourable. The transformation of the political and economic system has brought about fundamental change in this respect, too. Consequently, secured transactions have a renewed importance and legal actions resumed. Some cases are mentioned below to illustrate the types of problems that have appeared in court practice.

In one of the published cases decided by the Supreme Court soon after the effectiveness of the new rules, the rule concerning the method of enforcing security based on legal rules was interpreted.[5] From the very beginning of the application of the rules on secured transactions, problems connected with the enforcement of rights arising from the charge was an important question in the legal disputes.[6] In some cases the Supreme Court has explained how to distinguish security deposit and lien.[7] In other cases the consequences of the accessory character of the security were explained.[8] Problems arose in connection with a charge securing the maximum amount of debt in a long-term economic relation

5. Bírósági Határozatok [Law Reports] ("BH.") 1997 No. 243.
6. BH. 1996 No. 267; BH. 1996 No. 495.
7. BH. 2001 No. 543; BH. 2003 No. 288.
8. BH. 2001 No. 393; BH. 2003 No. 363; BH. 2007 No. 227.

where the debt was changing constantly in accordance with the revolving credit.[9] The question of assignment was put in connection with secured transactions, too.[10] Although there are problems in connection with the rights on "floating charge" there is only one case published by the Supreme Court concerning "crystallisation," i.e. specifying what elements of the property charged should be sold.[11]

It is obvious that there are several legal techniques of securing rights (e.g., retention of title, leasing, etc.). They are widely used in Hungarian practice, too. There were some cases decided by the Supreme Court where the question was whether the purpose of using other legal means was not circumventing a mandatory provision protecting the interests of the debtor. A typical agreement of this kind provides for the right of option granted to the creditor. According to the decision of the Supreme Court, the agreement is valid if the price to be paid under the option corresponds to the value (market price) of the immovable good and not to the amount of the debt.[12]

C. On the Present Situation

The Civil Code of 1959 preserved many elements of the Hungarian civil law of the period prior to World War II. Therefore, there was no need to start drafting a new code immediately after the political changes in 1990.[13] Nevertheless, some years later the conditions seemed to be favourable for drafting a new code. In 1998 the government made a decision on the codification. In recent years the concept of a new regulation of secured transactions was widely discussed.

The present economic situation in Hungary can be characterised with the following data. Charges on movable goods without possession are reported by the notary public registration network.[14] The overall value of registered securities in 1997 (the first year of registration) reached approximately HUF 600,000 million (about USD 3 billion). In 2002, the value was approximately HUF 11,400,000 million, or about USD 57 billion. The number of registered contracts concerning secured transactions at the end of 2002 totalled about 58,000. Out of these

9. BH. 2005 No. 152; BH. 2008 No. 22.
10. BH. 2002 No. 240.
11. BH. 2004 No. 192; BH. 2006 No. 120.
12. BH. 2005 No. 73; *see also* BH. 2001 No. 584.
13. *See* Attila Harmathy, *Process of Transition and Commercial Law in Central and Eastern Europe*, *in* NEW DEVELOPMENTS IN INTERNATIONAL COMMERCIAL AND CONSUMER LAW 367-82 (Jacob S. Ziegel ed., 1998); Attila Harmathy, *Transformation of Hungarian Civil Law*, *in* TRANSFORMATION OF THE HUNGARIAN LEGAL ORDER 1985-2005, at 279-86 (Andras Jakab, Peter Takács & Allan F. Tatham eds., 2007).
14. Gy Tolmár, *Zálogjogi nyilvántartás* [*Security Registration*], KÖZJEGYZŐK KÖZLÖNYE [BULLETIN OF NOTARY PUBLICS], 2003 No. 7, at 6-9.

contracts at the end of 2002, the proportion of charge of movables without possession was 59 percent, and those characterized by a "floating charge" comprised 16 percent. By the end of 2006, the proportion of "floating charges" had increased to 28 percent.[15] Recently, the importance of the abstract charge has increased considerably in the bank practice,[16] and by means of securitisation it has become an important form of refinancing bank credits.[17]

Credit issued to citizens and small business carry great importance even though the amount of the debt of individual debtors is small. Nevertheless, the aggregate amount is considerable. In 2006, the amount of credit issued for housing was HUF 688,000 million, or about USD 3.44 billion.[18] Banks, of course, play a vital role in credit.

As a result of privatisation, by the end of 2000 the foreign participation in the capital of banks was very high relative to that in other countries—66.7 percent—and the situation was similar for insurance companies.[19]

In the present international financial crisis and in light of the regulation of secured transactions, the economic situation of Hungary can be characterised as follows:

- the state budget deficit is high, the economic growth is small, the deficit of the balance of payment is also high, the amount of foreign debts has been increasing,

- the Hungarian banks have not owned securities based on foreign mortgages,

15. Anka Tibor,: *Hátra arc, előre? Az új Polgári Törvénykönyv tervezetének zálogjogi szabályairól* [*About Face, Ahead? The Rules on Secured Transactions in the Draft of the New Civil Code*], KÖZJEGYZŐK KÖZLÖNYE [BULLETIN OF NOTARY PUBLICS], 2007 No. 6, at 19.

16. Zámbó Tamás, *Útközben – de honnan és hová is?* [*In Transit – But from Where and in What Direction?*], KÖZJEGYZŐK KÖZLÖNYE [BULLETIN OF NOTARY PUBLICS], 2007 No. 6, at 11.

17. Botos András Gábor, *Várható változások a zálogjogi szabályozásban* [*Probable Changes in the Regulation of Secured Transactions*], KÖZJEGYZŐK KÖZLÖNYE [BULLETIN OF NOTARY PUBLICS], 2007 No. 6, at 24-25.

18. Szendrey Zoltán, *Az új Polgári Törvénykönyv zálogszabályai a lakossági finanszírozás szemszögéből* [*Rules of Secured Transactions of the New Civil Code: Credits Granted to Citizens*], KÖZJEGYZŐK KÖZLÖNYE [BULLETIN OF NOTARY PUBLICS], 2007 No. 6, at 35.

19. PÉNZÜGYI SZERVEZETEK ÁLLAMI FELÜGYELETE [STATE INSPECTION OF FINANCIAL INTITUTIONS]: ÉVES JELENTÉS 2000 [ANNUAL REPORT], 47, 66, 70-72 (2001). 47, 66, 70-72.

- the foreign banks having shares of Hungarian banks have not been directly endangered by the financial crisis up to now,

- the price of immovable goods has not increased considerably during recent years,[20]

- additional problems arise because of the inefficient and slow procedure of enforcing rights in immovable goods, particularly in the framework of insolvency and the procedure for winding up companies.[21]

Taking into consideration the data concerning the practice of secured transactions and the financial crisis there seems no special need to change the fundamental concepts of the regulation of secured transactions in Hungary.

20. Király Júlia, Nagy Márton & Szabó E. Viktor, *Egy különleges eseménysorozat elemzése – a másodrendű jelzáloghitel-piaci válság és (hazai) következményei* [*Analysis of a special series of event— the crisis of secondary mortgage market and its (domestic) consequences*], KÖZGAZDASÁGI SZEMLE [ECONOMIC REVIEW] 2008, at 608, 610, 613.

21. Póra András & Széplaki Valéria, *Hitelbiztosítékok hazai szabályozása, különös tekintettel a CRD elvárásaira* [*Domestic regulation of credit securities, taking into consideration in particular requirements of CRD*], MNB TANULMÁNYOK [ESSAYS PUBLISHED BY THE NATIONAL BANK OF HUNGARY] 2006, at 28.

The Emerging Legal Concept of Investment

Mary E. Hiscock*

I. INTRODUCTION

In May 2007, an arbitrator not far from Singapore had to resolve a dispute between a salvage company and the government of Malaysia.[1] The company had entered into a contract to salvage a cargo of Chinese porcelain from a British ship that had sunk in the Straits of Malacca in 1817. The dispute turned on the amount payable to the salvage company under the terms of that contract. One might have thought that this was an everyday dispute that would be settled by a summary proceeding in a local court for the recovery of debt. It became an international investment dispute, however, alleged to be an international wrong as a breach of a treaty between the governments of the United Kingdom and Malaysia,[2] and settled by an arbitration established under yet another international treaty.[3]

How can this be? What does international law consider to be an investment? The answer to this question is important both to determine whether there has been a contravention of an investment regime, and also to determine whether and where jurisdiction exists for the settlement of any dispute.

The context of this paper is the current range of investment regulation regimes in Asia, but the issues are universal. Investment regulation in Asia is governed by multiple layers of legal norms, many of

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1. *See* Malaysian Historical Salvors Sdn, Bhd v. Gov't of Malay., ICISD Case No. ARB/05/10 (May 17, 2007). Note that annulment proceedings for this award began on Mar. 31, 2008. *See* International Centre for Settlement of Investment Disputes ("ICSID"), Case Details, http://icsid.worldbank.org (last visited Feb. 1, 2009).

2. *See* Agreement Between the Government of the United Kingdom of Great Britain & Northern Ireland & the Government of Malayasia for the Promotion and Protection of Investments, U.K.-Malay., May 21, 1981.

3. *See* Convention on Settlement of Inv. Disputes Between States & Nationals of Other States, Mar. 18, 1965, 4 I.L.M. 524.

which are external to the host State of the investment. These norms deal with both aspects of the issue: definition and dispute resolution.

There have been relevant multilateral government regimes since 1995. The General Agreement on Trade in Services ("GATS") was an extension of regulation from goods to services and, although the supply of services does not always amount to investment, some does.[4] Trade Related Investment Measures ("TRIMS") codified earlier jurisprudence on how trade in goods can impact on investment regulation. Both emanated from the World Trade Organisation ("WTO").[5]

There are also multilateral regional trade agreements[6] that must comply with the regime of the WTO Agreements,[7] such as the ASEAN Free Trade Area (2003) and the North American Free Trade Agreement ("NAFTA") (1992).

There is also a proliferation of older-style bilateral investment agreements[8] as well as the newer mode of preferential trade agreements

4. This relationship is discussed further below in note 5.

5. GATS and TRIMS are part of the Marrakesh Agreement 1994, which establishes the WTO and constitutes a single treaty undertaking for members of the WTO. *See* Agreement Establishing the World Trade Organization, Apr. 15, 1994. There is a unified dispute resolution regime for any breach of the Agreement, the Understanding on Dispute Settlement ("DSU"). *See id.* at Annex 2.

6. More than 40 percent of the total number of regional trade agreements have been made since 2000. Mexico, Chile, Singapore, the United States, and Australia have been the most active states. The European Free Trade Association ("EFTA"), the European Union ("EU"), and the Association of Southeast Asian Nations ("ASEAN") are the most active country groups. According to the Asian Development Bank, as of December 2007, 220 active agreements have been notified to the WTO; there are a further 71 that have not been so notified, which cover East Asia, Oceania, and South Asia; a further 50 agreements have been proposed. *See* http://aric.adb.org/2/php.

7. *See* Gen. Agreement on Tariffs & Trade, art. XXIV, Apr. 15, 1994; *see also* Agreement Establishing the World Trade Organization, Annex 2, art. V, Apr. 15, 1994. These requirements apply to developing countries with less rigour than to developed countries. *See, e.g.*, Agreement Establishing the World Trade Organization, Annex 2, art. V(3), Apr. 15, 1994.

8. By the end of 2006, there were 2,651 such treaties, of which 110 had been renegotiated. *See* UNITED NATIONS CONFERENCE ON TRADE & DEVELOPMENT, INVESTOR-STATE DISPUTE SETTLEMENT AND IMPACT ON INVESTMENT RULEMAKING 3 (2007), *available at* http://www.unctad.org/iia. Despite their reciprocal nature, these treaties have always disproportionately benefited capital exporters. *See* Jeswald W. Salacuse, *BIT by BIT: The Growth of Bilateral Investment Treaties and their Impact on Foreign Investment in Developing Countries* 24 INT'L LAW. 655, 662 (1990). Issues also arise from the older BITs for some EU members, notably Austria and Sweden, currently before the European Court of Justice to determine whether the BIT obligations are incompatible with their obligations as members of the EU. *See Advocate General Sides with European Commission in its Bid to Have European Court of Justice declare Austria & Sweden in Violation of EU Law for Failure to Remedy "Incompatibility" of Earlier BITs & EU Law*, INVESTMENT ARB. REP., July 16, 2008, at 8-10, *available at* www.iareporter.com. The Advocate-General has delivered opinions that they are incompatible. *See id.*

between States[9]. There are national laws, regulations, policies and guidelines, and courses of governmental conduct. As measures, these must comply with WTO obligations and with any treaty obligations. Finally, States frequently enter into contracts with investment implications.

Each type of treaty or measure has its own description or definition of the covered investment, and its own method of dealing with disputes.[10] The rules of international law that limited participation in international legal disputes only to States and international organisations have given way under International Centre for Settlement of Investment Disputes 1966 ("ICSID") and other treaties to permit non-State investors to pursue claims directly against States. International dispute resolution is much more widespread and the participants, as well as the process, are much more sophisticated. This has meant a great increase in the number of claims relating to investments that have been pursued over the last thirteen years.[11] The range of issues that has been thrown up in these disputes is very large. The jurisprudence that has emerged from the awards of tribunals and the scholarly writing thereon has recharged the field of investment law with some vibrant and critical debates.

There are far too many issues arising from these disputes to canvass in this paper. The focus, therefore, is on how and by whom the balance is being struck between the rights and obligations of investors and the policies and interests of States in the context of the modern investment regime. Is this balancing now an inherent part of the concept of investment?

II. A BRIEF SYNOPSIS OF THE LAST 65 YEARS

The phenomenon of foreign direct investment emerges from the chaos at the end of World War II and immediately thereafter. In the pre-war twentieth century world, colonialism and portfolio investment served the interests of primarily European States in providing income, commodities, resources, and food. As the British, French, Portuguese, and Dutch empires collapsed or faded away, post-colonial independent regimes continued to provide commodities and resources for the First World, but on somewhat different terms.

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9. *See supra* note 6.

10. The United Nations Economic and Social Commission for Asia and the Pacific ("ESCAP") has a database of trade agreements. *See* Asia-Pacific Trade & Investment Agreement Database, http://www.unescap.org/tid/aptiad/agg_db.aspx (last visited Feb. 2, 2009).

11. In 1995, the ICSID had four arbitrations. In 2005, it had 100 including 26 new claims.

There was a flurry of nationalisation of foreign property, as for example in Indonesia. This was as far-reaching in its effect on international law as had been the nationalisations of the Russian revolution thirty years earlier. There was no doubt that the newly-independent States needed foreign capital in all its forms: but capital-exporting States placed a very high priority on the need for protection of their investments, often by means of direct control of the investment and the political, economic, and legal infrastructure that supported it.

At the same time, the international institutions that have been so important in the field of investment came into existence, including the World Bank Group. This in turn was responsible for two fundamental pieces of international legal architecture: the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards 1958[12] (the New York Convention) and the ICSID.[13] The New York Convention produced an international framework for the enforcement of arbitral awards and agreements to submit to arbitration, and the ICSID restricted the rules of sovereign immunity from suit, so that a State could irrevocably waive that immunity and engage in arbitration of investment disputes. The Organisation for Economic Development ("OECD") moved to take a strong position to represent the interests and concerns of capital exporting States. The United Nations Conference for Trade and Development ("UNCTAD") became a platform for the countries of the Third World.

The tipping point came in the 1970s, with the growing strength and belief of the capital-importing States in their rights to control the use and development of their own resources. This is seen most clearly in the General Assembly Resolutions on the New International Economic order ("NIEO").[14] There is a trend towards recognition of the importance of, and perhaps the right to, economic development in international instruments, beginning with ICSID,[15] and culminating in express provisions in contemporary preferential trade agreements ("PTAs"). The latter, despite their name, usually contain substantial provisions in

12. *See* Convention on the Recognition & Enforcement of Foreign Arbitral Awards, June 10, 1958, 21 U.S.T. 2517, 330 U.N.T.S. 38. There are 142 state parties to this Convention, and this covers most countries within this region.

13. *See* Convention on Settlement of Investment Disputes Between States & Nationals of Other States, Mar. 18, 1965, 4 I.L.M. 524. There are 143 Contracting States, with some exceptions in the region including Laos, Vietnam, Thailand, Myanmar, and India.

14. *See* G.A. Res. 3201, U.N. Doc. A/RES/S-6/3201 (May 1, 1974); G.A. Res 3281, U.N Doc. A/RES/29/3281 (Dec. 12, 1974). The earlier GA Resolution 1803 of 1962 on Permanent Sovereignty over Resources began this process.

15. There were earlier relevant provisions in the unsuccessful Havana Charter seeking to establish the International Trade Organisation ("ITO"). *See infra* note 20.

relation to investment. It is in these provisions that the new concept of investment emerges. Many of these PTAs have East and Southeast Asian States as parties.[16]

Capital importing States are anxious to retain whatever hardly-gained leverage they have gained over investment within their territories. This anxiety is reflected in the continuing reluctance of States to put liberalisation of investment on a revised WTO agenda. At the Ministerial Meeting of the WTO in Singapore in 1996, it was agreed that investment would be so included. Subsequently, however, it was dropped in 2003 from the agenda for the Doha Development Round at the insistence of a group of developing countries. All governments are caught in this dilemma between attracting foreign capital and developing and controlling national policies to satisfy national needs and priorities.

III. HOW HAS THE MEANING OF INVESTMENT CHANGED?

There is not and never has been a single authoritative legal definition of investment. The meaning of the term varies according to the text and context of the international instrument in which it is found.[17] In the earlier part of the twentieth century, the more commonly used term was "foreign property;" usually referring to the capital and real property of resident foreign nationals.[18] There is not even a constant meaning of investment as an economic phenomenon. It has evolved as business practice has changed over the years; as wealth has moved in international transactions from tangible assets to intangible assets; and as cross-border wealth-producing transactions are increasingly made between related companies, rather than with third parties.

In the still-born Havana Charter that was intended to establish the International Trade Organisation ("ITO"),[19] and to regulate both international trade and international investment there was no definition

16. *See* INTERNATIONAL INVESTMENT LAW: UNDERSTANDING CONCEPTS AND TRACKING INNOVATIONS, Annex at 162-72 (OECD 2008) (Table 3.A1.1 Bilateral Investment Treaties). These include Australia-Singapore, Japan-Philippines, Korea-Singapore, Us-Singapore, Chile-China, Chile-Korea, EFTA-Singapore.

17. *See* Vienna Convention on the Law of Treaties arts. 31-32, May 23, 1969, 1155 U.N.T.S. 331, 8 I.L.M. 679; *see generally* DOMINIQUE CARREAU & PATRICK JUILLARD, DROIT INTERNATIONAL ECONOMIQUE (3d ed. 2007).

18. For example the term "investment" is referred to as "foreign property" in the Organisation for Economic Co-operation and Development ("OECD") Draft Convention on the Protection of Foreign Property. *See* OECD Draft Convention on the Protection of Foreign Property, 7 I.L.M. 118 (1968) (Paris).

19. The Havana Charter was to be the third leg of the post-war architecture, together with the International Bank for Reconstruction and Development and the International Monetary Fund. The outbreak of the Cold War is usually seen as the reason for the Havana Charter's demise, which came about when the US Congress refused to ratify it.

of, but simply a reference to, "international investment."[20] It is noteworthy that the opening paragraph of Article 12 of the Havana Charter states that "[t]he Members recognise that: (a) international investment, both public and private, can be of great value in promoting economic development and reconstruction, and consequent social progress."[21] Although multilateral in structure, the Charter also envisioned the development of further bilateral and multilateral investment agreements between Members.[22]

The International Monetary Fund ("IMF") also developed a concept of investment for its purposes: the monitoring of balance of payments, but it was cast solely in economic terms that reflected the structure, the content, and control of investment. The IMF definition has also been adopted in some preferential trade agreements. Its definition of "direct investment" is used in the Thailand-Australia Free Trade Agreement of 2003 ("TAFTA").[23]

Older bilateral arrangements mostly defined investment by reference to national concepts, but in an international law context. Many Asian investment regimes e.g. Indonesia articulated their purposes and priorities.[24] The World Bank and UNCTAD monitored the balance.

To establish a jurisdictional basis for dispute resolution by arbitration, it has been the ICSID through Article 25(1) that has used the definition of investment. The dispute must arise directly from an investment; and it must be of a legal nature, that is, claiming a legal remedy and founded on legislation or a treaty.[25] The Rules on Commercial Arbitration of the United Nations Commission on International Trade Law ("UNCITRAL"), the International Chamber of Commerce ("ICC"), and the Stockholm Chamber of Commerce ("SCC"), which are all widely used both in treaties and in ad hoc arbitration, do

20. The obligations of Members were to provide reasonable opportunities for investment and to have due regard to avoid discrimination against and between foreign investments. *See* United Nations Conference on Trade and Employment: Havana Charter art. 12(2)(a), Mar. 24, 1948, *available at* http://www.worldtradelaw.net/misc/havana.pdf.

21. *See id.* art. 12(1)(a).

22. *See id.* art. 12(1)(d).

23. *See* Thailand-Australia Free Trade Agreement, Thai.-Aus., art. 901(c), July 5, 2004 (providing that "'direct investment' means a direct investment as defined by the International Monetary Fund under its Balance of Payments Manual, fifth edition (BMP 5), as amended.") This is the same meaning as that in the OECD Benchmark Definition of Foreign Direct Investment (4th ed). The BMP is presently being reviewed. It is a more restricted definition of investment than is found in most Australian preferential trade agreements.

24. These policies and the need for balance are seen in the preambles to Indonesia's Law No.1/1967 Concerning Foreign Investment and Law No.25/2007 on Capital Investment Regulation.

25. *See* CHRISTOPHER H. SCHREUER, THE ICSID CONVENTION: A COMMENTARY, 89, ¶ 3 (2001).

not "filter claims through their own autonomous notion of investment as a condition of jurisdiction *ratione materiae*."[26] So it is only ICSID arbitration that presents the issues in their most acute form, as *Malaysian Historical Salvors Sdn, Bhd v. Gov't of Malay.*, ICISD Case No. ARB/05/10 (May 17, 2007) illustrates.[27]

In the late 20th century, two different models of investment agreement emerged. The investment provisions in agreements such as the North American Free Trade Agreement ("NAFTA") became the template for subsequent US preferential trade agreements. These include the US agreements with Australia, Singapore, and Korea. There are more in the pipeline for Asia. The NAFTA text enlarged the scope of activity regarded as "investment"[28] and made it the focus of extensive and rigorous protection. This is typically done by having separate chapters dealing with investment and with liberalisation of trade in services, with limited interaction between them. Based on its domestic experience of NAFTA, the US subsequently sought in the Australian-US Free Trade Agreement ("AUSFTA"), although not in other PTAs with the region, to limit the dispute resolution options for investors.

The second model of investment agreement is based on the structure of the GATS. The purpose of GATS is to liberalise trade in services by supporting multilateral negotiations between Members of the WTO. There is no positive definition of services in GATS, but there are some exclusions. The relevant triggers of the application of GATS are the cross-border modes of supply of services. Those particularly relevant to investment include the supply of services through a commercial presence of a service provider in the territory of a service consumer, although these do not always amount to investment.[29] As a result of the jurisprudence, the cross-border supply of services electronically is also

26. Stephen Jagusch & Anthony Sinclair, *The Limits of Protection for Investments and Investors under the Energy Charter Treaty*, *in* INVESTMENT ARBITRATION AND THE ENERGY CHARTER TREATY 75 (Clarisse Ribeiro ed., 2006).

27. *See supra* note 1.

28. For example, Article 1139 provides for a broad and exhaustive list of assets with specific exclusions. The assets include foreign direct investment ("FDI"), equity securities, partnerships and other interests, and tangible and intangible property acquired "in the expectation . . . of economic benefit." Loans are included only when debt is long-term (more than 3 years) or is the movement of funds within related companies. Contract rights are covered only when there is a commitment of capital or equivalent resources, and the specific exclusions cover money claims arising from commercial contracts for the sale of goods and services.

29. *See* Patrick Mitchell v. The Democratic Republic of Congo, ICSID Case No. ARB/99/7 (2006). This was the annulment of an earlier ICSID award holding that there was jurisdiction where a law firm had been expropriated. The final hearing decided that a law firm is not "readily recognisable" as an investment either under the ICSID or under the US law.

included within GATS.[30] Typically, investment disciplines are divided between chapters on trade in services and investment, and the chapters interact more closely.

The difference in the results achieved by each of these models can be exaggerated, but they do have different effects in terms of liberalisation of investment regimes. The NAFTA-type agreements call for non-discrimination and transparency in more economic sectors, and they have a capacity to expand coverage through the application of most-favoured nation ("MFN") clauses, although these may be limited. The GATS-type agreements are more often used when countries are developing an investment infrastructure, and want a higher degree of flexibility. Expansion is through the negotiation of specific commitments, which may be positive or negative in terms of sectors. GATS-type agreements also usually do not permit MFN to apply to third parties. The OECD has concluded that MFN is not a significant factor in liberalisation of investment regimes.[31]

This leads to a convergence in regulation between trade (which had been the only area of regulation under GATT and its successor, the WTO) and investment, where previously there had been no multilateral regulation. The overlap between the obligations of Members to uphold the provisions of the GATT and their impact on national regulation of investment is spelled out in the TRIMS, where a number of practices that limit liberalisation of investment are set out as examples of breaches of GATT obligations. This potential overlap had already been recognised when the GATT had ruled that the implementation of the Canadian Foreign Investment Act was not consistent with Canada's obligations under the GATT[32].

As well as introducing new requirements for States, their extension made the WTO dispute resolution system available to disputants[33]. The

30. *See* Arbitrator Opinion, *United States-Measuring Affecting the Cross–Border Supply of Gambling and Betting Services*, WT/DS285/ARB (Dec. 21, 2007), *available at* http://www.wto.org/english/tratop_e/dispu_e/cases_e/ds285_e.htm.

31. *See generally* Marie-France Houde, Akshay Kolse-Patil & Sebastien Miroudot, *The Interaction Between Investment and Services Chapters in Selected Regional Trade Agreements* (OECD Trade Policy Working Paper No. 55 June 19, 2007), *available at* http://www.olis.oecd.org/olis/2006doc.nsf/LinkTo/com-daf-inv-td(2006)40-final. MFN has, however, been significant in extending other substantive and procedural rights. *See* Emilio Agustin Maffezini v. Kingdom of Spain, ICISD Case No. ARB/97/7 (Jan. 25, 2000).

32. *See* Canada Administration of the Foreign Investment Review Act, BISD 30S/140 (1983), *available at* www.worldtradelaw.net/reports/gattpanels/canadafira.pdf.

33. This will mean that there may well be a number of different avenues of dispute resolution open to States and investors, depending on their range of legal relationships. Who gets to make the controlling decision is an issue that is greater if a State chooses to pursue a claim on behalf of an investor? Are there intrinsic priorities? The decision in

objectives of the WTO are consistently liberalization, and market access. Whereas the history of investment agreements and modes of dispute resolution demonstrated that protection of foreign investment against the actions of host States were the principal objectives.

Globally, the jurisprudence of investor disputes is evolving, but not in a homogenous way. The extent to which there should be a concept of guidance from earlier precedents is a contentious issue amongst international commercial arbitrators.[34] Article 53 (1) of the ICSID states that awards are binding only on the parties to the awards. Some continuity of reasoning comes from the overlapping participation of arbitrators in a number of awards. For example, of the awards cited in note 37 below, two arbitrators (Professors Francisco Orrego Vicuna and Gabrielle Kaufmann-Kohler) acted in four of those eight cases. It is however argued that this personal continuity is not enough, and that an appellate framework should be developed, given that the arbitration of these disputes has a core public international law aspect in interpreting the provisions of treaties, and that arbitration is usually viewed as a private matter only of interest to the parties concerned.

There are three aspects for consideration. The first is that a qualitative element has been introduced into the concept of investment. This is part of a transition from an economic concept to a legal concept, but one responsive to its own legal and factual context. It is not an essential element in defining those kinds of investment that have been traditionally accepted as such, but it has been critical when the position is more ambivalent. Then what is required is a judgment that the putative investment contributes to the economic development of the State. The criteria to be satisfied come from the policies of the host State.

A related issue is whether a damaging economic effect of government policies on foreign interests is a wrong when the policy is transparent and non-discriminatory across a whole sector affecting foreigners and nationals alike. This has arisen frequently over the last fifteen years. It reflects the regulatory concerns of States, which have expanded to emphasise issues such as sustainable development, the environment, and public health[35].

Mexico - Taxes on Soft Drinks and Other Beverages, WT/DS308/AB/R (Mar. 6, 2006), would seem to indicate that the WTO does not accept that its jurisdiction is so restricted. At what point do parties take the decisive "fork in the road," which precludes the pursuit of any other possibility? Article 26 of the ICSID Convention covers this issue, but in the context of the WTO, this is being left to future jurisprudence.

34. *See* Professor Gabrielle Kaufmann-Kohler, Keynote Address at the Inaugural Conference of the Society of International Economic Law (July 17, 2008); *see also infra* note 40.

35. *See* Jan Paulsson, *Indirect Expropriation: Is the Right to Regulate at Risk?* (Dec. 12, 2005) (Symposium Co-Organised by ICSID, OECD, and UNCTAD, Making The

The third issue relates to the consequences of settling these matters by arbitration panels? Is this controversy a harbinger of fundamental change so that the legal definition of investment requires a dynamic element of achieving public policy?

IV. INVESTMENT MUST CONTRIBUTE TO DEVELOPMENT

In the *Malaysian Salvors* case, the arbitrator considered seven decisions of ICSID tribunals[36] relating to the definition of investment to decide whether the salvage contract between the Government of Malaysia and the company was an investment. In reviewing these cases and scholarly writings, the arbitrator, Michael Hwang SC, looked for "the hallmarks of investment"[37]. He began with Schreuer's analysis in his Commentary on ICSID.[38] Based on the words of the Convention and earlier decisions, Schreuer summarised the "typical characteristics" of an investment as the following:

- A certain duration
- The regularity of profit and return
- Mutual assumption of risk
- A substantial commitment
- The significance of the operation for the host government.

Most of International Investment Agreements: A Common Agenda), *available at* http://www.oecd.org/dataoecd/5/52/36055332.pdf.

36. *See generally* Salini Costruttori SpA & Italstrade SpA v. Kingdom of Morocco, ICSID Case No. ARB/00/4 (Jul. 23, 2001)("Salani"); *see also* Joy Mining Machinery Ltd v. Arab Republic of Egypt, ICSID ARB/03/11 (Jul. 30, 2004); Jan de Nul NV Dredging International NV v. Arab Republic of Egypt, ICSID Case No. ARB/04/13 (Nov. 6, 2008). *See generally* Consorzio Groupement LESI-DIPENTA v. Peoples Democratic Republic of Algeria, ICSID Case No. ARB/03/08 (Jan. 10, 2005); Bayindir Insaat Turizm Ticaret Ve Sanayi AS v. Islamic Republic of Pakistan, ICSID Case No. (ARB/03/29) (Nov. 14, 2005); Ceskoslovenska Obchodni Banka, A.S. v. Slovak Republic, ICSID Case No. ARB/97/4 (Dec. 29, 2004). *See Patrick Mitchell*, *supra* note 29. The first case where a jurisdictional controversy arose was *FedEx v. Venezuela*, ICSID Case No. ARB/96/3 (1997). Although the tribunal regarded the promissory notes in dispute as an investment, the tribunal importantly laid the foundation for subsequent awards by regarding investment as an objective concept, not one wholly determined by the will of the parties as expressed in their treaty. Later cases, particularly *Salini*, have considerably refined the ambit of discussion. *Saipem SpA v. Peoples Republic of Bangladesh*, ICSID Case No. ARB/05/07 (Mar. 21, 2007), also raises the jurisdictional issue but was not cited in *Malaysian Salvors*. It applies the *Salini* test and found there was an investment. However, economic contribution was not an issue. It is noteworthy, however, that Professors Gabrielle Kaufmann-Kohler and Christopher Schreuer were members of the panel of arbitrators.

37. *Malaysian Salvors*, *supra* note 1, ¶ 44.

38. *See* SCHREUER, *supra* note 25, ¶ 40.

The arbitrator subsequently contrasted this analysis (which he called the typical characteristics approach) with an alternative (which he called the jurisdictional approach).[39] The jurisdictional approach calls for a number of mandatory elements, all of which must be present before there is jurisdiction in an ICSID tribunal. However, the typical characteristics approach is more flexible, and takes a "holistic" approach to balance off strength in one element against weakness in another, possibly even to find jurisdiction if one element were missing. Given the range of facts that might come before ICSID, an empirical rather than a doctrinal approach is preferable. This has been the pattern with ICSID tribunals, and even though there is no doctrine of precedent with the decisions of tribunals,[40] their guidance is important.

The tribunal analyzed each of the ICSID decisions in turn, looking to see how each related to the two approaches set out above.

Salini Costruttori SpA & Italstrade SpA v. Kingdom of Morocco, ICSID Case No. ARB/00/4 (Jul. 23, 2001), concerned a construction contract to build fifty kilometers of a highway from Rabat to Fes. The contract was with a company working on the project under a concession agreement with the government of Morocco. The two Italian contractors had submitted a joint tender, which was accepted. The duration of the work according to the contract was to be thirty-two months. In fact, it took thirty-six months. The tribunal considered that the contractors had made contributions in money (through performance guarantees), in kind (through equipment and personnel), and in industry and skill. The length of the commitment fell in an acceptable range of two to five years. Each side assumed risks. Finally, there was no doubt that the work contributed to the economic development of the host state. Although looking at each factor in turn, the tribunal made a general assessment. However, the language used by them was consistent with either approach. The relevant laws were the Italian-Morocco BIT and also the ICSID.

In *Joy Mining Machinery Ltd v. Arab Republic of Egypt*, ICSID ARB/03/11 (Jul. 30, 2004), the contract was with a government agency for the provision of mining equipment at a cost of 13.3 million pounds sterling. The sellers also entered into performance guarantees of 9.6 million pounds sterling. The dispute was over the release of the

39. *See Malaysian Salvors*, *supra* note 1, ¶ 70.

40. The difficulty in reconciling the decisions even on a single treaty, not only of ICSID but of all tribunals with jurisdiction, has led some to believe that there is a need for a global investment arbitral appellate body. *See* Susan D. Franck, *The Legitimacy Crisis in Investment Treaty Arbitration: Privatizing Public International Law Through Inconsistent Decisions*, 73 FORDHAM L. REV. 1521 (2005); *but cf.* Sir Anthony Coleman, *The Question of Appeals in International Arbitration* (July 12, 2007) (paper presented to the UNCITRAL Congress, Modern Law for Global Commerce, Vienna).

guarantees. The tribunal regarded this as a normal commercial transaction, with no regularity of profit and return. There were no risks apart from those normally associated with a sale transaction, and no particular benefit to Egypt. Nor was it a significant commitment. The tribunal proceeded on the basis that all the features of investment should be satisfied, although conceding that the extent to which this would happen would depend on the facts of each case. The decision of the tribunal was that the guarantees were not an investment within the meaning of the UK-Egyptian BIT.

Consorzio Groupement LESI-DIPENTA v. Peoples Democratic Republic of Algeria, ICSID Case No. ARB/03/08 (Jan. 10, 2005), arose out of a concession agreement to build a dam. The language of the tribunal was not ambiguous. It favored the jurisdictional approach and squarely laid down three elements of jurisdiction: that the operation made a contribution to the country; that it had a certain duration; and that it involved risk. Specifically, a contribution to the economic development of the country is not required. They then went on to say that contribution in most cases would be covered by establishing the other elements.

On this latter point, the tribunal in *Patrick Mitchell* disagreed and said that such a contribution was an essential, but not a sufficient, characteristic of an investment, and the tribunal pointed out that in *CSOB* a loan was regarded as an investment because it did make a contribution to the economic development of the country. The language of the tribunal in *CSOB* was consistent with the typical characteristics approach. The *Mitchell* tribunal also reiterated that these broad concepts would vary in their nature depending on the facts of the case.

Bayindir Insaat Turizm Ticaret Ve Sanayi AS v. Islamic Republic of Pakistan, ICSID Case No. (ARB/03/29) (Nov. 14, 2005), a highway construction contract dispute, also exemplified the typical characteristics approach in that it took a holistic view of the facts of the case and saw the matter turning on the facts.

Jan de Nul NV Dredging International NV v. Arab Republic of Egypt, ICSID Case No. ARB/04/13 (Nov. 6, 2008), expressly followed *Salini* and used the typical characteristics approach, including a contribution to the economic development of the country. This was a dredging contract to deepen and widen the Suez Canal. The tribunal indicated that the length of time of the contract was also a likely pointer to economic benefit. Again, each element interacts with the other.

The conclusion of the tribunal in *Malaysian Salvors* was that, in the end, it would not make much difference which approach was taken by a tribunal. The decision is primarily a factual decision, and the language will reflect where the strength of the case lies. The tribunal will then

adopt the expression of a "Newtonian" or a "Cartesian" approach—depending on whether one moves from the particular to the general or the general to the particular, respectively.

The tribunal then looked at the facts of the salvage contract and concluded that the elements as spelled out in *Salini* could be made out here, but only at a superficial level. That made the economic contribution to the economy of Malaysia a decisive factor in the balance. All seven cases regarded economic development as an important, but not necessarily major, contribution where other factors were conclusive. The tribunal concluded that, even were the claimant to make out its best case, this would not make the contract an investment. This award is now subject to an annulment process. What happens in many cases at this point is that parties reach an agreed settlement. So it remains to be seen what will happen.

On the basis of this emerging jurisprudence, it is clear that particular issues arise from claims arising out of contract. A breach of contract can give rise to varying types of claims: denial of due process or failure to give fair and equitable treatment; lack of transparency; discriminatory behavior; and expropriation.[41] Each of these types of claims has been successful in the past depending on its facts. So the mere fact of the claim arising from contract does not mean that it cannot meet the criteria set out above to be an investment. It is just that this one did not.

There is a related controversy about the characterization of claims as arising out of contract or out of a treaty breach where the treaty contains an "umbrella clause." This controversy occurs when a state assumes responsibility for every undertaking with respect to investment, so that a breach of a contract becomes a breach of a treaty. This is presently a highly contentious area of legal debate, with arbitral decisions going in a number of directions.[42] But, the important point to remember is that not every breach of a treaty, nor every breach of contract, gives rise to an investment dispute.[43]

V. CONTRIBUTION TO ECONOMIC DEVELOPMENT

The awards in *Salini*, *Joy Mining*, *Bayindir*, and *CSOB* all speak of the requirement of the measure of the contribution to the economy of the host state being significant, or even, as in *Jan de Nul,* of being of

41. *See* Amco Asia Corp. and Others v. Republic of Indonesia, ICSID Case No. ARB/81/1, 23 I.L.M. 351 (Nov. 20, 1984); *see also* Mondev Int'l Ltd. v. United States of America, ICSID Case No. ARB (AF)/99/2, 42 I.L.M. 85 (Oct. 11, 2002).

42. Compare, for example, *Joy Mining* and *LESI-DIPENTA*, where the tribunals reached opposite views on the issue whether such clauses transform all contract disputes into treaty disputes.

43. *Joy Mining*, cited *supra* note 36, is an excellent example of this.

"paramount significance" in order for it to be an investment. In *LESI-DIPENTA*, the tribunal saw economic contribution as being implicit in the other elements of an investment, and thus it did not need to be separately assessed. In *Patrick Mitchell*, the tribunal spoke of a contribution not needing to be "sizable or successful . . . [but] to contribute in one way or another."[44] Furthermore, as Schreuer maintains, the investment must make a positive impact on a host state.[45]

The kinds of infrastructure works in *Salini*, *Bayindir*, and *LESI-Dipenta* can easily be seen to make a positive impact on a state. At one remove are guarantees in connection with sale of the equipment, as in *Joy Mining*, or financial rehabilitation, as in *CSOB*. Running a law firm, as in *Patrick Mitchell,* or salvaging a ship is another matter. The question must be objectively answered. It is not enough to say that this is a matter of state choice and decision and that consequently forecloses the matter.

In *Malaysian Salvors*, points concerning the benefits of employment to Malay nationals, the preservation of cultural and historical artifacts, the know-how of marine salvage especially where preservation is critical, the benefits to tourism, and the financial benefit to the Treasury through taxes and charges were all argued, but unsuccessfully. These arguments were regarded as insignificant, ephemeral, and even speculative.

One way of assessing feasibility is by looking at the post investment implementation compliance reports done by the World Bank when it finances an investment.[46] The report requires a joint statement of what benefits are expected, and is followed by a review to see how much has been accomplished. If the benefits are objective, then it would seem desirable that the state decide what will be a contribution, and whether that contribution is significant. With both the World Bank and the ADB, it is to the host state's own policies that the assessment is directed.

It has more recently been argued that the criterion of benefit should not be that of economic benefit alone. Marek Jezewski, in a paper recently given to the inaugural meeting of the Society for International Economic Law,[47] put forward the proposition that "contribution to economic benefit" should include contribution to areas of social policy and human rights, as happened in Poland under the guise of "solidarity"

44. *Patrick Mitchell*, *supra* note 29, ¶ 94.

45. *See* SCHREUER, *supra* note 25, ¶ 90.

46. *See* Economic Evaluation of Investment Operations, World Bank Policies OP 10.04 ¶ 1 (1994); Environmental Assessment, World Bank Policies BP 4.01 ¶ 23 (1999). The Asian Development Bank ("ADB") has a similar accountability mechanism.

47. Marek Jezewski, *There is No Freedom Without Solidarity: Towards a New Definition of Investment in International Economic Law* (paper presented to Society of International Economic Law Inaugural Conference) (July 14, 2008), *available at* http://ssrn.com/abstract=1159816.

and with the same effect. This would be a way of shoring up the rights to development of transitional and developing countries.

Another strategy that has been adopted in several PTAs within the region is the inclusion of a provision that protects the host state against claims where there has been a decision to introduce a policy that will adversely affect a section of the economy, including foreign interests. In the absence of such a provision, it may be argued that the decision would amount to expropriation, with the further consequence that the state must compensate some, but not all, those affected.[48] These clauses have been most visible in the area of environmental protection,[49] but it is likely that similar clauses will appear in relation to public health. In the WTO context, the issue of who decides such policies has become very heated since the dispute between the U.S. and the EU over the prohibition of imports of hormone fed beef,[50] and the delays in establishing a regime for inspection and approval for the import of genetically modified foodstuffs.[51] One can also anticipate that anti-terrorist and security measure will lead to the same debates over the relationship between the principles of state responsibility in international law, treaty obligations, and the desire of a national government to make decisions about the health and safety of its citizens.

VI. CONCLUSIONS

Why does it matter? The consequences exist at a number of levels. Internationally, in commercial transactions, we have a clash of

48. As happened under NAFTA with *Metalclad Corp. v. United Mexican States*, ICSID Case No. ARB (AF) 97/1, 40 I.L.M. 36 (Aug. 30, 2000), where a U.S. hazardous waste investor in Mexico made a successful claim after the responsible authority had denied planning approval. The grounds of the decision was breach of the transparency obligation. The award was partially set aside by the Supreme Court of British Columbia on the ground that the tribunal had exceeded its jurisdiction in its understanding of international customary law. *See* United Mexican States v. Metalclad Corp., [2001] B.C.S.C. 664 (Can.). But, the context of the claim would have been different in terms of the expectations engendered.

49. The "Investment and Environment" article of the Free Trade Agreement, U.S.-Singapore, art. 15.10, May 6, 2003, *available at* http://www.ustr.gov/Trade_Agreements/Bilateral/Singapore_FTA/Final_Texts/Section_Index.html, states that "[n]othing in this Chapter shall be construed to prevent a Party from adopting, maintaining, or enforcing any measure otherwise consistent with this Chapter that it considers appropriate to ensure that investment activity in its territory is undertaken in a manner sensitive to environmental concerns."

50. Appellate Body Report, *United States—Continued Suspension of Obligations in the EC—Hormones Dispute*, WT/DS526. This dispute began in 1996, and the procedures have not yet been concluded.

51. Three separate cases were brought by Argentina, Canada and the US against the EC (respectively DS 293, 292 & 291). The final determination was issued in 2006. Appellate Body Report, *European Communities—Approval and Marketing of Biotech Products*, WT/DS291, WT/DS292, WT/DS293 (Sept. 29, 2006).

regimes—of regulatory systems and of values—between trade, investment, and banking and financial services. There is a core understanding of what trade has meant for millennia: exchange for value of items that can be traded. The nature of the exchange and of the items has varied, as has the underlying rationale of the legal effect of trade. It is now seen fundamentally as a consensual transaction.

For more than sixty years, there has been international regulation of trade in goods by restricting the ability of governments to put certain restraints on trade through national law, practice, and policies. The values have been liberalization of trade and equality of market access through a concept of most favored nation. The mode of increasing the scope of regulation has been multilateral negotiation. In 1995, with the creation of the WTO, there was a critical global extension of regulation to include some, but not all trade in services and transactions in intellectual property related to trade. This brought most of the wealth gained in world trade under the WTO regulation, with new values of transparency as well as liberalisation and equal treatment. This is bound together by an apparently efficient dispute resolution system.

Investment as such has no such global counterpart. Yet, especially in the international sphere, it serves the same economic function and purpose as trade, and often it is a commercially logical extension of international trading activity. Investment is regulated in manner and scope in international law wholly by treaties—negotiated multilaterally or bilaterally. Critically, methods of dispute resolution will vary from treaty to treaty. The values expressed in those treaties for the last 50 years have been the protection of foreign investment and the liberalisation of investment regimes and market access. There is a growing acceptance of a need for balance with host state interests, as more and more countries both invest abroad and receive investments.

So the possibility of a transaction falling within the categories both of trade and of investment in international law may cause and has caused difficulties, particularly when a dispute arises.

There are some triggers for the appearance of these issues within the last 10 years. There is a great increase in the numbers of BITs and PTAs because of the apparent likely failure of the current round of WTO negotiations, where some of these issues were foreshadowed.

All of the relevant activities in trade and in investment concern the activities of governments. In most cases, if an individual trader or investor is affected, it is its government that takes up the issue, and the individual has no standing to pursue any claim. Dispute resolution is consultation, negotiation, arbitration with a hierarchy of panels and appeals. The results are published, and the hearings are increasingly open to the public.

The remedies developed within investment treaties, however, are significantly different from those developed by private law. International commercial arbitration has as its hallmarks, privacy, and confidentiality. Results are available only if the parties consent to publication, and those parties may now include non-State as well as State actors. There is no appellate review in many treaties and there is universally no acceptance of precedent. Public non party contributions to the arguments (amicus curiae briefs) may or may not be accepted.

So we have a phenomenon of investment decisions made by privately selected arbitrators, developing law of national and international significance, but without the safeguards of the comparable publicity of courts or legislators. If interpreting the scope of "investment" includes assessing the relevance and significance of national social and economic goals, then the problem is worse. Similar issues have arisen in WTO trade disputes, e.g. the dispute between the US and the EU over the banning of hormone fed beef, but there was no lack of publicity and debate in that case.

So are we seeing, through the dispute resolution regime, a convergence of public and private law in international trade and investment? Are private law processes affecting the rights and obligations of States towards non-State actors or other States? International commercial arbitration has well-developed international infrastructure, institutions, and practice for disputes between private parties and also States and non-State parties. The most important institution is the ICSID, which is now widely used as an agreed method of dispute resolution for disputes arising under BITs and PTAs.

ICSID itself is more than 40 years old and is based on settled principles of international law. States must consent to the exercise of the ICSID jurisdiction, and that consent is irrevocable. The consent is for agreed remedies where ICSID has jurisdiction under its own Rules. ICSID gives non-State actors standing in its arbitral proceedings.

So the fact that the core of the debate arises within arbitral awards of ICSID is extremely significant. The 8 arbitral awards are ICSID awards. They are all made within the last 7 years, and each is an investment dispute arising out of a contract. Several of these awards are currently under review within the processes of ICSID seeking annulment of the award. So the situation is fluid.

The example is the case of Malaysian Salvors—a dispute over money owing under a contract to salvage a historically important wreck; to catalogue and to sell the contents; and to divide the proceeds of sale between the Salvor and the Malaysian government. The dispute is an everyday argument over a debt. But it is claimed to be an international wrong, a breach of the UK—Malaysian BIT, and it is submitted for

arbitration to ICSID under that treaty after negotiations had failed. But ICSID declined jurisdiction because it found no element of benefit to Malaysia arising from this contract. It was a normal trading transaction, but it was not an investment. Because the parties chose ICSID arbitration, thus precluding litigation, there is no other formal method of dispute settlement open to them now, other than seeking the review of the award within ICSID.

The trend of reasoning from these cases leads to a conclusion that economic benefit to a host State is critical only if the transaction is not a "readily recognisable investment." Given the width of scope of the text in many investment treaties, it is not as easy to make this judgment now as it was originally in the 1960s when there was a debate about whether investment should be defined in ICSID. Before the 1960s, some investment contracts were still seen as based on public, rather than private, law principles. But the ICSID Convention itself gives such contracts private law features such as autonomy in choice of law.

So are we seeing here a real blurring of public and private law values and remedies, and the final decline of Westphalian sovereignty, as the depth of intrusion into domestic commercial law by international law and its institutions grows? Are we moving from a world where our starting point is that foreign investment is always protected to one where it is protected only if it makes a contribution to the host State? Who will set the parameters of that debate? Who will make the decisions? To whom are the decision makers accountable?

A Handy Tool for the Settlement of International Commercial Disputes

Dr. Éva Horváth*

I. THE "COCA-COLA PHENOMENON"

The Coca-Cola Company was established in 1886, employs 9500 worldwide, and it operates in more than 200 countries.

Let's imagine that you are a successful senior in-house counsel in the Legal Department of the Coca-Cola. Your job as head of the department's litigation unit is interesting work. Recently, disputes have arisen regarding the usage of Coca-Cola's trademarks in some countries. Over the course of a few weeks, you bring claims against partners in Mexico, Hungary, India, New-Zealand, and Zimbabwe. Naturally, the first task of a lawyer in this situation is to look at the contract signed with the above-mentioned partners to establish the proper venue. Should you file a claim in the state court of the relevant country or is your choice governed by an arbitration clause included in one of the contracts signed with the partners? If the contracts do not contain any provision regarding jurisdiction and/or if the case falls within the competence of a state court (or courts) seated in the country of the relevant partner, the lawyer may struggle to establish how and in which state court to initiate proceedings according to the applicable national code of civil procedure. Even if the lawyer can contact local counsel, the parties will still be eager to follow the progress of the case. Thus, their lawyer(s) must be familiar, to a certain extent, with the applicable legal provisions in the forum's court.

If we assume that countries tend to possess different legal traditions and that Coca-Cola has to initiate proceedings in the counter parties' state courts, the room for manoeuvring will not be forgiving. Should, however, our esteemed colleague from Atlanta be lucky enough to find that the relevant contracts provide for arbitration and the place of

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arbitration is in one of the above countries, she/he can avoid nightmares during the weekend before preparing and submitting the claims.

This article explains and illustrates why arbitration, as a "re-discovered" tool for the resolution of international commercial disputes, might be more convenient than filing claims before national state courts.

II. ROOTS

When speaking about the most popular means of alternative dispute resolution ("ADR")—i.e., mediation and arbitration—lawyers tend to think that these ways of dispute resolution are "phenomena" of our modern, globalised epoch. In fact, the origins of ADR can be traced back to ancient China, 2500 B.C. The schools of Confucianism and Taoism might be responsible for the endeavour of trying to handle controversies in a less aggressive way, to attempt to settle disputes and create harmony between partners again. This may remain true today. According to statistics from the Arbitration Court of the International Chamber of Commerce, of Asian parties who participated in ICC cases, only one-third initiated the proceedings. The remaining two-thirds ("preferring to be claimed against") were defendants.

And even skipping the history of private and public arbitration proceedings in the Greek and Roman Empires, the Middle Ages include examples of ADR practice. During this time, even in Europe, one can see that disputes between merchants and/or craftsmen were resolved within the competent guilds—by the master or some other "senior" colleague(s)—instead of allowing commercial disputes to be decided by "functionaries" exercising judicial power. Dispute resolution by laymen was in most cases more professional, less expensive, and less time-consuming than the proceedings of judges. That ancient pattern of alternative dispute resolution (as described above) might convince the experts of the United Nations Commission on International Trade Law ("UNCITRAL") to adopt and use these traditional methods of jurisdiction once again: that is, UNCITRAL could encourage businessmen to make use of ADR to eliminate difficulties caused by state court proceedings based on national codes of civil proceedings.

III. THE MODEL LAW ON INTERNATIONAL COMMERCIAL ARBITRATION

The divergences among provisions in different national procedure laws are sources of insecurity and uncertainty in the field of international commercial disputes. This explains why even the United Nations has moved toward harmonisation in this field. In 1958, the U.N. General Assembly adopted the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards. This Convention has been

very successful, and it has served to illustrate the necessity of unification of law regarding international commercial arbitration. At the same time, it has also stressed the importance of arbitration in the development of world trade. This phenomenon could well have influenced the U.N. Economic and Social Council ("ECOSOC") in its passing of resolution No. 708 in 1959, which invited governments "to consider sympathetically any measures for improving their arbitration legislation and institutions to encourage interested organizations in the development of arbitration facilities."[1] Of course, the establishment of UNCITRAL was a determinant step toward the unification and harmonization of international trade law.[2] This Resolution provided that ". . . [t]he commission shall further the progressive harmonisation and unification of the law of international trade by . . . preparing or promoting the adoption of new international conventions, **model laws** and uniform laws."[3] According to the Secretary General's report on the development of international trade law, "Commercial Arbitration" was included in this concept. During its successful activities, UNCITRAL achieved progress in the area of international arbitration. First, it drafted the UNCITRAL Arbitration Rules, which were endorsed by the U.N. General Assembly in 1976.[4] The mission of these rules was to lend a helping hand to parties in "ad hoc" arbitration, although even permanent arbitration courts used these Rules when elaborating or modernising their own rules of proceeding.

UNCITRAL's second step towards unification of arbitration law was the instigation of the Model Law on International Commercial Arbitration ("MAL"). The MAL Working Group—consisting of representatives of the thirty-six member states of UNCITRAL—had to decide several preliminary questions. First of these issues was the special nature of international commercial arbitration: some previous experiments had shown that the unification of national procedure laws would be difficult because this field of legislation arose from other areas of traditional domestic law. During the preparation of the MAL, UNCITRAL was careful to consider the provisions and phraseology of the two previous, related documents discussed above: the New York Convention and the UNCITRAL Rules. The main purpose of the MAL

1. ECOSOC Res. 708 (XXVII), U.N. ECSOR, 27th Sess., Supp. 1, U.N. Doc. E/3262 (Apr. 17, 1959).

2. G.A. Res. 2205 (XXI), U.N. Doc. A/6369 (Dec. 17, 1966). The author cannot resist the temptation to mention that UNCITRAL was established via a motion from Hungary.

3. *Id.* ¶ 8 (emphasis added).

4. G.A. Res. 31/98, U.N. Doc. A/RES/31/98 (Dec. 15, 1976).

drafters was to reduce the discrepancy between domestic procedural laws affecting international commercial arbitration.[5]

When choosing a route toward harmonisation, it is important to distinguish between the roles played by supranational organisations (e.g., the European Union) and classical international organisations (e.g., the United Nations). Instruments created by U.N. organisations, such as UNCITRAL, may only become binding in law after a state has decided to adopt it. This could happen by ratification—as in cases of a convention such as the United Nations Convention on Contracts for International Sale of Goods ("CISG")—or by domestic enactment—as with a model law like MAL. On the other hand, the instruments produced by supranational organisations are in most cases binding on all member states. Therefore, the results of harmonisation undertaken by UNCITRAL take full account of state sovereignty. When we recognize and respect the traditionally national character of procedural law, the elaboration of a model law would seem to be practical because it is more acceptable to the different states. MAL achieved wide adoption: in 2008, almost 50 countries have adopted its provisions.[6] This is evidence that the drafters succeeded in choosing model law as the appropriate instrument for the harmonisation of the laws of international commercial arbitration. MAL adopts the most essential elements of the appropriate legal framework of international arbitration proceedings. These include the following: the scope of application, the function of state courts in assisting and supervising arbitration, the arbitration agreement, the composition of an arbitral tribunal (appointment of arbitrators, grounds for challenges, challenging procedure), the jurisdiction of the arbitral tribunal (competence of the tribunal to rule on its own jurisdiction and to dictate interim measures), the arbitral proceedings' conduct (equal treatment of parties, determination of the rules of procedure, place of

5. *See* Corinne Montineri, *Legal Harmonisation Through Model Laws: The Example of the UNCITRAL Model Law on International Commercial Arbitration*, *in* CELEBRATING SUCCESS: 20 YEARS OF UNCITRAL MODEL LAW ON INTERNATIONAL COMMERCIAL ARBITRATION 13 (Sing. Int'l Arbitration Ctr. 2006).

6. The following states adopted MAL: Armenia, Australia, Austria, Azerbaijan, Bahrain, Bangladesh, Belarus, Bermuda (as an overseas territory of the United Kingdom), Bulgaria, Cambodia, Canada, Chile, Croatia, Cyprus, Denmark, Egypt, Estonia, Germany, Greece, Guatemala, Hungary, India, Iran (Islamic Republic of), Ireland, Japan, Jordan, Kenya, Lithuania, Madagascar, Malta, Mexico, New Zealand, Nicaragua, Nigeria, Norway, Oman, Paraguay, Peru, the Philippines, Poland, Republic of Korea, Russian Federation, Singapore, Scotland (within the United Kingdom), Slovenia, Spain, Sri Lanka, Thailand, Tunisia, Turkey, the Ukraine, Uganda, Venezuela (the Bolivarian Republic of), Zambia, and Zimbabwe. Within the United States of America, California, Connecticut, Illinois, Louisiana, Oregon, and Texas have adopted provisions of the MAL. Likewise, China's Hong Kong and Macau Special Administrative Regions have adopted the MAL.

arbitration, hearings and written proceedings, party default, the appointment of experts), making awards and proceedings' termination (form and content of arbitral award provision, its amendment and interpretation, settlements), setting aside arbitral awards, and the provisions regarding the recognition and enforcement of awards.

IV. THE MAIN PRINCIPLES OF MAL

A. Freedom of the Parties

The core element of arbitration is the parties' autonomy, which refers to the parties' actual decision-making—i.e., whether they would prefer the jurisdiction of state courts or whether they might decide to resolve their disputes by arbitration. The parties are free to nominate their arbitrators, to determine the rules of proceedings within the framework of the arbitration law at the seat of arbitration, and to choose the language for proceedings. They can also determine both the substantive law that will govern the dispute and the place of arbitration.

B. Burdening the National State Courts

To allow for "a private court procedure" like arbitration, the sovereign state must exercise some kind of control on the procedure so as to protect its own public order. This is particularly evident where the state chooses to enforce the decisions of an arbitral tribunal. An important decision is how close the link between national courts and international arbitration might be. If a national court has too much power to intervene both in arbitral proceedings and in the setting aside of awards, the parties' freedoms will be restricted. But if there is absolutely no "supervision" by national courts regarding arbitration, both the arbitral procedure and "its outcome"—the award—may be too unpredictable. In that case, both the parties' rights and the public order will be vulnerable to abuse.

V. WAYS OF ADOPTION

At the beginning of MAL's preparatory work, the drafters thought that it would be primarily useful for developing countries. In the last 20 years, however, many industrialised countries have reformed their arbitration laws by adopting MAL. Countries who utilised this model were not burdened by minimum adoption criteria. Consequently, they had a freedom to vary texts according to their own traditions or intentions regarding the drafting of new or modified arbitration provisions.

In adopting the MAL template, states have chosen the following ways of adapting and/or modifying MAL's provisions:

1. Some states simply translated the text and enacted it (e.g., the Russian Federation and California);
2. Other countries made editorial changes that did not affect the meaning of the recommended MAL text—for example, by renumbering, re-ordering, or re-prioritizing provisions, or by designating the appropriate court or appointing authority (e.g., Hungary);
3. Other states used their own terminology to reflect local usage or practice—for example, staying court proceedings or dismissing action for want of court jurisdiction, or Scotland's use of "arbiter" instead of "arbitrator";
4. Some states extended or limited the scope of MAL's application to domestic arbitration (e.g., Germany and Hungary);
5. Other states omitted certain MAL provisions such as Article 36's provisions regarding grounds for refusal of the enforcement of awards;
6. Some states, including Mexico and India, changed MAL's default rules that governed aspects of arbitration that the parties did not agree upon including, for example, the number of arbitrators;
7. Several states added supplemental provisions related to costs (Germany, New Zealand), interest (India), and immunity (Great Britain and Northern Ireland);
8. Other states specified the tribunal's powers concerning interim measures (e.g., Ireland); and
9. Some states added other avenues of recourse for use against awards, orders or directions (e.g., Austria).[7]

Notably, MAL does not include any provisions dealing with confidentiality. This is curious because confidentiality is one of arbitration's distinguishing characteristics and it embodies a benefit that would seem to be essential for parties choosing arbitration as a means of dispute resolution. Thus, some countries have provided for confidentiality regarding oral hearings and deliberations. But the arbitration law of those states remains silent on the publication of awards

7. *See* Lawrence Boo, *Modifications, Changes and Additions Made by States Adopting the Model Law on International Commercial Arbitration*, *in* CELEBRATING SUCCESS: 20 YEARS OF UNCITRAL MODEL LAW ON INTERNATIONAL COMMERCIAL ARBITRATION 19 (Sing. Int'l Arbitration Ctr. 2006).

(e.g., Singapore, Hong Kong SAR). This is particularly striking when compared with the fact (well-known to arbitration practitioners) that the ICC Court regularly publishes its awards in either full text or, at a minimum, in a sanitized form. A special problem follows confidentiality or its absence in connection with state court proceedings that arise out of any matter related to arbitration proceedings. In many countries, civil law procedures are (and should be) public. In those situations, the details of arbitration proceedings and awards may reveal, for example, when a party wants an ordinary court to set aside an arbitration decision. There is a conflict between the public nature of state court procedures and the basic principle of confidentiality in arbitration. Most codes of civil procedure do not address this problem and its resolution will depend on the relevant state court: will, for example, the court order in-camera hearings of such cases and restrict discovery of the files of entities that are not party to the arbitration proceedings?

VI. HARMONISATION VIA COLLECTION OF CASE LAW

As we have seen above, MAL was the successful result of the harmonisation of arbitration laws. A further step could have been *unification* via a convention relating to international commercial arbitration that might be ratified by states. As has already been pointed out, this approach carries with it some difficulties because of the states' resistance to ratify (more or less binding) international instruments touching upon their traditional domestic procedure law. UNCITRAL, however, found the right route to additionally harmonise international arbitration: namely, a more or less uniform interpretation of MAL by the collection and publication of case law. In 1988, the Commission established the so-called CLOUT system: Case Law On UNCITRAL Texts. This includes both a summary and the full text of decisions relating to both the CISG and the MAL. CLOUT includes decisions rendered both by state courts and arbitral tribunals. In 2001, the Commission reconsidered interpretations of certain articles of the CISG and found that the CISG was quite diversified. So a suggestion was made ". . . to prepare an analytical digest of court and arbitration cases." There were two possible ways of drafting the digest: (1) simply to make a note of diverging case law for information purposes or, alternatively, (2) to provide guidance as to the interpretation of instruments. The Commission suggested that "the digest could be merely a compilation of differences in interpretations of the Convention rather than a guide." It pointed out that the digest should not criticize domestic case law.[8] In

8. U.N. GAOR, 56th Sess., Supp. No. 17, U.N. Doc. A/56/17 ¶ 370 (June 25, 2001).

2002, the Secretariat began to draw up a similar digest in relation to MAL. The purpose of the MAL digest is to consider and report trends relating to interpretations of MAL. These could be influenced by the fact that they are based on a model law (and not a convention) whereby the method of a state's enactment will be determinative. Differences in interpretation may also come from divergences in understanding among state courts and arbitral tribunals.

VII. CONCLUSION

We are certainly able to say that UNCITRAL did a good job when drafting MAL and so, too, did the states that codified it in their national law. It is worth emphasising the fact that this model is the third pillar of a worldwide system: it stands alongside the New York Convention and the UNCITRAL Arbitration Rules as the basis of arbitration justice. Harmonisation in this area of international commercial law is thus being achieved, and the introduction of CLOUT and preparation of the Digest can only contribute to a more uniform interpretation of MAL.

* * *

And what about our learned colleague sitting in the Litigation Department of the Coca Cola Company?

We can only cross our fingers in the hope that she/he will find an arbitration clause in each contract signed by the Company with its partners from Mexico, Hungary, India, New Zealand and Zimbabwe. If those clauses include the jurisdiction of an arbitration court seated in one of the partners' countries, our colleague will have less trouble with the preparation and submission of claims because all those states—and Coca Cola's domestic home of Georgia in the United States, too—have adopted MAL. Thus, the lawyer likely will not find "surprising" provisions of any national code of civil procedure.

Factoring in Israel

Shalom Lerner

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I. INTRODUCTION

Factoring is a comprehensive, long-term relationship between a factor and an entity that sells assets or provides services to business customers ("supplier"). The factor provides the supplier with various services: financing, ledgering, collection of receivables and protection against customer default.[1] The UNIDROIT Convention on International Factoring defines a factor as an entity that performs at least two of the following functions: financing the supplier; maintenance of the receivables; collection of receivables; and guaranty against default by customers.[2] Due to the close legal relationship involved, many factoring agreements provide for exclusivity and prohibit the supplier from assigning its account receivables to any third party.

Factoring transactions have many nuances. In some cases, the supplier's customers are notified of the transaction, and are then required

1. PETER M. BISCOE, LAW AND PRACTICE OF CREDIT FACTORING 3 (1975). For different types of factoring, *see* NOEL RUDDY, SIMON MILLS & NIGEL DAVIDSON, SALINGER ON FACTORING 16-22 (4th ed. 2006).

2. UNIDROIT Convention on International Factoring, May 28, 1988, 27 I.L.M. 922, *available at* www.unidroit.org/english/conventions/1988factoring/1988factoring-e.htm.

to pay their debt directly to the factor. In other cases, the customers are not supposed to be notified of the transaction; this structure, known as non-notification or invoice discounting factoring, is preferred when the assignment of rights might be construed as financial weakness and adversely affect the supplier's business. In such cases, the supplier collects the debts for the factor, and holds the money in trust until actual transfer.[3]

Data collected by the World Bank indicates the increasing of the use of factoring. In 2005, about $1 trillion of factoring transactions took place. In certain countries with rapidly emerging economies, such as China, Mexico, Turkey, and Brazil, the scope of factoring transactions increased by more than 50% between 2000 and 2005. In each of these countries, the scope of factoring transactions exceeded $5 billion per year. One of the reasons for this increasing use is probably that factoring is a convenient financing method for new or growing businesses that do not have sufficient tangible assets to offer as collateral. Factoring is also suitable for seasonal traders that require financing for their expenses, before they receive income from customers.[4]

The factor and the supplier enter into a framework agreement that stipulates the terms for future transactions with respect to the transfer of monetary rights vis-à-vis specific customers. A factoring agreement typically includes a non-recourse provision, namely, that in the event that the factor is unable to collect the debt from the customers, the factor may not claim such debt from the supplier, except if the customer refuses to pay due to a commercial dispute regarding the quality of the product or service. Once the framework agreement is signed, the supplier offers the factor specific debts to be included under the framework agreement. The factor examines the financial position of each specific customer, and decides whether to purchase the rights against him. In a non-recourse agreement, the factor relies on the financial position of the supplier's customer, and therefore thoroughly examines it's financial position. This type of transaction is prevalent mainly in countries that have a developed credit rating system from which the factor can draw information about numerous businesses.[5] If the factor decides to purchase the rights with respect to a certain customer of the supplier, the factor and the supplier enter into an assignment of rights agreement. The assignment of rights

3. ROBERT R. PENNINGTON, BANK FINANCE FOR COMPANIES 42-43 (1987); International Factors v. Rodriguez, [1979] Q.B. 351 (U.K.).

4. Ken L. Lott & Robert G. Meyers, *Secured Lending*, 28 MERCER L. REV. 699 (1977).

5. *See The Role of Factoring for SME Finance*, AccessFinance (The World Bank Group) Dec. 2006, *available at* http://siteresources.worldbank.org/INTACCESSFINANCE/Resources/AFIssue15.pdf.

agreements is in accordance with the general terms of the framework agreement.

Factoring also plays an important role in international trade. In this arena, two factors are involved instead of one. The exporter sells goods to the importer under a supplier credit arrangement. The exporter contracts with a local factor, which works together with a factor in the country of the importer, and the two factors make all the arrangements necessary for the exporter: they look into the importer's financial position, provide for financing, provide protection against default, collect the debts of the supplier, etc. The exporter receives a line of credit from its local factor for the shipments it is to make to the importer. The factor in the importer's country inquires as to the importer's financial position, and advises the factor on the exporting side of the maximum risk that the importing factor agrees to assume. The factor in the importer's country assumes the credit risks. The factor in country of export pays the exporter, and the factor in the importer's country indemnifies the other factor for this payment. The exporter sends the importer goods under a supplier credit arrangement, transfers the bills to the factor in the country of export, and is thereby released from taking any further steps. The factoring companies guarantee payment by the importer. This mechanism eliminates the use of letters of credit, and therefore cuts the costs of the transaction. Collection is performed by the factors, saving the exporter operating expenses.

The development of international factoring has led to the foundation of an international association of factors, the Factors Chain International ("FCI"). The FCI sets forth the rules to be followed by its member factors in their transactions with one another. These rules relate to the distribution of risk between factors, the obligations they owe each other, the law governing disputes between factors from different jurisdictions, arbitration procedures, etc.[6]

Factoring differs from a simple assignment of rights. In a typical assignment of rights, the assignee provides the assignor with interim financing, and in consideration thereof, the assignor assigns its rights against various debtors. The factor, on the other hand, does not necessarily provide the supplier with interim financing. In any event, even when the factor finances the supplier's operations, it also provides other services, such as debt management and collection, and protection against customer default. In non-recourse transactions, the factor assumes the supplier's credit risks, whereas in simple assignments of

6. *See generally* Factors Chain International Home Page, http://www.factors-chain.com/ (last visited Nov. 15, 2008).

rights, an assignee that is unable to collect the debt from the debtor, may collect the debt from the assignor.[7]

Although factoring is relatively new to Israel, there are now several factoring companies here. As of now, these factoring companies provide services mainly to suppliers that sell their goods or services in Israel. Factoring is of special importance in Israel, because of the centralized structure of the local banking sector. In Israel, the banks have provided most of the financing in all branches of the economy, factoring offers suppliers an alternative. This development is welcome, because it creates competition in the financing sector and pushes down costs of conducting business. I believe that the legal system should facilitate this trend by developing a body of law that would be conducive to factoring transactions. The next two chapters will address two legal questions in the field of factoring: (i) is the transaction a sale or a security interest; and (ii) in the competition between a factor and a floating charge, which of the two prevails.

II. TRUE SALE VS. SECURITY INTEREST

There are two ways in which a creditor can transact in its rights against debtors: sale and security interest. The creditor may sell its rights to a third party or take a loan from a third party against a charge on the creditor's rights against the debtor. In an assignment by way of sale, the assignee is a purchaser, and in an assignment by way of security interest, the assignee is a secured creditor in the competition with the assignor's other creditors. The assignee's position as a purchaser is better than it is as a secured creditor. For example, under corporate law, when the court issues an order of protection against creditors, the court may suspend the right of a secured creditor to exercise its collateral, provided that adequate protection is provided for the rights of such secured creditor.[8] In the event of a true sale of the creditor's rights, the court does not have the power to adversely affect such rights. There are other implications to the distinction between the sale of a right and the creation of a security interest over such right. For example, the sale of a right does not have to be officially registered, whereas the collateralization of a right requires registration.[9] Further, if factoring is used by way of a security interest, the factor must repay the supplier amounts exceeding the principal and interest fixed in the agreement.

7. CA 12027/04 Nasser Aldin Salman v. Saliba & Sons Ltd. 2005(3) Takdin Elion 1100; CA 348/79 Goldman v. Michaeli [1981] IsrSC 35(4) 31.

8. Companies Act, 1999, S.H. 189, § 350(f).

9. Security Interests Law, 1967, 20 LSI 44 § 4 (Isr.); Companies Ordinance [New Version] 1983 D.M.I 761 § 178 [hereinafter Companies Ordinance].

However, it is not always easy to distinguish between a true sale and a security interest transaction. The court has held that "the typical attribute of an assignment by way of security interest is that . . . the assignee has the right to claim the assignor's debt from the assignor, in the event that the debt is not paid by the debtor."[10] If, under the agreement between the assignor and assignee, an assignee that is unable to collect the debt from the debtor, may not then collect the debt from the assignor, the transaction does not dovetail with the principles of security interests. Collateral is always ancillary to the debt; it guarantees the liability but does not replace it.[11] A lender who took collateral and whose debt is not paid when it becomes due, may exercise the collateral and collect his debt from the proceeds, or may file claim against the borrower for repayment of the debt.[12] In other words, a lender who received collateral may claim repayment of the loan from the borrower and is not obligated to exercise the collateral. If the assignee is not allowed to claim repayment from the assignor, this is not a relationship of lender and borrower.

In light of the above, non-recourse factoring cannot be deemed a security interest relationship and should rather be classified as a sale transaction. In a factoring agreement, the supplier makes various representations, which, if breached, are cause for the factor to terminate the agreement and receive repayment of any money that the factor has paid to the supplier. For example, the supplier represents that the customer owes a certain amount of money, that the statute of limitations has not run on the debt, that the goods delivered to the customer were adequate, etc. The supplier's obligation to repay the factor in the event that these representations are breached, is not indicative of a security interest. These matters are unrelated to the classification of the agreement as a sale or security interest transaction. As long as the factor has no right to claim repayment of all the money paid under the factoring agreement, the agreement is not a security interest. A right of recourse by which the supplier is obligated to repay the full amount paid by the factor in the event that the factor is unable to collect the debt from the supplier's customers, may be deemed a loan in which the rights serve as collateral. In such cases, the factor would be well advised to register its right with the Registrar of Companies. As under United States law, registration in and of itself shall not be deemed admission that the factoring transaction is not a sale agreement, but will, at the same time,

10. CA 3966/01 Yehoshua TBWA v. Bon Mart Millennium Ltd. (In Receivership) [2003] IsrSC 57(4) 952.

11. Security Interests Law § 15.

12. Security Interests Law § 23.

protect the factor if in a future dispute the court holds that the specifics of the transaction cause it to be classified as such.[13]

III. COMPETITION BETWEEN FLOATING CHARGE AND FACTOR

A. General—Competition Between a Floating Charge and an Assignee

The starting point for the analysis of a competition between a floating charge and a competing right is Section 169(b) of the Companies' Ordinance, which provides as follows:

> A floating charge does not provide the holder of the debenture priority or preference over the holder of a mortgage or a purchaser for consideration of the Company's real property, even if such holder or purchaser knew, upon creation of the mortgage or upon purchase, of the floating charge; if, however, the document creating the floating charge includes a restriction on the company's right to create security interests, and if this restriction is included in the details submitted for registration of the floating charge, then the floating charge shall prevail over any security interest created in violation of the restriction after the Registrar has registered these details.[14]

A classic floating charge is subordinate to the interests of secured creditors with a specific charge and the interests of purchasers of the company's assets. However, when the debenture creating the floating charge includes a restriction on the right of the chargor company to enter certain transactions without the prior consent of the chargee, except for business inventory, and provided that the floating charge and the restriction are both registered with the Registrar of Companies, then the chargee shall prevail over the holder of any competing right. For several decades now, drafters of debentures—which in most cases are banks—have incorporated such restrictions in their debentures as a matter of standard procedure. If taken verbatim, the latter part of Section 169(b) deals with the relationship between a floating charge and a subsequent specific charge; case law, however, has applied it also to the competition between a floating charge and a sale transaction, and has held, for example, that the holder of a floating charge prevails over an assignee that purchased from the company rights against its customers.[15] One court decision seems to draw a distinction between, on the one hand, an assignment of rights that is used as payment and is designed to satisfy an

13. 13.Companies Regulations (Reporting Particulars of Registration and Forms), 1999, KT 166.

14. Companies Ordinance, *supra* note 9.

15. CA 10907/03 Bank Leumi Le-Israel Ltd. v. State of Israel—Ministry of Health et al. 2005(2) Takdin Elion 3593.

earlier debt that the assignor owes the assignee, and, on the other hand, a financial assignment of rights, designed to provide interim financing to the assignor. The assignee prevails over a preexisting floating charge in the first case, but not in the second case.[16]

The holder of a floating charge prevails over a third party where the transaction between the company and such third party is in violation of the restriction in the debenture creating the floating charge. The outcome of the competition therefore depends on how the restriction is interpreted. We believe that this interpretation should be consistent with the inherent nature of the floating charge and must take into account the fact that the chargee wants to enable the company to continue to conduct business, and at the same time to block the creation of competing rights in favor of third parties. The balance between these two forces dictates the outcome of most conflicts. If the restriction is interpreted too broadly, there will be no difference between a floating charge and a fixed charge. The interpretation of certain transactions or actions must therefore be that they do not violate the restriction found in the debenture.[17]

As noted, the holder of a floating charge has no desire to adversely affect the company's usual course of business, which requires the purchase and processing of raw materials, the purchase and sale of finished goods, etc. In order to perform such actions, the company needs financing and needs to receive various services. The holder of the floating charge wants to facilitate these activities, which will improve the company's business and therefore also its ability to repay its debts. The holder of a floating charge does not, therefore, consider the purchaser of the company's inventory to be a competitor. A similar approach may apply with respect to a supplier of raw materials or other services that the company requires in its ordinary course of business.

The main competitor of the holder of a floating charge is another provider of financing. The holder of a floating charge seeks to be the primary or exclusive source of the company's financing. It is convenient for the holder of a floating charge to grant additional loans to the company, because the charge that it has secures all of the company's debts, without a ceiling, and will also apply to any further loan that the chargee provides. The chargee has access to information about the company's business and financial position, and can therefore save costs that would be incurred in a loan to an unfamiliar borrower.

16. Bankruptcy Case 2004/01, Bank Hapoalim Ltd. v. Metula Local Council, 2001(1) Takdin Mehozi 3992.

17. SHALOM LERNER, COMPANY CHARGES 188-89 (1996).

As mentioned, the holder of a floating charge is not concerned about purchasers or suppliers, but does not welcome competing lenders. In practice, however, there is no clear cut distinction between suppliers and lenders. Most suppliers provide the company with short-term credit for payment for the goods they provide—transforming such suppliers into lenders. It is my position that the holder of a floating charge does not consider all lenders to be competitors, but only those that require collateral.

To conclude, under Israeli law, the holder of a floating charge prevails over an assignee that provides financing to the assignor, regardless of whether the assignment is a security interest or a true sale. The holder of a floating charge considers all other secured lenders to be competitors, and seeks for the company to take the financing it needs from the chargee rather than from anyone else. At the same time, the holder of a floating charge is in no competition with others, like suppliers, whose function goes beyond the provision of financing. When the holder of a floating charge is unable to provide the company with a similar product or service, it is in its best interest that the company acquire what it needs from third parties, so that it can continue developing its business. Therefore, a transaction with such entities should not be deemed a competing transaction under the second part of Section 169(b) of the Companies Ordinance, and is therefore not subordinate to the floating charge.[18]

B. Floating Charge vs. Factor under English Law

The construct of a floating charge in Israel originated from English law. Factoring transactions are common in England, and it is therefore reasonable to examine the position of English law with respect to the competition between a factor and a floating charge. A comprehensive search only found one instance in English case law that dealt with a direct conflict between the two, *In re State Securities v. Liquidity Ltd.*[19] This decision relates to a preliminary stage, an injunction, and does not describe the terms of the factoring transaction, which apparently was a security interest. No clear guideline can therefore be extracted.

Perhaps the scarcity of conflicts between floating charges and factoring companies is due to the laws that apply to floating charges in England. In England, debentures routinely include restrictions on competing transactions that did not receive prior consent of the holder of the floating charge. However, the restriction is not registered with the

18. *See* Companies Ordinance, *supra* note 9.
19. [2006] EWHC (Ch.) 2644 (Eng.).

Registrar of Companies, and only if the party to the later transaction has actual knowledge of the restriction, is such party subject to the floating charge. Knowledge of the existence of a floating charge is not deemed knowledge of the restriction included in the debenture. Consequently, later competitors are not deemed to know of the restriction, and under the English rules of equity, a later good-faith competitor prevails over the holder of a preexisting right in equity. The floating charge under English law is a right in equity rather than a right at law.

In his book *Company Charges*,[20] William James Gough provides a following summary of the prevailing law:

> A prior registered floating charge is frequently liable to rank subsequent in priority to the legal or beneficial ownership acquired by an absolute assignment of book debts under a factoring arrangement. The company is free to sell its assets subject to the floating charge, so as to confer a clear title free of the floating charge. . . .
>
> Restrictive clauses . . .inserted into the floating charge to prevent the creation of subsequent adverse title security interests fail to provide blanket protection. They are effective only if the subsequent party has actual notice of the terms of the protective clause, Prior registration of the floating charge does not fix subsequent parties with statutory constructive notice. The judicial doctrine continues that there is constructive notice only of the existence of a floating charge and not of the restrictive clause contained within the contents of the floating charge.

As we can see, English law overlooks the well-known fact that debentures almost always include a restriction on subsequent transactions. Before Section 169(b) was amended in 1980, the law in Israel was similar.[21]

C. *Floating Charge vs. Factor under Israeli Law*

Israel has no case law relating directly to the competition between a floating charge and a factoring transaction. The law should therefore be extracted from the general principles of law and policy considerations. I believe that factoring companies that acquire the accounts receivable should prevails over preexisting floating charges. My reasoning is explained below.

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20. WILLIAM JAMES GOUGH, COMPANY CHARGES 432-33 (2d ed. 1996).

21. *See generally* CA 471/73 Temporary receivers of Electrogenics Ltd. v. Elcint Ltd. [1974] IsrSC 29(1) 121.

We have seen that a floating charge that restricts later transactions, prevails over an assignment in which the assignee purchased or received as collateral, rights of the chargor company toward third parties. However, I am of the opinion that an assignee that is not a lender or that also provides other functions, should prevails over the holder of a prior floating charge.

In a non-recourse factoring transaction, the factor's main role is to provide protection against default by the company's customers. The factor not only provides financing, but also assumes the company's credit risks, and renders additional services. With reduced credit risks, the company's liquidity improves, indirectly improving the position of the holder of the floating charge. The credit risk reduction increases the company's chances of paying its debts to the holder of the floating charge. The holder of the floating charge is not ready to render the company the services offered by the factor.

As mentioned, the factor provides the supplier with additional services, such as loan management and collection. This allows the management of the supplier to focus on production and marketing. Relieved of such chores as loan management and collection, the supplier's turnover increases, as do the chances that it will repay the holder of the floating charge. These services are unique to the factoring company. In Israel, the holders of floating charges are typically banks, which do not provide such services. In this respect, factoring companies resemble operating lease companies. In a financial lease, the lessee only gets financing, and the lessor is therefore a lender and is subject to the Security Interest Law. In an operating lease transaction, on the other hand, the lessee also receives maintenance and repair services with respect to the leased asset, and therefore, in the event that the lessee becomes insolvent, the leasing company shall prevail over the lessee's other creditors, and no registration is required in order for such priority to be enforced. Given the above, the restriction commonly included in floating charges should not apply to factoring transactions.

Use of factoring transactions in many countries is increasing rapidly, and these transactions play an important role in international commerce. Factoring plays an important role in Israel too. The banking sector in Israel is exceptionally centralized, with two banks accounting for approximately 60% of the local financing sector. Under these circumstances, competition should be encouraged such that the cost of financing is lowered. For this purpose, alternative financing avenues should be developed. If factoring extends to Israel's foreign trade, this would help increase exports and would significantly boost the Israeli economy.

The number of floating charges in Israel is very high, and most of these charges are in favor of banks. Any company that opens a business account with a bank and wishes to receive a credit line is required to create a floating charge in favor of the bank. The subordination of a factoring company to a preexisting floating charge would severely constrain the development of factoring transactions in Israel. In order to develop, factoring transactions need a supportive legal environment. There should be a body of law that facilitates the development of factoring transactions. In the competition between a factoring transaction and a preexisting floating charge, the interpretation should be that the factoring transaction prevails.

The floating charge in Israel was originally based on the English model, but the amendment of Section 169(b) in 1980 made it stronger than its counterparts in other Common Law jurisdictions. This strength gave the floating charge a monopoly in financing, and was therefore to blame for the cost of financing in Israel. A few years after the amendment, the legislature recognized that it had gone too far, and created an express exception for a purchase money security interest.[22] A similar approach should be applied with respect to factoring. It would be best if there were an express exception for factoring, but the desired outcome can be obtained even now, if the court interprets Section 169(b) narrowly, and holds that a factoring transaction does not violate the restrictive provision in the debenture.

IV. CONCLUSION

In order for factoring to extend to export transactions, the developed states must have a unified rules governing these transactions. The legislature and the courts should cause the rules governing factoring in Israel to be consistent with those that apply in other parts of the developed world. Such uniformity would enable Israeli companies to join the FCI and facilitate Israeli exports. A country whose laws impose hurdles for factoring transactions, will not be able to partake in this important development in the international commercial arena.

Israeli law as currently in effect does not address factoring transactions; Israel should adopt laws that facilitate such transactions. Such laws can expressly prioritize factoring over preexisting floating charges. This would of course require a definition of the types of factoring transactions that would receive such preference.

In addition, the rules of assignment of rights should be adjusted to accommodate for factoring. As currently in effect, the Assignment of

22. Companies Ordinance, *supra* note 9, § 169(d).

Obligations Law envisions a single assignment followed by a notice to the debtor. The law attributes much weight to this notice in the protection of the assignee's rights. For example, in a competition between two assignees, the assignee who first notified the debtor of the assignment shall prevail.[23] Also, the debtor may not invoke against the assignee arguments arising from other transactions he has with the assignor, if such arguments originate from facts that came into being after the notice of assignment.[24] The factor acquires many rights against the supplier's customers, and cannot rely on a notice to such customers as a key element in the protection of its rights. There are transactions in which the customers are deliberately not notified of the assignments, and in such case the factor might forfeit its rights to a subsequent assignee that notifies the customer of the assignment. In order to adjust the rules of assignment of rights to factoring transactions, it should be stipulated that registration of the transaction, rather than notice, will be the decisive element in the conflict of rights.

From an analytical point of view, the main issue discussed above—the competition between a floating charge and a factor—highlights the strength that a floating charge has under Israeli law. The charge is "floating" only by name, while in fact it has the same force as a fixed charge. In a classic floating charge, the controlling date that determines the outcome of a competition between rights, is the date on which the charge crystallized. Under Israeli law as currently in effect, however, and given the restriction in the language of all debentures and the recognition given to this restriction in statute, the critical date is that on which the floating charge was created and registered with the Registrar of Companies. This priority, which applies to all of the assets of the indebted company, is very extensive, and the conflict with the factor underscores the need to define additional exceptions.

23. *Id.* § 4

24. *Id.* § 2(a); *see* CA 8357/03 Israel Lands Administration, ILA v. Discount Bank of Mortgages, Ltd. 2006(4) Takdin Elion 124 (interpreting § 2(a)).

Recent Developments in Japanese Consumer Law

Kunihiro Nakata

I. INTRODUCTION

Japanese consumer law faced an important turning point in 2008. First, a Consumer Agency having general jurisdiction over consumer policies emerged.[1] The government prepared several bills for the fall Diet session enabling the establishment of the Agency in 2009. The decision in favor of the Consumer Agency symbolizes the remarkable shift of the administration from favoring the producer's point of view to that of the consumer. This can be regarded as evidence that consumer protection policy is finally becoming a political issue in Japan.

At the same time the movement towards a consumer law reform has surfaced. This paper will introduce the background and the present status of the amendment of three laws: the Consumer Contract Act, the Act on Specified Commercial Transactions ("Specified Transactions Act") and the Installment Sales Act.

II. THE INCREASE OF CONSUMER LAW AND ITS BACKGROUND

In recent years, consumer-related laws have been enacted or amended in an unprecedented quantity and quality. For example, we have seen the transformation of the Consumer Protection Fundamental Act into the Consumer Basic Act (2004); the enactment of the Consumer Contract Act and its amendment introducing the consumer group action system (2000 and 2006); the Product Liability Act (1994); the

1. The Consumer Agency is part of Prime Minister Yasuo Fukuda's policy. The legal provisions defining its organization and jurisdiction were examined in the Consumer Administration Promotion Conference (*Shôhisha gyôsei suishin kaigi*) summoned by the Prime Minister on an ad hoc basis. This Conference published a final report titled *Summary of the Consumer Administration Promotion Conference—Changeover to a consumer and living oriented administration* on June 13, 2008. Based on this report, the Cabinet adopted a "Basic Plan" which is going to be transformed into a bill and presented to the Parliament during the extraordinary session in August. The preparatory works are aimed at establishing the Consumer Agency in April 2009.

amendment of the Consumer Life Product Safety Act (2006); several amendments of the Specified Transactions Act regulating, for example, door-to-door or mail order sales (2000, 2002, 2004 and 2006); several amendments of the Installment Sales Act including the extension of its scope of application and the effects of the amendment of the Specified Transactions Act (from 2000 to 2006); the far-reaching 2006 reform of the Act Concerning the Regulation of Credit Business, the Act Concerning the Control of Receiving Capital Subscription, Deposits and Interest on Deposits and the Interest Rate Restriction Act in connection with the multiple debts problem; the enactment and amendment of the Act on Sales of Financial Products concerning financial transactions (enacted in 2000, amended every year between 2003 and 2006); the important amendment of the Act on Sales of Financial Products by the securities and exchange law reform (2006); and the Insurance Law (Commercial Law) reform movement which began in 2006. And in June 2008, this series of amendments was joined by the amendment of the Specified Transactions Act and the Installment Sales Act. All of these enactments and amendments have been substantial and have significantly changed the legal provisions regarding consumer-related problems.

Japanese consumer law originates from administrative regulations, including state and regional administrative measures against business entities. During the 20th century, private law regulations were added. Therefore, laws such as the Specified Transactions Act, the Installment Sales Act or the Securities and Exchange Act that had originally been enacted as business regulations were supplemented by rules for the benefit of consumers.

Such enactments and amendments occurred during the second half of the 1990s until the beginning of the 21st century, and they contained provisions having civil law consequences on the relationship between business operator and consumer.

The Consumer Contract Act (Sections 4, 8-10), the Product Liability Act (Section 3) and the Act on Sales of Financial Products (Sections 5 and 6) are examples of laws created as special acts of the Civil Code aiming at determining the private law rules between business and consumers. Additional interesting developments can be found in the amendments for the prevention of misrepresentation in the contract-concluding phase that affects the consumers' self-determination right. Business regulation laws focused on administrative norms are equipped with provisions carrying civil law consequences such as avoidance (e.g., Specified Transactions Act Sections 9-2, 40-3, 49-2, 58-2). These rules with civil law consequences have actually positively affected the resolution of consumer disputes.

Reform of the Consumer Life Product Safety Act and the law regulating the money lending business were expressly aimed at protecting consumer interests including their safety and property rather than business interests.

Traditionally, the political emphasis in Japan has been prioritized industrial development, but in the past few years there has been a turn towards respecting the consumer. This led to more regulations requiring consumer-oriented administrative measures.

This legislation embodies the 21st century consumer policy. It is characterized by the transformation of the Consumer Protection Fundamental Act into the Consumer Basic Act. From a market-administration point of view, the idea behind this transformation has evolved from consumer protection to consumer independence, and the emphasis has been shifted from *ex ante* to *ex post* regulation. Furthermore, the promotion of transparency and compliance management and establishing consumer rights as basic principles have been introduced in the Consumer Basic Act.

In this transformation process two tendencies in the consumer law domain have to be pointed out. The first is the increase of substantive law provisions with civil law consequences (private law rules) and the second is the reinforcement of public regulation expressly favoring consumer interest protection. The on-going reform of the Consumer Contract Act, Specified Transactions Act and the Installment Sales Act is focusing on the former, i.e. the creation and extension of private law rules.

Behind the above-mentioned reinforcement of consumer protection legislation there is a great number of emerging consumer problems. The inability to prevent injury threatens the consumers' trust in the market. For example, there have been cases in which insufficient product safety precaution by manufacturers caused serious harm, including incidents where people died because of defective gas fan heaters or boilers. There are also countless cases of misrepresentation of products or their origin: imported meat is sold as domestic beef or local chicken; products with expired use-by dates are relabeled and sold; Chinese eel with suspected residual agricultural chemicals is sold as a domestic product; and unsold sweets are disguised and sold as fresh ones. Cases of misrepresentation are reported virtually every day. Especially notable is the story of a famous first-class Japanese restaurant rearranging and serving leftovers.

III. THE AMENDMENT OF THE CONSUMER CONTRACT ACT

A. The Reform Movement

The Consumer Contract Act was enacted in April 2001 as a law related to consumer contracts intended to reduce the discrepancy in information and bargaining power between business entities and consumers.[2]

Currently the amendment of its substantive law rules is in discussion. In January 2007 the "Committee for the evaluation and examination of the Consumer Contract Act" was established within the Consumer Policy Committee of the 20th Quality-of-Life Policy Council (Kokumin Seikatsu Shingikai). In August of the same year a report titled "Evaluation of the Consumer Contract Act and the examination of its issues" (in the following referred to as the "Report") was published. (The author participated in the said Council as expert member from January to August 2007.)

Many issues were discussed in this Report. Most characteristic were the following:

1) Whether or not to establish the obligation to inform and to declare a contract concluded and, if violated, to consider the contract avoidable
2) Whether or not to introduce the suitability rule and to declare a contract concluded in violation of this rule void or avoidable
3) Whether or not to prohibit "unsolicited offers" and to declare a contract concluded in violation of this prohibition avoidable
4) The necessity of private law rules governing e-commerce

But the Report has only interim character because the final decisions have been postponed. The following chapter will examine its contents and show the prospective course of discussion.

B. Review of the Articles of the Present Consumer Contract Act

(1) The Definition of "Consumer"

According to Section 2 of the Consumer Contract Act, the distinction between "consumer" and "business operator" shall be made by the following criterion: if an individual "becomes a party to a

2. Approved in 2000 and enacted in April 2001, this law has been the basis for case law more than 180 court decisions during the six years of its existence—a number which exceeds the case law regarding other consumer related statutes.

contract as a business or for the purpose of business." But this law should also apply to side job sales methods or damages caused by the leasing of expensive telephones to sole traders. In fact, the term "business" might be interpreted flexibly and thus covering sole traders. But there needs to be a direct relationship to the "business" so that the criterion must be whether or not becoming a party to the contract is for a purpose directly related to one's business. In transactions that are merely indirectly related to one's business the individual will probably not have sufficiently perceived the contents of the respective contract.

(2) The Business Operator's "Duty to Inform"

In Section 3, a business operator's "duty to inform" is laid down as a duty to endeavor. The question has arisen whether the providing of information should be mandatory and even entitling to avoidance. The Report does not give a clear answer. But if deregulation asks for more self-responsibility of consumers for their decisions, the providing of accurate information will be the major premise. The recent cases of misrepresentation regarding food demonstrate that the business operator must actively give correct information related to consumer contracts. The absence of information concerning important issues as the prerequisite for the consumer's self-responsibility constitutes a violation of his self-determination. In such cases, the contractual ties should not prevail. Thus the duty to inform should explicitly be laid down as a legal duty entitling to avoidance whenever important elements usually affecting the decision whether or not to conclude the contract have been withheld.

(3) Section 4 is a Provision Concerning the Contracting Process, Extending the Provisions Regarding Defects of Manifestation

i. Subsection 1 entitles the consumer to avoidance if the business operator's indication has been contrary to the facts (misrepresentation).

ii. Subsequently subsection 2 provides that, in cases where the business operator provides advantageous facts while omitting the disadvantageous (i.e. in cases of non-notification of disadvantageous facts), that avoidance shall be allowed if the omission has been intentional. Although intent is required in the present law, there are convincing arguments for replacing it with negligence.

iii. The Consumer Contract Act only acknowledges two types of confusion cases which are the subject of subsection 3. This includes consumer-confusing invitations: intimidation by phone, repeated visits or calls, invitations using romantic

feelings (lover sales method) or the mental insufficiency of elderly people. Such solicitation acts are against the principle of good faith and are continuously devised. Similar to Section 10 of Consumer Contract Act, the creation of a general clause allowing avoidance of solicitations against good faith is strongly urged. The Report shows the tendency to epand the subject of confusion types and to examine additional types of solicitations to be covered in the future.

iv. Although it is possible to include motives in the important issues laid down in subsection 4 by means of interpretation, it would be preferable to eliminate any doubts by an explicit wording similar to Section 9-2, Section 6 subsections 1 and 2. The Report also asks for the extension of the notion of the "important issues" to include those related to the motives for concluding the contract.

(4) In regard with Section 9, which declares void any undue anticipated reparation clause, there was a discussion about the meaning of "average damage" in paragraph 1 and the burden of proof. If the business operator asks for damages exceeding the average damages as proved by the consumer the stipulation can be voided as far as the difference is concerned. But in court proceedings generally the burden of proof lies with the consumer. The Report, therefore, states that "somehow the difficulties of the consumer's burden of proof should be softened."

(5) The present law only has two Sections (Sections 8 and 9) listing undue clauses. Clauses that have been declared void by courts in the past or will be voided in consumer group actions in the future should be added. Such lists will make clear the scope of undue clauses and thus contribute to the enhancement of fair trade with consumers. The Report examines clauses limiting the right to contract cancellation or dissolution as well as exclusive jurisdiction and arbitration clauses.[3]

C. *The Suitability Rule as a Private Law Rule*

The suitability rule had been discussed and enacted as part of administrative regulation concerning financial transactions such as

3. Moreover, it is necessary to extend list of inadmissible contract clauses to rental contract clauses which have repeatedly been dealt with by court decisions. These include restitution clauses including natural wear and ordinary use or clauses withholding a part from the deposit without any reason.

futures contracts or contracts regarding financial products.[4] From a comparative law perspective there are not many examples in the private law sector. But in Japanese case law decisions have accumulated in which damages were awarded on the grounds of tort law or breach of contract in cases where there has been a significant breach of the suitability rule by solicitation. This is especially true in financial transactions. Recently the suitability rule is becoming more and more recognized as a rule binding business operators not only in financial transactions but in consumer transactions in general.[5]

The suitability rule should not be limited to administrative regulations. Given the growing damages by excessive selling of high price products to elderly, young people or housewives and the extended sales of sophisticated and expensive products and services due to deregulation, there is a greater need for private law rules providing a remedy in civil procedures. In these cases the definition of the suitability rule and the legal effect of its breach come into question. The suitability rule in the broad sense—that the business operator must conduct his solicitation and sales in a manner that suits the consumer's knowledge, experience and fortune etc.—must be laid down as a general obligation leading to liability under tort law.

At the same time, the violation of the suitability rule in the narrow sense (the business operator must not conduct sales or solicitation activities regarding specified consumers and specific products, not even with exhaustive explanations) can be interpreted as a solicitation violating the public order and the standards of decency. In this case, the effect should not be avoidance but the unilateral nullity to be claimed by the consumer.[6] The amended Specified Transactions Act, which will be referred to later, allows cancellation in excessive sales cases.

D. The Prohibition of Unsolicited Offers as a Private Law Rule

The prohibition and limitation of unsolicited offers to consumers who do not wish to contract exist within administrative regulations such as the prohibition of repeated offers to those who have expressed their

4. *See, e.g.*, Commodity Exchange Act, Section 215; Act on Sales of Financial Products, Section 40 para. 1. It is a prerequisite of the disclosure duty entitling to damages provided for in Act on Sales of Financial Products, Section 3 subsection 2.

5. *Cf.* Consumer Basic Act, Section 5 subsection 1 para. 3; Specified Transactions Act, Section 7 para. 3; Specified Transactions Act's Implementing Regulation, Section 7 paras. 2, 3; Tokyo Regional Ordinance For Consumer Life, Section 25 subsection 1; Tokyo Regional Ordinance For Consumer Life's Implementing Regulation, Section 5-2 para. 3.

6. The Report shows a tendency to comply with the suitability rule by extending the irritation provision to other types of irritating acts, thereby allowing cancellation.

rejection.[7] As a private law rule, however, there is only Section 4 subsection 3 of the Consumer Contract Act, which applies to a very restricted number of unsolicited offers. Unsolicited offers are the source of a large number of injuries to consumers.[8] Such offers menace the consumer's private life and the smooth arranging of his affairs. It is a solicitation method disturbing the calmness and freedom of decision. In addition, there are solicitation methods constituting unfair surprise. These kinds of unsolicited offers should basically be forbidden by administrative regulations and regarded as avoidable irritating acts according to Consumer Contract Act.[9]

IV. THE AMENDMENT OF THE SPECIFIED TRANSACTIONS ACT AND THE INSTALLMENT SALES ACT

A. Reform Movement

A large number of the injuries to consumers have occurred in connection with commercial transactions within the scope of the Specified Transactions Act. A good example is door-to-door sales. Credit transactions such as the closed-end sales finance transactions (*Kobetsu kappu kônyû assen torihiki*) have encouraged malicious and aggressive solicitation acts.[10] Two subcommittees have been working simultaneously and by mutual communication on the amendment of the two laws. On June 18, 2008 the amendments were promulgated and thus concluded. (The enactment will be within one and a half years from promulgation.) I will refer to the major issues of the amendment *infra*[11].

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7. The number of prohibitions of unsolicited offers included in recently amended ordinances, *e.g.*, Kyoto Municipal Ordinance for Consumer Life, is growing. Other administrative rules exist such as Specified Transactions Act, Sections 12-3, 17; Commodity Exchange Act, Section 214 para. 5; Act on Sales of Financial Products, Section 38 para. 5.

8. Among the complaints received by PIONET, those concerning door-to-door sales, mail order sales, phone solicitation sales and negative option sales occupied 78.6% in 2004, 60.1% in 2005 and 51.8% in 2006.

9. According to the Report, unsolicited offers are subjected to further examination along with the extension of the irritation provision.

10. There is a mutual link between the transactions subjected to the Specified Transactions Act and those regulated by the Installment Sales Act. Therefore, the amendment of the former has been discussed in the Specified Transactions Subcommittee of the Consumer Economy Subcommission within the Industrial Structure Council. The Installment Sales Act, however, was examined in the Basic Problems Subcommittee of the Installment Sales Subcommission of the Industrial Structure Council. Both Subcommittees publish their results on the website of the Ministry of Economy, Trade and Industry (http://www.meti.go.lp/committee/index.html#c2).

11. After the "Interim Summary" and the "Classification of issues," the guideline reports for both Subcommittees were published in November and December 2007. The trend is reinforcing consumer interests by 1) extending the private law rules and their

B. *The Reform Trend of the Specified Transactions Act*

1. Establishing and Extending Private Law Rules

i. Cancellation of Excessive Sales Enabled

Consider this hypothetical: a pensioner and mother living alone is visited by a salesman and persuaded to buy kimonos worth 10 million yen. Owing money to several credit companies, her savings have drained away. Her ability to judge has declined and most of the purchased kimonos have not even been unsealed.

In order to provide a remedy in such cases a new private law rule was established allowing *inter alia* the cancellation of contracts within one year after conclusion if the consumer has purchased products in a door-to-door sale in a quantity significantly exceeding his needs (Section 9-2 of the revised Specified Transactions Act). There is an exception, of course, for those cases where special circumstances substantiate the consumer's special need for these products.

It might have been possible to reach these situations by liberally applying principles governing profiteering or legal competence. But the revision bill only provides for a rule limited to door-to-door sales. According to the wording, subjective or procedural factors like the decline of judgment, mindlessness, imprudence, pressure, exploitation of lack of experience or the abuse of circumstances are not required. The high quantity of the purchased goods is the only objective factor allowing release from the contract, which admittedly implies a high degree of intervention.

The legal structure of this release from the contract is withdrawal instead of avoidance. This consequence of withdrawal is peculiar since it is neither cancellation because of nonperformance nor can be justified by the withdrawal based on the "cooling-off" principle.

But the introduction of this private law rule affects the door-to-door sales business in the sense that aimless selling of goods or services to people whose needs are uncertain will end up in a disadvantage. The Door-to-door Sales Business Association established a fund for the remedy of door-to-door sales victims which will hopefully lead up to mutual control of business operators themselves.

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scope of application and 2) extending administrative regulation reflecting the actual damage. The discussions directly led to the amendment law.

ii. The Rule Concerning Mail Order Sales Contract Dissolution and Returning of Goods Defined

In the absence of plain instructions in mail order sales regarding the exclusion of goods from being returned or the conditions for returning the purchased goods, the return of goods is now explicitly admitted in principle (Section 15-2 of the revised Specified Transactions Act). The return of goods is the consequence of the withdrawal from the mail order sales contract.

iii. Specification of Products and Services Abolished

So far only specified products and services had been subject to the regulations governing door-to-door sales, phone solicitation sales and mail order sales. Since this kind of legislation would always have stayed behind, it was replaced by principles applying to all kinds of products and services.[12]

2. Amendments Reinforcing Administrative Regulation

i. Prohibition of Repeated Solicitation of Persons Rejecting Door-to-Door Sales Established

In the case of door-to-door sales there is a duty to disclose the sales purpose and to verify the consumer's willingness. Further solicitation of people who have expressed their will not to conclude a contract is forbidden by Section 3-2 of the revised Specified Transactions Act. Offenses are subject to administrative measures. This regulation of unsolicited offers was not augmented by rules having civil law consequences like withdrawal.

ii. The Opt-In regulation Concerning Spam Emails

The number of spam emails is increasing. The amendment is changing the law from (a) the prohibition of sending emails to refusing recipients (so-called "opt-out regulation") to (b) the opt-in regulation which forbids the sending of advertising emails to other recipients than those who have previously asked for advertisements by email (*inter alia* Section 12-3 of the revised Specified Transactions Act).

12. In order to prevent consumer problems, the voluntary self control of the Door-to-door Sales Business Association is strengthened in Section 27-2 of the revised Specified Transactions Act.

C. The Reform Trend of the Installment Sales Act

1. Amendment Establishing and Extending Private Law Rules

i. Avoidance of Credit Contracts with Mandatory Repayment of Received Installments Established

The present law only entitles the consumer to refuse payment to the intermediary agent of the installment sale by means of connected defense. But even if the damage had increased because of the continuing credit contract, the paid money was not returned and thus no remedy for the consumer's material damage was provided.

The revised law permits the consumer to avoid the credit contract and to claim the paid money provided that the affiliated entity (selling business operator) 1) has misrepresented important issues concerning the credit contract or 2) has misrepresented circumstances concerning either the necessity of the credit contract or important issues influencing the decision to conclude the contract (*inter alia* Section 35-3-3-23 of the revised Installment Sales Act).

By this provision, a mechanism was introduced which causes disadvantages to the intermediary credit agent if he keeps or neglects a relationship with inappropriate affiliates. The repayment rule creates a strong incentive and motivation for the credit agent to control the affiliates and thus realizes the socially desirable control function.

ii. Scope of Application Revised Regarding Preconditions and Limitation to Specific Sales

The scope of application of the Installment Sales Act that had been limited to installment sales with more than two months payment term and more than three installments was extended to contracts with more than two months payment term and either one or two installments. Similar to the Specified Transactions Act, the subject of this law is no longer limited to specific products or services but now applies to all kinds of products and services (with several exceptions). Thus private law rules—not the administrative regulations alone—have a larger scope of application.

iii. Introduction of Consumer Group Action in the Specified Transactions Act

In order to prevent consumer trouble cases, the consumer group action system will also be introduced in the Specified Transactions Act.[13] By this amendment the entitled consumer associations can seek injunctive relief not only against acts of business operators violating the Consumer Contract Act but also against those constituting unlawful solicitation, advertisement or contract clauses offending the Specified Transactions Act.

2. Amendments Reinforcing Administrative Regulation

i. Reinforcement of Administrative Regulation Against Intermediary Agents Regarding Installment Sales of Individual Goods

Administrative regulation against intermediary agents regarding installment sales of individual goods which is often applied in cases of damages to consumers has been reinforced by introducing a registration system and strengthening the authority for administrative measures (*inter alia* Section 35-3-23 of the revised Installment Sales Act).

ii. Fair Credit Duty Established

Business operators offering individual credit are required to examine affiliated entities conducting door-to-door sales and are forbidden from authorizing credits to consumers in cases of undue solicitation (Sections 35-3-5 to 7 of the revised Installment Sales Act). Penalties have been stiffened and thus urge better control of affiliated entities.

iii. Excessive Credit Prevention Duty Reinforced

A general duty to prevent excessive credits was provided along with the mandatory use of credit information institutions, the duty regarding the making and keeping of credit examination documentation and the duty of individual examination (Sections 30-2, 30-2-2, 35-3-3 to 4 of the revised Installment Sales Act).

13. The Cabinet adopted a "Bill amending a part of the Consumer Contract Act and other laws," which will amend the Specified Transactions Act and the Consumer Contract Act and will be presented to the Parliament. By this law, the group action system will not only be extended to the Specified Transactions Act but also to the Act Against Unjustifiable Premiums and Misleading Representations (*Keihihin hyôji hô*).

V. CONCLUSION

Japanese consumer law significantly tends towards the prevention of damages to consumers by extending private law rules. On the other hand, this increase of private law rules outside the Civil Code will require a review of their relation with the Civil Code.

Currently the revision of the Civil Code is hurriedly being advanced. Especially the question how to modernize the contract law is the subject of discussions. In terms of the appropriate system, the question arises if consumer law should be incorporated into the Civil Code as in Germany or if it should be laid down in a special law as it is the case in France. Furthermore there are particular issues to be examined such as the relationship between the "person" as defined in the Civil Code and the term "consumer"; the problem of conformity between the theory of declaration of intent in the Civil Code and the "avoidance" or withdrawal determined in the respective consumer laws; and the applicability of the theory of damages to typical collective consumer damages consisting of a multitude of small claims against the development of new forms of remedy.

In any case the discussion about consumer law and consumer policy is not limited to the mere protection of consumer interests but must rather be seen in the context of administrative regulation aimed at operating a sound market system and at answering the question of how the protection of consumer interests can best be justified. Moreover, it will be linked to the policy development and realization by the "Consumer Agency" as an administrative body. It will undoubtedly be the major task of the Japanese private law to define the role and scope of the Civil Code as the fundamental market governing law. This is also a responsible mission for the Japanese consumer law.

Commercial Arbitration: Its Harmonization in International Treaties, Regional Treaties and Internal Law

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I. INTRODUCTION

Some say that Mercantile or Commercial Law should be studied methodologically by examining the subjects or persons who participate; the purpose or field of commerce; the relationship between resources and instruments of commerce; and, finally, the issues or conflicts inherent in the combination of the first three aspects of commerce.[1] The resolution of conflicts and problems in commerce may occur through a judicial or administrative process, regardless of whether the problems are of an intra-national or cross-border nature. This resolution may include regional or international procedures known as Insolvency Proceedings,[2] Commercial Arbitration.

Mexican legislation has incorporated the work of an international organization of the United Nations system, the UNCTAD/UNCITRAL,[3] and this incorporation is reflected in the current insolvency procedure. In addition, the Commercial Code now includes an arbitration proceeding that reflects this international influence.

II. BACKGROUND

In abstract terms, the arbitration proceeding is a heterocompositive method: it is an alternative to litigation, yet decided by an impartial third party. In arbitration, a neutral third party delivers a solution to the parties. The arbitrator is not simply a communicator proposes one or several possible solutions; rather, the arbitrator imposes a binding. "However, in order to make arbitration work, it is necessary that the parties had previously accepted, by common agreement, their submission to this form of solution."[4]

Title IV of the Mexican Commercial Code defines arbitration as any arbitral proceeding of a commercial nature, regardless whether or not it is brought before a permanent arbitration institution. International arbitration is the proper method when the parties, at the time of entering

1. ELVIA ARCELIA QUINTANA ADRIANO, THE SCIENCE OF COMMERCIAL LAW 1-43 (2d ed. 2003).

2. ELVIA ARCELIA QUINTANA ADRIANO, INSOLVENCY PROCEEDINGS, DOCTRINE, LAW, JURISPRUDENCE 191-213 (2d ed. 2004).

3. ELVIA ARCELIA QUINTANA ADRIANO, FOREIGN TRADE IN MEXICO: LEGAL FRAMEWORK, STRUCTURE AND POLICY 152-200, 240-300 (2d ed. 2003).

4. ADRIANO, COMMERCIAL LAW, *supra* note 1, at 509.

into an arbitration agreement, are established in different countries. International arbitration is also proper when (a) the place of arbitration, (b) the place to fulfill with a substantial portion of the obligations contained in the commercial relationship, or (c) the place in which the subject matter of litigation has a greater relationship, is located beyond the borders of the country where the parties are established.

III. WORKING HYPOTHESIS

This paper's working hypothesis follows the elements necessary for the use of arbitration to resolve a controversy: the existence of an agreement, a commitment clause in the agreement, actual arbitral commitment, and an arbitral or arbitration agreement.

The Commitment Clause is a section in the contract in which the parties provide that any legal dispute between them shall be submitted to arbitration for resolution. On the other hand, an Arbitral Commitment is an agreement of the parties *after* the dispute has arisen: in other words, the parties commit to arbitration after the threat of litigation is imminent. Finally, an Arbitration Agreement is the agreement of the parties that appoints an arbitrator, defines the obligations and rights of the arbitrators and parties, sets the time limits for resolution of the dispute, and specifies the fees to be paid by the parties.

IV. TYPES OF ARBITRATION

In Mexico there are several bodies of laws which govern arbitration according to its area of the law: i.e. labor, commercial and financial arbitration. There are also different approaches in commercial law. Consequently, it is important to mention that there are, for example, corporate, financial, maritime, and many other specialties each with different approaches. At the same time, each one of them provides arbitration specialized in diverse fields: i.e. patents, trademarks, copyrights.

This article will examine the legal framework of commercial arbitration. In this context, commercial arbitration is classified in the following three fields: (a) National Commercial Arbitration, (b) Regional Commercial Arbitration, and (c) International Commercial Arbitration.

V. LEGAL FRAMEWORK FOR REFERENCE IN MEXICO

Commercial Arbitration is located within the framework Mexican Commercial Law[5] and, therefore, is governed by several sources of law that include:[6]

- The Political Constitution of the United Mexican States
- The International Treaties subscribed to by Mexico
- The Commercial Code
- The Federal Code of Civil Procedure (supplementary applicability)
- The particular laws (special laws) related to a specific subject matter of commerce or those of a mercantile nature.

VI. NATIONAL COMMERCIAL ARBITRATION

When Mexico acceded to the Model Law of United Nations on International Commercial Conciliation prepared by the United Nations Commission on International Trade Law ("UNCITRAL") in 1985,[7] the legislators incorporated it into the Commercial Code in the space left by the Law of Bankruptcy and Temporary Receivership ("LBTR"). After the LBTR was decodified, Title IV emerged, which rules commercial arbitration in a series of new statutory Chapters, codified and included from article 1415 to article 1463.[8] These amendments to the Commercial Code were enacted in October 1989 as to the arbitral proceeding, and in July 1993 as to the enforcement of foreign judgments.[9] The nine chapters of Title IV of the Commercial Code[10] are as follows: General Provisions, Arbitration Agreement, Composition of Arbitral Tribunal, Jurisdiction of the same, Substantiation of Arbitral Proceedings, Costs, Annulment of Award, and, finally, one chapter refers to the Recognition and Enforcement of Awards.[11]

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5. ELVIA ARCELIA QUINTANA ADRIANO, COMMERCIAL LEGISLATION 107-200 (2005).

6. ELVIA ARCELIA QUINTANA ADRIANO,COMMERCIAL INSTITUTIONS 37-116 (2006).

7. *See* UNCITRAL Model Law on International Commercial Arbitration, June 25, 1985, A/40/17, *available at* http://www.uncitral.org/pdf/english/texts/arbitration/ml-arb/06-54671_Ebook.pdf.

8. Código de Comercio de Mexico [CÒD.COM.] [Commercial Code], *as amended*, Diario Official de la Federación [D.O.], 17 de Abril de 2008 arts. 1415-1463 (Mex.)

9. *See* ADRIANO, FOREIGN TRADE, *supra* note 3 at 204-60

10. *Id.* at 143-44.

11. *See* Código de Comercio de Mexico, *supra* note 8, arts. 1415-1463.

VII. OPERATION OF THE ARBITRATION IN MEXICO

Legal Nature. Chapter IV of the Commercial Code in force contemplates a group of procedural norms that regulate the Commercial Arbitration; and as it is well known, in Mexico, the subject matter of commerce by constitutional provision has a federal scope.[12] Commercial Arbitration is a judicial procedure, which is applied at national or international levels, as long as the situs of the forum is in Mexican territory, unless otherwise provided in other laws or international treaties to which Mexico is a signatory.[13] Likewise, it is applied when any of the parties requests its operation, or it is requested by the judge to adopt conservatory and interim measures or, when it is pleaded in writing to the judge to enforce an arbitral award in conformity with provisions of Chapter IX of the Commercial Code.[14]

Precisely stated, arbitration is any arbitral proceeding of a commercial nature, regardless of whether or not it is brought before a permanent arbitration institution. International Arbitration is that which takes place if the parties have their place of business situated in different countries at the time they enter into the arbitration agreement.[15]

An Arbitration Agreement is defined as an agreement whereby the parties decide to submit their controversies that have arisen between them regarding a particular juridical, contractual, or non-contractual relationship. The arbitration agreement may be in the form of a commitment clause included in the contract or by separate agreement.[16] The costs of an arbitration shall include the fees of the Arbitral Tribunal, the traveling and other expenses incurred by the arbitrators, the fees for expert advice or any other assistance required by the tribunal, traveling and other expenses incurred by the witnesses, among others, if approved by the Arbitral Tribunal.[17] The arbitral tribunal can be a sole arbitrator or a panel of arbitrators appointed to resolve a dispute.[18]

The Discretion to Decide. Whenever a provision of Title IV leaves to the discretion of the parties to freely decide a matter, such faculty shall include that of authorizing a third party, including an institution to decide on said matter. Because Title IV refers to an agreement between the parties, it is understood that such agreement includes all the provisions of the arbitration rules to which the agreement refers. If a provision refers to a claim, it shall also apply to a counterclaim, and when it refers to an

12. *Id.* art. 1415.
13. *Id.* arts. 1415-1416.
14. *See id.* arts. 1423-1425.
15. *See id.* art. 1416.
16. *See* Código de Comercio de Mexico, *supra* note 8, art. 1416.
17. *Id.*
18. *Id.*

answer shall also apply to a reply to the answer to said counterclaim, and the foregoing shall not affect the determination of the arbitrators as to their jurisdiction over the claim and counterclaim.[19]

Notice and computation of time periods. A notice is any written communication which has been delivered personally to the recipient or when it has been left at his establishment, usual residence or postal address. In the event none of the foregoing locations can be ascertained after a reasonable investigation, a written communication shall be deemed received when sent to the last establishment, usual residence or postal address known of the recipient by certified mail or any other form of delivery that shows the attempted delivery. A communication is deemed received on the day it was delivered.[20] Notably, these provisions shall not apply to communications in a judicial proceeding.[21]

In this context, time begins to run from the day following receipt of a notice, advice, communication or proposal. If the last day of the time period falls on an official holiday or a non-working day at the place of residence or establishment of the recipient, the time period shall be extended to the following working day.[22] If during the elapsing of time periods holidays or non-working days fall, they shall be included in the computation.[23]

Right to object. The right to object is deemed to have waived if one party to arbitration continues with the arbitration knowingly of the non-fulfillment with certain provision of the Commercial Code in Title IV that can be waived by said party, or such party knows that a requirement under the arbitration agreement has not been fulfilled.[24] The party shall voice his objection without justified delay or, if he has a time period which to comply and fails to do so, he shall be deemed to have waived the right to do so.[25]

Judicial intervention. Unless otherwise provided, in all matters governed by Title IV, there is no need for judicial intervention.[26] If judicial intervention is requested, the Federal District Court or the local trial court at the place where the arbitration is held shall be competent.[27] If the arbitration is held outside of the national territory, the recognition and enforcement of the award shall be under the jurisdiction of the first instance federal judge, or under the jurisdiction of the local trial judge at

19. *Id.* art. 1417.
20. *Id.* art. 1418.
21. *See* Código de Comercio de Mexico, *supra* note 8, art. 1418.
22. *Id.* art. 1419.
23. *Id.*
24. *Id.* art. 1420.
25. *Id.* art. 1420.
26. Código de Comercio de Mexico, *supra* note 8, art. 1421.
27. *Id.* art. 1422.

the place of residence of the debtor, or if the debtor has no residence, at the place where the assets are located.[28]

Arbitration Agreement. The arbitration agreement shall be in writing and signed by the parties, or it may be in an exchange of letters, telexes, telegrams or faxes, or any other means of telecommunication that properly records the agreement.[29] It may also be expressed on an exchange of a written complaint and a written answer from which the existence of the agreement can be signed by one party without being denied by the other.[30] If a contract refers to a document that contains a commitment clause, such clause shall constitute an arbitration agreement as long as it is in writing and its reference creates the implication that such clause is an integrating part of the contract.[31]

A judge hearing a matter that is subject to an arbitration agreement, shall remit the parties to arbitration at the time in which any of them files the corresponding petition, unless it is proven that said agreement is null, ineffective or impossible to enforce.[32] However, the arbitration proceedings may be initiated or prosecuted and the award may be entered while the matter is pending before the judge.[33] Even is there is an agreement for arbitration, the parties may request the judge to take conservatory and interim measures, prior to initiation of or during the arbitration proceedings.[34]

Composition of the Arbitral Tribunal. As a general rule, the parties may freely agree on the number of arbitrators, as well as the procedure to appoint them.[35] In an arbitration proceeding with three arbitrators, each party shall appoint one arbitrator and the appointed two shall name the third one. In the absence of such an agreement, the following shall apply:

- The sole arbitrator, upon request of any of the parties, shall be appointed by the judge.

- Three arbitrators, if any of the parties within 30 days of the request from the other party, does not appoint its corresponding arbitrator, then such arbitrator shall be appointed by the judge by request of the other party.

28. *Id.*
29. *Id.* art. 1423.
30. *Id.*
31. Código de Comercio de Mexico, *supra* note 8, art. 1423.
32. *Id.* art. 1424.
33. *Id.*
34. *Id.* art. 1425.
35. *Id.* art. 1426.

- If the two appointed arbitrators in the following 30 days do not agree to name the third arbitrator, upon request the arbitrator is appointed by the judge. If other options for the procedure of appointment are not foreseen, or one of the parties does not act in accordance with the stipulated agreement, or a third party, including an institution, does not comply with the functions that have been assigned, either party may petition the judge to adopt the necessary measures.

- The decisions of the judge are not appealable.

- The arbitrator, as of the moment of its appointment must disclose all circumstances that may give rise to a justified doubt of his impartiality and independence. The parties may freely agree on the procedure to challenge arbitrators. If an arbitrator is unable physically or by legal disposition to perform his functions, or for other reasons, his appointment shall terminate if he resigns, or if the parties agree to his removal.[36]

Jurisdiction or Arbitral Tribunal. The Arbitral Tribunal has the authority to determine its own jurisdiction and rule on any defenses regarding the existence or validity of an agreement for arbitration. The decision of an Arbitral Tribunal declaring a contract null shall not cause, for that simple fact, the invalidity of the commitment clause. The defense of lack of jurisdiction of the Arbitral Tribunal must be raised before the filing of the plea. The plea is legally admitted even if the parties appointed an arbitrator or participated in the appointment of one of the arbitrators.

The defense based on the excess of authority, must be asserted as soon as the subject matter is raised that supposedly exceeds the authority during the arbitration proceeding. The Arbitral Tribunal may resolve the defense immediately or in the final award on the merits; however, the tribunal may decide immediately if it finds the delay unjustified.

If the tribunal declares itself competent, prior to the issuance of the award on the merits, either party may petition a judge to decide definitely within thirty (30) days after receiving notice of the declaration, and his decision cannot be appealed. While such petition is pending, the Arbitral Tribunal may continue with its proceedings and pronounce its award.

36. Código de Comercio de Mexico, *supra* note 8, arts. 1427-1431.

The Arbitral Tribunal may, upon petition of any of the parties, order precautionary measures for the protection of the subject matter of the dispute, and may exact from either of the parties sufficient security in connection with such measures.[37]

Principles. The parties in the arbitration proceeding shall enjoy:

- Fairness
- Full opportunity to assert his rights
- Freedom to agree on the procedure to be followed by the Arbitral Tribunal
- Freedom to agree as to the location of the arbitration
- The free determination of language
- The start of arbitration proceedings[38]

If the parties do not reach an agreement, the tribunal:

- Shall determine the location considering the circumstances of the case, including the convenience of the parties.[39] The tribunal may, except if otherwise agreed to by the parties, convene at any location it deems appropriate to hold its deliberation, hear the parties, the witnesses or the experts, or to examine commodities or other assets or documents.[40]

- Shall determine the admissibility, relevancy and probative value.

- Shall determine the beginning of arbitration proceedings on the date the defendant receives a demand to submit the controversy to arbitration.[41]

- Shall determine the languages to be used in the proceedings; may order that any documentary evidence be accompanied by a translation into one of the languages agreed by the parties or determined by the tribunal.[42]

Requirements of the claim and response.[43] Within the time agreed by the parties or that determined by the tribunal, the plaintiff must set forth the controverted facts on which he bases his claims and the

37. *Id.* art. 1424.
38. *Id.* art. 1437.
39. *Id.* art. 1436.
40. *Id.* art. 1435.
41. Código de Comercio de Mexico, *supra* note 8, art. 1437.
42. *Id.* art. 1438.
43. *Id.* arts. 1439-1440.

recovery he demands. The defendant must respond to all that it is referred to in the claim, unless the parties agree otherwise on what the claim and response are to contain. The parties shall submit all the documents they consider relevant along with their pleadings, or make reference to them or the other evidence they intend to offer. Unless otherwise agreed to by the parties, they may modify or supplement their claims or responses, unless the tribunal considers such alterations inadmissible because they were presented with undue delay.

The arbitral tribunal shall decide if hearings are to be held for the submission of evidence or for oral argument, or if the proceedings shall substantiate by documents and other evidence. If the parties do not agree to the waiver of hearings, the tribunal shall hold them at the proper stage of the proceedings upon petition of one of the parties. The arbitral tribunal, or either of the parties with the approval of the former, may request the presence of the judge at the offer of evidence.

Sufficient advance notice shall be given to the parties regarding hearings and the convening of the tribunal to inspect commodities or other assets or documents. Copies of all testimony, documents, proofs, experts' reports and other information that a party presents to the arbitral tribunal shall be provided to all opposing parties.

Pronouncement of the Award and Conclusion of the Proceedings. The arbitral tribunal shall resolve the controversy in accordance with the principles of law chosen by the parties, and it shall be understood that all reference to the laws or rules of a specific country refer to its substantive law and not to its principles of conflicts of laws.[44] The arbitral tribunal shall resolve as *amiable compositeur* or *ex aequo et bono* only if the parties expressly authorize said tribunal to resolve in accordance with the terms of the agreement and shall take into account the mercantile customs which may be applicable to the case.[45] In arbitration proceedings where there is more than one arbitrator, all decisions shall be by a majority of votes. The chairman of the arbitral tribunal may resolve issues of procedure.[46] If parties reach a settlement that resolves the controversy, the tribunal shall terminate its proceedings; and if both parties so request, and the tribunal does not object, it shall enter their controversy as an arbitration award subject to the terms agreed by said parties.[47]

The award shall be in writing and shall be signed by the arbitrator or arbitrators. In arbitration proceedings with more than one arbitrator, the

44. *Id.* art. 1445.
45. *Id.*
46. Código de Comercio de Mexico, *supra* note 8, art. 1446.
47. *Id.* art. 1447.

signatures of a majority shall be sufficient, provided that it is stated the reasons for the lack of one or more signatures. The award shall set forth the date it was pronounced and the place where the arbitration was held. The award shall be deemed to have been pronounced at that location. Such an award shall have the same effects and consequences as any other award pronounced on the substance of the controversy.[48]

The proceedings of the arbitral tribunal terminate by a final award or by an order of the Arbitral Tribunal if the plaintiff withdraws his claim, unless the defendant objects to said withdrawal and the tribunal acknowledges his legitimate right to obtain a final determination regarding the controversy; the parties agree to terminate the proceeding; and the tribunal finds that the continuation of the proceedings will be unnecessary or impossible.[49] The tribunal concludes its functions unless: the parties agree upon a different time period, within thirty (30) days after a final award is entered, or either of them may, after due notice to the opposing party, petition the tribunal to correct an error of computation, of copying, typographical or of a similar nature in the award in order that the tribunal gives an interpretation upon an issue or upon a specific part of the award.[50]

Additional award. Within thirty days after receipt of notice of the award, either party may petition the tribunal to pronounce an additional award, upon due notice to the opposing party, regarding claims which were presented in the proceedings but omitted from consideration in the award. If the arbitral tribunal deems it justified, it shall decree the additional award within sixty days.[51]

Costs. The parties may adopt, either directly or through existing arbitration regulations, rules governing costs of the arbitration. The arbitral tribunal shall assess costs of the arbitration in its award.[52] The fees set by the arbitral tribunal shall be reasonable, taking into account the amount in controversy, the complexity of the issues, the time spent by arbitrators on the matter and any other circumstance that is relevant to the case. The fee of each arbitrator shall be determined separately and fixed by the arbitral tribunal.[53] If petitioned by a party and the judge consents to comply with his commitment, the arbitral tribunal shall fix the fees after consulting the judge who may provide the tribunal with recommendations he considers appropriate regarding the amount of the

48. *Id.* art. 1448.
49. *Id.* art. 1449.
50. *Id.* art. 1450.
51. Código de Comercio de Mexico, *supra* note 8, art. 1451.
52. *Id.* art. 1452.
53. *Id.* art. 1454.

fees.[54] The costs of the arbitration shall be borne by the party against whom an award is pronounced. The arbitral tribunal may make a pro rata distribution of the costs between the parties.[55] The arbitral tribunal shall decide, considering the circumstances of the case, which party shall pay the costs of representation and legal assistance, or if the costs can be prorated among the parties as long as the tribunal determines this to be reasonable.[56]

Whenever the arbitral tribunal decrees an order to conclude the arbitration proceedings, or pronounces an award in accordance with the terms agreed to by the parties, it shall fix the costs of the arbitration in the text of its order or award.[57] The arbitral tribunal may not charge additional fees for the interpretation, rectification or supplementation of its award.[58]

Once the arbitral tribunal has been constituted, it may request a deposit from each of the parties in equal amounts an as advance of the fees of the tribunal, expenses for trips and other expenditures of the arbitrators, as well as the costs for experts or any other assistance required. If a party so requests, and the judge consents thereto, the arbitral tribunal shall set an amount of deposit or of the additional amounts only after consulting with the judge.[59]

If deposits have not been made in full within thirty (30) days from notice by the tribunal to do so, it shall inform the parties of this fact so that the required payment may be made forthwith by each one of them. If payment is not made, the tribunal may order the suspension or dismissal of the arbitration proceeding.[60]

After the award has been pronounced, the tribunal shall deliver to the parties a statement of accounts related to the deposits received and shall reimburse the portion that was not used.[61]

Nullification of the arbitral award. Arbitration awards may only be nullified by a judge of competent jurisdiction for one of the following reasons: a) incapacity, where the party requesting the action of nullity proves that one of the parties to the arbitration agreement was subject to a legal incapacity; b) inadmissibility, where the arbitration agreement is shown to be invalid pursuant to the laws that were designated by the parties or, if no other laws were designated, the agreement is invalid

54. *Id.*
55. *Id.* art. 1455.
56. Código de Comercio de Mexico, *supra* note 8, art. 1455.
57. *Id.*
58. *Id.*
59. *Id.* art. 1456.
60. *Id.*
61. Código de Comercio de Mexico, *supra* note 8, art. 1456.

under Mexican law; c) the party was not given proper notice on the designation of one of the arbitrators or on the arbitration proceedings, or was prevented by any other reason to assert his rights; d) the award refers to a controversy which was not foreseen in the arbitration agreement, or contains determinations that exceed the terms of the arbitration agreement; e) the panel of the arbitral tribunal or the arbitration procedure was not in accord with the agreement between the parties, unless such agreement is in conflict with provisions of this Title IV of the Commercial Code which the parties cannot waive or, in the absence of such an agreement, the procedure was not in conformity with this Title; or f) the judge finds that in accordance with Mexican law, the object of the controversy is not subject to arbitration, or the award is contrary to public policy.[62]

The petition to nullify an award shall be presented within a period of three months from the date notice is given of the award.[63] If a petition for the annulment of an award has been presented to a judge, he may suspend the nullity proceedings where appropriate and upon petition of one of the parties, for a term determined by said judge to allow the arbitral tribunal to continue with the arbitration proceedings, or adopt any measures that, upon the opinion of the arbitral tribunal, eliminates the grounds of the annulment petition.[64] The annulment proceeding shall be brought on by special motion in accordance with the provisions of Article 360 of the Federal Code of Civil Procedure. The decision shall not be subject to any appeal.[65]

Recognition and enforcement of awards. Regardless of the country where an arbitration award is pronounced, it shall be recognized as binding and after submitting a petition in writing to a judge, it shall be enforced.[66] The party who asserts an award or petitions for its enforcement shall present the original of the award duly authenticated, or a certified copy of the same and the original of the arbitration agreement.[67] The recognition or enforcement of an award may only be denied, regardless of the country where the arbitration award is pronounced, if:

A. The party against whom the award is asserted proves to the judge of competent jurisdiction in the country where a demand is filed for recognition and enforcement that:

62. *Id.* art. 1457.
63. *Id.* art. 1458.
64. *Id.* art. 1459.
65. *Id.*
66. Código de Comercio de Mexico, *supra* note 8, art. 1461.
67. *Id.*

- One of the parties to the arbitration agreement was affected by a legal incapacity;
- The agreement is invalid under the applicable law chosen by the parties, or if nothing is mentioned in that respect, by the laws of the country where the award is pronounced;
- Said party was not duly notified regarding the designation of an arbitrator or in reference to the arbitration proceedings, or was unable for any other reason to assert his rights;
- The award refers to a controversy not foreseen in the arbitration agreement, or contains decisions that exceed the terms of the agreement; and
- The composition of the arbitral tribunal or the arbitration proceeding was not in accordance with the agreement between the parties, or in the absence of such an agreement, it was not in accordance with the law of the country where the arbitration was held;
- The award has not yet become binding on the parties or has been annulled or suspended by the judge of the country where the award was pronounced, or whose legal system was applied to pronounce said award.

B. The judge finds that according to Mexican law, the subject matter of the controversy is not susceptible of arbitration; or the recognition or enforcement of the award is contrary to public policy.

C. If a petition to declare the nullity or suspension of an award is brought before a judge of the country pursuant to whose laws the award was pronounced, the judge before whom the recognition or enforcement of the award may, if he so deems admissible, withhold his decision, and, upon request of the party petitioning recognition or enforcement of the award, he may also order to give sufficient security from the other party.

D. The recognition and enforcement proceedings shall be brought on by special motion in accordance with Article 360 of the Federal Code of Civil Procedure. The resolution shall not be subject to any appeal.[68]

68. *Id.* art. 1462.

VIII. RULES OF ARBITRATION OF THE MEXICO CITY NATIONAL CHAMBER OF COMMERCE

The Rules are integrated in four sections. The first section is named General Provisions, which describes the scope of application, notice, computation of time periods, representation and assistance, confidentiality and the release from liability.[69] These Rules define international arbitration as such arbitration in which the parties, at the time of entering into the arbitration agreement, have their domicile or establishment in different countries; or if the arbitration site is stipulated in the arbitration agreement or arranged thereunder, the site shall be a place to comply with a substantial portion of the obligations out of the country where the parties have their establishment.[70]

The second section is entitled "Composition of the Arbitral Tribunal," which provides the number of arbitrators to participate in the arbitration, which can be a sole arbitrator or three. Likewise, this section refers to the appointment, challenge, removal and death or resignation. In case of replacement of an arbitrator, the hearing shall be repeated.[71]

The third section refers to the Arbitration Proceeding, in which it is provided the place of arbitration, language, written statement of a claim, its response; including the amendments to the claim or to the response, the pleas related to the competent jurisdiction of the arbitral tribunal, time periods, evidences, hearings, experts, contempt, closure of hearing, waiver to object and the waiver to appeal before the judicial authority, as well as the accelerated arbitration.[72]

The fourth section pertains to The Award, its form and effect, the applicable law and the amiable compositeur, the settlement or other grounds for termination of arbitral proceedings, costs, their deposit and payment as well as the administrative fees.[73] The Transitory Article contained in section four rules in regard to the arbitration clause to be read as follows: "Any litigation, dispute or claim resulting from this contract or related to this contract, its default, resolution or nullity, shall be settled by arbitration in accordance with the Arbitration Rules of the

69. *See generally* Reglamento De Arbitraje De La Cámara Nacional De Comercio De La Ciudad De México [Mexico City National Chamber of Commerce Arbitration Rules], 25 de Septiembre de 2000 (Mex.), *available at* http://www.arbitrajecanaco.com.mx/.

70. *Id.* art. 5.

71. *See id.* arts. 7-19.

72. *See id.* arts. 20-37.

73. *See id.* arts. 38-49.

of the Mexico City National Chamber of Commerce, in force at the time of initiating the arbitration proceedings."[74]

IX. RULES OF ARBITRATION OF THE UNITED MEXICAN STATES CONFEDERATION OF INDUSTRIAL CHAMBERS

The Rules are integrated by four sections: the first section is named General Provisions, the second section refers to the Composition of the Arbitral Tribunal, the third section is known as the Arbitration Proceeding, and the fourth section describes in detail the award in the same manner as it is provided in the Rules of Arbitration of the Mexico City National Chamber of Commerce. As their title indicates, the present rules are addressed to the members of the Confederation of Industrial Chambers of the country.

It is fair to say that the Confederation of Industrial Chambers provides Rules of Commercial Mediation, which are useful to avoid the operation of litigation in arbitral or judicial forums; among the advantages of these Rules we can mention its flexibility, the preservation of business relationships among the parties, and the reduction of time and costs. Besides, this commercial mediation is easier and shorter than a litigious proceeding. The Rules of Commercial Mediation are integrated by one section only and contains 22 articles.

X. REGIONAL ARBITRATION: TREATIES EXECUTED BY MEXICO

Up to the present date, Mexico has executed several commercial treaties with other countries, but the most important are the NAFTA[75] and the EU-MEX FTA.[76] The Free Trade Agreement between several European Union member states and Mexico has a section related to the solution of controversies, and it provides for the establishment of a mechanism for consultation and solution of controversies with clear and quick procedures. This is the first time that the European Union incorporated this discipline in a commercial treaty and for concession prior to conciliation, before an appearance at an arbitration proceeding, Mexico reserves its right to challenge before the WTO. In this context, it is also important to mention the commercial treaty executed by Mexico and Japan.[77]

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74. Reglamento De Arbitraje De La Cámara Nacional De Comercio De La Ciudad De México, *supra* note 69, art. 49.

75. *See generally*, North American Free Trade Agreement, U.S.-Can.-Mex., Dec. 17, 1992, 1992 WL 812383.

76. *See generally,* Free Trade Agreement Between the EFTA States and the United Mexican States, July 1, 2001, *available at* http://www.efta.int/content/legal-texts/third-country-relations/mexico/MX-FTA.pdf/at_download/file.

77. ADRIANO, COMMERCIAL INSTITUTIONS, *supra* note 6, at 535-48.

In reference to the analysis of commercial arbitration, Mexico has acceded and maintains in force[78] the United Nations Convention subscribed to in New York in 1958 on the Recognition and Enforcement of Foreign Arbitral Awards; the Inter-American Convention subscribed in Panama in 1975 on International Commercial Arbitration;[79] the Inter-American Convention on Extraterritorial Validity of Foreign Judgments and Arbitral Awards, subscribed in Montevideo in 1979,[80] the UNCITRAL Model Law on International Commercial Arbitration 1985;[81] the 1989 document between Mexico and Spain known as the Convention on the Recognition and Enforcement of Judgments and Arbitral Awards in Civil and Commercial Matters subscribed by the United Mexican States and the Kingdom of Spain;[82] and the North American Free Trade Agreement Mexico-United States-Canada,[83] which specifically, in its article 2022 provides the following rule: "will encourage and facilitate the use of arbitration and other means of alternative dispute resolutions for the settlement of international commercial disputes between private parties."

XI. ARBITRATION IN THE MERCOSUR

The legal frame that rules the MERCOSUR is, among others, the Protocol of Brasilia for the Resolution of Controversies, 1991;[84] Commercial Arbitration Agreement of Mercosur, 1998; Agreement on International Commercial Arbitration Among Mercosur, Bolivia and Chile, 1998; the Protocol of Olivos for the Settlement of Disputes, Permanent Court of Review, 2002;[85] International Conciliation and Arbitration Court for Mercosur, TICAMER; International Arbitration Court for Mercosur; Arbitration Awards; Santiago Arbitration Center in

78. Elvia Arcelia Quintana Adriano, Legal-Commercial Evolution: from the XXth Century to the Beginning of the XXIst Century, International Overview of Commercial Law, Cultures and Compared Legal Systems, UNAM-Legal Research Institute 114-22 (2006).

79. *See* The Inter-American Convention on International Commercial Arbitration, Jan. 30, 1975, O.A.S.T.S. No 42, *available at* http://www.sice.oas.org/dispute/comarb/iacac/iacac2e.asp.

80. Inter-American Convention on Extraterritorial Validity of Foreign Judgments and Arbitral Awards, May 8, 1979, 18 I.L.M. 1224.

81. UNCITRAL Model Law on International Commercial Arbitration, *supra* note 7.

82. *See* Convention on Jurisdiction and Enforcement of Judgments in Civil and Commercial Matters, July 28, 1990, 29 I.L.M. 1413.

83. *See* North American Free Trade Agreement, *supra* note 75.

84. Protocol of Brasilia for the Settlement of Disputes, Dec. 17, 1991, 36 I.L.M. 691, *available at* http://www.sice.oas.org/trade/mrcsr/brasilia/pbrasilia_e.asp.

85. The Olivos Protocol for the Settlement of Disputes in MERCOSIR, Feb. 18, 2002, 42 I.L.M. 2.

Chile, 1992; Arbitration Chamber of Brazil, 1995; Arbitration Center of Uruguay; Arbitration Chamber of Paraguay, 1996.

XII. LEGAL FRAME FOR INTERNATIONAL REFERENCE

The evolution of mercantile or commercial legislation in all States is linked to historic and political phenomena in any of the three geographic levels: States, regions or international-global zones. In the evolution of legal amendments the harmonizing trend has been constant and the adoption of rules through "Model Laws" or through those derived from bilateral or multilateral treaties. The foregoing rules are a consequence of the intense activity of the United Nations Organization known as UNCTAD/UNCITRAL with the objective to make easier the commercial transactions, nowadays increasing in number and more dynamic which final destination is the satisfaction of their needs, along with the increase in consumption markets all around this globalized world, since distances are shorten and the accessibility offered by diverse technologic and scientific advances. All the above has been reflected in the decodifying movement that allowed the existence of specialized laws, and it is worth to mention the importance of making bilateral or multilateral treaties.[86]

In reference to the denomination of treaty, the practice provides a wide range of nomenclatures to invoke international treaties. In this order of ideas, it is to say that said denomination is also denoted as convention, settlement, agreement, pact, letter, declaration, protocol, exchange of notes, among others, all of them attributable to the same juridical act.[87]

XIII. INTERNATIONAL CONVENTIONS ON ARBITRATION AND MEDIATION.

In this respect the following international instruments will be cited: New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards, 1958;[88] Inter-American Convention on International Commercial Arbitration, Panama Convention, 1975;[89] Inter-American Convention on Extraterritorial Validity of Foreign Judgments and Arbitral Awards or Montevideo Convention, 1979 (CIDIP II);[90] UNCITRAL Model Law on International Commercial Arbitration,

86. Adriano, *Legal-Commercial Evolution*, *supra* note 78.

87. *Id.* at 535 (analyzing the topic in a wider fashion).

88. Convention on the Recognition and Enforcement of Foreign Arbitral Awards, June 7, 1959, 330 U.N.T.S. 38, *avaliable at* http://www.uncitral.org/uncitral/en/uncitral_texts/arbitration/NYConvention.html.

89. Inter-American Convention on International Commercial Arbitration, *supra* note 79.

90. Inter-American Convention on Extraterritorial Validity of Foreign Judgments and Arbitral Awards, *supra* note 80.

1985;[91] Convention on the Recognition and Enforcement of Judgments and Arbitral Awards in Civil and Commercial Matters subscribed by the United Mexican States and the Kingdom of Spain in 1989;[92] UNCITRAL Model Law on International Commercial Conciliation, 2002;[93] UNCITRAL Notes on Organizing Arbitral Proceedings, 1996;[94] UNCITRAL Arbitration Rules, 1976;[95] WTO Dispute Settlement Understanding;[96] WIPO Arbitration Rules, 2002;[97] WIPO Mediation Rules, 2002;[98] Convention on the Settlement of Investment Disputes between States and Nationals of Other States, ICSID, 1966.[99]

- International Organizations for Arbitration: Permanent Court of Arbitration, The Hague, 1899; World Trade Organization, WTO Dispute Settlement Page, 1994; ICC International Court of Arbitration, 1999; International Centre for Settlement of Investment Disputes, World Bank, ICSID, 1966; Permanent Tribunal of Arbitration, 1907; European Court of Arbitration; WIPO Arbitration and Mediation Center, 1994; International Court of Environmental Arbitration and Conciliation; Court of Arbitration for Sport, 1983; United Nations Commission on International Trade Law, UNCITRAL, 1966; World Trade Organization, WTO, 1995.

- Inter-American Organizations for Arbitration: Commercial Arbitration and Mediation Center for the Americas, CAMCA; Inter-American Commercial Arbitration Commission, IACAC, 1934.

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91. UNCITRAL Model Law on International Commercial Arbitration, *supra* note 7.

92. Convention on Jurisdiction and Enforcement of Judgments in Civil and Commercial Matters, *supra* note 82.

93. UNCITRAL Model Law on International Commercial Conciliation (2002), *available at* http://www.uncitral.org/uncitral/en/uncitral_texts/arbitration/2002Model_conciliation.html.

94. UNCITRAL Notes on Organizing Arbitral Proceedings (1996), *available at* http://www.uncitral.org/pdf/english/texts/arbitration/arb-notes/arb-notes-e.pdf.

95. UNCITRAL Arbitration Rules (1976), *available at* http://www.uncitral.org/pdf/english/texts/arbitration/arb-rules/arb-rules.pdf.

96. WTO Understanding on Rules and Procedures Governing the Settlement of Disputes, *available at* http://www.wto.org/english/tratop_e/dispu_e/dsu_e.htm.

97. WIPO Arbitration Rules, *available at* http://www.wipo.int/amc/en/arbitration/rules/.

98. WIPO Mediation Rules, *available at* http://www.wipo.int/amc/en/mediation/rules/.

99. Convention on the Settlement of Investment Disputes between States and Nationals of Other States, Mar. 18, 1965, 4 I.L.M. 524.

XIV. CONVENTION ON THE RECOGNITION AND ENFORCEMENT OF FOREIGN ARBITRAL AWARDS (NEW YORK, JUNE 10, 1958).

The Convention on the Recognition and Enforcement of Foreign Arbitral Awards dated on June 10, 1958 is integrated by 16 articles and this international instrument is in force as of June 7, 1959.[100] The Convention, when ratifying or accessing to it, shall come into force on the ninetieth day following the date of deposit of the third instrument.[101] This Convention, of which the Chinese, English, French, Russian and Spanish texts shall be equally authentic, shall be deposited in the archives of the United Nations.

This Convention is used to recognize and enforce arbitral awards that are "made in the territory of a State other than the State where the recognition and enforcement of such awards are sought."[102] The Convention also applies to "arbitral awards not considered as domestic awards in the State where their recognition and enforcement are sought."[103] The arbitral award shall include awards "made by arbitrators appointed for each case, but also those made by permanent arbitral bodies to which the parties have submitted."[104]

There are two effects of the arbitration clause: the positive effect and the negative effect. The first positive effect refers the parties in dispute to arbitration; and the second, a negative effect, provides an inhibition of the tribunals in respect to disputes in arbitration, without infringing the domestic law.[105]

When States sign or ratify this New York Convention, the State may apply the Convention rules to recognize and enforce awards.[106] Additionally, the State may apply the Convention to disputes "arising out of legal relationships."[107] In this manner, the signing States shall recognize a written agreement where the parties agree to arbitration "concerning a subject matter capable of settlement by arbitration."[108] The agreement, in writing, shall include an arbitral clause.

The court of a Contracting State shall "refer the parties to arbitration, unless it finds that the said agreement is null and void,

100. Convention on the Recognition and Enforcement of Foreign Arbitral Awards, *supra* note 88.
101. *Id.* at 9.
102. *Id.* art. 1, ¶ 1.
103. *Id.*
104. *Id.* ¶ 2.
105. Convention on the Recognition and Enforcement of Foreign Arbitral Awards, *supra* note 88, ¶ 1.
106. *Id.* art. 1, ¶ 3.
107. *Id.*
108. *Id.* art. 2, ¶ 1.

inoperative, or incapable of being performed."[109] Each Contracting State shall recognize the authority of the arbitral award and shall also allow its enforcement.[110] More onerous conditions, higher fees, or charges shall not be "imposed on the recognition or enforcement of domestic arbitral awards."[111] To obtain the recognition and enforcement at the time of application, the Contracting State shall supply "the duly authenticated original award or a duly certified copy" of said original, which meets the conditions required for its authenticity; and the original agreement or a duly certified copy of the original, which meets the conditions required for its authenticity.[112] If the agreement is not made in an official language of the country, "the party applying for recognition and enforcement of the award shall produce a translation of these documents into such language."[113] The translated agreement must be "certified by an official or sworn translator or by a diplomatic or consular agent."[114]

Recognition and enforcement of the award may be refused if:

a) It is applied, "at the request of the party against whom it is invoked, only if that party furnishes to the competent authority where the recognition and enforcement is sought, proof that":

b) The parties were "under some incapacity";

c) "The agreement is not valid under the law to which the parties have subjected it";

d) One of the parties "was not given proper notice of the appointment of the arbitrator or of the arbitration proceedings or was otherwise unable to present his case";

e) "The award deals with a difference not contemplated by the commitment to arbitration";

f) "The composition of the arbitral tribunal or the arbitral proceeding was not in accordance with the agreement of the parties";

g) "The award has not yet become binding on the parties, or has been set aside or suspended by a competent authority of the country."[115]

"The recognition and enforcement of an arbitral award may also be refused if the competent authority where the recognition and enforcement is sought, finds that: the subject matter of the difference is not capable of settlement by arbitration," or the recognition or

109. *Id.* ¶ 3.

110. Convention on the Recognition and Enforcement of Foreign Arbitral Awards, *supra* note 88, art. 3.

111. *Id.*

112. *Id.* art. 4, ¶ 1.

113. *Id.* ¶ 2.

114. *Id.*

115. Convention on the Recognition and Enforcement of Foreign Arbitral Awards, *supra* note 88, art. 5.

enforcement of the award would be contrary to the public policy of that country.[116]

If petition to set aside or suspend an award has been made to the proper authority, said authority may "adjourn the decision on the enforcement of the award and may also, on the application of the party claiming enforcement of the award, order the other party to give suitable security."[117] "The provisions of the present Convention shall not affect the validity of multilateral or bilateral agreements concerning the recognition and enforcement of arbitral awards entered into by the Contracting States."[118] Additionally, the provisions shall not "deprive any interested party of any right he may have to avail himself of an arbitral award in the manner and to the extent allowed by the legislation or the treaties of the country where such award is sought to be relied upon."[119] "The Geneva Protocol on Arbitration of 1923 and the Geneva Convention on the Execution of Foreign Arbitral Awards shall cease to have effect between Contracting States on their becoming bound and to the extent that they become bound, by this Convention."[120]

"This Convention shall be ratified and the instrument of ratification shall be deposited with the Secretary-General of the United Nations."[121] This Convention is open for accession to all Member States of any specialized organization of United Nations.[122] Any State may "declare that this Convention shall extend to all or any of the territories for the international relations of which it is responsible" or only to one or several of its territories.[123] "Any Contracting State may denounce this Convention by a written notification to the Secretary-General of the United Nations. Denunciation shall take effect one year after the date of receipt of the notification by the Secretary-General."[124] "Any State which has made a declaration or sent a notification," may declare at any time thereafter that "this Convention shall cease to extend to the territory concerned one year after the date of the receipt of the notification by the Secretary-General."[125]

116. *Id.* ¶ 2.
117. *Id.* art. 6.
118. *Id.* art. 7, ¶ 1.
119. *Id.*
120. Convention on the Recognition and Enforcement of Foreign Arbitral Awards, *supra* note 88, ¶ 2.
121. *Id.* art. 8, ¶ 2.
122. *Id.* art. 9, ¶ 1.
123. *Id.* art. 10, ¶ 1.
124. *Id.* art. 13, ¶ 1.
125. Convention on the Recognition and Enforcement of Foreign Arbitral Awards, *supra* note 88, ¶ 2.

XV. INTER-AMERICAN CONVENTION ON INTERNATIONAL COMMERCIAL ARBITRATION (PANAMA, JANUARY 30, 1975)[126]

The Inter-American Convention on International Commercial Arbitration, dated on January 30, 1975, incorporates 13 articles and this international instrument is in force as of June 16, 1976.[127] At the moment of accessing or ratifying this Convention, it shall enter into force on the 30th day following the date of deposit of the second instrument of ratification.[128] By signing this Convention, the Governments of the Member States of the Organization of American States ("OAS") undertook "to submit to arbitral decision any differences that may arise or have arisen between them with respect to a commercial transaction."[129]

Arbitrators for the dispute are "appointed in the manner agreed upon by the parties," or they may be appointed by a third party.[130] Arbitrators of the dispute may be from a country party to the dispute or may be foreigners.[131] "In the absence of an express agreement between the parties, the arbitration shall be conducted in accordance with the rules of procedure of the Inter-American Commercial Arbitration Commission."[132] "An arbitral decision or award that is not appealable under the applicable law or procedural rules shall have the force of a final judicial judgment."[133] Its enforcement or "recognition may be ordered in the same manner as that of decisions handed down by national or foreign ordinary courts."[134]

The recognition and enforcement of "the decision may be refused, at the request of the party against which it is made": by the parties, since they were subject in the agreement to some incapacity; the party was "not duly notified of the appointment of the arbitrator or of the arbitration procedure to be followed, or was unable to present his defense"; "that the decision concerns a dispute not envisaged in the agreement between the parties to submit to arbitration"; "that the constitution of the arbitral tribunal or the arbitration procedure has not been carried out in accordance with the terms of the agreement signed by

126. *See* The Inter-American Convention on International Commercial Arbitration, *supra* note 79.
127. *Id.*
128. *Id.* art. 11.
129. *Id.* art. 1.
130. *Id.* art. 2.
131. The Inter-American Convention on International Commercial Arbitration, *supra* note 79, art. 2.
132. *Id.* art. 3.
133. *Id.* art. 4.
134. *Id.*

the parties," or "the constitution of the arbitral tribunal or the arbitration procedure has not been carried out in accordance with the law of the State where the arbitration took place"; "that the decision has not yet become binding on the parties or has been annulled or suspended by a competent authority of the State in which, the decision has been made."[135]

"The recognition and execution of an arbitral decision may also be refused if the competent authority of the State in which the recognition and enforcement is requested finds that the subject of the dispute cannot be settled by arbitration under the law of that State; or, that the recognition or execution of the decision would be contrary to the public policy of that State."[136] If the competent authority "has been requested to annul or suspend the arbitral decision, the authority before which such decision is invoked may, if it deems it appropriate, postpone a decision on the execution of the arbitral decision and, at the request of the party requesting execution, may also instruct the other party to post suitable securities."[137]

Member States of the OAS may sign this Convention[138], which is ultimately subject to ratification.[139] "The instruments of ratification shall be deposited with the General Secretariat" of the OAS.[140] Additionally, this Convention remains open for signature by any other State.[141]. "This Convention shall remain in force indefinitely, but any of the States' Parties may denounce it. The instrument of denunciation shall be deposited with the General Secretariat of the Organization of American States. After one year from the date of deposit of the instrument of denunciation, the Convention shall no longer be in effect for the denouncing State, but shall remain in effect for the other States Parties.[142] The original instrument of this Convention, the English, French, Portuguese and Spanish texts of which are equally authentic, shall be deposited with the General Secretariat of the Organization of American States.

135. *Id.* art. 5.
136. *Id.* art. 5, ¶ 2.
137. The Inter-American Convention on International Commercial Arbitration, *supra* note 79, art. 6.
138. *Id.* art. 7.
139. *Id.* art. 8.
140. *Id.*
141. *Id.* art. 9.
142. The Inter-American Convention on International Commercial Arbitration, *supra* note 79, art. 12.

XVI. INTERNATIONAL ARBITRATION

The emergence of international arbitration began at the end of the 18th Century by means of the Jay Treaty, dated on November 19, 1794, and executed by and between Great Britain and the United States of America. Additionally, the First Peace Conference of The Hague in 1899 is presented as the first and most important step to arbitration: the establishment of the Permanent Court of Arbitration.

This article asserts that International Arbitration has grown due to an enormous evolution based on different modalities of law, and that those modalities derive from procedures which have been specifically established in international treaties among different States. Arbitration is considered a method by which the parties in dispute agree to submit their differences to a third party or to a Tribunal specially composed for such purpose to resolve said dispute according to rules of law specified by the parties, with the understanding that the decision has to be accepted by the contenders as a final arrangement. In other words, arbitration is a manner in which to resolve international controversies in a peaceful and amicable form, when the parties in dispute agree to submit their difference to a person or group of persons, which decision shall be binding on the contenders. In this way, the purpose of arbitration is to carry out the arrangement of litigations between the States as sovereign entities, by means of arbitrators appointed freely by the parties or by the judge on a basis of respect to juridical institutions.

XVII. RULES OF ARBITRATION OF THE INTERNATIONAL CHAMBER OF COMMERCE

The Rules of Arbitration of the International Chamber of Commerce ("ICC") are formed by 35 articles and 3 appendices. Specifically, the rules include a Model Clause for Arbitration and other Model Clause for the Pre-Arbitral Referee Procedure:[143]

"All disputes arising out of or in connection with the present contract shall be finally settled under the Rules of Arbitration of the International Chamber of Commerce by one or more arbitrators appointed in accordance with the said Rules of Arbitration."[144]

In addition, the rules offer a model clause for pre-arbitral referee procedure of ICC and ICC Arbitration:

143. International Chamber of Commerce, Rules of Arbitration, Jan. 1, 1998, 36 I.L.M. 1604 (1998), *available at* http://www.iccwbo.org/uploadedFiles/Court/Arbitration/other/rules_arb_english.pdf.

144. *Id.*

> Any party to this contract shall have the right to have recourse to and shall be bound by the pre-arbitral referee procedure of the International Chamber of Commerce in accordance with its Rules for a Pre-Arbitral Referee Procedure. All disputes arising out of or in connection with the present contract shall be finally settled under the Rules of Arbitration of the International Chamber of Commerce by one or more arbitrators appointed in accordance with the said Rules of Arbitration.[145]

The International Court of Arbitration is the arbitration body attached to the ICC. The Court is comprised of members appointed by the World Council of the ICC.[146] The primary purpose of the Court is "to provide for the settlement by arbitration of business disputes of an international character."[147] If provided in the arbitration agreement, the Court may also require "settlement by arbitration in accordance with these Rules of business disputes not of an international character."[148] "The Chairman of the Court or, in the Chairman's absence or otherwise at his request, one of its Vice-Chairmen shall have the power to take urgent decisions on behalf of the Court, provided that any such decision is reported to the Court at its next session."[149] The rules also provide for a Secretariat of the Court (the "Secretariat"), which "under the direction of its Secretary General ("Secretary General") shall have its seat at the headquarters of the ICC."[150]

The Rules define the Arbitral Tribunal as the Tribunal that "includes one or more arbitrators."[151] Claimant is defined as including one or more claimants," Respondent is defined as including "one or more respondents," and finally, an "Award includes, inter alia, an interim, partial or final Award."[152]

"All notifications or communications from the Secretariat and the Arbitral Tribunal shall be made to the last address of the party or its representative for whom the same are intended, as notified either by the party in question or by the other party. Such notification or communication may be made by delivery against receipt, registered post, courier, facsimile transmission, telex, telegram or any other means of telecommunication that provides a record of the sending thereof."[153] "A notification or communication shall be deemed to have been made on the

145. *Id.*
146. *Id.* art. 1, ¶ 1.
147. International Chamber of Commerce, Rules of Arbitration, *supra* note 143.
148. *Id.*
149. *Id.* ¶ 3.
150. *Id.* ¶ 5.
151. *Id.* art. 2.
152. International Chamber of Commerce, Rules of Arbitration, *supra* note 143, art. 2
153. *Id.*

day it was received by the party itself or by its representative, or would have been received."[154] Periods of time specified in or fixed under the present Rules, shall start to run on the day following the date a notification or communication is deemed to have been made."[155] "When the day next following such date is an official holiday, or a non-business day in the country where the notification or communication is deemed to have been made, the period of time shall commence on the first following business day."[156]

The rules also proscribe the manner for commencing the arbitration. "A party wishing to have recourse to arbitration under these Rules shall submit its Request for Arbitration ("Request) to the Secretariat, which shall notify the Claimant and Respondent of the receipt of the Request and the date of such receipt. The date on which the Request is received by the Secretariat shall, for all purposes, be deemed to be the date of the commencement of the arbitral proceedings."[157] The Request shall "contain the following information: a) the name in full, description and address of each of the parties; b) a description of the nature and circumstances of the dispute giving rise to the claim; c) a statement of the relief sought, including, to the extent possible, an indication of any amounts claimed; d) the relevant agreements and, in particular, the arbitration agreement; e) all relevant particulars concerning the number of arbitrators and their choice, and any nomination of an arbitrator required thereby; and f) any comments as to the place of arbitration, the applicable rules of law and the language of the arbitration."[158] The Claimant shall also "make the advance payment on administrative expenses."[159]

The Secretariat, once it has sufficient copies of the Request and the required advance payment, "shall send to the Respondent for its Answer to the Request, a copy of the Request and the documents annexed thereto."[160]

The Answer to the request and the counterclaim will be made within 30 days from the receipt of the Request from the Secretariat. The Respondent must file an Answer (the "Answer") containing "the following information: a) its name in full, description and address; b) its comments as to the nature and circumstances of the dispute giving rise to

154. *Id.*
155. *Id.*
156. *Id.*
157. International Chamber of Commerce, Rules of Arbitration, *supra* note 143, art. 4, ¶¶ 1-2.
158. *Id.* art. 4, ¶ 3.
159. *Id.* art. 4, ¶ 4.
160. *Id.* art. 4, ¶ 5.

the claim(s); c) its response to the relief sought; d) any comments concerning the number of arbitrators and their choice in light of the Claimant's proposals" and "any nomination of an arbitrator" that may be required; and "e) any comments as to the place of arbitration, the applicable rules of law and the language of the arbitration."[161]

Counterclaims made by the Respondent must be filed with its Answer and must "provide: a) a description of the nature and circumstances of the dispute giving rise to the counterclaim(s); and b) a statement of the relief sought, including, to the extent possible, an indication of any amount(s) counterclaimed."[162]

If the Respondent does not file an Answer with the Court, "or if any party raises one or more pleas concerning the existence, validity or scope of the arbitration agreement, the Court may decide, without prejudice to the admissibility or merits of the plea or pleas, that the arbitration shall proceed if it is prima facie satisfied that an arbitration agreement under the Rules may exist."[163]

"If any of the parties refuses or fails to take part in the arbitration or any stage thereof, the arbitration shall proceed notwithstanding such refusal or failure."[164] The rules offer specific guidelines for the person or persons deciding the matter. "The Arbitral Tribunal shall continue to have jurisdiction to determine the respective rights of the parties and to adjudicate their claims and pleas even though the contract itself may be non-existent or null and void."[165] "Every arbitrator must be and remain independent of the parties involved in the arbitration."[166] "The decisions of the Court as to the appointment, confirmation, challenge or replacement of an arbitrator shall be final and the reasons for such decisions shall not be communicated. By accepting to serve, every arbitrator undertakes to carry out his responsibilities in accordance with these Rules."[167] "The disputes shall be decided by a sole arbitrator or by three arbitrators. Where the parties have not agreed upon the number of arbitrators, the Court shall appoint a sole arbitrator, save where it appears to the Court that the dispute is such as to warrant the appointment of three arbitrators."[168] "In confirming or appointing arbitrators, the Court shall consider the arbitrator's nationality, residence and other

161. *Id.* art. 5, ¶ 1.
162. International Chamber of Commerce, Rules of Arbitration, *supra* note 143, art. 5, ¶ 5.
163. *Id.* art. 6, ¶ 2.
164. *Id.* art. 6, ¶ 3.
165. *Id.* art. 6, ¶ 4.
166. *Id.* art. 7, ¶ 1.
167. International Chamber of Commerce, Rules of Arbitration, *supra* note 143, art. 7, ¶¶ 4-5.
168. *Id.* art. 8, ¶¶ 1-2.

relationships with the countries of which the parties or the other arbitrators are nationals and the prospective arbitrator's availability and ability to conduct the arbitration in accordance with these Rules."[169] "Where the Court considers that the circumstances so demand, it may choose the sole arbitrator or the chairman of the Arbitral Tribunal from a country where there is no National Committee, provided that neither of the parties objects within the time limit fixed by the Court. The sole arbitrator or the chairman of the Arbitral Tribunal shall be of a nationality other than those of the parties."[170]

Generally, "[t]he Court shall be at liberty to choose any person whom it regards as suitable" to fulfill functions as an arbitrator.[171] "An arbitrator shall be replaced upon his death, upon the acceptance by the Court of the arbitrator's resignation, upon acceptance by the Court of a challenge, or upon the request of all the parties. An arbitrator shall also be replaced on the Court's own initiative when it decides that he is prevented de jure or de facto from fulfilling his functions, or that he is not fulfilling his functions in accordance with the Rules or within the prescribed time limits."[172] "When an arbitrator is to be replaced, the Court has discretion to decide whether or not to follow the original nominating process. Once reconstituted, and after having invited the parties to comment, the Arbitral Tribunal shall determine if and to what extent prior proceedings shall be repeated before the reconstituted Arbitral Tribunal."[173]

141. "The Secretariat shall transmit the file to the Arbitral Tribunal as soon as it has been constituted, provided the advance on costs requested by the Secretariat at this stage has been paid."[174] "The place of the arbitration shall be fixed by the Court unless agreed upon by the parties."[175] Additionally, "the Arbitral Tribunal may deliberate at any location it considers appropriate."[176]

"In all cases, the Arbitral Tribunal shall act fairly and impartially and ensure that each party has a reasonable opportunity to present its case."[177] "In the absence of an agreement by the parties, the Arbitral Tribunal shall determine the language or languages of the arbitration, due

169. *Id.* art. 9, ¶ 1.
170. *Id.* art. 9, ¶¶ 3-4
171. *Id.* art. 9, ¶ 6.
172. International Chamber of Commerce, Rules of Arbitration, *supra* note 143, art. 12, ¶¶ 1-2.
173. *Id.* art. 12, ¶ 4.
174. *Id.* art. 13
175. *Id.* art. 14 ¶ 1.
176. *Id.* art. 14, ¶ 3.
177. International Chamber of Commerce, Rules of Arbitration, *supra* note 143, art. 15, ¶ 1.

regard being given to all relevant circumstances, including the language of the contract."[178]

The Arbitral Tribunal shall draw up a document stating the terms of reference and a procedural timetable. This document should be based on the basis of documents or in the presence of the parties, and it "shall include the following particulars: a) the full names and descriptions of the parties; b) the addresses of the parties to which notifications and communications arising in the course of the arbitration may be made; c) a summary of the parties' respective claims and of the relief sought by each party, with an indication to the extent possible of the amounts claimed or counterclaimed; d) unless the Arbitral Tribunal considers it inappropriate, a list of issues to be determined; e) the full names, descriptions and addresses of the arbitrators; f) the place of the arbitration; and g) particulars of the applicable procedural rules and, if such is the case, reference to the power conferred upon the Arbitral Tribunal to act as *amiable compositeur* or to decide *ex aequo et bono.*"[179]

"The Arbitral Tribunal shall proceed within as short a time as possible to establish the facts of the case by all appropriate means. After studying the written submissions of the parties and all documents relied upon, the Arbitral Tribunal shall hear the parties together in person if any of them so requests or, failing such a request, it may of its own motion decide to hear them."[180] "The Arbitral Tribunal may decide to hear witnesses, experts appointed by the parties or any other person, in the presence of the parties, or in their absence provided they have been duly summoned."[181] "When a hearing is to be held, the Arbitral Tribunal, giving reasonable notice, shall summon the parties to appear before it on the day and at the place fixed by it. If any of the parties, although duly summoned, fails to appear without valid excuse, the Arbitral Tribunal shall have the power to proceed with the hearing."[182] "When it is satisfied that the parties have had a reasonable opportunity to present their cases, the Arbitral Tribunal shall declare the proceedings closed. Thereafter, no further submission or argument may be made, or evidence produced, unless requested or authorized by the Arbitral Tribunal."[183]

"As soon as the file has been transmitted to it, the Arbitral Tribunal may, at the request of a party, order any interim or conservatory measure

178. *Id.* art. 16.
179. *Id.* art. 18, ¶ 1.
180. *Id.* art. 20, ¶¶ 1-2.
181. *Id.* art. 20, ¶ 3.
182. International Chamber of Commerce, Rules of Arbitration, *supra* note 143, art. 21, ¶¶ 1-2.
183. *Id.* art. 22, ¶ 1.

it deems appropriate."[184] "Before the file is transmitted to the Arbitral Tribunal, and in appropriate circumstances even thereafter, the parties may apply to any competent judicial authority for interim or conservatory measures."[185]

"The time limit within which the Arbitral Tribunal must render its final Award is six months. Such time limit shall start to run from the date of the last signature by the Arbitral Tribunal or by the parties of the Terms of Reference," or "from the date of the notification to the Arbitral Tribunal by the Secretariat of the approval of the Terms of Reference by the Court."[186]

"When the Arbitral Tribunal is composed of more than one arbitrator, an Award is given by a majority decision. If there be no majority, the Award shall be made by the chairman of the Arbitral Tribunal alone. The Award shall state the reasons upon which it is based. The Award shall be deemed to be made at the place of the arbitration and on the date stated therein."[187] "Before signing any Award, the Arbitral Tribunal shall submit it in draft form to the Court. The Court may lay down modifications as to the form of the Award and, without affecting the Arbitral Tribunal's liberty of decision, may also draw its attention to points of substance."[188] "An original of each Award made in accordance with the present Rules shall be deposited with the Secretariat. The Arbitral Tribunal and the Secretariat shall assist the parties in complying with whatever further formalities may be necessary. Every Award shall be binding on the parties."[189]

"After receipt of the Request, the Secretary General may request the Claimant to pay a provisional advance in an amount intended to cover the costs of arbitration until the Terms of Reference have been drawn up."[190] "As soon as practicable, the Court shall fix the advance on costs in an amount likely to cover the fees and expenses of the arbitrators and the ICC administrative costs for the claims and counterclaims which have been referred to it by the parties."[191] "The advance on costs fixed by the Court shall be payable in equal shares by the Claimant and the Respondent." Any provisional advance paid "will be considered as a partial payment. However, any party shall be free to pay the whole of the advance on costs in respect of the principal claim or the counterclaim

184. *Id.* art. 23, ¶ 1.
185. *Id.* art. 23, ¶ 2.
186. *Id.* art. 24, ¶ 1.
187. International Chamber of Commerce, Rules of Arbitration, *supra* note 143, art. 25, ¶¶ 1-3.
188. *Id.* art. 27.
189. *Id.*
190. *Id.* art. 30.
191. *Id.* art. 30, ¶ 1.

should the other party fail to pay its share."[192] "When the Court has set separate advances on costs," each of "the parties shall pay the advance on costs corresponding to its claims. When a request for an advance on costs has not been complied with, and after consultation with the Arbitral Tribunal, the Secretary General may direct the Arbitral Tribunal to suspend its work and set a time limit, which must be not less than 15 days, on the expiry of which the relevant claims, or counterclaims, shall be considered as withdrawn. Should the party in question wish to object to this measure, it must make a request within the aforementioned period for the matter to be decided by the Court. Such party shall not be prevented, on the ground of such withdrawal, from reintroducing the same claims or counterclaims at a later date in another proceeding."[193]

"If one of the parties claims a right to a set-off with regard to either claims or counterclaims, such set-off shall be taken into account in determining the advance to cover the costs of arbitration in the same way as a separate claim insofar as it may require the Arbitral Tribunal to consider additional matters."[194]

"The costs of the arbitration shall include the fees and expenses of the arbitrators and the ICC administrative expenses fixed by the Court, in accordance with the scale in force at the time of the commencement of the arbitral proceedings, as well as the fees and expenses of any experts appointed by the Arbitral Tribunal and the reasonable legal and other costs incurred by the parties for their defense in the arbitration."[195] "The Court may fix the fees of the arbitrators at a figure higher or lower than that which would result from the application of the relevant scale should this be deemed necessary due to the exceptional circumstances of the case."[196] "The final Award shall fix the costs of the arbitration and decide which of the parties shall bear them or in what proportion they shall be borne by the parties."[197] "The parties may agree to shorten the various time limits set out in these Rules."[198]

"The Court, on its own initiative, may extend any time limit which has been modified" if it deems it "necessary to do so in order that the Arbitral Tribunal or the Court may fulfill their responsibilities in accordance with these Rules."[199]

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192. International Chamber of Commerce, Rules of Arbitration, *supra* note 143, art. 30, ¶ 3.
193. *Id.* art. 30, ¶ 4.
194. *Id.*
195. *Id.* art. 31, ¶ 1.
196. *Id.* art. 31, ¶ 2.
197. International Chamber of Commerce, Rules of Arbitration, *supra* note 143, art. 31, ¶ 3.
198. *Id.* art. 32, ¶ 1.
199. *Id.* art. 32, ¶ 2.

"In all matters not expressly provided for in these Rules, the Court and the Arbitral Tribunal shall act in the spirit of these Rules and shall make every effort to make sure that the Award is enforceable at law."[200]

XVIII. CONCLUSION

The harmonizing movement motivated and encouraged by United Nations within the UNCTAD/UNCITRAL, through model laws and international treaties, is clearly expressed in the regulation as it relates to the solution of disputes by means of the commercial arbitration, whether it is of a national, regional or international nature. The legislation has been adopted at those three levels. However, it is a must the continuous study, analysis and modifications of the Internal Procedure Law as to the enforcement of awards.

200. *Id.* art. 35.

Global Unification of Transport Law: A Hopeless Task?

Jan Ramberg*

In the late 1800s and the beginning of the 1900s important steps were taken to unify transport law starting on the regional level in Europe with carriage of goods by rail with CIM (now COTIF/CIM).[1] For carriage by air the Warsaw Convention[2] (now Montreal Convention 1999)[3] appeared in 1929 and CMR for International Carriage of Goods by Road in 1956.[4] Maritime transport became subjected to the 1924 Bill of Lading Convention[5] (the so-called Hague Rules) as supplemented by the 1968 Protocol[6] (the so-called Hague/Visby Rules). Therefore, I think it is fair to suggest that at the time of the mid-1970s a global unification of transport law had been achieved although, admittedly, COTIF/CIM and CMR have to be regarded as regional unifications.

With the advent of carriage of goods in containers, the interest naturally focused on carriage from point-to-point whereby different modes of transport could be integrated in the same contract of carriage.[7]

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1. Uniform Rules Concerning the Contract for International Carriage of Goods by Rail (COTIF/CIM), May 9, 1980, *available at* http://www.jus.uio.no/lm/cim.rail.carriage.contract.uniform.rules.19xx/toc.html.

2. Convention for the Unification of Certain Rules Relating to International Carriage by Air (Warsaw Convention), Oct. 12, 1929, 49 Stat. 3000, *available at* http://www.jus.uio.no/lm/air.carriage.warsaw.convention.1929/doc.html.

3. Convention for the Unification of Certain Rules for International Carriage by Air (Montreal Convention), May 28, 1999 (entered into force Nov. 4, 2003), *available at* http://www.jus.uio.no/lm/air.carriage.unification.convention.montreal.1999/.

4. Convention on the Contract for the International Carriage of Goods by Road (CRM), May 19, 1956, 399 U.N.T.S. 189, *available at* http://www.jus.uio.no/lm/un.cmr.road.carriage.contract.convention.1956/doc.html.

5. Convention for the Unification of Certain Rules Relating to Bills of Lading (Hague Rules), Aug. 25, 1924, 51 Stat. 233.

6. Protocol to Amend the International Convention for the Unification of Certain Rules of Law Relating Bills of Lading (Hague/Visby Rules), Feb. 23, 1968 (entered into force June 23, 1977), *available at* http://www.jus.uio.no/lm/sea.carriage.hague.visby.rules.1968/doc.html.

7. *See* RALPH DE WIT, MULTIMODAL TRANSPORT: CARRIER LIABILITY AND DOCUMENTATION (Lloyd's of London Press Ltd. 1995); J. Ramberg, *Multimodal*

Difficulties arose to create a suitable legal regime to control maritime carriage of goods since maritime law differed considerably from the law of the other modes of transport. The carrier of goods by sea enjoyed particular exemptions (such as the exemption for error in navigation and the management of the vessel and of fire)[8] and much lower monetary limits of liability than those which applied to the other modes.[9] Efforts to create a new régime for maritime transport were initiated and resulted in the so-called Hamburg Rules 1978.[10] Somewhat later, the 1980 UN Convention on Multimodal Transport of Goods[11] appeared. The Hamburg Rules have entered into force but on a limited scale and the Multimodal Transport Convention has not entered into force and will presumably remain unsuccessful in its present form. With the Hamburg Rules maritime transport became more akin to transport by other modes, since the particular exemptions for error in navigation and the management of the vessel and of fire were removed.

So, in the 1980s it seemed as if the development of transport law pointed at a broader international unification within the whole field of transport law. But the Hamburg Rules failed to effectively replace the old system under the Hague and the Hague/Visby Rules and the 1980 Multimodal Transport Convention remained unsuccessful. This resulted in an on-going disunification of international maritime law. Therefore, the CMI initiated efforts to bridge the gap between the old system represented by the Hague and the Hague/Visby Rules and the new system evidenced by the Hamburg Rules. Also, measures were taken to achieve statutory support for electronic recording of information in order to replace the paper Bill of Lading which so far had to rest on agreement between the contracting parties, e.g. by using the CMI Rules for Electronic Bills of Lading. The CMI initiated a co-operation with UNCITRAL to achieve an entirely new convention. The work has been going on for quite some time and has resulted in the UN Convention on Contracts for the International Carriage of Good Wholly or Partly by Sea called the Rotterdam Rules as a result of an invitation to sign the convention in Rotterdam in the fall of 2009.

Transport: A New Dimension in the Law of Carriage of Goods?, *in* ETUDES OFFERTES À RENÉ RODIÈRE 481 (Dalloz Paris 1981).

8. Hague/Visby Rules art. 4.2(a), (b).

9. *See* for a survey, JAN RAMBERG, INTERNATIONAL COMMERCIAL TRANSACTIONS 193 (Int'l Chamber of Commerce Publ. 3d ed., 2004).

10. United Nations Convention on the Carriage of Goods by Sea (Hamburg Rules), March 31, 1978, 17 I.L.M. 608, *available at* http://www.uncitral.org/uncitral/en/uncitral_texts/transport_goods/Hamburg_rules.html.

11. U.N. Convention on International Multimodal Transport of Goods, May 24, 1980, UN Doc. TD/MT/CONF/17, *available at* http://www.jus.uio.no/lm/un.multimodal.transport.1980/doc.html.

In the meantime, the European Commission (DG VII) initiated a study in order to assess the possibilities of finding appropriate solutions.[12] Also, the Economic Commission for Europe (Economic and Social Council), in September 1999, discussed the matter in a particular Working Party on Combined Transport.[13] There, the need was stressed to achieve: "an international legal régime providing easily understandable, transparent, uniform and cost-effective liability provisions for all relevant transport operations, including transhipment and temporary storage, from the point of departure to the point of final destination."[14] It is hard to disagree with that objective.

Recent transport law legislation in Germany resulted in the reformed part of the Handelsgesetzbuch dealing with carriage, freight forwarding and warehousing in an act dated 25 June 1998.[15] The effect of the legislation is basically limited to domestic transports, since Germany retains its ratification of the international conventions relating to the different modes of transport.[16]

The aforementioned Working Party on Combined Transport set up by the Economic Council for Europe concluded that "a new attempt had to be made to arrive at international uniform and mandatory legislation on liability in international transport based on the existing unimodal liability regime."[17] It was suggested that this should be at a global scale and not be restricted to sub-regional or regional areas.[18] The new régime should be mandatory without the possibilities for the parties to opt out.[19]

The aforementioned amendments of the German Handelsgesetzbuch of 25 June 1998 contain an interesting new methodology. Here, in Section 449 on "abweichende Vereinbarungen," it is permitted to depart from the mandatory rules on liability[20] but in principle "only by an agreement reached after detailed negotiations, whether for one or similar

12. *See* REGINA ASARIOTIS, H.J. BULL, MALCOLM A. CLARKE, R. HERBER, A. KIANTOU-PAMPOUKI, D. MORAN-BOVIO, JAN RAMBERG, R. DE WIT & S. ZUNARELLI, INTERMODAL TRANSPORTATION AND CARRIER LIABILITY (European Commission, Luxembourg: Office for Official Publications of the European Communities 1999).

13. *See* U.N. Econ. & Soc. Council [ECOSOC], Inland Transport Comm, Working Group on Combined Transport, Report: *Possibilities for Reconciliation and Harmonization of Civil Liability Regimes Covering Combined Transport*, U.N. Doc. RANS/WP.24/1999/2 (Nov. 12, 1999), *available at* http://daccessdds.un.org/doc/UNDOC/GEN/G99/242/42/PDF/G9924242.pdf?OpenElement (last visited Nov. 7, 2008).

14. *Id.* ¶ 19.

15. *See* Rolf Herber, *The New German Transport Legislation*, 33 EUR. TRANSPORT L. 591 (1998).

16. *See id.* at 605.

17. *See* ECOSOC, *supra* note 13, ¶ 22.

18. *See id.* ¶ 23.

19. *See id.* ¶ 25.

20. *See* Herber, *supra* note 15, at 598-99.

contracts between the parties."[21] The methodology to disallow agreements on liability by standard form contracts rather than by "detailed negotiations" is correct, since it quite rightly recognizes the disappearance of real contractual intent in modern contracting techniques with standard form contracts and the exchange of electronic messages. Re-establishment of the traditional requirement of real contractual intent is understandable and, if such real intent could be proven, the important principle of freedom of contract is recognized even in the field of transport law. However, by necessity future contracting must rest upon standardized techniques. It is therefore questionable whether mandatory transport law could be retained in its present form even if supplemented by a possibility to depart from the mandatory law by a contractual arrangement based upon detailed negotiations between the parties.

While the UN Convention on Contracts for International Carriage Wholly or Partly by Sea[22] bridges the gap between the Hague and the Hague/Visby Rules on the one hand and the Hamburg Rules on the other by removing the particular defenses available to the maritime carrier under the Hague and the Hague/Visby Rules and by increasing the monetary limits of liability to account for world inflation since the 1920s,[23] there may well be considerable difficulties to get a broad international consensus on the innovations contained in the UN Convention. One such controversial aspect concerns the expansion of the Convention to cover not only the maritime segment but also pre-carriage and on-carriage by other modes of transport[24] (the so-called "maritime plus"). Difficult problems arise in determining the applicability of the Convention in relation to other potentially applicable legal régimes to the same transport.[25] Further, the Convention as such does not actually cover transport additional to maritime transport as it merely gives the maritime carrier the option to include such additional carriage in his contract.[26] In practice, this may well result in considerable difficulties for the customers to determine whether or not the carrier has exercised that option. Furthermore, it is not helpful to expand a unimodal transport convention to cover other modes as well,

21. Section 449.

22. U.N. General Assembly, Commission on International Trade Law, Working Group III (Transport Law), Note from the Secretariat: *Draft Convention on the Carriage of Goods [Wholly or Partly] [By Sea]*, U.N. Doc. A/CN.9/WG.III/WP.101 (Nov. 14, 2007) [hereinafter *Convention*].

23. *See Convention*, *supra* note 22, art. 99, ¶ 6(b).

24. *See* Francesco Berlingieri, *A New Convention on the Carriage of Goods by Sea: Port-to Port or Door-to Door?* 8 UNIFORM L. REV. 265, 268 (2003).

25. *See id.* at 269.

26. *See Convention*, *supra* note 22, art. 1.1 (may provide for carriage by other modes in addition to the sea carriage).

since nowadays the important factor for customers is not exactly how goods have been carried and which mode of transport has been used but rather the desire to get the goods in the right condition to the right place at the right time.

The UN Convention also expands to cover anyone acting as a "maritime performing party."[27] The definition of such a party would include anyone performing or undertaking to perform any of the carrier's obligations during the period between the arrival of the goods at the port of loading of a ship and their departure from the port of discharge of a ship but with the exception that an inland carrier is only to be considered a maritime performing party to the extent that it performs or undertakes to perform its services exclusively within a port area.[28] The definition clearly includes stevedoring companies and cargo terminals in the seaport. This may cause some problem to multi-purpose cargo terminals in the seaports, as it would be difficult for them to determine to what extent the goods stored in the terminal are subjected to the maritime convention. Indeed, the failure of the 1991 Convention on Operators of Transport Terminals[29] to come into force (four states have ratified so far while five are required for the convention to enter into force)[30] presumably depends on the difficulties which would arise for cargo terminals being exposed to different systems of liability depending upon the contemplated modes of carriage.[31] If that convention does come into force, the situation would be further aggravated.

Generally, the UN Convention evidences an imbalance between shippers and carriers. While the carrier enjoys the privilege of a monetary limitation of liability for a breach of *any* of its obligations,[32] the shipper would incur an unlimited liability,[33] e.g. in case of incorrect information given to the carrier.[34] While it might be understandable that the maritime carrier would prefer to have joint and several liability comprising everyone acting as shipper and consignee, it may be

27. *See id.* arts. 4.1(a), 20.

28. *See id.* art. 1.7 (definition).

29. U.N. Convention on the Liability of Operators of Transport Terminals in International Trade, Apr. 19, 1991, *available at* http://www.uncitral.org/pdf/english/texts/transport/ott/X_13_e.pdf.

30. *See* UNCITRAL—Status of the 1991 U.N. Convention on the Liability of Operators of Transport Terminals in International Trade, http://www.uncitral.org/uncitral/en/uncitral_texts/transport_goods/1991Convention_status.html (last visited Nov. 4, 2008).

31. *See* Enrico Vincenzini & Jan Ramberg, La Convenzione Sulla Responsabilità Degli Operatori di Transport Terminals nel Commerzio Internationale, 1990-II DIRITTO DEI TRASPORTI 121 (1990).

32. *See Convention, supra* note 22, art. 59.1.

33. *Compare id. with id.* art. 59.

34. *See id.* art. 28.

considered less acceptable that a party having had nothing to do with the contract of carriage should be liable under the Convention. Nevertheless, the Convention contains a definition of "documentary shipper."[35] In order to qualify as such it is sufficient that the party accepts to be named as "shipper" in the transport document or electronic transport record.[36] This might be particularly harmful for Ex-Works and FOB-sellers who may, without knowing the consequences, accept to appear as documentary shippers in Bills of Lading. Also, the particular rules for the frequent case where no one appears to claim the goods at their destination[37] tend to erode the value of the Bill of Lading as a negotiable instrument controlling disposition of the goods in the sense of Art. 58 of the UN Convention on Contracts for the International Sale of Goods (CISG).[38] The situation becomes even worse when—at the last moment in the deliberations in the UNCITRAL Commission—the carrier becomes entitled to issue a negotiable bill of lading without a promise only to deliver the goods against one original or its electronic equivalent (Art. 47.2).

During the deliberations in the UNCITRAL Commission in June 2008, the African and Arab States, as well as Australia and Canada, took a firm stance against what they considered an improper imbalance between the interests of shippers and carriers.[39] Also, the problems caused by the expansion of the Convention to deal with non-maritime transport (the "maritime plus") caused some States (Germany, Finland, and Sweden) to suggest a possibility to make reservations with respect to the applicability of the Convention to more than the maritime segment.[40] This was rejected by the majority and instead a compromise was reached to the effect that, whenever the maritime carrier extends the contract to cover non-maritime transport, existing conventions regulating such transport would supersede.[41]

While the regulation of maritime transport primarily relates to contracts and the particular role of Bills of Lading, air and land transport has developed with performing carriers in mind. It may well be that performing carriers should at least to some extent be controlled by

35. *See id.* art. 1.9.

36. *See id.*

37. *See Convention*, *supra* note 22, arts. 47-49.

38. U.N. Convention on Contracts for the International Sale of Goods (CISG), Apr. 11, 1980, 19 I.L.M. 668, *available at* http://www.uncitral.org/pdf/english/texts/sales/cisg/CISG.pdf.

39. In particular due to the exception for volume contracts in Article 1.2 (definition) and Article 80 (freedom of contract) and the long list of exemptions in Article 17.3.

40. Such reservation is, however, unnecessary as the option system would permit regional and global systems to co-exist.

41. *See* Berlingieri, *supra* note 24, at 269.

mandatory law but the position of contracting carriers is different. Contracting carriers offer a contract of carriage but entrust performance to somebody else and should–as other contracting parties in business-to-business transactions–be permitted to enjoy freedom of contract. Otherwise, we are facing a number of incomprehensible inconsistencies. Why is it that mandatory transport law covers loss of or damage to the goods—and in some cases also delay in delivery[42]—but not other important parts of the contract, such as non-performance, misdelivery, freight and added services? Why should a CISG-seller selling DDP Incoterms 2000 be permitted to exempt himself totally from liability for events occurring during the transport,[43] while he cannot do so if he were to conclude two contracts, one contract of sale Ex-Works with additional transport contract(s)?

In my view, the only way forward lays in shifting the perspective back to performance and away from contract. Protection of customers could be maintained and further enhanced by pinning mandatory liability on the performing carriers and permitting direct actions against the carriers even when contracts of carriage have been entered into with other parties.[44] The present unimodal transport conventions could be maintained basically in their present form but supplemented by Protocols, where necessary, to exempt non-performing parties from the scope of applicability of the conventions. Such a move would facilitate the on-going efforts by the EU Commission to develop appropriate rules applicable to transport integrators and logistics service providers disassociated from the strait-jackets of mandatory transport law.[45]

42. *See Convention*, *supra* note 22, art. 4; *cf. id.* art. 21.

43. *See* CISG, *supra* note 38, art. 79.

44. *See* JAN RAMBERG, THE LAW OF TRANSPORT OPERATORS IN INTERNATIONAL TRADE (Norstedts Juridik 2005).

45. *See id.* at 184-87.

Transnational Consumer Law—Reality or Fiction?

Norbert Reich*

I. BEYOND SPACE AND TIME: CYBER LAW

The traditional legal mechanisms of consumer protection are usually limited to national law and, to some extent, to the law of supranational organisations like the European Union ("EU"). There may be trends to extend the sphere of application or to make sure that EU nationals can always refer to the protection of their home country, but this will be difficult to implement in a globalised market with transactions easily crossing borders, especially by the use of the internet. This is particularly obvious in cases of software transactions: there is not a national marketplace, only a virtual marketplace, not determined by space and time. The partners may not know each other's residence, only their IP address; the payment and the download-delivery is done via the internet, without any personal contact of the parties being a necessary or usual prerequisite of the transaction. It seems impossible or at least very complicated under existing conflict rules to determine jurisdiction and applicable law.[1]

International uniform laws like the Convention for the Sale of Goods ("CSIG") ratified by most States (with the exception of the United Kingdom, Portugal and Ireland) exclude consumer transactions "unless the seller . . . neither knew or ought to have known that the goods were bought for (personal, family or household) use" (Article 2a) and are not

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* This article is part of a greater study on "Crisis and Future of European Consumer Law," published in the *British Yearbook of Consumer Law,* 2008/2009, at 3-65. *See also* my earlier paper in the 2008 edition of the *Uniform Commercial Code Law Journal*, at pages 67 to 77.

1. There is abundant literature of this phenomenon. *See* HANS MICKLITZ, NORBERT REICH & PETER ROTT, UNDERSTANDING EUROPEAN CONSUMER LAW ch. 7 (2008). In *Understanding European Consumer Law*, the authors discuss the practical application of the consumer protection provisions of Article 5 the Rome Convention, Article 6 of the new Regulation (EC) No. 593/2008 of the EP and the Council of 17 June 2008 on the law applicable to contractual obligations *("Rome I")*, 2008 O.J. (L 176), 6, and of specific EC directives to cross-border transactions.

mandatory in their legal application according to Article 6.[2] They are therefore not appropriate for cross-border consumer transactions. Other soft-law initiatives like the UNIDROIT-principles[3] are limited to commercial transactions and while the Principles of European Contract Law contain some rather weak consumer protection provisions[4] they are applicable (if at all) only to transactions within the EU. Both are without prejudice to mandatory consumer protection law. The globalisation of trade in consumer markets, in particular via the internet, has not generated a globalisation of law. "Cyber law" is still an empty catchword without a supportive legal framework that would force transactions via e-commerce into the national legal system. In any event, the national legal system is not adequate any more for these transactions.

The World Trade Organisation ("WTO") has not yet emerged as an actor in transnational private law or, in particular, consumer law, with the exception of intellectual property via the TRIPS agreement.[5] This is due to the WTO's mostly "negative" impact on national (and supranational) law: it is concerned with impediments to international trade mostly by product-related regulations which cannot be justified by mandatory and proportionate public interests like health or safety.[6] Therefore, the WTO does not have jurisdiction for setting mandatory standards for international commercial and consumer transactions, including conflict resolution.

II. CONSUMER LAW AS IMPEDIMENT TO E-COMMERCE?

Some authors go even further in their critique. Consumer law (in the narrow sense as used by the EU or in a broader sense as advocated here) is always based on mandatory standards, such as information,

2. JAN RAMBERG, INTERNATIONAL COMMERCIAL TRANSACTIONS 25 (3d ed. 2004); U. Magnus, *in* A. STAUDINGER, CISG IN BGB-KOMMENTAR art. 2, paras. 10-31 (13 ed. 2005).

3. Michael Joachim Bonell, *The UNIDROIT Principles and Transnational Law*, *in* THE PRACTICE OF TRANSNATIONAL LAW 23 (K.P. Berger ed., 2001); Michael Joachim Bonell & R. Peleggi, *UNIDROIT Principles of International Commercial Contracts and Principles of European Contract Law: A Synoptical Table*, 2004 UNIFORM L. REV. 315-96 (comparing the Unidroit principles with the Principles of European Contract Law (Lando-Principles)).

4. Hans-W. Micklitz, *The Principles of European Contract Law and the Protection of the Weaker Party*, 27 J. CONSUMER POL'Y 339-56 (2004).

5. Ralf Michaels & Nils Jansen, *Private Law Beyond the State? Europeanisation, Globalisation, and Privatisation*, 54 AM. J. COMP. L. 843, 867 (2006).

6. For details, *see* HANS-W. MICKLITZ, INTERNATIONALES PRODUKTSICHERHEITSRECHT 257 (1995) (arguing it should be transformed into a "human right of safety." *See also* WTO – TECHNICAL BARRIERS AND SPS MEASURES 96-120 (R. Wolfrum et al. eds., 2007) (providing a detailed commentary on the clause concerning actions "necessary to protect human, animal or plant life or health" of Art. XX (b) GATT and related agreements).

quality, fairness in pre-formulated contract terms, adequate remedies, non-discrimination rules, and access to justice. This entire complex of protection is vested upon a functioning state legal order which makes the judge the final arbiter in consumer disputes. Law is state-oriented and guaranteed. In the EU, this follows the fundamental right to judicial protection under Article 6 of the European Convention of Human Rights ("ECHR"), confirmed on many occasions by the European Court of Justice ("ECJ")[7] and to be included in Article 6 of the Lisbon Treaty on European Union integrating the Charter of Fundamental Rights in the EU and in particular Article 47 on judicial protection into EU law. In its numerous cases concerning the obligations of Member States to implement and enforce Community consumer law, the Court has insisted on this *obligation de résultat* of states also under Article 10 EC; a violation may even make the state directly liable towards consumers under the *Francovich*-doctrine.[8]

This concept of consumer protection is challenged as a consequence of a globalised trade and consumer market. This challenge comes in a seemingly contradictory direction:

- Consumer law is criticised because it becomes an impediment to trade by imposing mandatory standards on business which differ from country to country or region to region. As a result, search cost for finding out applicable law to consumer transactions become unreasonably high.

- As a seemingly contradictory consequence, consumer law cannot be fully be implemented in a globalised world. State borders are still legal borders, especially in the enforcement of consumer rights.

Consumer law in the traditional, state based concept runs the risk of becoming an ideology: instead of protection, it compartmentalises the (global) market, and at the same time it promises a protective standard which it cannot possibly achieve. For some authors there seems to be only one way out of this dilemma: If mandatory consumer protection standards prove to be dysfunctional to trade, the easiest way therefore to overcome this dilemma would be a system of liberalised world trade based on self-regulation while guaranteeing freedom of contract for business and freedom of choice for consumers.

7. Takis Tridimas, THE GENERAL PRINCIPLES OF COMMUNITY LAW 418 (2d ed 2006); NORBERT REICH, UNDERSTANDING EU LAW 239 (2d ed. 2005).

8. Case C-178/94, Dillenkofer et.al. v. Germany, 1996 E.C.R. I-4845.

III. *LEX MERCATORIA ELECTRONICA* AS EMERGING "TRANSNATIONAL LAW"?

International commercial law had to face the challenges of globalisation already for many years because trade is by its very nature directed across borders, and the emerging *lex mercatoria* seemingly has been an answer to these challenges. The concept of *lex mercatoria* is quite controversial and cannot be discussed here in detail.[9] It relates to a set of norms, practices, and standards in international trade and conflict resolution mechanisms mostly through arbitration which have evolved through commercial usage and customs, and have to some extent been "codified" by private international organisations like the International Chamber of Commerce ("ICC"), International Standardising Organisations like ISO, international law harmonising institutions like UNIDROIT, and specialised organisations for special business areas or for specific ways of communication—e.g., ICANN in the particular case of the internet.[10] The basis of applicability in commercial contracts is not state law or an international treaty, but usually agreement of the parties which need not be express and formalised, but can be implied. This practice may result in *general principles* which are accepted by the relevant business community as guidelines for their commercial transactions. They will usually be enforced in arbitration; arbitrators will use them in contract interpretation and decision making unless the arbitration agreement provides otherwise. Therefore, some authors argue for a "private ordering," meaning a law created by the economic agents themselves which results in a "global governance" of self-regulation.[11] Other authors refer to a "global civil society" which emerges as a "law creating instance" via a "creeping codification of transnational law."[12]

These concepts seem however to be somewhat exaggerated and misleading because in the end the basis of their applicability to international commercial transactions is the free will of the parties. The parties can always opt-out of these "standards" or "principles" even

9. *See* KLAUS P. BERGER, THE CREEPING CODIFICATION OF THE LEX MERCATORIA (1999); THE PRACTICE OF TRANSNATIONAL LAW (Klaus P. Berger ed. 2002); CHRISTIAN JOERGES, INGER-JOHANNE SAND & GUNTHER TEUBNER, TRANSNATIONAL GOVERNANCE AND CONSTITUTIONALISM (2004); Michaels & Jansen, *supra* note 5, at 870 (also referring to the "private law created within the internet community").

10. *See* G. Teubner, *Societal Constitutionalism: Alternatives to State Centred Constitutional Theory?*, *in* JOERGES, SAND AND TEUBNER, *supra* note 9, at 18; Jochen von Bernstorff, *The Structural Limitations of Network Governance: ICANN as a Case in Point*, *in* JOERGES, SAND AND TEUBNER, *supra* note 9, at 257. This is not the place to discuss these concepts.

11. *See* PETER-GRALF CALLIESS, GRENZÜBERSCHREITENDE VERBRAUCHERVERTRÄGE 196 (2006).

12. *See* THE PRACTICE OF TRANSNATIONAL LAW, *supra* note 9, at 12–19.

though there may be no incentives to do so, or transaction cost economics will force the parties to subscribe to these standards. It may also be imputed that, if the parties did not come to an agreement on applicable law or if there are doubts on interpretation, the *lex mercatoria* like the UNIDROIT principles will be applicable as "general principles," commercial practice or custom, particularly in commercial arbitration.[13] But arbitration is subject to second level control in enforcement proceedings by Member State or EU "*ordre public*," as the ECJ has said in its seminal *ECO-Swiss*[14] and *Claro* judgments.[15]

Can these concepts of *lex mercatoria*, of "private ordering of markets," of "global governance via self-regulation" be transferred to consumer law? This is indeed the thesis of the German author G.-P. Calliess in his seminal work on *Transnational Consumer Contracts.* He proposes these concepts as an alternative to the erosion of national (and EU) consumer law in a globalised context. He discusses a number of initiatives and mechanisms which seem to confirm his theory:

> By establishing a global civil constitution for a transnational consumer contract law, reflexive institutions must be created which organise the phenomena of self-regulation and of private ordering in such a way, that on one hand they promote effective legal protection via alternative consumer protection mechanisms, and on the other guarantee fairness and justice of such procedures via-à-vis the consumer.[16]

This radical separation of (transnational) consumer law from the state (or the EU)—and as a consequence from the existing state controlled mechanisms of consumer protection—provokes critique. Such a concept has a number of weaknesses. No representative consumer association exists world wide which could promote or at least monitor and support these standards in some sort of collective consumer interest. It cannot be implied that this would be taken care of by business institutions themselves. Neither state power nor collective action by social partners

13. For the UNIDROIT principles, *see* Bonell, *supra* note 3, at 28–36.

14. Case C-126/97, Eco Swiss China Time v. Benetton Int'l, 1999 E.C.R. I-3055 (concerning the competition *ordre public*).

15. Case C-168/05, Elisa Maria Mostaza Claro v. Centro Movil Milenium, 2006 E.C.R. I-10421. *See* Norbert Reich, *More clarity after* Claro*?*, 2007 EUR. REV. CONTRACT L. 41. *But see* a critique by P. Landolt, *Limits on Court Review of International Arbitration Awards Assessed in Light of States' Interests and In Particular in Light of EU Law Requirements*, 2007 ARBITRATION INT'L 63-91, 77-82. For a recent discussion, *see* N. Reich, *Negotiations and Adjudication: Class actions and arbitration clauses in consumer contracts*, *in* THE FUTURE OF CLASS ACTIONS IN THE EU 345-60 (Cafaggi & Micklitz eds., 2009).

16. *See* CALLIESS, *supra* note 11, at 340 (translation by author).

can guarantee the promises which Calliess sets out.[17] There is no consumer consensus to accept unilaterally-imposed standards by the international "business" or "e-commerce" community. A "global civil society" may exist on the business side using the internet (even though this seems quite doubtful due to conflicting interests as von Bernstorff has shown with regard to ICANN[18]); it certainly is not true with regard to highly fragmented consumer markets.

In his search for an alternative to the traditional state oriented consumer law, Calliess is satisfied if the soft-law mechanisms of 'transnational consumer law' at least attain what he calls "*rough justice*"[19]—probably meaning lower standards of protection than already guaranteed within existing consumer law. This must be achieved through different ADR-mechanisms, including possibly consumer arbitration. What are the standards by which these mechanisms are supposed to function? What about third-party effects of these "private orderings" vis-à-vis consumers as individuals or as a group which must be legitimised either by democratic processes or by agreement of those concerned? Is there an international consensus on certain minimal standards for consumer protection? How far is the principle of freedom of contract—which indeed is a basic rule of international commercial transactions—extended to consumer transactions which are, as we have seen, excluded both from the "hard law" of the CISG and the "soft law" of the UNIDROIT-principles?

"Rough justice" as advocated by Calliess means indeed *rough* justice—only a vague guarantee of certain consumer expectations which can hardly be called "rights" and which usually can be "enforced" only via private arbitration not subject to any public control or transparency, and without clear rules on applicable law. The concept of "transnational law" remains unclear and illusionary; it hits the death stroke to the consumer *acquis* either on an EU or a national basis. It is already doubtful whether it can really be called law at all. This either requires some state monitoring, or a minimum consensus between the parties—two elements well set out in Article 1134 of the French Code Civil whereby "*les conventions légalement formées tiennent lieu de loi à ceux qui les ont faites*" ("contracts legally entered into take force of law for those who have made them").

Calliess defends his concept with the following words:

17. *See* D. Schiek, *Private rulemaking and European governance—issues of legitimacy*, 2007 EUR. L. REV. 443 (concerning the need for (collective) autonomy to justify private rulemaking in the EU context). This also applies to international law.

18. *See* von Bernstorff, *supra* note 10, at 274–81.

19. CALLIESS, *supra* note 11, at 351.

> Transnational law describes a third category of autonomous legal systems beyond the traditional categories of national or international law. Transnational law is created and developed by the global civil society through acts creating law (Rechtsschöpfungskräfte). (1) It is based (a) on general principles of law and (b) on practice and custom in the civil society, which leads to their confirmation and further development. (2) Its application, interpretation and development is regularly *conferred* to private providers of dispute resolution mechanisms. (3) Its mandatory character is based on legally (rechtsförmig) organised orders and enactment of social-economic sanctions. (4) A codification of transnational law—if at all—occurs in the form of general catalogues of principles and rules, standardised contract forms and codes of conduct which are established by private standard setting institutions (Normierungsinstitutionen).[20]

This definition may be true for the classical *lex mercatoria* but always requires some express or implied agreement between the parties to be applicable in their relations if there has been no constitutionally delegated power behind its enactment. It cannot be used against third parties like consumers who have not participated in the elaboration of this "transnational law," neither personally nor via their representatives. We do not argue that law always requires state enactment—but if this is not the case there must at least be some other mechanisms substituting the decision of the legislator which can only be party autonomy of those concerned, whether individual or collective. Even the argument of Calliess set out above requires some sort of "conferral" of power to (binding?) dispute resolution mechanisms, but does not explain who has validly effected this transferral to the detriment of state or other legitimate mechanisms; the idea of an "international civil society" is too vague and too abstract to have this power of conferral. Therefore, the concept of "transnational law" cannot be transferred to consumer transactions even in a globalised setting without the state because of the lack of equality of parties and the limited freedom of choice for consumers.

It is interesting to see that the so-called institutions of an international "civil society" upon which Calliess relies for his concept of "transnational law" refer themselves to mandatory standards which are set by state (or international[21] respective to supranational) law. It seems

20. *Id.* at 371 (italics added) (translated by author).

21. The need for mandatory international standards has been emphasised by the International Council on Human Rights Policy. *See* INT'L COUNCIL ON HUMAN RIGHTS POL'Y, BEYOND VOLUNTARISM: HUMAN RIGHTS AND THE DEVELOPING INTERNATIONAL OBLIGATIONS OF COMPANIES (2002), *available at* http://www.ichrp.org/files/reports/7/107_report_en.pdf; *see also* Michele Micheletti & Andreas Follesdal, *Shopping for Human Rights*, 30 J. CONSUMER POL'Y 167, 167 (2007).

that the international "civil society" (which is, in my opinion, a fiction anyway) cannot live without the state as will be shown in the following section.

IV. THE EVOLUTION OF SOFT-LAW STANDARDS—AN ALTERNATIVE TO "HARD" LAW?

It can be useful to look at some of the soft-law standards which have been developed by internet service providers. Most of these are American, being the main players on the global market for e-commerce. The surprising point in all these systems seems to be that they offer the consumer certain mechanisms to guarantee satisfaction and to resolve disputes, but they do not completely replace the traditional, state bound consumer law and protection. The following examples are documented by Calliess:

- The Better Business Bureau*OnLine* "Code of Online Business Practice"[22] contains 5 principles, including consumer satisfaction. It recommends informal dispute settlement mechanisms, including non-binding or conditionally binding arbitration (under which the decision is binding on the company if the consumer elects to accept the decision, thereby making it binding on the consumer as well), without pre-empting further governmental actions in this field; the critical point for arbitration is obviously the 'election by the consumer'—can it be done in general contract terms communicated electronically to the consumer?—Calliess does not answer this question.

- Agreement between Consumers International and the Global Business Dialogue on Electronic Commerce – Alternative Dispute resolution Guidelines.[23] ADR mechanisms are greatly encouraged, dispute resolution may be based on equity or codes of conduct. Binding arbitration before the dispute is to be avoided "where such commitment would have the effect of depriving the consumer of the right to bring an action before the courts." Development of ADR is left to governments. The

22. *See* Better Business Bureau, BBBOnline, Code of Online Business Practices, www.bbbonline.org/reliability/code/CodeEnglish.pdf; *see also* CALLIESS, *supra* note 11, at 422 (quoting full text).

23. GLOBAL BUSINESS DIALOGUE ON E-COMMERCE, ALTERNATIVE DISPUTE RESOLUTION GUIDELINES (2003), *available at* http://www.gbd-e.org/pubs/ADR_Guideline.pdf; *see also* CALLIESS, *supra* note 11, at 439.

guidelines contain a plea for deregulation of formal requirements for ADR and for a clarification of rules on jurisdiction and applicable law to be dealt with in "a manner that encourages both business investment and consumer trust in electronic commerce."

- American Bar Association (Task force) Recommendation on Best Practices for Online Dispute Resolution Service ("ODR") Providers:[24] It clearly states that ODR Providers "should disclose the jurisdiction where complaints against the ODR provider can be brought, and any relevant jurisdictional limitations."

- ICC's "Resolving disputes online—Best practices for ODR in B2C and C2C transactions":[25] They insist that "companies should not obligate consumers to agree to use binding dispute resolution processes prior to the materialisation of a dispute. However, where permissible under local law, pre-dispute commitments to binding dispute resolution are acceptable if they are clearly disclosed before the initial transaction is completed. This will allow consumers to take the dispute resolution provision into consideration and make an informed choice about doing business with the company." Again, the main point is "clear disclosure" which must be determined by the applicable law to the contract. US-American and Canadian law is much more generous in allowing electronically agreed arbitration clauses through so-called "click-wrap" agreements than the law of the Member States or EU law itself.[26]

The examples show that a concept of "transnational consumer law" based on self- or co-regulation by "civil society" cannot work in practice. Therefore, the main argument against such "*lex mercatoria electronica*"

24. AMERICAN BAR ASS'N TASK FORCE ON ECOMMERCE AND ADR, RECOMMENDED BEST PRACTICES FOR ONLINE DISPUTE RESOLUTION PROVIDERS, *available at* http://www.abanet.org/dispute/documents/BestPracticesFinal102802.pdf; *see also* CALLIESS, *supra* note 11, at 448.

25. INT'L CHAMBER OF COMMERCE, RESOLVING ONLINE DISPUTES (2003), *available at* www.iccwbo.org/home/statements_rules/statements/2004/DISPUTES-rev.pdf; *see also* CALLIESS, *supra* note 11, at 458.

26. Comb v. PayPal Inc., 218 F. Supp. 2d 1165, 1176 (N.D. Cal. 2002); *see also* Canadian Supreme Court, Dell Computer Corp. v. Union des Consommateurs, [2007] 2 S.C.R. 801, 2007 SCC 34 (Can.). For an overall critique, *see* Reich, *supra* note 15, at 46.

is still the binding force of state consumer law and consumer protection mechanisms which are part of the constitutional heritage of Member States and the Union under Article 6(2) EU, 6 ECHR. Traders may of course enhance consumer satisfaction and make dispute resolution easier by encouraging ADR mechanisms, a policy explicitly supported by EC initiatives.[27] Consumers should be given easy access to ADR mechanisms provided they are fair and transparent as proposed in EU recommendations 98/257/EC and 2001/310/EC.[28] But the final arbiter in a consumer dispute—even under transnational conditions—which cannot be resolved by ADR should always be a court of law. This may create obstacles and difficulties to e-commerce in a globalised virtual market place; it may also be difficult and eventually impossible to enforce. But this is not an argument against national or EU consumer law, it is the price to be paid for globalisation allowing greater access for traders to world markets which does not automatically overcome legal barriers.

27. *See* MICKLITZ, REICH & ROTT, *supra* note 1, at 359–64.
28. 1998 O.J. (L 115); 2001 O.J. (L 109).

Priority Conflicts as a Barrier to Cooperation in Multinational Insolvencies

Jay Lawrence Westbrook*

Although we have made remarkable progress in the last decade in the management of multinational insolvencies, the fundamental anomaly remains: a global economic crisis must be managed by various national courts. Our judges must act like a team of surgeons, each of whom is able to treat only one part of the patient. This article discusses one of the most important difficulties that arise from that awkward system.

I. THE PROBLEM OF PRIORITIES

Although insolvency systems around the world share fundamental premises and purposes, there are many variations which present substantial obstacles to cooperation among courts in the insolvencies of multinational corporations. Among the most important of these differences are varying rules governing priorities (preferences) among creditors in the distribution of the value realized in insolvency proceedings, whether liquidation or reorganization. From a broad policy perspective, the differences are not crucial, yet each one represents a contentious result in a particular case because one party or another will be advantaged or disadvantaged. Meaningful cooperation among courts will often require that one or the other priority system prevails. The question is whether a court will feel so bound by the local system so as to prevent cooperation with a foreign court.

This problem did not appear in the old-style territorialist approach to international insolvency. Each court grabbed the assets it could reach and distributed them according to local priority rules. Only when courts try to cooperate to maximize value and fairness in a multinational case does the problem of differing priorities arise. In recent years we have seen the general acceptance of "modified universalism"—a pragmatic, accommodating form of the universalist approach to insolvency that

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seeks to promote cooperation between courts and to produce results as near as possible to the ideal of a single, global proceeding.[1] This approach also permits a meaningful chance for a global reorganization of a business, thus avoiding the serious loss of value almost always associated with piecemeal liquidation. Yet the clash of priority systems presents a serious obstacle to the universalist project.[2]

The differences in priority rules are numerous.[3] In some countries, for example, secured parties enjoy an absolute priority in the proceeds of their collateral, while in others certain creditors may come ahead of the secured party in the distribution of those proceeds. In the latter jurisdictions, those who trump the secured party will vary from the tax collector to the insolvency administrator to the general unsecured creditors. Many countries give their own taxes a special lien or general priority while refusing to distribute anything on account of another country's taxes. Virtually all systems give a priority to moneys owed to workers, but the entitlements protected and the nature and amount of employee preferences vary greatly.[4] These three types of parties—secured parties, tax authorities, and employees—are favored in most systems, but in differing ways and to differing degrees.

These and other differences create a number of difficulties. The obvious one is distribution of proceeds. For example, if a division of a company is sold as a whole, including assets and operations in several countries, how shall the proceeds be allocated and distributed? But the problem goes beyond allocation in distributions. It extends to decisions about the management of the insolvency case. For example, suppose that a higher price can be obtained for the division as a whole, but one of the countries involved could realize more for its priority claimants by separately selling the assets in that country. Does that country's court have the power to cooperate in the maximization of value even if it results in a somewhat lower distribution for the creditors favored by local priorities? Note that nowadays the effect of applying local priority rules

1. *See* HIH Cas. & Gen. Ins. Ltd., [2008] UKHL 21, [2008] 1 W.L.R. 852, ¶ 6, *available at:* http://www.publications.parliament.uk/pa/ld/ldjudgmt.htm [hereinafter *HIH*]. The case is also known as "*McGrath v. Riddell*."

2. It should be noted that even the holdouts for territorialism in the academy admit that cooperation is important and cooperation of any kind leads quickly to the kinds of issues discussed in this paper. Lynn M. LoPucki, *The Case for Cooperative Territoriality in International Bankruptcy*, 98 MICH. L. REV. 2216, 2218-20 (2000).

3. *See generally* Jay Lawrence Westbrook, *Universal Participation in Transnational Bankruptcies*, *in* MAKING COMMERCIAL LAW: ESSAYS IN HONOUR OF ROY GOODE 419 (Ross Cranston ed., 1997); Jay Lawrence Westbrook, *Universal Priorities*, 33 TEX. INT'L L.J. 27 (1998).

4. *See generally* Janis Sarra, *An Investigation into Employee Wage and Pension Claims in Insolvency Proceedings Across Multiple Jurisdictions: Preliminary Observations*, 16 NORTON J. BANKR. L. & PRAC. 835 (2007).

will often *not* be a choice to benefit local creditors over foreigners. In almost all countries, foreigners are given equal treatment and modern communication means that many creditors, especially large multinational creditors, will file in all relevant proceedings. Thus the choice is not between local and foreign creditors but between local and foreign priority systems. The conflicts exist in both liquidation and reorganization cases, but are more subtle and more serious in the latter.

The priority issue is most highly focused when the question is turnover of assets for administration and distribution by a foreign administrator. Under the Model Law on Cross-Border Insolvency, one proceeding is designated as the "main" proceeding for a company.[5] That designation is given to the court in the country that is the center of main interests of the insolvent business. Although the Model Law permits secondary proceedings in each relevant jurisdiction,[6] it also allows turnover of assets to the main proceeding for distribution.[7] Modified universalism's goal is a single worldwide distribution, which would suggest turnover of all assets to the primary court for distribution under its rules or under some protocol agreed to by the relevant courts. Assuming that a particular court is committed to advancing the universalist goal, is it prevented from doing that because the foreign court will distribute the proceeds in a way different from that commanded by the local court's statutory priorities? Precisely that question was recently presented to the House of Lords.

II. THE HIH CASE

HIH, an Australian insurance company, entered insolvency proceedings in Australia. It had substantial assets in the United Kingdom, primarily in the form of reinsurance claims. A provisional liquidation was opened in England and provisional liquidators appointed. The Australian liquidation court sent a letter of request to the English court asking that the English assets be released to the Australian liquidators for distribution in that proceeding. The grant or denial of the request would substantially impact the fortunes of various creditors because of a difference in the priority rules of the two jurisdictions. The

5. G.A. 52/158, art. 2(b), U.N. Doc. A/RES/52/158 (Jan. 30, 1998), art. 2(b) [hereinafter "Model Law"]. *See generally* IAN FLETCHER, INSOLVENCY IN PRIVATE INTERNATIONAL LAW: NATIONAL AND INTERNATIONAL APPROACHES (2005); CROSS-BORDER INSOLVENCY: A COMMENTARY ON THE UNCITRAL MODEL LAW (Look Chan Ho ed., 2006). The EU Regulation has a similar provision. *See* Council Regulation 1346/2000, 2000 O.J. (L 160) 1 (EU).

6. Model Law, *supra* note 5, arts. 25-32.

7. *Id.* art. 21(1)(e).

Australian rules gave a priority to claimants under insurance policies over other creditors; the English rules did not.[8]

The lower courts decided that they were bound by the English priority rules and therefore could not release the assets to be distributed under the Australian rules. The House of Lords disagreed. Although the decision was unanimous, there was a sharp split as to the rationale for the result. The wise reader will turn to English experts to understand the full analysis of English law in the various judgments. For the international observer, the key dispute was over the role of universalism in English common law.

Three of the five members of the panel were content to decide that the restraining effect of the English priority system was overcome by the application of an unusual feature of English law, section 426 of the Insolvency Act.[9] That section reflects a special reciprocity in insolvency matters among a small group of jurisdictions, including Australia and England. The panel majority held that section 426 permitted the turnover of assets to the Australian proceeding notwithstanding the resulting change in distributional results.

The judgment of Lord Hoffmann, with Lord Walker's concurrence, took a very different approach. He found that universalism, in a modified and pragmatic form, was "a golden thread" running through English common law in matters of international insolvency. In his view, universalism requires that the English court turn over assets in cooperation with a foreign court as a general rule unless there is some principle of justice or UK public policy that prevents the turnover. Here, there was no such obstacle and thus turnover was required. The application of section 426 was unnecessary.

Two of the remaining three members of the panel squarely disagreed with Lord Hoffmann. Lord Scott and Lord Neuberger would have refused turnover absent the special relationship with Australia under section 426. Thus, it seems clear that these two panel members would have declined to turn over the assets to an American trustee, for example, while Lord Hoffmann and Lord Walker would ordinarily permit turnover.[10] Lord Phillips took a third path, agreeing with the result under section 426 and declining to reach the question of

8. *HIH*, [2008] UKHL 21, ¶ 51. By the time of the decision in the House of Lords the English system had been altered to give a similar priority to insurance claimants. While the change did not apply to the *HIH* case, the change naturally made it easier to conclude that England had no great policy antagonism to the Australian system.

9. Insolvency Act, 1986, § 426(4)-(5) (Eng.).

10. The United States is not a section 426 nation. For the most part, , the insurance industry in the United States is regulated at the state level. The state regulations generally have priority rules similar to the Australian system. *See* United States v. Fabe, 508 U.S. 491, 494 (1993).

universalism. If the same question involving a country that lacks the benefit of section 426 were to come before this panel again, his would be the decisive vote in the case.[11]

Lord Hoffmann pointed out that the rule favored by Lord Scott would mean that turnover would rarely occur except in those few countries where section 426 applies. The differences in detail among priority systems would ensure that result. Lord Neuberger acknowledged that result with some apparent regret.[12] As noted above, such a rule as to priority inevitably impacts other, larger decisions beyond turnover or allocation of proceeds, including decisions about the scope and nature of asset sales and the choice of liquidation versus reorganization. Thus, if local priority systems prevent turnover, they likely prevent many other forms of cooperation as well. For example, a refusal to apply a moratorium on asset seizures to a certain type of creditor based on local practices may doom a global effort at reorganization. For all these reasons, the fact that in Lord Hoffman's thoughtful opinion two of five judges found a form of modified universalism in English common law is the strongest and most important support for that concept in any of the modern cases.

III. THE DISMISSAL SOLUTION

Lord Scott's position in *HIH* rested ultimately on the mandatory effect of English statutory rules in a pending "winding up" proceeding. It is not clear what rules would apply had the foreign liquidators sought possession of the assets through an appropriate civil action in the absence of an English insolvency case. The advantage to acting without opening an insolvency proceeding would be that the priority rules and other statutory constraints in the English statute would presumably not come into effect. Even if an English winding-up were pending, might it be possible to reach the same result by moving to dismiss the English proceeding on the ground of comity, while ordering the transfer of the assets?

11. The European Regulation has no provision similar to section 426.
12. *HIH*, [2008] UKHL 21; [2008] 1 W.L.R. 852, ¶ 76.

The idea that dismissal of the "secondary" proceeding[13] solves the technical problem of local rules constraining cooperation has taken root in the United States. Since the adoption of section 304 of the United States Bankruptcy Code in 1978,[14] United States courts have become used to the idea of two different sorts of insolvency cases for foreign companies: a full proceeding and a special "ancillary" proceeding. The full proceeding is of the same sort used for domestic companies. The special "ancillary" proceeding is designed solely for cooperation with a foreign proceeding by way of injunction against creditor action, turnover, discovery, and the like. This special proceeding does not have rules for claims processing, distribution of proceeds, and other systems characteristic of a regular domestic insolvency case. A companion provision, section 305, gives the courts the authority to dismiss a full insolvency case in the best interests of creditors or in deference to a foreign proceeding. Thus, an American bankruptcy court could resolve the problem presented in *HIH* by dismissing the full United States insolvency case with its constraining rules of priority and procedure, eliminating any conflict between those rules and its discretion to release United States assets to a foreign "main" proceeding.[15]

The replacement of section 304 with the new Chapter 15 points to the same approach. Dismissal as a tool of cooperation following the adoption of Chapter 15 is illustrated by *In re Compañía De Alimentos Fargo, S.A.*,[16] although that case did not involve a priority issue as such.[17] In that case an involuntary insolvency proceeding was

13. The idea of a full local insolvency case as a "secondary" proceeding permeates the EU Regulation. *See, e.g.*, Jay Lawrence Westbrook, *Multinational Enterprises in General Default: Chapter 15, The ALI Principles, and The EU Insolvency Regulation*, 76 AM. BANKR. L.J. 1 (2002); IAN F. FLETCHER, INSOLVENCY IN PRIVATE INTERNATIONAL LAW 246 (1999); Manfred Balz, *The European Union Convention on Insolvency Proceedings*, 70 AM. BANKR. L.J. 485, 489 (1996); Wolfgang Lueke, *The New European Law on International Insolvencies: A German Perspective*, 17 BANKR. DEV. J. 369, 395 (2001); Robert Wessels, *European Union Regulation On Insolvency Proceedings*, 20 AM. BANKR. INST. J. 24, 26 (2001). The Model Law also contemplates local full bankruptcy proceedings, but does not call them "secondary."

14. Section 304 was the predecessor to Chapter 15 of the Bankruptcy Code governing cooperation with foreign insolvency proceedings. Chapter 15 essentially adopts the Model Law.

15. *See, e.g.*, *In re* Axona Int'l Credit & Commerce, Ltd., 88 B.R. 597 (Bankr. S.D.N.Y. 1988), *aff'd*, 115 B.R. 442 (Bankr. S.D.N.Y. 1990), *appeal dismissed*, 924 F.2d 31 (2d Cir. 1991) (following U.S. preference recovery, U.S. case dismissed and assets transferred to Hong Kong proceeding).

16. 376 B.R. 427 (Bankr. S.D.N.Y. 2007). *See also In re* Bd. of Dirs. of Multicanal S.A., 314 B.R. 486 (Bankr. S.D.N.Y. 2004), *rev'd on other grounds* Argentinian Recovery Co. LLC v. Bd. of Dirs. of Multicanal S.A., 331 B.R. 537 (S.D.N.Y. 2005).

17. No Chapter 15 case was filed in *Fargo*. For a case that did involve Chapter 15, see *In re* Bd. of Dirs. of Telecom Argentina, S.A., 528 F.3d 162 (2d Cir. 2008) (Chapter 15 case in which approval of reorganization not barred by differences in rules).

commenced against an Argentinean company, Fargo, by certain of its United States creditors despite the pendency of a reorganization proceeding in Argentina. The creditors claimed the foreign proceeding was being conducted unfairly if not corruptly. In particular, the petitioning creditors were concerned that a major secured creditor in the case had too much leverage because the Argentinean stay did not apply to secured parties. Although there were few assets to administer in the United States, they apparently hoped the United States moratorium would apply to the secured party and thus level the playing field. The bankruptcy court refused to fall in with this plan and dismissed the United States case in deference to the Argentinean one, after finding that Argentinean insolvency law was generally fair.

Aside from claims of corruption and complaints about procedure, the petitioners drew the judge's attention to important differences between the United States and Argentinean systems. For example, Argentina does not provide for "equitable subordination" of claims, nor does it grant broad discovery to unhappy creditors. The court was not persuaded that these differences were fundamental enough to justify a parallel proceeding in the United States. Note that these and other differences in procedure might well have as much practical impact in a multinational case as a difference in priority.

IV. OBSTACLES TO THE DISMISSAL SOLUTION

I do not know in which jurisdictions the dismissal solution can be employed, but certainly in a number of countries the similar problem of parallel civil litigation is resolved by the dismissal of the local action where the law requires deference to the foreign one. In common law countries, such a dismissal might be pursuant to the concept of *forum non conveniens* or simple abstention.[18] In civil law countries, the fact that the foreign action was filed first may give rise to a dismissal *lis pendens*. Perhaps the same concepts should be available in the bankruptcy context where the foreign proceeding deserves deference.

The main substantive difficulty is a sort of vested rights theory, a notion that a creditor has a right to a certain distribution of those funds that come under control of a given court.[19] A related argument is that the application of local law to the claims filed in each jurisdiction yields

18. *See* AMERICAN LAW INSTITUTE, TRANSNATIONAL INSOLVENCY: COOPERATION AMONG THE NAFTA COUNTRIES 76-82 (2003) (Procedural Principle 23 and 24). *See generally* RUSSELL J. WEINTRAUB, INTERNATIONAL LITIGATION AND ARBITRATION: PRACTICE AND PLANNING 211-70 (5th ed. 2006); ANDREAS F. LOWENFELD, INTERNATIONAL LITIGATION AND ARBITRATION 300-49 (3d ed. 2003).

19. *See* Lynn M. LoPucki, *Cooperation in International Bankruptcy: A Post-Universalist Approach*, 84 CORNELL L. REV. 696, 709-13 (1999).

more predictable results. This idea might have had some basis when bankruptcy laws were oriented to the protection of local creditors, but nowadays many creditors file in each local proceeding around the world.[20] The amount to be distributed by a particular court in a territorial system is a free-floating function of a) the assets of the debtor that happen to be in its jurisdiction at the moment when those assets become subject to the local moratorium or dispossession order and b) the number and amount of the claims that may be filed in that court by both local and international creditors. The amount to be distributed is therefore often impossible to predict even at the start of the local case, much less at the time credit was extended. Even secured creditors, unless they have a mortgage on real property, are subject to the rapid movement of personal property and its proceeds from one jurisdiction to another, a mobility that may make a mockery of "situs" choice-of-law rules.

Therefore, it would seem that a notion of vested rights or creditor reliance will often be implausible and impractical in the application of distribution rules, while making cooperation impossible in many cases for the reasons explained earlier. If we are to have a workable system of international cooperation, we have to choose a single priority system for distribution that reflects these realities. In most cases, the approach that will produce the most predictable and generally fair result—although by no means highly predictable or completely fair—will be to distribute assets through the main proceeding or under its distribution rules. If we become dissatisfied with the current approach to determining which proceeding is the main one,[21] then we should focus our efforts on developing a better one, because there is no other solution that shows promise.

It is hard to see how international creditors—banks, investment funds, large international suppliers, and the like—could object to such an approach. However, there is a legitimate concern about small, local creditors, including employees and suppliers. These creditors cannot be expected to be sophisticated in planning for insolvency risks or able to protect themselves in distant proceedings. It is for that reason that we should have a system of claims facilities in any jurisdiction where there are a substantial number of such creditors. Such a facility, operating through the courts or through a system of arbitration, could permit these creditors to make and prove their claims at home and in their own languages. If there are too few creditors to justify such a system in a

20. *See* Jay Lawrence Westbrook, *A Global Solution to Multinational Default*, 98 MICH. L. REV. 2276, 2292 (2000).

21. That is the "center of main interests" test. *See generally* Case C-341/04, *In re* Eurofood IFSC Ltd., 2006 E.C.R. I-3813; *In re* Bear Stearns High-Grade Structured Credit Strategies Master Fund, Ltd., 389 B.R. 325 (S.D.N.Y. 2008).

given country, it would be sensible to pay them in full from local assets before the assets are transferred to the main proceeding. Such a system has been recommended by the American Law Institute's Transnational Insolvency Project.[22]

There is a second group of claims that require special attention in this context: tax and other public claims. The problem here is that many insolvency laws refuse to enforce such claims in favor of foreign tax authorities. It is probably essential to international cooperation to pay such claims locally before transferring property to a main jurisdiction that has such laws. Neither fairness nor public reaction could abide permitting a foreign corporation to hoodwink local taxing authorities or otherwise milk the local public purse and then whisk away the local assets without payment of these public claims.

Finally, there is the question of claims in tort (delict). This sort of claim has the potential to create concern about universalism, especially in common law countries with rules relatively favorable to tort claimants. The concern would be that these claimants would not receive fair treatment in a primary jurisdiction where claims of that sort are not favored.[23] On the other hand, cases dealing with such claims have managed to find acceptable compromises. The most notable example is the Dow Corning (silicone implant) case in the United States.[24] Furthermore, it is important to note that no country offers a priority to tort claimants generally, so the policymakers have not indicated a special concern for those claimants. Whatever the proper solution, this area is another one that may require some special rules once we have enough litigation to better understand the issues presented.

V. CONCLUSION

Modified universalism has received a strong impetus from the eloquent opinion of Lord Hoffman in *HIH*. It is one of several major steps forward that we have taken in the effort to match the reach of insolvency laws to the boundaries of a global market. Yet we have far to go. An important obstacle to cooperation and the ultimate ideal of a single, worldwide proceeding is the presence of so many varying rules

22. AMERICAN LAW INSTITUTE, PRINCIPLES OF COOPERATION IN TRANSNATIONAL INSOLVENCY CASES AMONG THE MEMBERS OF THE NORTH AMERICAN FREE TRADE AGREEMENT Procedural Principle 22 (2003).

23. The pendency of tort claims in the United States and claims by another group of sympathetic parties, pensioners, in the United Kingdom was a major factor hindering cooperation in the Federal Mogul multinational bankruptcy.

24. *See, e.g.*, Roberts v. Picture Butte Municipal Hospital, [1999] 4 W.W.R. 443 (A.Q.B.) (staying a Canadian tort action in deference to a global settlement in an United States Chapter 11 proceeding).

concerning the distribution of the values realized by insolvency proceedings. The way forward in some jurisdictions may be found in the dismissal solution combined with sensitivity to the special treatment that may be appropriate for certain types of claims.

Class Actions to Remedy Mass Consumer Wrongs: Repugnant Solution or Controllable Genie? The Canadian Experience

Jacob Ziegel*

I. NATURE OF PROBLEM

From a Canadian perspective, by far the most important and pressing problem facing postindustrial societies is not the adoption of more consumer legislation but the non- or negligible enforcement of existing laws. The problem is bad enough when it is experienced by consumers with individual grievances, but it grows exponentially when the wrong affects not just a handful of consumers but thousands of consumers. Drawing on the Canadian experience, examples abound all around us: false advertising, collusive price fixing, harmful drugs and therapeutic devices, usurious interest rates, unlawful banking charges, "vanishing premiums" in life insurance contracts, inflated prices for automobile repairs, and other consumer services.

II. GOVERNMENTS AS PART OF THE PROBLEM, NOT THE SOLUTION

In Canada (and the same is surely true of other countries in the Western hemisphere), there is no shortage of federal and provincial consumer legislation. Much of it has been adopted over the past forty years. Only rarely is the legislation accompanied by machinery for its effective enforcement. Between 1960 and 1980, the federal government in Canada and many of its provinces established new ministries and new

* Professor of Law Emeritus, University of Toronto. This short paper was presented at the biennial conference of the International Academy of Commercial and Consumer held in Bamberg, Germany, on August 1-3, 2008. This paper also retraces, and updates, ground covered by me in an earlier publication. *See* Jacob Ziegel, *Consumer Class Actions in Canada and the Class Action Remedy, in* LIBER AMICORUM BERND STAUDER, DROIT DE LA CONSOMMATION/KONSUMENTENRECHT/CONSUMER LAW 587 (Luc Thevenoz & Norbert Reich eds., Schulthess 2006).

agencies whose ostensible purpose was to promote consumer interests and to protect consumers against market abuses and wrongful practices. Regrettably, these initiatives only had a short shelf life and, with modest exceptions, the new ministries were later quietly closed down or merged into other much larger government departments.[1] The federal and provincial governments were able to perform this vanishing trick because consumers, as a pressure group, are notoriously unorganized and, unlike most other economic interest groups, rarely wield significant political power.

As a result—and again I speak largely from a Canadian perspective—the consumer is left largely to his or her own devices. Litigation in Canada is, for the most part, enormously expensive and time consuming. Actions in Small Claims Courts, while provided for under provincial law and not requiring the retention of lawyers, nevertheless demand much patience and effort. Most consumers do not find it worthwhile to expend the energy necessary to obtain redress for smaller claims but prefer to take their lumps and learn from experience. Various government agencies—federal, provincial, municipal—may have the power to intervene but, for the most part, their resources, too, are very limited and rarely extend to ensuring mass relief for consumers adversely affected by the wrongful conduct.

Hence the question posed at the beginning of this paper. The question is whether a solution can be wrought that addresses in scope and effectiveness the magnitude of the problem where the wrong affects a plurality of consumers. All developed societies have had to confront this dilemma, and most still do. However, there is little consensus about the right solution, even among members of the same legal family and with similar economies. This paper concerns one of the much debated and most controversial of the alternatives, the class action solution, which has now been adopted in legislative form by all the provinces in Canada, with the exception of Prince Edward Island, and by the federal government in the form of amendments to the rules of procedure of the Federal Court of Canada. By class action I mean a representative action brought by one or more plaintiffs on behalf of themselves and all other

1. *Cf.* COMMERCIAL AND CONSUMER SALES TRANSACTIONS: CASES, TEXT AND MATERIALS 16-17 (Jacob S. Ziegel & Anthony J. Duggan eds., 4th ed. 2002) ("If it is accurate to describe the 1960s and 1970s as the golden age of postwar consumerism, it seems equally safe to predict that historians will record the 80s as largely a period of consolidation and retrenchment and, in several provinces, even a period of dismemberment of programs already in place. . . . [E]ven in its heyday there was often more form than substance to governmental commitment to consumer protection.").

members of the class seeking relief for a wrong alleged to have been committed against them by the defendant.[2]

III. COMMON LAW BACKGROUND

In common law jurisdictions, the class action remedy (then known as a 'representative action') was actually developed by the English Courts of Equity long before it also became available in the common law courts. However, because Equity's remedial powers were limited to cases where the Equity courts had jurisdiction, so was the scope of the representative action. The future must have looked promising when the common law courts and courts of equity were fused in England in 1873 and all the royal courts of justice were endowed with a full panoply of remedies, including the power to award damages.

However, any expectations for an enlarged role for the representative action were quickly dashed as it transpired that the post-1873 courts had little sympathy for representative actions in which the gist of the claim was for damages. In particular, in a leading case, *Markt & Co v. Knight Steamship Co. Ltd.*, the English Court of Appeal held that a representative action could not be brought in a claim for damages based on breach of contract because the damages had to be separately assessed for each member of the class.[3] In 1983, in another leading case, *Naken v. General Motors of Canada Ltd.*,[4] the Supreme Court of Canada gave a broader explanation for rejecting representative claims seeking damages by reasoning that the sparse rules of court governing representative claims were quite inadequate to enable the courts to handle such claims. In the Court's view, it was up to the provincial

2. There is a difference of opinion among judges in the few cases in which the issue has been raised whether the legislation also permits class actions for declaratory judgments. In one such recent action brought in Ontario the representative plaintiff sought a declaration that an oath of allegiance to the Crown required of new Canadian citizens was unconstitutional since it violated the class members' freedom of conscience under the Canadian Charter of Rights and Freedoms. The Ontario court refused to strike out the action as vexatious because the representative had previously litigated the same action in a personal action brought by him against the federal government. However, the court did not address the issue whether a declaratory action was admissible or appropriate under the Ontario Class Proceedings Act. *See* Roach v. Canada, [2007] 86 O.R.3d 101 (Can.); *cf.* A.L. v. Ontario (Minister of Community and Social Services), [2003] O.J. 2405 (O.S.C.J. June 16, 2003), *rev'd on other grounds*, Larcade v. Ontario (Minister of Community and Social Services), [2005] O.J. 1924 (O.S.C.J. Div. Ct. May 13, 2005). In *L.A. v. Ontario*, a class action seeking damages and a declaration that the defendants had breached their statutory duties, Judge Cullity held *inter alia* that a class proceeding was not the preferable procedure under the Ontario Class Proceedings Act and that the members of the class could obtain adequate relief by bringing individual actions for a declaration.

3. [1910] 2 K.B. 1021.

4. [1983] 1 S.C.R. 72 (Can.).

legislatures to put meat on the bone if the Parliamentarians wanted representative actions to be taken seriously.

IV. SUBSEQUENT DEVELOPMENTS

Canadian consumer advocates felt they knew what the appropriate remedy should be because they were familiar with Rule 23 of the Federal Rules of Civil Procedure in the US and believed that a Canadian counterpart could play the same beneficial role in Canada. Surprisingly, it was Quebec, a civil law jurisdiction, which first adopted the class action remedy (*recours collectifs)* in 1978 in its revised Code of Civil Procedure.[5] The common law provinces did not join the band until 1992 when Ontario adopted its Class Proceedings Act (CPA).[6] Since then all the common law provinces, with the exception of Prince Edward Island (Canada's smallest province), have enacted similar legislation.

V. INFLUENCE OF THE OLRC REPORT

A major factor in Ontario's decision to adopt class action legislation was the monumental three-volume report on Class Actions, produced by the Ontario Law Reform Commission in 1982 ("The Report").[7] The Report was six years in the making, and has rightly been hailed as the most thorough and carefully researched class actions report produced in the Commonwealth. The Report found that the existing remedies in Ontario, with respect to mass wrongs, were seriously inadequate and that well crafted and carefully considered class action legislation was the right solution because it accomplished three key objectives.[8] *First,* it promoted economic justice by providing a mechanism for the redress of

5. Art 999-1051, added by S. Que. 1978, c.8, s.3, as am. There are conflicting theories explaining Quebec's pioneering role in introducing class action legislation in Canada. Professor Glenn of McGill University has suggested that it was because, although Quebec is a civil law jurisdiction in many respects, in the procedural sphere the Quebec courts had adopted the common law model of litigation. H. Patrick Glenn, *The Dilemma of Class Action Reform*, 6 OXFORD J. LEGAL STUD. 262, 262 (1986). Even if Professor Glenn is correct about the common law influence, it does not explain why Quebec adopted class action legislation long before the common law provinces did. A better explanation offered to the author by Professor Ronald Macdonald, also of McGill University, is that a strong social democratic government was in power in Quebec in the late 1970s and that the decision to follow the Rule 23 model was based on ideological grounds and had little to do with common law influences on Quebec rules of procedure.

6. Ontario, Class Proceedings Act, S.O. 1992, c.6 [hereinafter Ont. Act].

7. *See* ONTARIO LAW REFORM COMMISSION, REPORT ON CLASS ACTIONS (Ministry of the Attorney General 1982).

8. *Id.* at 117-45. These goals have been frequently cited with approval in subsequent Canadian judgments, including a leading judgment of the Supreme Court of Canada. *See* Hollicks v. Toronto (City), [2001] 3 S.C.R. 158 (Can.).

grievances that would otherwise remain unanswered.[9] *Second,* it led to economies in the use of judicial resources.[10] This was because, in the absence of a class action remedy, members of the class would be obliged to bring individual actions which, if the class was large enough, could overwhelm judicial resources.[11] *Third,* the threat of a class action will lead to behavioural modification by putative defendants who would not be deterred by the threat of individual actions but would be deterred by the possibility of a large damage award, quite possibly running into the millions of dollars.[12] These class action goals have been frequently reiterated by Canadian courts, in considering defendants' attempts to have a class action dismissed before it could proceed to trial. However, the advantages do not take into account some of the less attractive features of class actions, the very features that have often persuaded governments in other jurisdictions to reject the class action remedy. I consider these objections in a later part of this presentation.

VI. PRECONDITIONS TO CERTIFICATIONS OF ACTION

There are some differences among the class action provisions of the common law provinces and even greater differences between the Ontario Act and the Quebec provisions. However, all the common law provinces share in common the following five requirements a class plaintiff must satisfy before a court will issue a certificate authorizing the plaintiff to proceed to trial of the action:[13]

1. The plaintiff must have a cognizable cause of action.
2. The members of the class must be identifiable.
3. The claims of the class members must raise common issues.
4. A class action must be the 'preferable procedure' for the resolution of the common issues.

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9. ONTARIO LAW REFORM COMMISSION, *supra* note 7, at 117-45.

10. *Id.*

11. This prediction has been corroborated by British experience since 2006. There, the district courts were deluged with hundreds of actions by bank customers against British banks following allegation by *Which?,* a consumer magazine, that the banks were levying excessive charges for overdrafts and other bank services. *See Banks' Profits '£2.5bn a year' From Overdraft Fees,* WHICH?, July 8, 2008, *available at* http://www.which.co.uk/news/2008/07/banks-profits-25bn-a-year-from-overdraft-fees-151247.jsp; *see also* Rachael Mulheron, *Reform of Collective Redress in England and Wales: A Perspective of Need,* at 121 et seq. (2008) (research paper submitted to the Civil Justice Council of England and Wales), *available at* http://www.civiljusticecouncil.gov.uk/files/collective_redress.pdf.

12. *See* ONTARIO LAW REFORM COMMISSION, *supra* note 7.

13. Ont. Act, s.5.

5. The representative plaintiff is a person who (i) will fairly and adequately represent the interests of the class, (ii) has produced a plan for the proceeding that sets out a workable method of advancing the proceeding on behalf of the class and notifying members of the class of the proceeding, and (iii) does not have, on the common issues for the class, an interest in conflict with the interests of other class members.

Statistics show that, in practice, only about five percent of class actions proceed to trial. The other actions are settled at an earlier stage, are discontinued by the plaintiff, or are dismissed by the court. The heavy lifting by the parties occurs during the precertification stage as the defendant challenges one or more (and frequently all five) of the preconditions to certification. This phase of the action may run for five years or more because of the voluminous affidavit material filed by the defendant, the complexities of the factual and legal issues, and the frequency of appeals from the decision of the motion judge.[14] A conspicuous feature of the Canadian class action scene is the critical supervisory role played by the courts at every phase of the proceedings.

VII. OPTING IN AND OPTING OUT; AND NATIONAL CLASS ACTIONS

All of the provincial legislation requires intraprovincial members of a class who wish to be excluded from certification or from any settlement of the action *to opt out* of the action or any proposed settlement; they are not required to opt in before they can be considered to be members of the class. This feature of Canadian class action law—highly controversial in

14. The practice in Ontario is for a judge to be assigned to a class action at the beginning of the suit and to remain the judge of record for the remainder of the case. *Garland v. Consumers' Gas Co.* is a good example of the litigiousness of class actions. [2004] 1 S.C.R. 629, 2004 SCC 25 (Can.). The action was started in 1994 and was not finally disposed of until 2007. In between there were numerous motions before the judge of first instances, several appeals to the Ontario Court of Appeal, and two appeals to the Supreme Court of Canada. The main issue in *Garland* was whether the defendant utility's late payment penalties ("LPP") had breached section 347 of the Canadian Criminal Code limiting maximum interest rates to 60 per cent per annum even though the LPP had been approved by the Ontario Energy Board before it was introduced by Consumers' Gas. The action was finally settled for about $22 million, half of which was earmarked to cover counsel fees and disbursements. The other half, by agreement of the parties and with the court's approval, was paid over, *cy-près*, to a fund, "Out of the Cold," that provided financial assistance to low income families who could not afford to pay their winter heating bills. This *cy-près* use of part of the settlement monies was agreed upon between the parties because it would have been too expensive for Consumers' Gas to calculate and remit the small amounts payable to its several million customers.

the United Kingdom and many parts of the European Union—was regarded in the OLRC Report as fundamental to the viability of class actions and has never been seriously questioned in Canada.

More controversial are the questions whether a Canadian province also has the constitutional power to extend the opt-out rule to non-residents of the province, in which the class action is started—in other words, whether a province has the power to authorize a national class action—and whether other provinces are obliged to recognize a class action purporting to have extraprovincial reach. The British Columbia Act provides[15] that non-residents can only be included in an action if they opt in. The Ontario and Manitoba courts have held[16] that non-residents can be included on an opt-in basis, if there is a substantial connection between the action and the province. In 2008, a divided Quebec Court of Appeal reached the opposite conclusion.[17]

An even more troubling issue—and one that has arisen with increasing frequency in recent years—occurs where a class action involving the same defendant is brought in more than one province. Frequently counsel will agree among themselves regarding which of them is to have carriage of the case, and in which province, and how settlement negotiations are to be conducted and on what terms. Absent such agreement, it remains unclear whether a class action in one province will preclude the bringing of an action in another province. These issues too remain to be resolved by the Supreme Court of Canada. In a comprehensive report, the Uniform Law Conference of Canada has recommended[18] the establishment of a national class action register so that counsel and the courts can readily establish when a class action has been started anywhere in Canada. However, the Report stopped short of recommending the establishment of a multiprovincial judicial panel

15. B.C. Class Proceedings Act, SBC 1995, c. 21, s. 16(2) [hereinafter B.C. Act].

16. *See e.g.*, Nantais v. Teletronic Pty., [1996] 28 O.R.3d 523 (Can.); Currie v. McDonald's Restaurants of Canada Ltd., [2005] 74 O.R.3d 321 (Can.); Ward v. Canada, [2007] 220 Man. R.2d 224 (Can.).

17. Hocking v. Haziza and HSBC Bank Canada, [2008] QCCA 800 (Can.). In *Lepine v. Post Office*, the Quebec Court of Appeal also affirmed a lower court decision refusing to recognize an Ontario class action settlement purporting to include Quebec members of the class but the decision was based on the alleged inadequacy of the notice given the Quebec class members of the Ontario proceedings. Lepine v. Post Office, [2007] QCA 97 (Can.). At this time of writing (November 2008), the *Lepine* case is on appeal to the Supreme Court of Canada but the Supreme Court's decision is not expected till some time in 2009. *See* Janet Walker, *Recognizing Multijurisdiction Class Action Judgments within Canada: Key Questions—Suggested Answers*, 46 CAN. BUS. L.J. 450 (2008).

18. Uniform Law Conference of Canada, Report of the Committee on the National Class and Related Interjurisdictional Issues: Background, Analysis, and Recommendations (2005).

(similar to the Multidistrict Litigation panel system used by federal courts in the US) to determine which province is to have carriage of a class action. The national class action register is in course of being implemented and Canadian judges are discussing among themselves the feasibility of a multiprovincial judicial panel.

VIII. FORMS OF CLASS ACTION JUDGMENTS AND CLASS ACTION SETTLEMENTS

A frequent objection by defendants to a class action is that the costs of ascertaining who are the members of the class, and the damages they have suffered as a result of the defendant's conduct, will greatly exceed any likely compensation payable to the members if the action is successful. The provincial class action legislation provides the courts with a variety of tools to address these and other issues. For example, the court may render judgment in favour of the class on the issue of the defendant's liability but require members of the class to bring individual actions to prove the quantum of damages suffered by them. Alternatively, the individual assessments may be referred for determination by a court official or outside arbitrator. The court may also award judgment in a lump sum and entitle members of the class to make individual claims against the fund on a pro rata basis.[19] The legislation also authorizes the use statistical techniques to determine the quantum of illicit gains made by a culpable defendant[20] and may make a *cy-près* award requiring the gain to be paid to a worthy cause where the costs of identifying and distributing the gains among members of the class would exceed any likely benefits to the class.[21]

All the class action legislation provides that a settlement reached between the parties has no legal effect unless and until it has been approved by the court.[22] Canadian courts take their adjudicative role very seriously and will frequently write lengthy judgments to justify the settlement agreed upon by the parties or requiring the parties to make amendments to the agreement. Notice must also be given to members of

19. Ont. Act, ss.24-25.

20. *Id.* at s.23.

21. For example, in *Consumers' Gas*, cited *supra* note 14, the parties agreed that the amount of the defendant's unlawful gain (approximately Can.$10 million) should be paid to a fund providing indigent families with assistance in meeting their winter heating bills. In *Markson* v. *MBNA Canada Bank*, [2007] O.J. 1684 (O.C.A. May 2, 2007), the Ontario Court of Appeal approved the use of statistical techniques to determine how many of the Bank's customers had paid bank charges that exceeded the ceiling permitted by section 347 of the Canadian Criminal Code. *See also* Cassano v. Toronto-Dominion Bank, [2007] O.J. 4406 (O.C.A. Nov. 14, 2007) (strongly affirming the courts' flexible powers in dealing with the remedial aspects of a successful action).

22. *E.g.*, Ont. Act, s.29(2).

the class entitling the members to opt out of the settlement or to file objections to the terms of the settlement.[23] So far, however, Canadian courts have not gone to the length of requiring an opinion from a third party on the fairness of the settlement, although there is much to be said for this prophylactic device.[24]

Closely related to class action settlements is the question of the amount and payment of class action counsel's fees and disbursements. The fees and disbursements may amount to a sizable share of the total settlement figure. Individual class action members may only receive a token amount, or they may only be entitled to free repair or replacement of a defective part, or to a longer period of service where the service was interrupted because of the defendant's fault. Typically, the class action legislation does not spell out, or does not spell out fully, how counsel's fee is to be determined and how the approach differs among the provincial courts. In Ontario and the other provinces, it is common for plaintiff's solicitor and the named plaintiff in the class action to enter into a written fee and costs agreement before the action is initiated. In the overwhelming number of cases, the representative plaintiff will lack the means to pay the solicitor and would be unwilling to lend his name to the action if the benefit of a successful action would largely accrue to the other members of the class. Typically, all fees and costs agreements require the court's approval for their effectiveness.[25] A distinguishing feature of the statutory provisions applying to contingency fee agreements is that they entitle the plaintiff's solicitor to apply to the court to have the solicitor's "base fee" increased by a multiple to be applied to the base fee ("multiplier").[26] Multiplier applications are the norm and have given rise to complex judgments in their own right.[27] The purpose of a multiplier award is to compensate the plaintiff's firm for the high risks and uncertainty involved in agreeing to represent the plaintiff as

23. *See id.* at s.8(1).

24. In the case of settlements in other areas of the law involving infants or other persons under a legal disability, Canadian courts have long required the approval of the Public Guardian or other public official. There is nothing in the class action legislation precluding a judge from requiring a fairness opinion from a third party. Additionally, it is a little surprising that Canadian judges have not exercised this power where individual class members have little to gain from the proposed settlement and have a negligible incentive to appear on the settlement hearing to voice their objections.

25. *See id.* at ss.32-33. In practice, and for his own protection, the plaintiff's solicitor will usually enter into a written fees and costs agreement with the named plaintiff before the action is initiated. It is also common for the agreement to provide that the solicitor will only be entitled to recover his fee and disbursements from the plaintiff if the action is successful.

26. *See e.g., id.* at s.33(2).

27. A leading Ontario case is *Gagne v. Silcorp Limited*, [1998] 41 O.R.3d 417 (Can.).

well as the long period of time that will often elapse before judgment is rendered or the action is settled before trial. In large and complex class action litigation, the approved counsel fee may run into the millions of dollars, and this may give rise to the impression that class actions are a feeding trough for hungry lawyers. The impression is largely unfounded. It is especially so if one remembers that it may have taken five or more years for the action to be settled or to come to trial and that counsel ran the risk of not recovering any fee and not recovering the firm's disbursements (usually very heavy) if the action was unsuccessful.[28]

IX. COSTS AGAINST UNSUCCESSFUL PLAINTIFF

Recovering costs against unsuccessful plaintiffs is an area where the provinces have adopted different approaches. In Ontario, the basic class action rule is that costs follow the event.[29] This means that the unsuccessful representative plaintiff may be exposed to very heavy costs, possibly amounting to hundreds of thousands of dollars, which, in most cases, he cannot begin to absorb himself.[30] The Ontario Act provides that the court may relieve the unsuccessful plaintiff from having to pay costs if the class action was a test case, raised a novel point of law, or involved a matter of public interest.[31] The British Columbia[32], Saskatchewan[33] and Manitoba[34] Acts are more plaintiff-friendly and provide that costs may only be awarded against the plaintiff if the action was frivolous, and even then the award is discretionary. Plaintiffs'

28. *See e.g.*, Garland v. Consumers' Gas Co., [2004] 1 S.C.R. 629 (Can.). In the *Consumers' Gas* case, the total settlement amount approved by the court was approx $22 million, of which plaintiff's counsel received approx $12 million to cover counsel's fees and disbursements over the fifteen year litigation period. This is not an extravagant amount by any measure.

29. *See* Ont. Act, s.31.

30. Not all representative plaintiffs are impecunious. In the *Kerr v. Danier Leather Inc.* litigation, the Ontario Court of Appeal refused to relieve the plaintiff from having to pay the costs of the unsuccessful action, reputed to amount to a million dollars or more, because the plaintiff had deep pockets and was a major shareholder in the defendant company. [2005] 77 O.R.3d 321 (Can.). The Supreme Court of Canada upheld this aspect of the Court of Appeal's judgment as well, [2007] 3 S.C.R. 331, 2007 SCC 44 (Can.), and Justice Binnie, writing the Court's opinion, went out of his way to point out that the plaintiff had engaged in a calculated gamble in starting the class action, and that it was therefore not unfair to penalize the plaintiff. Aside from such special cases as *Danier Leather,* there is a point of view, which the writer shares, that counsel has a duty to warn the representative plaintiff of the costs risk if the action is unsuccessful. Some observers go further and argue that plaintiff's counsel has an obligation to indemnify the plaintiff against a costs award where counsel has selected the representative plaintiff in the case.

31. *See* Ont. Act, s. 31(1).

32. *See* Class Proceedings Act, 1995 S.B.C., ch.21.

33. *See* The Class Actions Act, 2001 S.S., ch. 21.

34. *See* The Class Proceedings Act, 2002 S.M., ch. 130.

counsel take the position that this is the right approach since plaintiff's counsel and, in some cases the plaintiff himself, have to dig deeply into their pockets to keep the class action going without running the additional risk of having to indemnify the defendant if the action is unsuccessful. The Quebec class action law has finessed the problem in a unique way. It allows a successful defendant to recover costs but only on the scale of costs approved in the small claims division of the Quebec Court.[35]

X. CLASS ACTION FUNDING

In the overwhelming number of class actions, the representative plaintiff is in no better position to fund the action than he is in a position to absorb the costs of an unsuccessful action. Only two of the provinces, Ontario and Quebec, have meaningfully addressed the issue in Canada, although the Quebec approach is the more ambitious of the two.[36] In Ontario, the provincial government established a class proceedings fund about the time the CPA came into effect and contributed the sum of five million dollars to establish the fund.[37] The Ontario legislation also established a board, whose members are appointed by the Law Foundation of Canada, to administer the fund and to consider applications from plaintiff's counsel for financial support.[38] The support is only available to cover disbursements, not any part of counsel's fees.[39] The risk of non-payment of fees remains with counsel. If the Fund agrees to support the litigation and the action is unsuccessful, the defendant is entitled to apply to the Fund for recovery of the defendant's costs.[40] If the action is successful, the plaintiff will be required to repay the contribution to the plaintiff's costs made by the Fund. In addition, the Fund will be entitled to receive ten percent of the judgment awarded in favour of the class. In practice, the Ontario provisions have not had much impact on the funding of class actions, and this for two reasons. First, most plaintiffs' counsel view the Fund as seriously underfunded given the number of class actions in progress at any time. Because of this feature, counsel do not deem it worth while to expend the time necessary to satisfy the administrators' demanding requirements to qualify for funding assistance. The second reason is that most counsel take the position that, if they are expected to absorb the risk of non-

35. *See* An Act Respecting the Class Action, 2000 R.S.Q., c. R-2.1, Title II.
36. *See* Law Society Amendment Act (Class Proceedings Funding), 1992 S.O., c. L 8; *see also* An Act Respecting the Class Action, *supra* note 35.
37. *See* Law Society Amendment Act, *supra* note 36, at s.59.1(1).
38. *See id.* at ss.55.3, 59.1, 59.2.
39. *See id.* at s.59.1(2).
40. *See id.* at s.59.4(1).

payment of their fees if the action is unsuccessful, they might as well continue to finance the disbursements as well.

In Quebec, the scope of the *Fonds d'aide aux recours collectifs* ("Fonds") provided for under the province's class actions law,[41] is significantly more ambitious in scope than the Ontario plan. The *Fonds* is an ongoing financial responsibility of the Quebec government and, if the application is granted, the financial assistance will cover, up to the agreed amount, the plaintiff's attorney fees and disbursements (including the fees of expert witnesses) as well as other expenses related to the preparation of or bringing of the case.[42] Therefore, the Quebec government plays an active financial role in supporting class actions.

XI. OTHER IMPEDIMENTS TO CLASS ACTIONS

Apart from the certification requirements and the financial challenges facing plaintiff's counsel, there are other obstacles that stand in the way of Canadian class actions. Two are of particular importance. The first is the proliferating use of arbitration clauses in consumer agreements obliging consumers to resort to arbitration to settle any disputes and prohibiting recourse to class actions. The validity and fairness of such arbitration provisions in consumer agreements has triggered an enormous volume of litigation and scholarly discussion in the United States. So far as Canada is concerned, the position is unsettled. Before legislation was introduced to resolve the issue, the majority of Ontario courts held that the arbitration provisions were contrary to public policy and were unenforceable. The Ontario government clarified the position in 2005 by adopting an amendment to the province's Consumer Protection Act[43] invalidating the effectiveness of such arbitration provisions. The British Columbia courts have adopted a more nuanced position and have held that the existence of arbitration provisions in the parties' agreement is merely another factor to be taken into consideration by the court in determining whether a class action is the preferable procedure for handling the plaintiff's complaint.[44]

These relatively tranquil waters were deeply disturbed by the Supreme Court of Canada's holding, in a divided opinion, in *Union des*

41. *See* An Act Respecting the Class Action, *supra* note 35, at Title II.

42. *See id.* at art. 29; *see also* Fonds d'aide aux recours collectifs, Rapports annuel 2006-07, *available at* http://canlii.org/qc/laws/regu/r-2.1r.4/20060718/whole.html (providing further details about the operation of the Quebec plan).

43. Stat. Ont. 2004, c.19, s.4, amending Stat. Ont. 2002, c.30, Sched. A.

44. Mackinnon v. National Money Mart Co., [2004] B.C.L.R.2d (Can.).

consommateurs v. Dell Computers Corp.[45] that arbitration provisions in consumer agreements were not contrary to the public interest or the provisions of Quebec's *Code civil.* The majority judgment also held that, in any event, any objections by the consumer about the enforceability of the arbitration clause had to be raised before the arbitrator and could not be entertained by the courts. The Supreme Court's decision generated a lot of commentary,[46] much of it critical. Remarkably, so far as Quebec itself was concerned, the decision itself was dead on arrival because the Quebec Assembly had passed an amendment on the day argument on the case opened in the Supreme Court invalidating mandatory consumer arbitration provisions. However, the *Dell* decision may continue to influence common law courts in those provinces that have not enacted invalidating provisions.[47]

The other impediments facing consumer class actions are less of an immediate threat but constitute a greater long term danger. This 'threat' is that federal and provincial legislation will severely restrict or even outlaw certain types of class actions against governments. Many of the class actions launched over the past fifteen years have been against the several levels of government—federal, provincial and municipal—alleging breach of the defendants' common law duties of care or statutory obligations to the same effect, or holding a government entity vicariously liable for wrongs committed by agents acting on behalf of the governmental agency. In several of the cases, the damages claimed to have been suffered by members of the class have run into a billion dollars or more. The surprise is that the federal and provincial governments have not acted earlier to restrain such class actions or to provide alternative means for settling them. The precedents certainly exist where federal and provincial governments have adopted legislation,

45. Union des consommateurs v. Dell Computers Corp., [2007] 2 S.C.R. 801, 2007 SCC 34 (Can.). The Court released a companion decision to the same effect and on the same day in *Muroff v. Rogers Wireless Inc.*, [2007] 2 S.C.R. 921, 2007 SCC 35 (Can.).

46. *See e.g.*, Shelley McGill, *The Conflict Between Consumer Class Actions and Contractual Arbitration Clauses*, 43 CAN. BUS. L.J. 359 (2006); Shelley McGill, *Consumer Arbitration and Class Actions: The impact of* Dell Computer Corp. v. Union des consommateurs, 45 CAN. BUS L.J. 334 (2007).

47. In British Columbia, two trial courts have held that the Supreme Court's decision is not binding on British Columbia courts because of important differences in the class action and commercial arbitration legislation of Quebec and British Columbia. *See* Mackinnon v. National Money Mart Co., [2008] 293 D.L.R.4th 478; Seidel v. Telus Communications Inc., [2008] B.C.J. 1347 (B.C.S.C. July 16, 2008) (Masuhara, J.). Both judgments are under appeal. The Ontario Court of Appeal has reached the same conclusion as the British Columbia courts though on somewhat different grounds. *See* Smith Estate v. National Mart Co., [2008] 92 O.R.3d 224 (O.C.A.) (As previously noted, a 2005 amendment to the Ontario Consumer Protection Act invalidated mandatory arbitration clauses in consumer agreements. The Ontario actions in *Mackinnon*, *supra*, involved proceedings that were commenced before 2005.).

and in some cases made it retroactive,[48] outlawing individual and collective claims of various kinds. It may be that the difference between those cases and the cases that have triggered class actions is that the latter have usually involved claims for personal injuries or psychological harm,[49] or of physical damage to the class members' property,[50] and that governments were concerned about the public backlash if they were perceived to be shirking their responsibilities. The difference of course between claims against governments and class action claims against profit making enterprises is that the latter carry insurance or can self-insure against claims for defective products and services and, if the worse comes to the worst, can seek protection under Canada's bankruptcy legislation. Governmental services are provided on a non-profit basis for the public benefit and, unless the defendant governmental agency is separately incorporated, any claims that are settled must ultimately be paid for by all taxpayers.[51]

XII. THE FUTURE OF CLASS ACTIONS IN CANADA

No great controversy surrounded the introduction of class action legislation in Canada in the 1990s or more recently, and there is no visible pressure by business groups or government agencies to dismantle the legislation or to make radical changes. There may be a variety of reasons for this acquiescence. The few cases that have gone to trial have not involved juries and the defendants have not faced the threat of huge damage awards common in some parts of the United States. Theoretically, punitive damages are claimable in Canadian class actions,

48. *See e.g.*, Ont., Estate Administration Tax Act 1998 (precluding recovery of unlawfully imposed probation fees); *see also* Wolfe D. Goodman, *Unlawful Taxes and the Supreme Court's Decision in* Eurig, 31 CAN. BUS. L.J. 291, 298 (1999); Authorson v. Canada (Attorney General), [2007] 86 O.R.3d 321 (O.C.A.) (upholding validity of amendments to the federal Department of Veterans Affairs Act retroactively precluding actions against the Department for breach of its fiduciary duties in failing to invest properly veterans' pension funds under its administration).

49. The hepatitis infected blood cases brought against the federal and provincial governments in the early 1990s fall into this category. So do the claims brought against the federal government for physical and sexual abuse suffered by native students at residential schools established by the federal government in the last century, though the schools themselves were run by various Christian denominations or independent contractors retained by the government.

50. As in the class action brought against the federal government by Canadian cattle farmers alleging they suffered heavy losses because the federal government negligently admitted into Canada British cattle suffering from the 'mad cow' disease.

51. There are exceptions, but for the most part it is not usual in Canada for government departments and agencies to be separately incorporated—why not is unclear since conferment of corporate personality on a department or agency would be quite simple.

as they may be claimed in other civil actions,[52] but apparently there is no reported case of punitive damages being awarded in a class action context. Again, as previously noted, Canadian judges have taken very seriously their roles as gatekeepers to screen out frivolous, extravagant, or unwieldy claims with the result that perhaps less than half of the class actions have reached the certification stage.[53] Yet another reason is that the deep pockets of defendants have enabled them to put up a stiff fight and either to defeat the claims entirely or to settle them on an acceptable basis. No doubt, Canadian businesses and governments would prefer not to be encumbered with class actions. I suspect, however, they have sensibly concluded that Canadian public opinion would not tolerate repeal of the legislation and that the average voter views the legislation as an important bulwark by the "little guy" against the overweening power of big business and big government.

XIII. WHAT CAN OTHER COUNTRIES LEARN FROM THE CANADIAN EXPERIENCE?

I offer the following list:

1. For the reasons explained in the last section, class actions to address mass wrongs, at least as structured in Canada, are not the unmitigated evil they are often perceived to be in continental Europe (though surely not in all EU countries) or the United Kingdom. Class actions, coupled with contingent fees for the lawyers who initiate them, are not an ideal solution but they are the second best solution if governments are unable or unwilling to absorb the costs of other remedial vehicles.
2. Adoption of the opting-out principle for the efficient conduct of class actions is unavoidable if class actions are to achieve optimal results.[54] Traditional objections in Europe to the opting out approach are not persuasive and

52. Whiten v. Pilot Insurance Co., [2002] 1 S.C.R. 595, 2002 SCC 18 (Can.).

53. Ward Branch, at paragraphs 4.41950 et seq. of *Class Actions in Canada* (a loose leaf service published by Canada Law), cites the following statistics. In Quebec, as of the end of 2007, there were 872 motions for certification and 399 certification decisions. Certification was granted in 231 cases, 58 actions were tried on their merits and 36 judgments were rendered in the plaintiffs' favour. With respect to Ontario, as of February 2008, there had been 224 certification hearings. Of 126 contested certification hearings, 74 were certified after the hearing. Another 96 certification orders were issued by consent. Twelve cases were settled, wholly or partially, after certification. Five cases were determined on their merits and 4-5 cases were dismissed.

54. Professor Mulheron, *supra* note 11, has shown this convincingly with respect to the effect of Group Litigation Orders ("GLOs") in England and the restriction of GLOs to litigants who have opted in.

have more to do with objections to an entrepreneurial litigation culture than with the establishment of effective means to remedy mass wrongs. Judicial oversight of class actions can, and should be able to, avoid abuses linked to use of the opting out rule and other class action abuses.

3. A class action system, precluding the use of juries and the availability of punitive damages, can be implemented and avoid the abuses associated with US class action practices. Also, very reputable lawyers can be attracted to act as plaintiffs' counsel in class actions. Based on the Canadian experience, the common complaint that plaintiffs' lawyers are largely driven by greed is unwarranted.[55] Defendant companies and governments can mitigate the burden and costs of class actions by investigating and offering prompt redress when substantiated complaints first come to light, e.g., reversing excessive banking charges, correcting false product claims, and appointing mediators to assess claims and recommend suitable settlements. However, allowing defendants *ex ante* to deny consumer plaintiffs the right to sue in the regular courts is not an appropriate policy.
4. The question whether, and to what extent, governments should be exposed to class actions involving large pecuniary claims requires further investigation. So should be the issue whether a ceiling should be imposed on the amount of recoverable damages where claims are made against governments.

XIV. CONCLUSION

In law, as in other spheres of public policy, difficult choices often have to be made between competing values. In the area of mass wrongs against consumers, the choice is between governments doing too little and allowing the harm to go without a remedy or allowing carefully regulated class actions under court supervision to bridge at least part of the gap. I believe Canadian experience supports the latter choice.

55. Note also the common belief in Canada that defendants' lawyers in class actions do at least as well financially as plaintiffs' lawyers, and that, unlike plaintiffs' lawyers, they don't have to worry about recovering their fees!

Comments

Taking Judicial Notice of the Genocide in Rwanda: The Right Choice

Rebecca Faulkner*

I. INTRODUCTION

At the Roman Catholic Church compound in Shangi, Rwanda, bloody handprints remain on the walls as a gruesome reminder of the Hutu massacre of Tutsis that occurred on April 18, 1994.[1] In one room, handprints stretch from floor to ceiling, showing how Tutsis stood on one another's shoulders in desperate efforts to reach ceiling crawl spaces and the roof in order to hide from Hutu militiamen.[2] Other rooms are bullet-pocked or partially blown apart by hand grenades.[3] Although no one knows for sure, it is estimated that as many as 4,000 Tutsis—adults and children alike—were hacked, shot, or beaten to death at the Shangi

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1. *See* Jonathan C. Randal, *A Mosaic of Bloody Handprints Recalls 4,000 Tutsis' Last Day of Life*, WASH. POST, June 29, 1994, at A17.
2. *See id.*
3. *See id.*

church that day.[4] As horrifying as the events at Shangi are, they mark just a fraction of the Tutsis massacred throughout Rwanda in the span of just four months in the summer of 1994.[5]

Following the atrocities committed against Rwandan Tutsis, the United Nations formed the International Criminal Tribunal for Rwanda ("ICTR" or "Tribunal") to prosecute those accused of these heinous acts.[6] The ICTR has since tried dozens of cases and uncovered evidence of genocide on a large scale.[7] Yet, until recently, the Tribunal addressed the issue of genocide in Rwanda as an issue of fact for the prosecutor to prove in each case.[8] However, on June 16, 2006, in *Prosecutor v. Karemera, et al.*, the Appeals Chamber for the ICTR issued a decision upholding the Prosecutor's interlocutory appeal and taking judicial notice of the fact that "[b]etween 6 April 1994 and 17 July 1994, there was a genocide in Rwanda against the Tutsi ethnic group" as a fact of common knowledge.[9] Taking judicial notice of genocide in Rwanda means that the prosecutor in this and future cases need no longer offer evidence to prove that genocide occurred; the fact of genocide in Rwanda is now beyond argument.[10] With the evidence compiled in ICTR cases, like the bloody handprints left at Shangi, the Tribunal's decision is difficult to dispute.

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4. *See id.*

5. *See* Gabriel Packard, *Rwanda: Census Finds 937,000 Died in Genocide*, N.Y. AMSTERDAM NEWS, Apr. 8, 2004, at 2-2.

6. *See* International Criminal Tribunal for Rwanda, www.ictr.org (follow "About the Tribunal" hyperlink; then follow "General Information" hyperlink) (last visited Jan. 11, 2009).

7. *See* International Criminal Tribunal for Rwanda, *supra* note 6 (follow "Cases" hyperlink; then follow "Status of Cases" hyperlink).

8. *See, e.g.*, Prosecutor v. Nyiramasuhuko, Case No. ICTR 97-21-T, ¶ 127-28 (May 15, 2002) (declining to take judicial notice of genocide, "prefer[ing] in the circumstances of the present case to hear evidence and arguments on this issue, rather than to take judicial notice of those legal conclusions"); Prosecutor v. Kajelijeli, Case No ICTR 98-44A-T, Decision on the Prosecutor's Motion for Judicial Notice Pursuant to Rule 94 of the Rules, ¶ 19 (Apr. 16, 2002) (declining to take judicial notice of genocide in Rwanda); Prosecutor v. Semanza, Case No. ICTR 97-20-I, Decision on the Prosecutor's Motion for Judicial Notice and Presumptions of Facts Pursuant to Rules 94 and 54, ¶ 36 (Nov. 3, 2000) (declining to take judicial notice of genocide because "the question is so fundamental, that formal proofs should be submitted bearing out the existence of this jurisdictional element crime"); Prosecutor v. Kayishema, Case No. ICTR 95-1-T, Judgment, ¶ 273 (May 21, 1999) (holding that the question of genocide is so fundamental to the case against the accused that the Trial Chamber feels obligated to make a finding of fact on the issue).

9. Prosecutor v. Karemera et al., Case No. ICTR 98-44-AR73(C), Decision on Prosecutor's Interlocutory Appeal of Decision on Judicial Notice, ¶ 33-35 (June 16, 2006).

10. *See Semanza*, Case No. ICTR 97-20-I, Decision on the Prosecutor's Motion for Judicial Notice and Presumptions of Facts Pursuant to Rules 94 and 54, ¶ 17.

Yet the Appeals Chamber's ruling in *Karemera* took many observers by surprise, for prosecutors had asked the Tribunal to take judicial notice of the genocide in Rwanda in past cases without success.[11] Aside from the novelty of this decision, commentators question the prudence of the Appeals Chamber's decision, arguing that it is unwise and illogical,[12] as well as conceptually flawed.[13] This Comment examines the issue of judicially noticing genocide in Rwanda and argues that it is a positive step in the right direction. In responding to arguments against judicially noticing the genocide in Rwanda, this Comment is divided into three principle sections. The first section discusses the historical context of violence in Rwanda and the procedural context of *Prosecutor v. Karemera*. The second section provides a more detailed discussion of judicial notice and the ways in which that term has been defined. Finally, the third section addresses the ICTR's decision to take judicial notice of the genocide in Rwanda in *Prosecutor v. Karemera*. Discussion of *Karemera* is further divided into four subsections: an explanation of the Appeals Chamber's reasons for noticing genocide; an examination of the arguments against noticing genocide; a response to the arguments against noticing genocide; and an argument in support of noticing genocide.

II. HISTORICAL AND PROCEDURAL CONTEXT

A. A Brief History of Violence in Rwanda

Rwanda has long been a country of conflict. From its earliest days, discord between its two major ethnic groups, the Hutus and the Tutsis, has divided the country.[14] In 1916, Rwanda became a Belgian colony.[15]

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11. *See* Prosecutor v. Karemera et al., Case No. ICTR 98-44-R94, Decision on Prosecution Motion for Judicial Notice, ¶ 6 (Nov. 9, 2005) (citing Prosecutor v. Niyitegeka, Case No. 96-14-T, Decision on the Prosecutor's Motion for Judicial Notice of Facts (Sept. 4, 2002); *Nyiramasuhuko*, Case No. ICTR 97-21-T; *Kajelijeli*, Case No ICTR 98-44A-T, Decision on the Prosecutor's Motion for Judicial Notice Pursuant to Rule 94 of the Rules; Prosecutor v. Ntakirutimana, Case No. 96-10-T, Decision on the Prosecutor's Motion for Judicial Notice of Adjudicated Facts (Nov. 22, 2001); *Semanza*, Case No. ICTR 97-20-I, Decision on the Prosecutor's Motion for Judicial Notice and Presumptions of Facts Pursuant to Rules 94 and 54).

12. *See* Ralph Mamiya, *Taking Judicial Notice of Genocide? The Problematic Law and Policy of the Karemera Decision*, 25 WIS. INT'L L.J. 1, 1 (2007).

13. *See* Brittan Heller, *Noticing Genocide*, 116 YALE L.J. POCKET PART 101, 101 (2006).

14. *See Rwanda: How the Genocide Happened*, BBC NEWS, Apr. 1, 2004, http://news.bbc.co.uk/2/hi/africa/1288230.stm.

15. *See* United Kingdom Foreign and Commonwealth Office, Country Profiles: Rwanda, http://www.fco.gov.uk (follow "Country profiles" hyperlink; then follow "Sub Saharan Africa" hyperlink) (last visited Jan. 11, 2009).

Believing the Tutsis to be superior to the Hutus,[16] the Belgians gave the Tutsis almost all of the political power,[17] further fueling the animosity between the two ethnic groups. Over time, tensions mounted, and violent clashes occurred sporadically.[18] On April 6, 1994, however, Rwanda exploded into chaos with the assassination of its president, Juvenal Habyarimana.[19] Violence erupted between the Hutu majority and the Tutsi minority, with the Hutu-led interim government advocating and inciting violence against Tutsis and moderate Hutus.[20] During the one hundred days that followed President Habyarimana's assassination, from early April to mid July, the atrocities committed by the Hutu government led to the slaughter of approximately one million Tutsis and moderate Hutus,[21] and the displacement of many more.[22] It was this wholesale violence against the Tutsis that led the United Nations to form the International Criminal Tribunal for the Prosecution of Persons Responsible for Genocide and Other Serious Violations of International Humanitarian Law Committed in the Territory of Rwanda and Rwandan Citizens Responsible for Genocide and Other Such Violations Committed in the Territory of Neighbouring States; or more simply, the International Criminal Tribunal for Rwanda.[23]

B. Prosecutor v. Karemera *and Judicially Noticing Genocide*

Prosecutor v. Karemera[24] is one of the cases currently before the ICTR.[25] The three defendants in this case, Edouard Karemera, Mathieu Ngirumpatse, and Joseph Nzirorera, are charged with committing heinous crimes in 1994.[26] During this time, the defendants were all high-level officials in the Mouvement Révolutionnaire Nationale pour le Développement, or National Revolutionary Movement for Development

16. *See Rwanda: How the Genocide Happened*, *supra* note 14.

17. *See* United Kingdom Foreign and Commonwealth Office, *supra* note 15.

18. For example, in a series of riots beginning in 1959, more than 20,000 Tutsis were killed, *see Rwanda: How the Genocide Happened*, *supra* note 14, and approximately 150,000 fled into neighboring countries, *see* CIA, The World Fact Book: Rwanda, https://www.cia.gov/library/publications/the-world-factbook/geos/rw.html (last visited Jan. 11, 2009).

19. *See Rwanda: How the Genocide Happened*, *supra* note 14.

20. *See* United Kingdom Foreign and Commonwealth Office, *supra* note 15.

21. *See* Packard, *supra* note 5.

22. *See* CIA, *supra* note 18.

23. *See* International Criminal Tribunal for Rwanda, *supra* note 6 (follow "About the Tribunal" hyperlink; then follow "General Information" hyperlink).

24. Case No. ICTR 98-44.

25. *See* International Criminal Tribunal for Rwanda, *supra* note 6 (follow "Cases" hyperlink; then follow "Status of Cases" hyperlink).

26. *See* Prosecutor v. Karemera et al., Case No. ICTR 98-44-I, Amended Indictment, (Aug. 24, 2005).

("MRND"), the political party that controlled Rwanda's 1994 interim government.[27] All three were members of the MRND's Steering Committee.[28] Additionally, Karemera served as Minister of the Interior for the interim government and as the MRND's First Vice-President,[29] Ngirumpatse served as the MRND's President,[30] and Nzirorera served as the MRND's National Secretary.[31] Each was charged with using the power of his position to plan, instigate, order, commit, or otherwise aid and abet in the planning, preparation, or commission of the crimes charged in the indictment.[32]

The Amended Indictment of August 24, 2005 charges each of the defendants with seven counts.[33] The first four counts are pursuant to Article 2 of the Statute of the Tribunal, and charge the defendants with: "(i) conspiracy to commit genocide, (ii) direct and public incitement to genocide, *and* (iii) genocide, *or alternatively* (iv) complicity in genocide."[34] The next two counts are pursuant to Article 3 of the Statute of the Tribunal, and charge the defendants with: "(v) rape, *and* (vi) extermination *as* crimes against humanity."[35] The final count is pursuant to Article 4 of the Statute of the Tribunal, and charges the defendants with "(vii) murder and causing violence to health and physical or mental well-being *as* serious violations of Article 3 common to the Geneva Conventions and Additional Protocol II."[36] The most egregious, and arguably the most serious, of these crimes is genocide.[37]

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27. *See id.* ¶ 1-3.
28. *Id.*
29. *See id.* ¶ 1.
30. *See id.* ¶ 2.
31. *See Karemera*, Case No. ICTR 98-44-I, ¶ 3.
32. *See id.* ¶ 4.
33. *See* Prosecutor v. Karemera et al., Case No. ICTR 98-44-I, Amended Indictment, (Aug. 24, 2005).
34. *Id.* (emphasis in the original).
35. *Id.* (emphasis in the original).
36. *Id.* (emphasis in the original).
37. Article 2, section 2 of the Statute for the International Criminal Tribunal for Rwanda defines genocide as:

> Any of the following acts committed with intent to destroy, in whole or in part, a national, ethnical, racial or religious group, as such:
>
> (a) Killing members of the group;
>
> (b) Causing serious bodily or mental harm to members of the group;
>
> (c) Deliberately inflicting on the group conditions of life calculated to bring about its physical destruction in whole or in part;
>
> (d) Imposing measures intended to prevent births within the group;
>
> (e) Forcibly transferring children of the group to another group.

Statute of the International Tribunal for Rwanda, 1994, art. 2(2).

In its motion filed on June 30, 2005,[38] the Prosecutor asked the Trial Chamber to take judicial notice of the fact that genocide occurred in Rwanda in 1994 as a fact of common knowledge.[39] The Trial Chamber held, somewhat contradictorily, that: (1) it does not matter whether genocide occurred in Rwanda for purposes of the Prosecutor's case against the accused, for that is not a fact to be proved, and (2) taking judicial notice of the fact that genocide occurred in Rwanda would lessen the Prosecutor's obligation to prove his case.[40] On November 9, 2005, the Trial Chamber therefore denied the Prosecutor's motion as it related to judicial notice of genocide.[41]

Unhappy with this decision, the Prosecutor filed a motion for certification to appeal the Trial Chamber's decision in an interlocutory appeal and on December 2, 2005, the Trial Chamber granted this motion.[42] After carefully reviewing the issue *de novo*, the Appeals Chamber agreed with the Prosecutor and held that "the fact that genocide occurred in Rwanda in 1994 should have been recognized by the Trial Chamber as a fact of common knowledge."[43] The Appeals Chamber then remanded the matter to the Trial Chamber for further consideration consistent with the Appeals Chamber's decision.[44] The case is currently back before the Trial Chamber.[45]

III. JUDICIAL NOTICE

Before determining whether the Appeals Chamber's ruling in *Prosecutor v. Karemera* was a prudent decision, it is important to discuss the concept of judicial notice itself. Judicial notice is an important and powerful tool for courts. By taking judicial notice of a fact, the court relieves the prosecutor of his formal burden of producing evidence of

38. *See* Prosecutor v. Karemera et al., Case No. ICTR 98-44-R94, Decision on Prosecution Motion for Judicial Notice (Nov. 9, 2005).

39. Additionally, the Prosecutor asked the Trial Chamber to take judicial notice of five other facts of common knowledge and 153 facts that had been previously adjudicated in other ICTR cases. For purposes of this Comment, however, these additional facts are unimportant. *See id.* ¶ 7.

40. *Id.*

41. *See id.* ¶ 6.

42. *See* Prosecutor v. Karemera et al., Case No. ICTR 98-44-T, Certification of Appeal Concerning Judicial Notice (Dec. 2, 2005).

43. Prosecutor v. Karemera et al., Case No. ICTR 98-44-AR73(C), Decision on Prosecutor's Interlocutory Appeal of Decision on Judicial Notice, ¶ 35 (June 16, 2006).

44. *See id.* ¶ 57.

45. *See id.* (remanding the matter to the Trial Chamber for further consideration in a manner consistent with the Appeals Chamber's Decision).

that fact at trial.[46] Thus, judicial notice expedites the trial process[47] by reducing the necessary amount of evidence and witnesses, and promotes the efficiency of the court.[48] It also fosters judicial economy[49] and ensures the consistency and uniformity of decisions.[50] Yet, as important as these traits are to the judicial process, they must be balanced against the court's equally important "mandate to ensure a fair and equitable trial for the Accused."[51]

A. The ICTR's Definition of Judicial Notice

Rule 94 of the ICTR's Rules of Procedure and Evidence states that:

> (A) A Trial Chamber shall not require proof of facts of common knowledge but shall take judicial notice thereof.
>
> (B) At the request of a party or *proprio motu*, a Trial Chamber, after hearing the parties, may decide to take judicial notice of adjudicated facts or documentary evidence from other proceedings of the Tribunal relating to the matter at issue in the current proceedings.[52]

In addition to dealing with different types of facts—those of common knowledge and those that have been previously adjudicated—the two subsections have one major difference: Rule 94(A) is mandatory while Rule 94(B) is discretionary.[53] Thus, the applicable subsection may make a great deal of difference to the ultimate outcome. While both subsections are important and useful tools when dealing with judicial notice, the remainder of this Comment discusses Rule 94(A) exclusively, for in *Karemera,* the Appeals Chamber took judicial notice of genocide only as a fact of common knowledge.[54] Regardless of the subsection

46. *See* Prosecutor v. Semanza, Case No. ICTR 97-20-I, Decision on the Prosecutor's Motion for Judicial Notice and Presumptions of Facts Pursuant to Rules 94 and 54, ¶ 17 (Nov. 3, 2000).

47. *See id.* ¶ 20.

48. *See* Prosecutor v. Karemera et al., Case No. ICTR 98-44-T, Decision on the Prosecutor's Motion for Judicial Notice, ¶ 2 (Apr. 30, 2004).

49. *Id.*

50. *See Semanza*, Case No. ICTR 97-20-I, ¶ 20.

51. *Id.* ¶ 18.

52. Rules of Procedure and Evidence, 2006 ICTR Acts & Docs. Rule 94.

53. *See id.* (Rule 94(A) uses the language "shall" while Rule 94(B) uses the language "may" when discussing judicial notice.).

54. *See* Prosecutor v. Karemera et al., Case No. ICTR 98-44-AR73(C), Decision on Prosecutor's Interlocutory Appeal of Decision on Judicial Notice, ¶ 38 (June 16, 2006)(taking judicial notice of genocide in Rwanda as a fact of common knowledge). Although there may be strong arguments for taking judicial notice of the genocide in Rwanda under Rule 94(B), for the sake of brevity and simplicity I will leave that discussion for another comment.

used, however, Rule 94 provides no guidance as to what constitutes a fact of "common knowledge" or an "adjudicated fact."[55] The Tribunal has therefore had to provide definitions for these phrases through its jurisprudence.

In *Prosecutor v. Semanza*,[56] the Trial Chamber closely examined the issue of judicial notice, focusing primarily on prominent legal treatises in order to formulate a definition for facts of common knowledge.[57] It determined that a fact of common knowledge is one that is not subject to reasonable dispute.[58] The Trial Chamber went on to state that a fact is not subject to reasonable dispute if "it is either generally known within the territorial jurisdiction of a court or capable of accurate and ready determination by resort to sources whose accuracy cannot reasonably be called into question."[59] The Trial Chamber listed the days of the week, general historical facts, geographical facts, and the laws of nature as examples of facts that meet this test for facts of common knowledge.[60] The Tribunal also considered judicial notice in *Prosecutor v. Bizimungu*.[61] In its December 2, 2003 decision, the Trial Chamber determined that facts of common knowledge are those facts that are "of such notoriety, so well known and acknowledged that no reasonable individual with relevant concern can possibly dispute them."[62]

Based on the Trial Chamber's decisions in *Semanza* and *Bizimungu*, the Tribunal has developed a more precise definition of facts that constitute "common knowledge" than that provided by Rule 94(A) alone.[63] It is this definition that the Trial Chamber should have applied in *Karemera* when determining whether to take judicial notice of genocide in Rwanda. And it is this definition that this Comment will use to argue that the Appeals Chamber made the right decision when it granted the Prosecutor's motion for judicial notice.

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55. *See* Rules of Procedure and Evidence, 2006 ICTR Acts & Docs. Rule 94.

56. Case No. ICTR 97-20.

57. *See* Prosecutor v. Semanza, Case No. ICTR 97-20-I, Decision on the Prosecutor's Motion for Judicial Notice and Presumptions of Facts Pursuant to Rules 94 and 54, ¶ 22 (Nov. 3, 2000).

58. *See id.* ¶ 23.

59. *Id.* ¶ 24.

60. *See id.* ¶ 23.

61. *See* Prosecutor v. Bizimungu et al., Case No. ICTR 99-50-I, Decision On Prosecution's Motion for Judicial Notice Pursuant to Rules 73, 89 and 94, (Dec. 2, 2003).

62. *Id.* ¶ 23.

63. *See generally Bizimungu*, Case No. ICTR 99-50-I (explaining that facts of common knowledge are facts that are notorious and so well known and acknowledged that they cannot reasonably be disputed by an individual with relevant concern); *see also Semanza*, Case No. ICTR 97-20-I (explaining that facts of common knowledge are facts that are not subject to reasonable dispute because they are either generally known within the territorial jurisdiction of a court or capable of accurate and ready determination by resort to sources whose accuracy cannot reasonably be questioned).

B. The ICTY's Definition of Judicial Notice

The International Criminal Tribunal for the Former Yugoslavia ("ICTY") is a tribunal very similar to the ICTR. The ICTY was established in 1993, in response to violations of international humanitarian law that occurred in the territory of the former Yugoslavia in 1991.[64] Looking at the ICTY's interpretation of judicial notice is relevant to the ICTR for a number of reasons. First, the ICTY served as a model for the establishment of the ICTR, and the ICTR drew in whole or in substantial part on many of the ICTY's basic legal texts, including the Rules of Procedure and Evidence.[65] Important for purposes of this Comment, the ICTR's rule of evidence on judicial notice, Rule 94, is the same as the ICTY's rule, also Rule 94.[66] Second, and even more important for purposes of this Comment, the two tribunals share one Chamber of Appeals.[67] For these reasons, much of what the two tribunals do is closely linked, so understanding the ICTY's interpretation of judicial notice is helpful to understanding the ICTR's view.

Unlike the ICTR, the ICTY has not been asked to take judicial notice of genocide. It has been asked, however, to take judicial notice of facts under Rule 94(A) in a number of cases,[68] and so like the ICTR, it has interpreted the language of Rule 94(A) to make it more useful.[69] For

64. *See* International Criminal Tribunal for the Former Yugoslavia, www.icty.org (follow "Welcome to the New ICTY Website" hyperlink; then follow "The About section" hyperlink) (last visited Jan. 11, 2009).

65. *Compare* Rules of Procedure and Evidence, 2007 ICTY Acts & Docs. *and* Rules of Procedure and Evidence, 2006 ICTR Acts & Docs.

66. In fact, the two rules are nearly identical. The ICTR adopted Rule 94(A) verbatim, and changed Rule 94(B) only slightly: the ICTY's rule states that the Tribunal may take judicial notice of facts "relating to matters at issue," Rules of Procedure and Evidence, 2007 ICTY Acts & Docs. Rule 94(A), while the ICTR's version states that the Tribunal may take judicial notice of facts "relating to the matter at issue," Rules of Procedure and Evidence, 2006 ICTR Acts & Docs. Rule 94(A).

67. International Criminal Tribunal for the Former Yugoslavia, *supra* note 64 (follow "Welcome to the New Website" hyperlink; then follow "Chambers" hyperlink).

68. *See, e.g.*, Prosecutor v. Marijacic, Case No. IT 95-14-R77.2, Decision on Prosecution Motion for Judicial Notice and Admission of Evidence (Jan. 13, 2006) (Prosecution request asking the Trial Chamber to take judicial notice of documents falling into one of three categories: newspaper articles; court documents of the International Tribunal; and selected Croatian laws); Prosecutor v. Simic, Case No. IT 95-9, Decision on Defense Request for Trial Chamber to Take Judicial Notice (July 7, 2000) (Defense request asking the Trial Chamber to take judicial notice of the Prosecution's position, as reflected in the Weekly Press Briefing issued by the International Tribunal on June 14, 2000).

69. *See, e.g.*, Nikolic v. Prosecutor, Case No. IT 02-60/1-A, Decision on Appellant's Motion for Judicial Notice (Apr. 1, 2005); Prosecutor v. Milosevic, Case No. IT 02-54-AR73.5, Decision on the Prosecution's Interlocutory Appeal Against the Trial Chamber's 10 April 2003 Decision on Prosecution Motion for Judicial Notice of Adjudicated Facts (Oct. 28, 2003).

example, in *Prosecutor v. Milosevic*,[70] the Appeals Chamber, recognizing that "Rule 94(A) [does not] explain what 'facts of common knowledge' are," defined these facts as material that is notorious.[71] In *Nikolic v. Prosecutor*,[72] the Appeals Chamber went on to state that facts of common knowledge are facts that are "common or universally known facts," and must be facts that are "not the subject of reasonable dispute."[73] Thus, taking judicial notice of facts of common knowledge implies that those facts cannot be challenged at trial.[74]

Decisions by both the ICTY and the ICTR interpreting judicial notice pursuant to Rule 94(A) thus provide a fuller understanding of what constitutes facts of common knowledge. Facts of common knowledge are those facts that are notorious, universally known or at least generally known in the territorial jurisdiction of the court, capable of accurate and ready determination, and not subject to reasonable dispute.[75] With these definitions, we now have the framework for concluding that the genocide in Rwanda is a fact of common knowledge, and that the Appeals Chamber acted properly in *Karemera* when it took judicial notice of that fact pursuant to Rule 94(A).

IV. NOTICING GENOCIDE IN *KAREMERA*

A. The Appeals Chamber's Reasons for Noticing Genocide

In *Karemera*, the Appeals Chamber provided a number of reasons supporting its decision to take judicial notice of genocide in Rwanda as a fact of common knowledge pursuant to Rule 94(A).[76] The first reason was simply that the genocide in Rwanda fits within the definition of a fact of common knowledge.[77] Using the language of *Semanza*, the Appeals Chamber stated that "[t]here is no reasonable basis for anyone to

70. *Milosevic*, Case No. IT 02-54.

71. *See Milosevic*, Case No. IT 02-54-AR73.5, Decision on the Prosecutor's Interlocutory Appeal Against the Trial Cahamber's 10 April 2003 Decision on Prosecution Motion for Judicial Notice of Adjudicated Facts (Oct. 28, 2003).

72. *Nikloic*, Case No. IT 02-60.

73. *Nikolic*, Case No. IT 02-60/1-A, ¶ 10.

74. *See id.*

75. *See Nikolic* Case No. IT 02-60/1-A; Prosecutor v. Bizimungu, Case No. ICTR 99-50-I, Decision On Prosecution's Motion for Judicial Notice Pursuant to Rules 73, 89 and 94, (Dec. 2, 2003); *Milosevic*, Case No. IT 02-54-AR73.5, Decision on the Prosecution's Interlocutory Appeal Against the Trial Chamber's 10 April 2003 Decision on Prosecution Motion for Judicial Notice of Adjudicated Facts (Oct. 28, 2003); Prosecutor v. Semanza, Case No. ICTR 97-20-I, Decision on the Prosecutor's Motion for Judicial Notice and Presumptions of Facts Pursuant to Rules 94 and 54 (Nov. 3, 2000).

76. *See* Prosecutor v. Karemera et al., Case No. ICTR 98-44-AR73(C), Decision on Prosecutor's Interlocutory Appeal of Decision on Judicial Notice (June 16, 2006).

77. *Id.* ¶ 35.

dispute that, during 1994, there was a campaign of mass killings to destroy, in whole or at least in very large part, Rwanda's Tutsi population."[78] To substantiate this claim, the Appeals Chamber pointed to United Nations' reports detailing the genocide in Rwanda, which were a key impetus for the Tribunal's establishment, and the very name of the Tribunal itself—the International Criminal Tribunal for the Prosecution of Persons *Responsible for Genocide.*[79]

The Appeals Chamber's second reason supporting its decision to take judicial notice of genocide in Rwanda was the fact that it is no longer necessary for the Tribunal to build the historical record.[80] The Appeals Chamber found that while this role was important during the early part of the Tribunal's history, "at this stage, the Tribunal need not demand further documentation."[81] The historical record of the genocide in Rwanda has been thoroughly documented through the Tribunal's previous judgments,[82] "books, scholarly articles, media reports, U.N. reports and resolutions, national court decisions, and government and NGO reports."[83] That genocide occurred in Rwanda is a fact that no longer necessitates proof; it is "a classic instance of a 'fact of common knowledge.'"[84] It is therefore an appropriate fact for Rule 94(A) judicial notice.

A third reason the Appeals Chamber offered in support of its decision was that, unlike the Trial Chamber, the Appeals Chamber believed that the issue of judicially noticing genocide is "of obvious relevance to the Prosecution's case."[85] Although insufficient in itself to prove the case against the accused, it is a necessary factor.[86] Showing a nationwide campaign of genocide is also relevant because it provides the context within which to understand individual defendants' actions.[87]

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78. *Id.*
79. *See id.*
80. *See id.*
81. *Karemera*, Case No. ICTR 98-44-AR73(C), ¶ 35.
82. *See, e.g.*, Prosecutor v. Kayishema, Case No. ICTR 95-1-T, Judgment, ¶ 291 (May 21, 1999); Prosecutor v. Semanza, Case No. ICTR 97-20-T, Judgment and Sentence, ¶ 273-472 (May 15, 2003) (providing a lengthy discussion, replete with details, of specific instances of the genocide that took place in Rwanda); Prosecutor v. Musema, Case No. ICTR 96-13-A, Judgment and Sentence, ¶ 316 (Jan. 27, 2000) (setting out factual findings of massacres that took place in the Bisesero Region of Rwanda); Prosecutor v. Akayesu, Case No. ICTR 96-4-T, Judgment, ¶ 112-126 (Sept. 2, 1998) (containing a lengthy findings of fact detailing genocide in Rwanda).
83. Prosecutor v. Karemera et al., Case No. ICTR 98-44-AR73(C), Decision on Prosecutor's Interlocutory Appeal of Decision on Judicial Notice, ¶35 (June 16, 2006) (footnotes omitted).
84. *Id.*
85. *Id.* ¶ 36.
86. *See id.*
87. *See id.*

Thus, the Appeals Chamber explicitly rejected the Trial Chamber's first reason for declining to take judicial notice of the genocide in Rwanda.

Linked with this argument is the Appeals Chamber's response to the Trial Chamber's second contention, that judicially noticing genocide will lessen the Prosecutor's burden in convicting the individual accused.[88] The Appeals Chamber similarly rejected this argument, stating that even if the Tribunal takes judicial notice of genocide, the Prosecutor must still offer evidence demonstrating the individual guilt of each of the accused.[89] Specifically, in order to prove its case against the defendants in *Karemera*, the Prosecutor must show that particular actions by the accused constitute genocidal conduct, and that each of the accused acted with the requisite mental state.[90] Even with judicial notice of genocide, without such proof the Prosecutor cannot prove his case against the defendants. The Appeals Chamber further noted that these proof requirements serve to protect the procedural rights of the accused.[91]

Based on the foregoing reasons, the Appeals Chamber rejected arguments put forward by the Trial Chamber and the defendants that genocide in Rwanda is not an appropriate fact for judicial notice.[92] The Appeals Chamber found that noticing this fact would not truncate the historical record, lessen the Prosecutor's burden in convicting the accused, or infringe upon the defendant's procedural rights.[93] It further found that the fact is relevant to the Prosecutor's case.[94] Based on the evidentiary record and the facts known to the Tribunal, the Appeals Chamber concluded that "[t]here is no reasonable basis for anyone to dispute that, during 1994, there was a campaign of mass killings intended to destroy, in whole or at least in very large part, Rwanda's Tutsi population."[95] Therefore, the Appeals Chamber found that noticing genocide is appropriate pursuant to Rule 94(A).[96]

B. Arguments Against Noticing Genocide

While the Appeals Chamber found ample support for its decision that taking judicial notice of genocide in Rwanda is appropriate, there are others who disagree.[97] Their reasons for rejecting the decision are many,

88. *See Karemera*, Case No. ICTR 98-44-AR73(C), ¶ 37.
89. *See id.*
90. *See id.*
91. *See id.*
92. *See id.* ¶ 38.
93. *See Karemera*, Case No. ICTR 98-44-AR73(C), ¶ 35-37.
94. *See id.* ¶ 36.
95. *Id.* ¶ 35.
96. *See id.* ¶ 38.
97. Since the Appeals Chamber's decision, two comments have been published criticizing its decision to take judicial notice of genocide: Mamiya, *supra* note 12 and

and at first glance some seem persuasive. Most of these arguments aim to show the imprudence of noticing genocide, and can be placed into two categories, which I will call "efficiency arguments" and "procedural arguments" for purposes of this Comment. However, one commentator, Ralph Mamiya, disagrees with the Appeals Chamber's decision entirely, and questions whether genocide in Rwanda fulfills the criteria for a fact of common knowledge at all.[98]

In his comment, *Taking Judicial Notice of Genocide? The Problematic Law and Policy of the Karemera Decision*,[99] Mamiya argues that the genocide in Rwanda is not a fact of common knowledge.[100] He concedes that the Rwandan genocide "is, after all, one of the best-known humanitarian tragedies in history,"[101] but argues that the intent aspect of the definition of genocide precludes this from being an appropriate fact for judicial notice.[102] He contends that, while it is possible for the world at large to know of the conduct that constitutes genocide, it is not possible for the general public to know of the specific intent of the individual perpetrators.[103] The types of evidence needed to prove specific intent—"official memoranda; the testimony of experts; victims and informants; a comprehensive investigation"[104]—are not available to the world at large.[105] He maintains that without such evidence, people make assumptions based on rumor and published account. While these assumptions may be generally correct, they are not an appropriate basis for judicial notice.[106] Mamiya thus argues that based on its intent aspect, genocide is not an appropriate fact for judicial notice.[107]

Even setting aside this argument and assuming that genocide may be an appropriate fact for judicial notice, Mamiya and other commentators advance a number of additional arguments in an effort to show that the decision to take judicial notice of genocide in Rwanda was unwise.[108] The first category of arguments contains what I will refer to as "efficiency arguments." These include arguments that noticing genocide will truncate the judicial record, impede reconciliation, and

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Heller, *supra* note 13. These commentators argue that the Appeals Chamber's decision was unwise, illogical, and conceptually flawed.

98. *See* Mamiya, *supra* note 12, at 14.
99. *Id.*
100. *See id.* at 14-17.
101. *Id.* at 14.
102. *See id.* at 16.
103. *See* Mamiya, *supra* note 12, at 16.
104. *See id.*
105. *See id.*
106. *See id.*
107. *See id.*
108. *See, e.g.*, Mamiya, *supra* note 12; Heller, *supra* note 13.

prove time consuming for future cases.[109] For example, in her comment *Noticing Genocide*,[110] Brittan Heller argues that taking judicial notice of genocide will truncate the judicial record by foreclosing future discussion about whether genocide occurred, and preventing further presentation of evidence and testimony.[111] Mamiya concurs, arguing that "[o]ne of the most fundamental goals of international criminal fora is to establish a history of the events that they examine;"[112] noticing genocide prevents the Tribunal from setting out an "impartial, detailed, and well-publicized record"[113] of those events.[114] Heller also believes that noticing genocide will impede reconciliation, for the accused will no longer be called upon to explain or excuse their actions.[115] Finally, she argues that while judicial notice aims at promoting efficiency, noticing genocide may actually lead to more time and money spent, due to attorneys' and defendants' unwillingness to accept the decision and the resulting appeals.[116] In short, these commentators argue that noticing genocide conflicts with many of the ICTR's most important efficiency goals.[117]

The second category of arguments against taking judicial notice of genocide consists of what I will refer to as "procedural arguments." These include arguments that noticing genocide violates basic legal principles, as well as the rights of the accused.[118] For example, Heller argues that taking judicial notice of genocide violates basic legal principles by conflating issues of law with issues of fact.[119] She contends that judicial notice is reserved for factual determinations, and argues that a finding that genocide occurred is not a fact; it is a legal conclusion that the elements of a crime have been met.[120] Another procedural argument advanced against noticing genocide is that it violates the rights of the accused.[121] In *Karemera*, for instance, the defendants argued that noticing genocide would prejudice them by removing both the presumption of innocence and the right to confront their accusers.[122]

109. *See* Heller, *supra* note 13, at 102-03.
110. *Id.*
111. *See id.* at 102-03; *see also* Mamiya, *supra* note 12, at 17-18.
112. Mamiya, *supra* note 12, at 17.
113. *Id.*
114. *See id.*
115. *See* Heller, *supra* note 13, at 103.
116. *See id.*
117. *See id.*; Mamiya, *supra* note 13.
118. *See* Heller, *supra* note 13, at 103.
119. *See id.*
120. *See id.*
121. *See* Prosecutor v. Karemera et al., Case No. ICTR 98-44-AR73(C), Decision on Prosecutor's Interlocutory Appeal of Decision on Judicial Notice, ¶ 34 (June 16, 2006).
122. *See id.*

Together, these arguments consist of the notion that judicial notice of genocide is inappropriate, for it violates important procedural aspects of the law.

C. *Response to Arguments Against Noticing Genocide*

The following section addresses and responds to the arguments set forth above, and argues that the various reasons presented in opposition to noticing genocide are unsound. The arguments against noticing genocide may seem persuasive upon a first reading; however, upon closer inspection they lose much of their appeal. Aside from Mamiya's argument that genocide is not a fact of common knowledge at all,[123] the rest of the arguments share one fatal flaw: they disregard the fact that Rule 94(A) is mandatory rather than discretionary.[124] In what follows, this Comment will first expand upon this assertion, and then move on to rebut Mamiya's argument that genocide is not a fact of common knowledge.[125]

The first and most problematic issue with all of the arguments advanced above—with the exception of the argument that genocide is not a fact of common knowledge at all—is that these arguments disregard the fact that Rule 94(A) is mandatory.[126] The rule states: "[a] Trial Chamber shall not require proof of facts of common knowledge but shall take judicial notice thereof."[127] In other words, "the Trial Chamber has no discretion to determine that a fact, although 'of common knowledge,' must nonetheless be proven through evidence at trial."[128] Yet, all of the efficiency and procedural arguments overlook that fact. Instead, the commentators attempt to show that the Appeals Chamber abused its discretion because its decision will make the trial more costly or time consuming, or truncate the judicial record[129]—arguments that are appropriate under Rule 94(B), but not Rule 94(A). If the Tribunal determines that the genocide in Rwanda is a fact of common knowledge, the Tribunal must take judicial notice of that fact pursuant to the mandatory nature of Rule 94(A). There may still be arguments that the decision is inefficient or procedurally unsound, but those are arguments not about whether the Appeals Chamber acted correctly in *Prosecutor v. Karemera*, but about the Tribunal's wisdom in enacting Rule 94(A). For this reason, all of the efficiency and procedural arguments fail.

123. *See* Mamiya, *supra* note 12, at 14-17.
124. *See* Rules of Procedure and Evidence, 2006 ICTR Acts & Docs. Rule 94.
125. *See* Mamiya, *supra* note 12, at 14-17.
126. *See generally id.*; Heller, *supra* note 13.
127. Rules of Procedure and Evidence, 2006 ICTR Acts & Docs. Rule 94(A).
128. *Karemera*, Case No. ICTR 98-44-AR73(C), ¶ 23.
129. *See generally* Mamiya, *supra* note 12; Heller, *supra* note 13.

Regardless of our opinions of the prudence or imprudence of taking judicial notice of genocide, our first and only inquiry must be whether the fact that genocide occurred in Rwanda fits the criteria for a fact of common knowledge.

Ralph Mamiya seems to recognize this to some degree. In his comment, Mamiya argues that the genocide in Rwanda does not meet Rule 94(A)'s criteria for a fact of common knowledge because of its intent element.[130] However, this argument also fails. While it is true that in proving genocide the Prosecution has the burden of proving specific intent, or *dolus specialis*, it is also true that in the case of genocide in Rwanda there is ample evidence to support such a burden. We may never have direct evidence of intent, but that should hardly be cause for concern. Proof of intent is often based on circumstantial evidence—which can be every bit as convincing as direct evidence—and in the case of genocide in Rwanda, there is ample circumstantial evidence. Mamiya himself admits that "the use of radio and public speakers to widely disseminate the hate-filled messages of 'Hutu Power' made the intent behind the Rwanda genocide clearer than most."[131] Further, the fact that one ethnic group was targeted and that almost half a million people from that ethnic group were killed within the span of a few months[132] provides strong circumstantial evidence of genocidal intent.

Mamiya's claim that the types of evidence needed to prove specific intent—"official memoranda; the testimony of experts; victims and informants; a comprehensive investigation"[133]—are not available to the world at large[134] is also unpersuasive. The testimony of victims and informants is available through the transcripts of cases that have already been completed, as well as cases that are working their way through trial. Additionally, the inquiry and documentation that went into the preparation of each of the indictments and trials of ICTR defendants constitutes a comprehensive investigation. While not every official memorandum of the interim Hutu government and not every victim may be available to testify as to the genocidal intent in Rwanda, there is sufficient evidence available to the world at large to determine that those in power in Rwanda during the summer of 1994 had a genocidal intent when they slaughtered the Tutsis.

130. *See* Mamiya, *supra* note 12, at 16.
131. *Id.*
132. *See* Packard, *supra* note 5.
133. Mamiya, *supra* note 12, at 16.
134. *See id.*

Furthermore, as the Tribunal noted in the *Semanza* decision, facts for judicial notice need not necessarily be known to the world at large.[135] It is enough that the facts are "generally known within a tribunal's territorial jurisdiction."[136] In this case, the Rwandan genocide is common knowledge among people in Rwanda. There are many Rwandans who lived through the ordeal and have first-hand knowledge of the events that occurred. There are also traces of what happened still evident in Rwanda, such as the church compound at Shangi.[137] To claim that genocide is not a fact of common knowledge because of the intent element of genocide is to deny all of this evidence. While the specific intent of each individual defendant may not be common knowledge, it is impossible to overlook all of the relevant evidence that points to the overall genocidal intent of those in power during the summer of 1994. The evidence available to those in Rwanda and to the world at large provides compelling—even if circumstantial—evidence of a genocidal intent.

There is also ample evidence to support the conduct element of genocide for judicial notice. The events that occurred during the summer of 1994 in Rwanda are notorious and capable of accurate and ready determination. They have been documented in books,[138] scholarly articles,[139] United Nations reports,[140] national court decisions,[141] and previous ICTR decisions.[142] There are also numerous media reports that document the events.[143] Even the full name of the Tribunal itself—the

135. *See* Prosecutor v. Semanza, Case No. ICTR 97-20-I, Decision on the Prosecutor's Motion for Judicial Notice and Presumptions of Facts Pursuant to Rules 94 and 54, ¶ 23 (Nov. 3, 2000).

136. *Id.*

137. *See* Randal, *supra* note 1.

138. *See, e.g.*, ROBERT LYONS, INTIMATE ENEMY: IMAGES AND VOICES OF THE RWANDAN GENOCIDE (Zone Books 2006); GERARD PRUNIER, THE RWANDA CRISIS: HISTORY OF A GENOCIDE (Hurst 1998) (1995).

139. *See, e.g.*, Helen M. Hintjens, *Explaining the 1994 Genocide in Rwanda*, 37 J. MOD. AFR. STUD. 241 (1999); Alex de Waal, *Genocide in Rwanda*, 10 ANTHROPOLOGY TODAY 1 (1994); Peter Uvin, *Reading the Rwandan Genocide*, 3 INT'L STUD. REV. 75 (2001).

140. *See, e.g.*, G.A. Res. 49/206, U.N. Doc. A/RES/49/206 (March 6, 1995); G.A. Res. 54/188, U.N. Doc. A/RES/54/188 (Feb. 9, 2000).

141. *See, e.g.*, Mukamusoni v. Ashcroft, 390 F.3d 110 (1st Cir. 2004); Ntakirutimana v. Reno, 184 F.3d 419 (5th Cir. 1999).

142. *See, e.g.*, Prosecutor v. Akayesu, Case No. ICTR 96-4-T, Judgment (Sept. 2, 1998); Prosecutor v. Kayishema, Case No. ICTR 95-1-T, Judgment (May 21, 1999); Prosecutor v. Musema, Case No. ICTR 96-13-A, Judgment and Sentence (Jan. 27, 2000); Proseutor v. Semanza, Case No. ICTR 97-20-T, Judgment and Sentence (May 15, 2003).

143. *See, e.g.*, Donatella Lorch, *Rape Used As Weapon in Rwanda/Future Grim for Genocide Orphans*, HOUS. CHRON., May 15, 1995, at 1; Randal, *supra* note 1; Sebastian Rotella, *Genocide Findings Cause an Uproar; A French Judge Says the Current Rwanda Leader Plotted the '94 Chaos that Left 800,000 Dead*, L.A. TIMES, Feb. 17, 2007, at A1.

International Criminal Tribunal for the Prosecution of Persons *Responsible for Genocide*—accepts the fact of genocide in Rwanda as a fact of common knowledge. In short, that genocide occurred in Rwanda is beyond reasonable dispute, and Mamiya's contention that the genocide is not a fact of common knowledge[144] is unfounded.

D. Support for the ICTR's Decision to Notice Genocide

Thus far I have tried to show that genocide is a fact of common knowledge, and that the arguments against taking judicial notice of the genocide in Rwanda fail upon closer inspection. However, there are also many reasons that the decision to take judicial notice was a prudent one in its own right. In the following section, I will discuss these reasons and show that even if Rule 94(A) was discretionary, the Tribunal made the right choice when it took judicial notice of the genocide in Rwanda.

One argument in favor of the Appeals Chamber's decision to notice genocide is that it promotes the ICTR's judicial efficiency.[145] Judicial notice aids the tribunal in using its time and financial resources more efficiently, and thus more effectively.[146] Another argument is that judicial notice helps the Court to maintain a uniform interpretation of commonly reviewed facts.[147] Once the Tribunal takes judicial notice of a certain fact, that fact will be viewed and understood the same for all cases. This uniformity in turn leads to fairness between defendants in different cases, for all defendants will be treated similarly.

Another, and perhaps the strongest argument, is that judicially noticing genocide may play a significant role in the healing process for many Rwandans, while at the same time maintaining the prosecutor's burden of proving individual defendants' guilt. By taking judicial notice of the genocide in Rwanda, the Tribunal publicly acknowledges that the genocide did, in fact, take place and affirms the strength and courage of all those Rwandans who lived through the ordeal. It also provides support against those who would argue that the mass murder of Tutsis never occurred in Rwanda, preventing something similar to the Holocaust denial from occurring. Furthermore, the decision may also provide some measure of closure, for with acceptance the healing process can begin.

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144. *See* Mamiya, *supra* note 12, at 14.

145. *See* Prosecutor v. Karemera et al., Case No. ICTR 98-44-T, Decision on the Prosecutor's Motion for Judicial Notice, ¶ 2, (Apr. 30, 2004).

146. *Id.*

147. *See generally* Prosecutor v. Semanza, Case No. ICTR 97-20-I, Decision on the Prosecutor's Motion for Judicial Notice and Presumptions of Facts Pursuant to Rules 94 and 54, ¶ 20 (Nov. 3, 2000).

Just as importantly for the Tribunal is the fact that the decision does these things without lessening the prosecutor's burden of proving the guilt of the individual defendants in each case. In order to prove its case against the accused, the prosecutor still has to provide evidence showing that the conduct and intent elements of genocide can be satisfied as to each individual defendant. The prosecutor will still be called on to make his case and carry the burden of proof, while each defendant will still have the opportunity to disprove the prosecutor's assertions or provide any defenses that defendant may have. This also provides a resolution to many of the efficiency arguments made by commentators and discussed above. By carrying the burden of proof as to each individual defendant, the prosecutor will actually build the historical record, rather than truncate it, through the presentation of evidence and testimony about the conduct and intent of each defendant that appears before the Tribunal. Thus, there are many reasons that taking judicial notice of the genocide in Rwanda was a prudent decision by the Appeals Chamber.

V. CONCLUSION

The events that occurred in Rwanda during the summer of 1994 were horrific. Almost one million people were killed based solely on their ethnicity.[148] Since that time, prosecutors in many of the cases before the International Criminal Tribunal for Rwanda had argued that the fact that genocide occurred in Rwanda should be judicially noticed, but without success.[149] That is, until the Appeals Chamber took judicial notice of the Rwandan genocide on June 16, 2006, in *Prosecutor v. Karemera, et al.*[150] Many commentators have since argued that this was an unwise decision.[151] However, upon closer inspection all of these arguments fail. Rule 94(A) provides that the Tribunal shall take judicial notice of facts of common knowledge,[152] and the genocide in Rwanda fits the definition of a fact of common knowledge. With all of the information available to the world at large, and especially to the Tribunal and its territorial jurisdiction, there is no room left to dispute that the genocide did in fact occur. Because the genocide is a fact of common knowledge, and also because it was a good decision, the Appeals Chamber made the right choice when it took judicial notice of the genocide in Rwanda.

148. *See* Randal, *supra* note 1.

149. *See* Prosecutor v. Karemera et al., Case No. ICTR 98-44-R94, Decision on Prosecution Motion for Judicial Notice (Nov. 9, 2005).

150. Prosecutor v. Karemera et al., Case No. ICTR 98-44-AR73(C), Decision on Prosecutor's Interlocutory Appeal of Decision on Judicial Notice, ¶ 38 (June 16, 2006).

151. *See, e.g.*, Mamiya, *supra* note 12; Heller, *supra* note 13.

152. *See* Rules of Procedure and Evidence, 2006 ICTR Acts & Docs. Rule 94.

Made in China: Who Bears the Loss and Why?

Elizabeth Ann Hunt*

Your own safety is at stake when your neighbor's house is ablaze.

–Horace[1]

I. INTRODUCTION

"The bottom line is: If you're worried about Chinese exports, rest assured the local stuff is without doubt many, many times worse."[2] CNN correspondent John Vause, who has continued to reside in Beijing during China's product safety crisis,[3] states the heart of the matter. "When ordering at restaurants, I wonder: Is that drug-tainted fish and shrimp? Did that pork come from a pig that was force-fed wastewater? Any melamine added to those noodles?"[4] A blatant disregard for safety within China[5] has caused widespread concern on the part of the United States and China's other trading partners.[6] Among the first major

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1. ThinkExist, http://thinkexist.com/quotes/horace/3.html (last visited May 11, 2009).

2. John Vause, *Ordering Food in Beijing Makes Me Nervous*, CNN, July 26, 2007, *available at* http://www.cnn.com/2007/WORLD/asiapcf/07/26/btsc.vause.china/index.html.

3. *See id.*

4. *Id.*

5. *See generally Shoppers Offered Few Safeguards against Wild West Imports*, CNN, July 26, 2007, *available at* http://www.cnn.com/2007/US/07/26/madeinchina.overview/ [hereinafter *Wild West Imports*].

6. *See China Calls for Cooler Heads over Product Safety*, REUTERS, May 23, 2007, *available at* http://www.alertnet.org/thenews/newsdesk/PEK18216.htm (discussing poisoned Chinese toothpaste that was exported to the Dominican Republic); *see also Chinese, Japanese Officials Meet to Discuss Poisoned Dumpling Scare*, INT'L HERALD TRIB., Feb. 4, 2008, *available at* http://www.iht.com/articles/ap/2008/02/04/asia/AS-GEN-Japan-China-Dumpling-Scare.php (stating that many Japanese stores and restaurants no longer sell Chinese products).

indications of a problem with Chinese products was the March 15, 2007 discovery by the Food and Drug Administration ("FDA")[7] that Chinese wheat gluten contaminated with melamine had been processed into North American pet products and was killing cats and dogs.[8] The consequent pet deaths resulted in over one hundred lawsuits[9] being filed against companies that had sold the tainted products,[10] including one lawsuit against a Chinese supplier.[11]

Melamine proved to be just the beginning of the scare,[12] as Chinese-made toothpaste,[13] seafood products,[14] tires,[15] and toys[16] were recalled en masse. Most notably, Mattel Inc. was forced to recall over twenty-one million Chinese-made toys in a five-week period.[17] Many of the toys were defective in design,[18] including Polly Pocket dolls that were

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7. *See Safety of Chinese Imports: Oversight and Analysis of the Fed. Response before the S. Comm. on Commerce, Sci., and Transp.* (July 18, 2007) (statement of Murray M. Lumpkin, M.D., Deputy Comm'r for Int'l and Special Programs), *available at* http://www.fda.gov/ola/2007/chineseimport071807.html [hereinafter *Oversight and Analysis*].

8. *See* Jeromy Lloyd, *Wake up and Smell the Lead*, MARKETING MAG., Sept. 10, 2007, *available at* http://www.marketingmag.ca/english/news/media/article.jsp?content=20070910_70136_70136.

9. *See* Brandon Bailey, *Lawsuit Targets Chinese Supplier: Tainted-Pet-Food Case Seeks Damages from Chemical Firm*, SAN JOSE MERCURY NEWS, Aug. 9, 2007, *available at* http://www.mercurynews.com/ (click the Help tab, then the Past Articles tab; enter "Lawsuit Targets Chinese Supplier" into the "Enter Search Terms" box; select "in headline" from the "Appearing" box; select "2007" in the "Choose articles from" section; hit "Search").

10. *See Oversight and Analysis*, *supra* note 7.

> Melamine is a molecule that has a number of industrial uses, including use in manufacturing cooking utensils. It has not been approved for use as an ingredient in human or animal food in the U.S., and it is not permitted to be used as fertilizer in the U.S., as it is in some parts of the world.

Id.

11. *See* Bailey, *supra* note 9.

12. *See Wild West Imports*, *supra* note 5.

13. *See Oversight and Analysis*, *supra* note 7.

14. *See id.*

15. *See* David Barboza & Andrew Martin, *Chinese Company Denies Tire Defect*, N.Y. TIMES, June 27, 2007, *available at* http://www.nytimes.com/2007/06/27/business/worldbusiness/27tires.html?_r=1&oref=slogin.

16. *See* Louise Story & David Barboza, *Mattel Recalls 19 Million Toys Sent from China*, N.Y. TIMES, Aug. 15, 2007, *available at* http://www.nytimes.com/2007/08/15/business/worldbusiness/15imports.html?_r=1&pagewanted=all&oref=slogin.

17. *China Seizes on Mattel Apology to Emphasize Safety*, REUTERS, Sept. 24, 2007, *available at* http://www.reuters.com/article/healthNews/idUSPEK2141420070924.

18. *See Magnets in Toys, a Hidden Danger*, Consumer Reports Blog, Nov. 21, 2006, http://blogs.consumerreports.org/safety/2006/11/magnets_in_toys.html (last visited May 11, 2009),

> The magnets in these popular toys may look innocuous: they are only 1/8-inch in diameter and are embedded in the hands and feet of some dolls and in plastic clothing, hair pieces and other accessories. But they are very dangerous if they fall out and are swallowed or aspirated. When more than one magnet is

manufactured with unsafe magnets.[19] Other toys were coated with excessive amounts of lead paint,[20] causing controversial medical monitoring class action lawsuits to be filed.[21] If what John Vause says is true, and Chinese products in China are "many, many times worse"[22] than the Chinese products exported to the United States, an exploration of the Chinese tort system and the recourse available to Chinese plaintiffs may provide some provocative answers as to how the "Made in China" scare was allowed to happen and how another scare can be prevented. This Comment will explore the effectiveness of litigation as a tool for protecting both United States and Chinese consumers when regulatory enforcement proves inadequate.

II. BACKGROUND

The acting chair of the Consumer Product Safety Commission ("CPSC"), an independent federal regulatory agency,[23] has indicated that ensuring the safety of Chinese-made toys for United States consumers is one of her highest priorities and is the subject of "vital talks currently in place between CPSC and the Chinese government."[24] This statement provides some comfort for United States consumers, but it does not reveal who or what is ensuring that Chinese-made toys are safe for

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> swallowed, they can attract each other and cause intestinal perforation, infection or blockage and be fatal. The CPSC said that it knows of three reports of serious injuries to children who swallowed more than one magnet. All three suffered intestinal perforations that required surgery.

Id. Mattel, Inc. has since improved the design of its Polly Pocket dolls, ensuring that magnets are properly embedded and sufficiently secured. *Id.*

19. *See id.*

20. *See* Lloyd, *supra* note 8.

21. *See* Gina Passarella, *Class Action Suits Seeking Medical Monitoring Filed over Recalled Mattel Toys*, THE LEGAL INTELLIGENCER, Aug. 21, 2007, *available at* http://www.law.com/jsp/article.jsp?id=1187600831516. The parents of Nydia Monroe are trying to establish a medical monitoring fund that would cover the cost of lead poisoning tests for their daughter and other possibly affected children. According to the complaint, damages in excess of $5,000,000 are requested. The damages would include "the costs of medical monitoring, interest, attorney fees, and other costs." *Monroe v. Mattel, Inc.*, No. 2:07-cv-03410 (E.D. Pa. Aug. 17, 2007), transferred to *In Re* Mattel, Inc. Toy Lead Paint Products Liability Litigation, No. 2:07-ml-01897 (C.D. Cal. Dec. 27, 2007), simply alleges negligence while a similar class action suit, *Powell v. Mattel, Inc.*, No. 2:07-cv-06517 (C.D. Cal. removal filed. Oct. 9, 2007), alleges "strict product liability, negligence, and violations of the business professions code of California." *Id.*

22. Vause, *supra* note 2.

23. United States Consumer Product Safety Commission, http://www.cpsc.gov/cpscpub/pubs/178.html (last visited May 11, 2009). The Consumer Product Safety Commission has jurisdiction over approximately 15,000 types of consumer products. The agency's mission is to ". . . protect the public against unreasonable risks of injuries and deaths associated with consumer products." *Id.*

24. *Fisher-Price Recalls 1M Toys*, CNN, Aug. 1, 2007, *available at* http://www.cnn.com/2007/US/08/01/toy.recall.ap/index.html.

Chinese consumers. The issue is compounded by the lack of adequate incentives for Chinese manufacturers to make safe products for consumers of either country. Product liability statutes and judicial precedent provide such incentives in other countries.

Product liability insures "that the costs of injuries resulting from defective products are borne by the manufacturers that put such products on the market rather than by injured persons who are powerless to protect themselves."[25] Legal scholar Judge Guido Calabresi, of the United States Court of Appeals for the Second Circuit, discusses theories of liability in *The Costs of Accidents*.[26] Calabresi's analysis involves identifying the "acts or activities" that will most cheaply allow for accident avoidance.[27] He points out that one party to a transaction may be in a superior position to evaluate expected accident costs.[28] Calabresi illustrates his point with a discussion of rotary mowers.[29] Based upon the assumption that the rotary mower industry is best informed about the expected accident cost of mower use, the cost will be placed upon the industry.[30] Mower prices will reflect the expected cost, thus informing the public, who will be able to buy a higher priced mower or abstain from buying and indirectly force the mower companies to make safer products.[31]

As applied to the recent situation with China, it is clear that the Chinese companies are the cheapest cost avoiders. United States consumers cannot reasonably be expected to consider the costs of melamine and lead paint, or a skipped safety measure, if they are completely unaware and unadvised. Furthermore, it would seem that the Chinese companies have not reflected increased accident costs in their pricing.

It cannot be denied that Chinese pricing is extremely low when compared to United States pricing.[32] A study conducted by Morgan Stanley estimates that the low pricing of Chinese products saved United States consumers six hundred billion dollars during the period of 1996 to 2006.[33] Additionally, the fact that some Chinese companies use

25. Greenman v. Yuba Power Prod., Inc., 377 P.2d 897, 901 (Cal. 1963).
26. GUIDO CALABRESI, THE COSTS OF ACCIDENTS (1970).
27. *See id.* at 135-73.
28. *See id.* at 163.
29. *See id.*
30. *See id.*
31. *See* CALABRESI, *supra* note 26.
32. *See* Pete Engardio & Dexter Roberts with Brian Bremner, *The China Price*, BUS. WK., Dec. 6, 2004, *available at* http://www.businessweek.com/magazine/content/04_49/b3911401.htm.
33. *See* Vice Premier: China-U.S. Trade Offers Mutual Benefit, Win-Win Progress, Embassy of the People's Republic of China in the United States of America, May 18, 2007, http://www.china-embassy.org/eng/xw/t320366.htm [hereinafter Mutual Benefit].

dangerous ingredients and skip necessary steps to increase profits[34] is evidence that there is a lack of consideration for the increased costs associated with such activities. Assuming the validity of the assertion that Chinese pricing does not accurately reflect accident costs, United States consumers have been rendered unable to make informed decisions about Chinese product safety based upon market prices.

The "Made in China" scare is a complex situation with multidimensional players and responsibilities. The plaintiffs involved in the litigation are American; the defective products are Chinese; the defendants are American.[35] It appears that the Chinese companies will not be held liable to the United States consumers in tort,[36] so it must be answered whether they will be held liable at all, and to what extent, for the products they manufacture. Legal theorist Judge Richard Posner, of the United States Court of Appeals for the Seventh Circuit, has developed a theory about accident reduction.[37] His approach suggests that economic actors will forego preventative measures when the cost of accidents, and therefore the cost of liability, is less than the cost of prevention.[38]

Although Judge Posner's theory is relevant in the United States, it has limited impact in China. With China's tort system and damage scheme as they currently stand, Chinese manufacturers may be able to avoid both the cost of prevention *and* the cost of liability.[39] It is questionable whether some Chinese manufacturers are made to bear any of the losses they cause.[40] The Chinese civil law system supports the idea that victims are to be fully compensated by tortfeasors.[41] However, a system of insufficient access to the courts, compensatory damage awards that are not truly compensatory, and no punitive damage awards has left Chinese tort victims with little recourse.[42]

While United States citizens have access to competent attorneys and state and federal courts that will allow arguments for damages related to

34. *See* Barboza & Martin, *supra* note 15.

35. *See* Roger Parloff, *China's Newest Export: Lawsuits*, FORTUNE, July 5, 2007, *available at* http://money.cnn.com/2007/07/05/news/international/chinese_lawsuits.fortune/index.htm (stating that "[n]o American lawyer interviewed for this article was contemplating suing Chinese entities in Chinese courts, where tiny damage awards and frequently hostile local judges often make litigation pointless.").

36. *See id.*

37. *See* Richard Posner, *A Theory of Negligence*, 1 J. LEGAL STUD. 29, 33 (1972).

38. *See id.*

39. *See generally* JIANSHENG LI, LAW ON PRODUCT QUALITY CONTROL AND PRODUCT LIABILITY IN CHINA (2006).

40. *See id.* at 457-89.

41. *See id.* at 467.

42. *See id.* at 457-89.

loss of a pet[43] or funds for medical monitoring,[44] Chinese citizens are routinely under-compensated for tortious injuries and deaths, and often not compensated at all.[45] As United States attorneys are scrambling to find plaintiffs for class action suits regarding defective products made in China,[46] many Chinese citizens never file claims because the damages awarded are so low that they may incur more expense pursuing a cause of action than they are able to recover.[47] In China, attorneys' fees and litigation handling fees are sufficient to deter the injured from seeking compensation.[48]

III. AN ILLUSTRATIVE EXAMPLE: HANGZHOU ZHONGCE RUBBER CO.

On August 12, 2006, an accident on the Pennsylvania turnpike left two men dead and one man with permanent brain damage.[49] A tire defect had caused a tread to suddenly become wrapped around an axle, resulting in a loss of vehicular control and a consequent rollover collision into an embankment.[50] The Hangzhou Zhongce Rubber Co. in Hangzhou, China is being blamed for the loss.[51]

A lawsuit filed on May 4, 2007 by Woloshin and Killino, P.C. alleges that the accident resulted from a tire that was lacking a gum strip, a necessary safety component.[52] Following the Pennsylvania accident, as well as an ambulance rollover in New Mexico, Foreign Tire Sales was ordered by the National Highway Traffic Safety Administration to recall approximately 450,000 tires imported from Hangzhou Zhongce Rubber Co.[53] It is alleged that the Hangzhou Zhongce Rubber Co. "deliberately and secretly" removed the gum strip feature from the tires they imported to the United States in order to cut costs.[54] The forced tire recall and the potential damage awards in the wrongful death and personal injury cases

43. *See Pet Owners Unlikely to be Compensated in Suits*, ASSOCIATED PRESS, Apr. 1, 2007, *available at* http://www.msnbc.msn.com/id/17899884/.

44. *See* Passarella, *supra* note 21.

45. *See* LI, *supra* note 39, at 457-89.

46. *See, e.g.*, Woloshin & Killino, P.C., http://www.killinofirm.com/ (last visited May 11, 2009).

47. *See, e.g.*, Zhang Jieting v. Toyota Company of Japan and Yao Yutang v. Shanghai Beer Corp., *cited in* LI, *supra* note 39, at 495.

48. *See* LI, *supra* note 39, at 457-89.

49. *See Fatal Crash Prompts Distributor to Press for Chinese Tire Recall*, MOTOR TREND, June 25, 2007, *available at* http://www.motortrend.com/features/newswire/29473/index.html [hereinafter *Fatal Crash*].

50. *See id.*

51. *See* Andrew Martin, *Chinese Tires are Ordered Recalled*, N.Y. TIMES, June 26, 2007, *available at* http://www.nytimes.com/2007/06/26/business/worldbusiness/26tire.html.

52. *See Fatal Crash*, *supra* note 49.

53. *See id.*

54. *See id.*

are two measures that will help to ensure future tire safety in the United States.[55]

The United States tort system faces no shortage of lawyers who will zealously represent clients on a contingent fee basis and prosecute their cases at no charge until there is a settlement or a favorable jury verdict.[56] A quick internet search[57] reveals the abundance of plaintiffs' attorneys who are anxious to represent consumers affected by unsafe Chinese products. The largest association of American plaintiffs' lawyers, the American Association for Justice ("AAJ"), is also the world's largest trial bar.[58] The purpose of the AAJ is to ensure that any individual who is tortiously harmed can get "justice in America's courtrooms,"[59] even when challenging "the most powerful interests."[60]

Justice in the courtroom has an entirely different meaning in China, where there were only 110,000 lawyers for a population of 1248.1 million at the end of 1998,[61] or, nine lawyers for every 100,000 people.[62] Contrasted with 1999 figures for the United States (about 1,000,000 lawyers for a population of 270.561 million people, or, 370 lawyers for every 100,000 people),[63] it becomes clear that obtaining legal representation in China is a more difficult task than it is in the United States.[64] All of China's lawyers are members of the All China Lawyers Association,[65] which claims a membership of only 110,000.[66] With such an inadequate supply of lawyers, most Chinese cases proceed without counsel.[67] Chinese plaintiffs do not have the benefit of a legal team that is willing to pay their filing fees, medical records costs, expert witness fees, or trial preparation costs.[68] Pursuing recovery through the Chinese system involves time and effort, as well as attorneys' fees and expenses

55. *See id.*

56. *See* About AAJ, Mission & History, http://www.justice.org/cps/rde/xchg/justice/hs.xsl/418.htm (last visited May 11, 2009) [hereinafter AAJ]. AAJ was formerly the Association of Trial Lawyers of America ("ATLA").

57. Using the terms "Chinese," "product," and "lawyer" in a Google search produces an abundance of law firms handling Chinese product litigation for consumers.

58. *See* AAJ, *supra* note 56.

59. *Id.*

60. *Id.*

61. LI, *supra* note 39, at 447.

62. *Id.*

63. *Id.*

64. *See id.*

65. All China Lawyers Association Law Committees, http://www.chineselawyer.com.cn/html/union/englishunion/briefintroduction.html (last visited May 11, 2009) [hereinafter All China Lawyers].

66. *Id.*

67. *See Class Action Litigation in China*, 111 HARV. L. REV. 1523, 1536 (1998) [hereinafter *Class Action*].

68. *See generally*, LI, *supra* note 39, at 457-89.

related to prosecution of the case.[69] Many Chinese tort victims regard legal recourse as being too risky to pursue,[70] as a court's monetary award, if any, may be less than the cost of engaging in litigation.[71]

With regard to the Foreign Tires Sales recall, New York Times writers David Barboza and Andrew Martin discuss "assertions that experts say point to a common problem: Chinese manufacturers win a contract after agreeing to make a product, following certain guidelines or specifications, and then, often for cost reasons, switch to a cheaper ingredient or process that lowers costs."[72] The lawyer representing Foreign Tire Sales has asserted that the omitted gum strips would have cost the Hangzhou Zhongce Rubber Co. less than one dollar per tire.[73] A recall of the 450,000 tires will cost between $50,000,000 and $80,000,000 (between $111 and $178 per tire).[74] Additionally, the wrongful death and personal injury cases are likely to result in damage awards in the millions of dollars.[75]

The tremendous loss resulting from this deliberately skipped safety step could have been prevented for $450,000.[76] Applying Judge Posner's formula,[77] it is obvious that the cost of accidents resulting from Hangzhou Zhongce Rubber Co.'s faulty tires is not less than $450,000. In *Reforming Products Liability*, author Kip Viscusi concluded that the value of life in the United States was at least $2,400,000 in 1990.[78] If Hangzhou Zhongce Rubber Co. had followed the Hand Formula and considered the probability that one life would be lost as a result of the gum strips missing from its tires, it would not have skipped the safety step. However, Chinese manufacturers may not care about the Hand Formula. Even if Hangzhou Zhongce Rubber Co. had considered the potential for loss of life, it may have skipped the step anyway.

The reality of the situation is that Hangzhou Zhongce Rubber Co. may end up paying nothing. The National Highway Traffic Safety Administration insists that Foreign Tire Sales is the liable party.[79]

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69. *See id.* at 475.
70. *See id.* at 447.
71. *See id.*
72. Barboza & Martin, *supra* note 15.
73. *See id.*
74. *Id.*
75. *See generally* Thomas H. Cohen, J.D., Ph.D. & Steven K. Smith, Ph.D., *Civil Trial Cases and Verdicts in Large Counties, 2001*, U.S. Dep't of Just., *available at* http://www.ojp.gov/bjs/pub/pdf/ctcvlc01.pdf [hereinafter *Cases and Verdicts*].
76. *See* Barboza & Martin, *supra* note 15.
77. *See* Posner, *supra* note 37 (stating that "[w]hen the cost of accidents is less than the cost of prevention, a rational profit-maximizing enterprise will pay tort judgments to the accident victims rather than incur the larger cost of avoiding liability.").
78. *See* W. KIP VISCUSI, REFORMING PRODUCTS LIABILITY 108 (1991).
79. *See* Barboza & Martin, *supra* note 15.

Despite the likelihood that Hangzhou Zhongce Rubber Co.'s defective tires will put Foreign Tire Sales out of business, traffic safety administrator Nicole R. Nason has stated, "If you import the equipment, you assume the responsibility."[80] The difficulty with applying United States economic principles to tort law in China, and with regard to Chinese products, is the fact that Chinese manufacturers do not bear the appropriate level of accident costs caused by their products in the Chinese market or in the foreign market.[81] The outcome of the $80,000,000 lawsuit filed by Foreign Tire Sales against Hangzhou Zhongce Rubber Co. is uncertain, as the Chinese manufacturer denies all liability.[82]

Furthermore, as in the case of the pet product lawsuit that was filed against a Chinese supplier, Chinese companies often have no assets in the United States and it is difficult to ascertain who or what owns them in China.[83] According to Professor Robert Berring, "Chinese courts are often inhospitable to foreign claims, especially those that reflect on Chinese national pride or integrity."[84] He said, "They may never respond. It may take a lot of time. But I don't see why a Chinese company should be immune from liability in the United States."[85] As of February 6, 2008, international law experts were unaware of any situation during which a United States plaintiff successfully collected on a verdict against a Chinese company.[86]

An examination of the extent to which Chinese companies are held liable for the injuries caused by products in the Chinese market is warranted to determine why China's tort system is ineffective at deterring manufacturers from skipping safety measures. A comparison of the United States product liability system and the Chinese product liability system may reveal why United States companies are answering for the losses caused by products purchased from Chinese suppliers.

80. *Id.*
81. *See* LI, *supra* note 39, at 476.
82. *See Fatal Crash*, *supra* note 49; *see also* Barboza & Martin, *supra* note 15.
83. *See* Bailey, *supra* note 9.
84. *Id.*
85. *Id.*
86. *U.S. Product Suits Fall Short in China*, THOMSON FIN., Feb. 6, 2008, http://money.cnn.com/news/newsfeeds/articles/newstex/AFX-0013-22828207.htm (stating that the United States and China lack any type of treaty that would provide for judgment enforcement between the two countries) [hereinafter *Product Suits Fall Short*].

IV. THE UNITED STATES PRODUCT LIABILITY SYSTEM

A. Doctrine

Product liability law in the United States traditionally has been rooted in a standard of negligence.[87] However, in *Greenman v. Yuba Power Products, Inc.*,[88] the Supreme Court of California adopted a new form of product liability: strict liability.[89] The opinion, written by Justice Roger Traynor in 1963, states that a "manufacturer is strictly liable in tort when an article he places on the market, knowing that it is to be used without inspection for defects, proves to have a defect that causes injury to a human being."[90] Among the first indications of a potential shift from negligence to strict liability was Justice Traynor's concurrence in the 1944 case *Escola v. Coca Cola Bottling Co. of Fresno*.[91]

In *Escola*, a soda bottle broke in the plaintiff's hand as she placed it in the refrigerator of the restaurant where she worked.[92] The majority allowed the plaintiff an inference of negligence based upon the fact that the bottle would not have exploded if the manufacturer had exercised due care.[93] Defendant's exclusive control at the time of manufacture was critical to the plaintiff's case, as bottles do not develop latent defects post-manufacture.[94] Foreshadowing his opinion in *Greenman*, Justice Traynor wrote: "Even if there is no negligence, however, public policy demands that responsibility be fixed wherever it will most effectively reduce the hazards to life and health inherent in defective products that reach the market."[95] Justice Traynor further argued that the manufacturer is in a better position than the public to afford protection against the risk of injury.[96]

Two years after the *Greenman* decision,[97] the American Law Institute published Section 402A of the Restatement (Second) of Torts,[98] which applies to "[o]ne who sells any product that is in a defective

87. *See* Escola v. Coca Cola Bottling Co. of Fresno, 150 P.2d 436 (Cal. 1944).
88. Greenman v. Yuba Power Prod., Inc., 377 P.2d 897 (Cal. 1963).
89. *See id.*
90. *Id.* at 900.
91. *Escola*, 150 P.2d at 440-44.
92. *Id.* at 437-38.
93. *Id.* at 440.
94. *Id.*
95. *Id.*
96. *Escola*, 150 P.2d at 441.
97. Greenman v. Yuba Power Prod., Inc., 377 P.2d 897 (Cal. 1963).
98. RESTATEMENT (SECOND) OF TORTS § 402A (1965).

condition unreasonably dangerous to the user or consumer."[99] As reasonableness is a central concept of negligence,[100] it would seem that the drafters of the Restatement were indecisive about the application of a strict liability standard.[101] However, the Restatement (Third) of Torts: Products Liability,[102] published in 1998, applies to "[o]ne engaged in the business of selling or otherwise distributing products who sells or distributes a defective product."[103]

The Products Liability Restatement reflects a partial abandonment of reasonableness and the negligence standard and an expansion from liability of sellers exclusively to liability of sellers *and* distributors.[104] The chain of liability now runs from supplier to manufacturer; manufacturer to vendor; vendor to retailer; retailer to purchaser; and purchaser to injured party.[105] The strict liability standard requires evidence that the product at issue was defective at the time of manufacture and that it caused the plaintiff's injuries.[106] A defendant need not be at fault for a plaintiff to prevail under a theory of strict liability.[107]

B. Policy Justifications for Strict Liability

Most jurisdictions in the United States have adopted a strict liability standard for cases involving defective products.[108] The consequent economic incentive for manufacturers to make and distribute safe products has been cited as one of the most significant developments in tort law.[109] The current policy justifications for a movement from negligence to strict liability are reminiscent of Justice Traynor's arguments in *Escola* and *Greenman*: (1) manufacturers are in the best position to assume the risks of injuries and spread the cost of those risks by charging consumers higher prices;[110] (2) total accident costs are

99. Mark A. Franklin, Robert L. Rabin & Michael D. Green, Tort Law and Alternatives 566 (2006).

100. *See id.* at 50-60.

101. *See id.* at 50-60, 616.

102. RESTATEMENT (THIRD) OF TORTS: PRODUCTS LIABILITY (1998).

103. *Id.* § 1.

104. *See* FRANKLIN, *supra* note 99, at 566-67.

105. *See id.* at 566-71.

106. *See* WERNER PFENNIGSTORF, A COMPARATIVE STUDY OF LIABILITY LAW AND COMPENSATION SCHEMES IN TEN COUNTRIES AND THE UNITED STATES 19 (1991).

107. *See id.*

108. *See id.*

109. *See* Jeffrey Robert White, *Top 10 in Torts: Evolution in the Common Law*, TRIAL, July 1996, *available at* http://www.thefreelibrary.com/Top+10+in+torts:+evolution+in+the+common+law-a018526923 [hereinafter TRIAL].

110. *See* Escola v. Coca Cola Bottling Co. of Fresno, 150 P.2d 436, 441 (Cal. 1944); *see also* PFENNIGSTORF, *supra* note 106, at 19; VISCUSI, *supra* note 78, at 45.

reduced by charging manufacturers without regard for a negligence standard;[111] and (3) the burden of proving negligence in manufacturing is too great for a consumer, who has little to no knowledge of the manufacturing process.[112] It has been argued that society is best served by treating the risks of injuries from defective products as a cost of doing business.[113] The value of a business is negatively impacted by "[a]ccidents, product recalls, and adverse information events related to product safety,"[114] the combination of which produces a strong economic incentive for manufacturers to make safe products.

C. *Legal Representation and Access to the Courts*

United States plaintiffs enjoy the benefits of a contingency fee system.[115] On a contingency basis, if a plaintiff's case is not successfully settled or tried by retained counsel, the plaintiff does not owe a fee.[116] However, if the plaintiff does recover a monetary sum, counsel is entitled to a pre-arranged percentage of the amount recovered from the defendant.[117] The consequence of such an arrangement is that counsel for the plaintiff bears all of the economic risk associated with litigation.[118] The contingency fee has been referred to as an individual's "key to the courthouse."[119] Absent such a system, a tort victim who could not afford competent counsel would be unable to present effectively his or her case and seek compensation for wrongful injury.[120] Greater access to legal counsel is one of several factors cited as contributing to an increase in civil litigation over the years.[121]

D. *Damage Awards*

The purpose of a damage award for an unintentional tort is "to return the plaintiff as closely as possible to his or her condition before the accident."[122] Compensatory damage awards usually are comprised

111. *See Escola*, 150 P.2d at 441; *see also* PFENNIGSTORF, *supra* note 106, at 19.
112. *See Escola*, 150 P.2d at 441; *see also* PFENNIGSTORF, *supra* note 106, at 19.
113. *See Escola*, 150 P.2d at 441; *see also* TRIAL, *supra* note 109.
114. MICHAEL J. MOORE & W. KIP VISCUSI, PRODUCT LIABILITY ENTERING THE TWENTY-FIRST CENTURY 5 (2001).
115. *See* FRANKLIN, *supra* note 99, at 16.
116. *See id.*
117. *See id.*
118. *See* PFENNIGSTORF, *supra* note 106, at 32.
119. Herbert M. Kritzer, *The Wages of Risk: The Returns of Contingency Fee Legal Practice*, 47 DEPAUL L. REV. 267 (1998).
120. *See* PFENNIGSTORF, *supra* note 106, at 32.
121. *See id.* at 35 (*citing* Donald G. Gifford and David J. Nye, *Litigation Trends in Florida: Saga of a Growth State*, 39 U. FLA. L. REV. 829, 869 (1987)).
122. FRANKLIN, *supra* note 99, at 698.

of: loss of earnings from time of accident to time of trial;[123] possible future loss of earnings;[124] past and future medical expenses;[125] and pain and suffering.[126] The jury in a tort case is responsible for determining damage awards, and is expected to do so with little instruction.[127] As Justice Traynor pointed out in his *Seffert v. Los Angeles Transit Lines*[128] dissenting opinion, "The jury and the trial court have broad discretion in determining the damages in a personal injury case."[129] Such broad discretion has been the subject of much debate surrounding tort reform, particularly with regard to pain and suffering awards and punitive damage awards.[130] Punitive damages awards are justified as a deterrent to "willful and wanton conduct."[131]

According to a comprehensive study done by the U.S. Department of Justice in 2001, the median product liability award in the seventy largest United States counties was $450,000 for the 70 out of 154 trials that were won by a plaintiff.[132] Of those trials, three involved punitive damage awards, the median of which was $433,000.[133] Of the eleven product liability trials involving a wrongful death claim, the median award was $2,000,000.[134] It is important to note, however, that the vast majority of product liability claims that are not voluntarily dismissed by plaintiffs are settled out of court and never proceed to trial.[135] Furthermore, the cases that get filed in court tend to involve large monetary claims, while small claims may never be pursued.[136]

V. THE CHINESE PRODUCT LIABILITY SYSTEM

A. Doctrine

The People's Republic of China ("PRC") began to recognize the rights of consumers[137] thirty years after the *Greenman* decision[138] had re-

123. *See id.* at 706.
124. *See id.* at 706-09.
125. *See id.* at 706.
126. *See id.* at 709-13; *see also* Seffert v. Los Angeles Transit Lines, 364 P.2d 337 (Cal. 1961).
127. *See* PFENNIGSTORF, *supra* note 106, at 27.
128. *Seffert*, 364 P.2d 337.
129. *Id.* at 344-345.
130. *See, e.g.*, PFENNIGSTORF, *supra* note 106, at 31.
131. *Id.* at 28.
132. *See Cases and Verdicts*, *supra* note 75.
133. *Id.*
134. *Id.*
135. *See* VISCUSI, *supra* note 78, at 6.
136. *See id.*
137. *See generally* Li Han, *The Product Quality Law in China: A Proper Balance between Consumers and Producers?* 6 J. CHINESE & COMP. L. 1 (2003).

shaped product liability law in the United States.[139] The perceived United States product liability crisis of the late 1980's had already come and gone by the time the PRC was adopting its first law expressly to address product liability.[140] The Law of the People's Republic of China on Product Quality ("PQL") became effective on September 1, 1993.[141] Simply put, Chinese product liability law has not had the decades of development that United States product liability law has experienced. The PQL was amended by the Standing Committee of the National People's Congress ("NPCSC") on July 8, 2000, and the new law became effective on September 1, 2000.[142] As stated in the PQL, the objective of the law is to "strengthen the supervision and control over product quality, to define the liability for product quality, to protect the legitimate rights and interests of users and consumers and to safeguard the socioeconomic order."[143]

Unlike product liability law in the United States, which is rooted in common law, Chinese product liability law is based entirely upon statute.[144] As defined in Article 34 of the PQL, a defect "means the unreasonable danger existing in [a] product which endangers the safety of human life or another person['s] property; where there are national or trade standards safeguarding the health or safety of human life and property defect means inconformity to such standards."[145] The PQL language more closely resembles the "unreasonably dangerous" phrasing of Section 402A of the Restatement (Second) of Torts[146] than it does the phrasing of the Products Liability Restatement.[147] Indeed, there is much discussion about whether the PRC should adopt a strict liability standard or a fault-based standard.[148]

B. Policy Justifications for Strict Liability

The PQL does not expressly address the idea of strict liability.[149] However, the following policy goals were afforded consideration by the

138. Greenman v. Yuba Power Prod., Inc., 377 P.2d 897 (Cal. 1963).
139. *See* TRIAL, *supra* note 109.
140. *See* Han, *supra* note 137, at 3.
141. *See id.* at 1.
142. *Id.*
143. Law of the People's Republic of China on Product Quality [PQL], ch. 1, art. 1, *in* LAUREN J. SAADAT, THE LAWYER'S GUIDE TO CHINA'S TECHNICAL REGULATIONS FOR IMPORTED PRODUCTS 95 (2001).
144. *See* Han, *supra* note 137, at 2.
145. PQL ch. 4, art.34, *cited in* SAADAT, *supra* note 143, at 102.
146. RESTATEMENT (SECOND) OF TORTS § 402A (1965).
147. RESTATEMENT (THIRD) OF TORTS: PRODUCTS LIABILITY (1998).
148. *See generally* Han, *supra* note 137.
149. *See id.* at 8.

drafters of the legislation: (1) consistency with international legal practice for optimal "economic and trade exchanges";[150] (2) the "practical needs" and considerations of China;[151] and (3) China's developing market economy.[152] After a study of international legislation involving countries such as the United States, the United Kingdom, Japan, Canada, Taiwan, and Germany, the Chinese legislature determined that most countries with a product liability system have adopted strict liability as the principle standard of liability.[153] Further evidence that strict liability may have been the legislative intent of the drafters can be found through a consideration of China's economic and political scheme around 1993.[154] At the time of the PQL's adoption, China's market was flooded with fake, inferior, and defective products, but consumer protection laws were not yet a reality.[155]

C. *Legal Representation and Access to the Courts*

Considered "the worst of that 'stinking ninth category' of antisocial elements called intellectuals"[156] during the Anti-Rightist Campaign and the Cultural Revolution, Chinese lawyers have rapidly grown in number during recent history.[157] As recently as 1980, there were only 3,000 lawyers practicing in the entire country.[158] Contrasted with the current figure of 110,000 lawyers,[159] it is evident that change has encompassed China's legal arena.[160] During the Anti-Rightist Campaign and the Cultural Revolution, the practice of law was outlawed and lawyers were accused of being capitalists whose purpose was contrary to "socialist ideology and the state interest."[161] The legal profession was reborn when Deng Xiaoping became the Communist Party leader in 1978.[162] However, the organization of non-state law firms was forbidden until 1988,[163] as all lawyers were considered "state legal workers."[164] A lack

150. *Id.* at 7-8.
151. *Id.*
152. *Id.*
153. *See* Han, *supra* note 137, at 8.
154. *See id.*
155. *See id.*
156. Jerome A. Cohen, *Reforming China's Civil Procedure: Judging the Courts*, 45 AM. J. COMP. L. 793 (1997).
157. *See Class Action*, *supra* note 67, at 1536.
158. *Id.*
159. *See* All China Lawyers, *supra* note 65.
160. *See Class Action*, *supra* note 67, at 1536-40.
161. Al Young, *The Continuing Lack of Independence of Chinese Lawyers*, 18 GEO. J. LEGAL ETHICS 1133, 1135 (2005).
162. *See id.*
163. *See Class Action*, *supra* note 67, at 1536.
164. *Id.*

of individual autonomy regarding case selection and practice management limited the amount of profit expected and sought by Chinese lawyers.[165]

The promulgation of the Lawyers Law[166] in 1996, which definitively allows for the formation of law firms as cooperatives or partnerships, created profit motivation within the legal field.[167] However, fee restrictions continue to render many cases undesirable, and plaintiffs are often unable to retain counsel.[168] Figures from the Supreme People's Court reveal that of the 4,889,353 cases heard in 1995, only 863,574 involved lawyer participation.[169] National fee standards dictate the amount lawyers may charge for their services.[170] Economic cases and property cases face an upper limit of "three percent of the amount in controversy."[171] With little economic incentive for lawyers to accept a plaintiff's case under the current system, many have decided to either disregard the law and charge an excess amount (or a contingency fee) or turn to commercial practice.[172]

It is important to note that while the Lawyers Law of 1996 has afforded Chinese lawyers an increased sense of independence from their government, representation of a client whose case is unfavorable to the government, or even against the government, may lead to retaliation.[173] The idea of an individual winning a lawsuit against the government is a new concept in China.[174] The case of a five-year old boy's HIV infection illustrates this point.[175]

Li Ning contracted HIV during a 1996 procedure performed at a government hospital in the county of Xinye, and was subsequently awarded $47,000 (USD), to be paid by the Xinye County Health Department.[176] While the award was considered to be a "milestone in a country where the courts have long been subservient to the Communist

165. *See id.*
166. Zhonghua Renmin Gongheguo Lüshi Fa [People's Republic of China Lawyers Law], *in* 1996 ZHONGHUA RENMIN GONGHEGUO XIN FAGUI HUIBIAN [COLLECTED NEW LAWS AND REGULATIONS OF THE PEOPLE'S REPUBLIC OF CHINA], No. 2, at 39.
167. *See Class Action*, *supra* note 67, at 1536.
168. *See id.*
169. *Id.* (citing Zhongguo Falü Nianjian Bianji Bu, LAW YEARBOOK OF CHINA (1996)).
170. *See Class Action*, *supra* note 67, at 1536-37.
171. *Id.*
172. *See id.* at 1537.
173. *See generally* Young, *supra* note 161.
174. *See id.*
175. *Id.* at 1147-48.
176. *Id.*

Party,"[177] it is strikingly small for the contraction of a fatal disease, especially since Ning's treatment was estimated at $50,000 (USD) a year.[178] At the time Ning's family received the verdict in 2000, China did not have laws regarding medical malpractice and the system was seriously tilted in favor of hospital defendants.[179] Aware of the difficulties with pursuing such a cause of action and the consequent rejection of the case by many attorneys, a law professor named Zhang Qian decided to represent Ning at no charge.[180] Despite Qian's request for $1,340,000 (USD) in damages, Ning ended up receiving approximately $24,000 (USD) of a $47,000 (USD) award,[181] the inadequacy of which is evident. Most hospitals in China do not carry malpractice insurance,[182] a factor that contributes to a lack of justice for plaintiffs.

In another partial victory against the Chinese government, up to $1,200,000 (USD) was awarded by the Wuxian People's Court in Jiangsu to the family of a woman who died after contracting HIV during a blood transfusion at the Nanzhang County Hospital.[183] The court found that the hospital had failed to screen its blood supplies and was therefore culpable "beyond reasonable doubt."[184] The woman's husband and their baby subsequently became infected with HIV and are to be compensated periodically.[185] The lawyer for the plaintiffs reflected concern that financial troubles within the hospital would prevent his clients from being paid.[186]

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177. Young, *supra* note 161, at 1147-48 (citing Philip P. Pan, *Children's Lawsuits Force China to Confront AIDS; Slowly and with Difficulty, a Culture of Litigation Takes Root*, WASH. POST, July 7, 2001, at A01).

178. *See id.*

179. *See id.*

180. *Id.*

181. *Id.*

182. *See* Li Fangchao, *Medical Malpractice Insurance Made Compulsory*, CHINA DAILY, Nov. 4, 2004, *available at* http://www.chinadaily.com.cn/english/doc/2004-11/04/content_388673.htm.

> According to a report by the Beijing Insurance Regulatory Committee released this June, less than 20 city hospitals have taken out medical malpractice insurance. And only two insurance companies, PICC Property and Casualty Co Ltd and the Beijing Branch of Taiping Life Insurance Co Ltd, offer such a policy.

Id.

183. *See China Court Awards Huge Compensation for HIV Blood Transfusion*, U.S. Centers for Disease Control and Prevention (Sept. 12, 2001), *available at* http://www.thebody.com/content/art17991.html.

184. *Id.*

185. Hu Yan, *AIDS Patient Gets US $1.2 M*, CHINA DAILY, Nov. 9, 2001, *available at* http://www.china-aids.org/english/News/News012.htm.

186. *Id.*

D. Damage Awards

Appeal to juror sympathy, an effective strategy in the United States,[187] would be futile in China, where the system of compensatory damages is strictly mathematical.[188] The perceived value of an individual's life in China can be calculated using geography and income data.[189] As stated in Article 29 of the December 4, 2003 Supreme People's Court Interpretation:

> Compensation for death is calculated on the basis of 20 times the previous year's average net income of urban residents in the city where the court is located, or the average net income of rural residents where the court is located. However, if the decedent is 60 or over, compensation is reduced by one year for each year over 60, provided that the compensation is based on 5 years for decedents 75 or over.[190]

The lack of ambiguity in Article 29 should make the calculation of expected accident costs a less cumbersome task for manufacturers in China than it is for manufacturers in the United States, where juries have broad discretion in assessing damages.[191]

Like manufacturers in a negligence regime, manufactures in a strict liability regime are expected to take cost-justified precautions.[192] The impact of cost justification in China is striking and is best illustrated by the Hand Formula. According to statistics compiled by the World Health Organization ("WHO"), rural households in China had a per capita annual net income of $356 (USD)[193] while urban households had a per capita disposable income of $1138 (USD) in 2004.[194] At the end of 2004, 26.1 million Chinese citizens lived in rural areas with an annual

187. *See* Paul D. Boynton, *$21M Verdict Upheld Despite Juror 'Sympathy' for Plaintiffs: Woman Said She Would 'Fairly' Assess Case*, MO. LAW. WKLY, Oct. 28, 2002, *available at* http://www.lawyersusaonline.com/reprints/dbj10.htm.

188. *See* George W. Conk, *A New Tort Code Emerges in China: An Introduction to the Discussion with a Translation of Chapter 8—Tort Liability, of the Official Discussion Draft of the Proposed Revised Civil Code of the People's Republic of China*, 30 FORDHAM INT'L L.J. 935, 946 (2007).

189. *See id.*

190. *Id.*

191. *See* Seffert v. Los Angeles Transit Lines, 364 P.2d 337, 344-345 (Cal. 1961).

192. *See Economic Analysis of Alternative Standards of Liability in Accident Law*, http://cyber.law.harvard.edu/bridge/LawEconomics/neg-liab.htm (last visited May 11, 2009).

193. Demographics, Gender and Poverty, World Health Organization Regional Office for the Western Pacific, http://www.wpro.who.int/countries/05chn/ (last visited Feb. 10, 2008).

194. *Id.*

per capita net income below $81 (USD).[195] Utilizing those figures, it would be possible for a Chinese individual's life to be valued at just $1,620 (USD). Compared to life valuation in the United States, which measures in the millions of dollars,[196] it becomes evident that a Chinese manufacturer will take a different approach to accident prevention than will a United States manufacturer. Such economic analysis may explain the seemingly unacceptable level of precaution taken by Chinese companies.

VI. CONCLUSION

While it has been predicted that China will become more aligned with the international legal community during the next ten years,[197] United States consumers and businesses will need an immediate course of action with regard to this dangerous trading partner. Some consumers have decided to remove Chinese products from their households altogether,[198] but the feasibility of such a plan is questionable at best. Chinese products are much more affordable than American products.[199] Furthermore, they seem to be inescapable.[200] As documented by Sara Bongiorni in *A Year without "Made in China": One Family's True Life Adventure in the Global Economy*,[201] trying to avoid Chinese products is more of an experiment than a way of life. Consumers can visit the website of the CPSC for product safety and recall information[202] to eliminate known dangers from their homes, but the unknown dangers can be just as worrisome.

Product recall lists are not enough for John Mazziotti, mayor of Palm Bay, Florida, who has proposed a ban on Chinese-made products.[203] Mazziotti's concerns include: product quality and safety,[204]

195. *Id.*

196. *See generally* VISCUSI, *supra* note 78.

197. *See Product Suits Fall Short*, *supra* note 86 (stating that within a decade, China is likely to conform more closely to international legal standards).

198. *See, e.g.*, Press Release, Calls for Boycott Begin on Dangerous Chinese Products (Aug. 8, 2007), http://www.usrecallnews.com/2007/08/press-release-calls-for-boycott-begin.html.

199. *See* Mutual Benefit, *supra* note 33.

200. *See* Dirk Lammers, *Avoiding 'Made in China' Labels Not Easy*, WASH. POST, June 29, 2007, *available at* http://www.washingtonpost.com/wp-dyn/content/article/2007/06/29/AR2007062901901.html.

201. *See* SARA BONGIORNI, A YEAR WITHOUT "MADE IN CHINA": ONE FAMILY'S TRUE LIFE ADVENTURE IN THE GLOBAL ECONOMY (1997).

202. Recalls and Product Safety News, U.S. Consumer Product Safety Commission, http://www.cpsc.gov/cpscpub/prerel/prerel.html (last visited May 11, 2009).

203. *See* Mary-Rose Abraham, *Florida City Tries to Ban Chinese Products*, ABC NEWS, Oct. 24, 2007, *available at* http://abcnews.go.com/Business/CreativeConsumer/story?id=3765361&page=1.

human rights abuses in China,[205] China's record on pollution,[206] and a loss of United States jobs in the manufacturing sector.[207] The proposed ban would prevent the city from purchasing products made in China that cost more than $50[208] or are composed of parts, half of which are made in China.[209] George Wang, president of the U.S.-China Exchange Association, asserts that such a measure would be irrational, as a cost-benefit analysis would clearly disfavor avoiding all Chinese products.[210]

As long as the demand for Chinese-made products continues, there will be companies in the United States to import the products. Law firms such as McDermott Will & Emery have formed Chinese Products Practice Groups to advise these companies of their rights and responsibilities with regard to importation from China.[211] Their recommendations include: maintaining adequate insurance coverage;[212] adding liability-minimizing provisions to contracts with Chinese manufacturers;[213] and seeking indemnification from Chinese companies following product recalls, class actions, and other lawsuits.[214] As discussed earlier, indemnification is a near impossibility.[215] United States companies will face a disproportionate burden until Chinese manufacturers are made to bear the losses caused by their products.

While tort reform in China, particularly an increase in compensatory damage awards and the addition of punitive damage awards, is the most effective way to influence manufacturer behavior, change does not happen overnight. China admits that the products it manufacturers for export are of a higher quality than those manufactured for domestic use.[216] In fact, twenty percent of the products manufactured for use in China fail to meet basic requirements.[217] China's overall conformity to international safety standards would protect consumers and eliminate the

204. Tom Leonard, *Florida City Proposes Ban on Goods from China*, TELEGRAPH.CO.UK., Oct. 30, 2007, *available at* http://www.telegraph.co.uk/news/main.jhtml?xml=/news/2007/10/29/wflorida129.xml.

205. *Id.*

206. *Id.*

207. *Id.*

208. *See id.*

209. *See* Leonard, *supra* note 204.

210. *See* Abraham, *supra* note 203.

211. *See* Chinese Products, Client Services, McDermott Will & Emery, http://www.mwe.com/chineseproducts/ (last visited May 11, 2009).

212. *Id.*

213. *Id.*

214. *Id.*

215. *See* Parloff, *supra* note 35.

216. *See* Richard Spencer, *The China Factory behind Mattel Toy Scare*, TELEGRAPH.CO.UK, Aug. 8, 2007, *available at* http://www.telegraph.co.uk/news/main.jhtml?xml=/news/2007/08/22/wtoy122.xml.

217. *See id; see also Wild West Imports*, *supra* note 5.

current need for over-regulation. However, until such standards are met, governmental agencies will be responsible for ensuring consumer safety.[218]

The CPSC reached an agreement with China's General Administration of Quality Supervision, Inspection and Quarantine (AQSIQ) on September 11, 2007.[219] The agreement calls for China to upgrade its inspection of products to be shipped to the United States and to cooperate with the CPSC in locating the sources of hazardous products.[220] Additionally, the FDA has opened an office in China.[221] Officials will concentrate on heightened safety standards for producers and increased regulation,[222] the idea being to place the burden on China and rely less on inspections in the United States.[223]

Placing the burden on China is exactly what needs to happen. China must be responsible for a level of precaution that corresponds with the expected accident costs of its products. If the United States is to maintain a trade relationship with China, Chinese manufacturers will need to become accountable for safety. While it is evident that a lack of regulatory enforcement cleared the way for defective products to enter the United States, the root of the problem lies elsewhere. An environment of danger is thriving in China due to an unpredictable, newly developing tort system; a lack of incentive for manufacturers to make safe products; and a long history of complete and total disregard for safety. Tort reform, accompanied by an increase in plaintiffs' attorneys, would open the doors to the courthouse and compel Chinese manufacturers to exercise due care in the production of their products.

218. *See* Press Release, U.S. Consumer Product Safety Commission, U.S. and Chinese Product Safety Agencies Announce Agreement to Improve the Safety of Imported Toys and Other Consumer Products, Sept. 11, 2007, http://www.cpsc.gov/cpscpub/prerel/prhtml07/07305.html [hereinafter Product Safety Agencies]; *see also FDA Looks for "Boots on the Ground" in China*, REUTERS, Feb. 5, 2008, *available at* http://www.reuters.com/article/topNews/idUSN0518943220080205 [hereinafter *Boots on the Ground*].

219. *See* Product Safety Agencies, *supra* note 218.

220. *See id.*

221. *See U.S. Opens Food Safety Office in China after Scares*, CNN, Nov. 19, 2008, *available at* http://www.cnn.com/2008/WORLD/asiapcf/11/19/china.fda.poisoned/index.html.

222. *See id.*

223. *See id.*

Do We Have an Agreement? Examining the Constitutionality and Legality of the Security and Prosperity Partnership of North America, and the Legal Ramifications of its Informality

R. Chris Van Landingham*

I. INTRODUCTION

The Security and Prosperity Partnership of North America ("SPP") is a tri-lateral partnership formed in 2005 between the United States, Canada, and Mexico.[1] The three countries previously took numerous steps such as the creation of the North American Free Trade Agreement ("NAFTA")[2] to increase the economic prosperity of the continent, and following the terrorist attacks of September 11, 2001, the countries began working more closely to ensure continental security.[3] However, U.S. President George W. Bush, Canadian Prime Minister Paul Martin and

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1. *See* Press Release, White House, Joint Statement by President Bush, President Fox, and Prime Minister Martin (Mar. 23, 2005), *available at* http://www.whitehouse.gov/news/releases/2005/03/20050323-2.html [hereinafter Joint Statement].

2. Implementation of the North American Free TradeAgreement (NAFTA) began on January 1, 1994. This agreement will remove most barriers to trade and investment among the United States, Canada, and Mexico. Under the NAFTA, all non-tariff barriers to agricultural trade between the United States and Mexico were eliminated. In addition, many tariffs were eliminated immediately, with others being phased out over periods of 5 to 15 years. This allowed for an orderly adjustment to free trade with Mexico, with full implementation beginning January 1, 2008.

U.S. Department of Agriculture, Foreign Agriculture Service, North American Free Trade Agreement, http://www.fas.usda.gov/itp/Policy/NAFTA/nafta.asp (last visited Feb. 9, 2008).

3. *See* Joint Statement, *supra* note 1.

Mexican President Vicente Fox felt that additional steps needed to be taken.[4] This desire to increase continental cooperation in these areas resulted in the establishment of the SPP.[5]

This Comment is divided into seven parts. Part I introduces the SPP and explains its background, origins, and purpose. Part II of the Comment provides a detailed overview of the two primary agendas of the SPP: security and prosperity. Part III explains how the SPP's agenda is being implemented throughout North America. Part IV explains the executive branch's constitutional authority in the areas of foreign policy and treaty making, and defines the SPP as an agreement. Part V of the Comment describes the role and purpose of the North American Competitiveness Council within the SPP. Part VI parses the Federal Advisory Committee Act and argues that the North American Competitiveness Council violates provisions of the Act. Finally, Part VII of the Comment concludes that although the SPP is constitutional, its informal legal origins and structure may lead to future confrontations between the three branches of U.S. federal government.

The SPP is premised on the idea that the security and prosperity of each of the three member nations is mutually dependent on the other nations.[6] The security goals include establishing a common approach to

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4. *See id.*
5. *See id.*
6. *See id.*

> The SPP is a White House-led initiative among the United States and the two nations it borders—Canada and Mexico—to increase security and to enhance prosperity among the three countries through greater cooperation. The SPP is based on the principle that our prosperity is dependent on our security and recognizes that our three great nations share a belief in freedom, economic opportunity, and strong democratic institutions. The SPP outlines a comprehensive agenda for cooperation among our three countries while respecting the sovereignty and unique cultural heritage of each nation. The SPP provides a vehicle by which the United States, Canada, and Mexico can identify and resolve unnecessary obstacles to trade and it provides a means to improve our response to emergencies and increase security, thus benefiting and protecting Americans.

See SPP.gov, Myths vs. Facts, http://spp.gov/myths_vs_facts.asp (last visited Jan. 5, 2007) [hereinafter Myths vs. Facts]. The SPP lists the following benefits to North American citizens:

> To save lives, prevent injuries, and make consumer goods safer, the United States, Canada and Mexico signed separate agreements for advance notifications when consumer goods violate one country's safety standards or pose a danger to consumers. To strengthen border security, Mexican and U.S. agencies are exchanging information and establishing protocols to detect fraud and smuggling, and address border violence. To speed up response times when managing infectious disease outbreaks, the United States and Canada signed an agreement to enable simultaneous exchange of information between virtual national laboratory networks. To speed cargo shipping, the three countries are developing uniform in-advance electronic exchange of cargo manifest data for

security and making the movement of traffic across the borders more efficient.[7] The prosperity goals include improving the quality of life for citizens of the three member states and enhancing the competitiveness of North America in the global marketplace.[8]

II. AGENDAS

A. Security Agenda

The security agenda has three goals: secure North America from external threats, prevent and respond to threats from within North America, and streamline the secure movement of low-risk traffic across shared borders.[9]

To secure North America from external threats the SPP is creating a North American traveler security strategy.[10] The SPP is also implementing a cargo security strategy for the purpose of screening cargo before it leaves foreign ports in conjunction with inspection at the first entry point into North America.[11] The SPP member states are currently creating a joint bioprotection strategy for prevention and response to natural as well as intentional threats to public health, food, and agriculture.[12]

The SPP's second security goal provides a system of joint prevention and response to threats from within North America. To accomplish this, the SPP is currently enhancing the North American maritime transportation and port security and establishing equivalent approaches to aviation security.[13] The member states are also working

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> maritime, railroad and motor carriers. To develop a coordinated strategy aimed at combating counterfeiting and piracy, a task force of senior officials from the three North American countries has been established. To reduce the cost of trade, the United States and Canada decreased transit times at the Detroit/Windsor gateway, our largest border crossing point, by [fifty] percent. To reduce market distortions, facilitate trade, and promote overall competitiveness, the North American Steel Trade Committee developed a new strategy that focuses on improving innovation and market development.

Id.

7. *See* Press Release, White House, Security and Prosperity Partnership of North America Security Agenda (Mar. 23, 2005), *available at* http://www.whitehouse.gov/news/releases/2005/03/20050323-3.html [hereinafter Security Agenda].

8. *See* Press Release, White House, Security and Prosperity Partnership of North America Prosperity Agenda (Mar. 23, 2005) *available at* http://www.whitehouse.gov/news/releases/2005/03/20050323-1.html [hereinafter Prosperity Agenda].

9. *See* Security Agenda, *supra* note 7.

10. *See id.*

11. *See id.*

12. *See* Security Agenda, *supra* note 7.

13. *See id.*

toward a comprehensive plan for combating transnational threats to the respective countries including threats from terrorism, drug trafficking, smuggling and organized crime.[14] The SPP is also increasing intelligence sharing between the member states regarding North American security, implementing common approaches to protect critical infrastructure and also to respond to cross-border terrorist incidents and natural disasters.[15]

The third security goal focuses on streamlining the secure movement of low-risk traffic across shared borders. To accomplish this, member states are working towards implementing a border strategy that improves the legitimate flow of people and cargo at ports of entry within North America.[16] New technologies are being developed[17] and deployed by the SPP to accomplish these security goals.[18]

B. Prosperity Agenda

The stated goal of the prosperity agenda is "to enhance the competitive position of North American industries in the global marketplace and to provide greater economic opportunity for all [North American] societies, while maintaining high standards of health and safety for [the North American] people."[19] To accomplish its prosperity goals, the SPP is working to improve productivity, reduce the costs of trade, and enhance the quality of life.[20]

The SPP outlined three steps to improve productivity. First the SPP regulates cooperation, generating growth by lowering costs for North American business producers and consumers, maximizing cross-border trade, and minimizing barriers.[21] Second, the SPP uses sectoral collaboration to facilitate business.[22] To enhance the competitiveness of North American industries the SPP requires increased cooperation among the member states in key industry sectors such as automobiles,

14. *See id.*
15. *See id.*
16. *See id.*
17. The government of Mexico has begun to use biochips (microchips that are implanted under the skin) to curb illegal immigration from Guatemala and Belize across the southern border of Mexico. This implant will replace the "local pass" that is currently used to enter Mexico. *See Lou Dobbs Tonight* (CNN television broadcast Dec. 28, 2007), *available at* http://www.youtube.com/watch?v=0XScXum6vjM. It seems plausible that a similar biochip eventually might be used throughout the continent.
18. *See* Security Agenda, *supra* note 7.
19. *See* Prosperity Agenda, *supra* note 8.
20. *See id.*
21. *See id.*
22. *See id.*

and steel.[23] Further, the member states also cooperate in promoting energy efficiency, increasing energy supplies and promoting new technologies to strengthen the continent's energy markets.[24] The SPP is improving the safety and efficiency of the continent's transportation systems while working toward a freer flow of capital and providing financial services throughout North America.[25] Finally, the member states work together, expanding partnerships in higher education, science and technology to "invest in our people."[26]

Reducing the costs of trade is the second prosperity goal. To accomplish this, the SPP lowered trade transaction costs and made duty free treatment under NAFTA easier in order to move goods more efficiently.[27] The SPP is also working toward more efficient movement of people by facilitating the movement of businesspersons within the continent while reducing taxes and other charges residents face when relocating to different North American countries.[28]

The final prosperity goal is to enhance the quality of life. To achieve this goal the member states act as joint stewards of the environment; improving air quality, enhancing water quality, combating the spread of invasive marine species, protecting biodiversity, and protecting the oceans' ecosystems.[29]

The member states are also creating a safer and more reliable food supply while facilitating agricultural trade by enhancing food safety, laboratory coordination and work through the North American Biotechnology Initiative ("NABI") to develop a regulatory policy related to the agricultural biotechnology sectors in the individual countries.[30] Finally they will enhance public health coordination in disease prevention, improve the health of indigenous people, and adopt the best practices for registering medical products.[31]

III. IMPLEMENTATION OF AGENDA

A. Working Groups

In order to improve productivity, reduce the costs of trade, and enhance the quality of life, the SPP established working groups "to fulfill

23. *See id.*
24. *See* Prosperity Agenda, *supra* note 8.
25. *See id.*
26. *Id.*
27. *See id.*
28. *See id.*
29. *See* Prosperity Agenda, *supra* note 8.
30. *See id.*
31. *See id.*

the vision of the North American Heads of state."[32] These groups are charged with consulting with stakeholders, setting specific, achievable, and measurable goals and implementation dates, and identifying steps the member governments can take to achieve these goals.[33] These groups are divided into 10 areas: manufactured goods and sectoral and regional competitiveness; movement of goods; energy; environment; e-commerce and information communications technologies; financial services; business facilitation; food and agriculture; transportation; and health.[34]

B. Current Projects and Accomplishments

There are several security projects already underway.[35] In the area of traveler and cargo security, the member states agreed to develop biometric standards, such as digital fingerprints, for passports, visas, driver's licenses and other traveler and border documents.[36] Member states are also developing ways to control the import and export of radioactive substances within North America.[37]

In order to coordinate bioprotection, the three member states are performing joint exercises within the public health and food systems to react to potentially vulnerable areas.[38] The member states have also developed a continental plan to respond to pandemic influenza.[39]

The SPP is coordinating the law enforcement and intelligence networks of the three states.[40] Prosecutors and investigators from all three countries are increasing cooperation with their North American counterparts to address coordination of security in areas such as organized crime, counterfeiting, drug and alcohol trafficking, and arms smuggling.[41] Trilateral law enforcement also coordinates antiterrorism efforts including sharing terrorist watch lists and other intelligence.[42]

The member states are also increasing border security by implementing hi-tech equipment along the borders[43] to increase the

32. SPP.gov, Prosperity Working Groups, http://spp.gov/prosperity_working/index.asp?dName=prosperity_working (last visited Oct. 2, 2007).

33. *See id.*

34. *See id.*

35. *See* SPP.gov, Security Annex, at 49, *available at* http://spp.gov/2006_report_to_leaders/security_annex.pdf?dName=2006_report_to_leaders.

36. *See id.*

37. *See id.* at 53.

38. *See id.* at 55.

39. *See id.* at 57.

40. *See* Security Annex, *supra* note 35, at 65-68.

41. *See id.*

42. *See id.*

43. The U.S. Department of Homeland Security is building a wireless border network between the United States and Mexico to be used to watch for illegal

efficiency of the secure flow of people and goods.[44] They also exchange research and information concerning cross-border infectious animal diseases.[45]

Several prosperity projects are underway.[46] In the area of manufactured goods, the SPP is working to make more compatible regulations for automobiles and automobile parts.[47] The three states are coordinating environmental regulations as they relate to automobiles and the automobile industry.[48] The SPP is giving Canadian and Mexican companies access to the U.S. Food and Drug Administration's medical devices "small business discount" to facilitate the trade of medical devices.[49]

The SPP reduced the "rules of origin" costs for goods traded within North America to facilitate movement of the goods across the borders.[50] The SPP also created common principles for e-commerce within the three member states.[51]

The Bush Administration pushed a project which, though not the official name, many call the "NAFTA Superhighway."[52] If realized, this superhighway will include lanes for trucks, trains, and utility lines that go from the Mexican border at Laredo, Texas to the Canadian border north of Duluth, Minnesota.[53] The long stretch of highway will enable foreign companies, such as those from China, to send cargo to seaports in

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immigrants. *See* Government Executive.com, http://www.govexec.com/story_page.cfm?articleid=37393 (last visited Feb. 7, 2007).

44. *See* Security Annex, *supra* note 35, at 77.

45. *See id.*

46. *See* SPP.gov, Prosperity Annex, at 6, *available at* http://spp.gov/2006_report_to_leaders/prosperity_annex.pdf?dName=2006_report_to_leaders (last visited Oct. 6, 2007).

47. *See id.* Fifty-three percent of automobile parts imported into the United States comes from Canada and Mexico. *See* WILBUR L. ROSS, FED. RES. BANK OF CHI., PROSPECTS FOR AUTOMOTIVE SUPPLIERS (Apr. 18, 2006), *available at* http://www.chicagofed.org/news_and_conferences/conferences_and_events/files/2006_auto_ross.pdf.

48. *See* Prosperity Annex, *supra* note 46, at 6.

49. *See id.* at 8.

50. *See id.* at 12.

51. *See id.* at 14.

52. JEROME R. CORSI, THE LATE GREAT U.S.A.: THE COMING MERGER WITH MEXICO AND CANADA 91-92 (WND Books 2007). Corsi believes that the SPP, like NAFTA, is just a stepping stone to an ultimate plan to form a North American Union. He wrote in the foreword of the book that

> More than a declaration of friendship by neighboring countries, the agreements made at the Waco summit were perhaps the reason our borders with Mexico and Canada have remained so porous . . . policy makers in the three nations and multinational corporations have placed the United States, Mexico and Canada on a fast track to merge together economically and politically.

Id.

53. *See id.*

Mexico and then ship the cargo to the United States and Canada.[54] Transport trucks and trains will not have to stop for U.S. customs until they reach the Kansas City "SmartPort."[55] Though this "port" is located within the United States, it will most likely be considered Mexican soil.[56]

The first portion of this proposed "superhighway" is the Trans-Texas Corridor and is currently under construction.[57] The website of the Trans-Texas Corridor describes the project as "a proposed multi-use, statewide network of transportation routes in Texas that will incorporate existing and new highways, railways and utility right-of-ways."[58] The proposed route for the corridor is 600 miles along Interstate-35 from the Mexican border to north of Dallas, Texas.[59]

There are also plans to develop four other transportation corridors: the Pacific, Atlantic, East and West corridors.[60]

IV. CONSTITUTIONAL AUTHORITY FOR FOREIGN POLICY AND TREATIES

A. Executive Powers and Treaty Ratification

Article II Section 1 of the United States Constitution states, "The executive Power shall be vested in a President of the United States of America."[61] However, the Constitution fails to define "executive power."[62] In his concurring opinion in *Youngstown Sheet and Tube Co. v. Sawyer*,[63] Justice Jackson opines that if the aforementioned clause constituted a grant of all executive powers of which the Federal government was capable, "it is difficult to see why the forefathers bothered to add several specific items, including trifling ones."[64]

Justice Jackson laid out three categories in which executive power would fall, stating that first, when the President acts with Congressional authorization he "would be supported by the strongest of presumptions

54. *See id.* at 92.
55. *Id.*
56. *See* CORSI, *supra* note 52, at 92.
57. *See id.* In January 2009, the Texas Department of Transportation announced that plans for the Trans-Texas corridor had been halted. *See* Michael A. Lindenberger, *Trans Texas Corridor is Dead, TxDOT Says,* THE DALLAS MORNING NEWS, Jan. 6, 2009, *available at* http://www.dallasnews.com/sharedcontent/dws/dn/latestnews/stories/010609dnmetttc.43c00ac6.html.
58. Trans-Texas Corridor Overview, http://ttc.keeptexasmoving.org/projects/ (last visited Oct. 2, 2007).
59. *See id.*
60. *See* CORSI, *supra* note 52, at 120.
61. U.S. CONST. art. II, § 1.
62. *See id.*
63. 343 U.S. 579 (1952).
64. *Id.* at 579.

and the widest latitude of judicial interpretation. . . ."[65] Second, when the President does not act with Congressional authorization he may enter "a zone of twilight in which he and Congress may have concurrent authority, or in which its distribution is uncertain."[66] Finally, when the President acts against Congressional will, "his power is at its lowest ebb."[67] In *Dames & Moore v. Regan*,[68] the Supreme Court clarified this, stating that the President's power does not fit neatly into Justice Jackson's three categories "but rather at some point along a spectrum running from explicit congressional authorization to explicit congressional prohibition."[69]

Article II Section 2 of the U.S. Constitution states, the President "shall have Power, by and with the Advice and Consent of the Senate, to make treaties, provided two thirds of the Senators concur. . . ."[70] The U.S. differs from most other states because here the term "treaty" has a particular meaning: it is an agreement made and signed by the President with the advice and consent of the Senate.[71]

Therefore, any agreement not signed by the President and not ratified by the Senate is not a treaty. However, the President has authority in conducting foreign affairs to enter into binding agreements without conforming to the rigid constitutional requirements of a treaty.[72] As with all executive powers, the authority to enter into binding agreements is stronger when acting pursuant to specific Congressional enactments and weaker when acting without Congressional consent.[73]

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65. *Id.* at 637.
66. *Id.*
67. *Id.* at 637-38.
68. 453 U.S. 654 (1981).
69. *Id.* at 669.
70. U.S. CONST. art. II, at § 2.
71. *See* DAVID J. BEDERMAN, INTERNATIONAL LAW FRAMEWORKS 158 (Foundation Press 2001).
72. *See* Robinson v. Harbert Int'l, 743 F. Supp. 797, 801 (N.D. Ala. 1990). *Robinson* concerned the Compact of Free Association, which was not a treaty because it had not been ratified by the Senate. However, the Court found that,

> the President's authority in conducting foreign affairs includes the power to enter into certain binding agreements, such as the Compact of Free Association, with foreign nations without complying with the formal requisites of a treaty. The President's authority to act is especially strong when the President acts pursuant to a specific congressional enactment. In this case, the President acted on the authority of 48 U.S.C. § 1681(a) (1954), and the results of his action, the Compact, received explicit congressional approval in the Act of 1985.

Id.
73. *See id.*

B. Is the SPP a Treaty, Dialogue, or Executive Agreement?

The SPP website claims it is not an agreement, nor was it signed by the President and ratified by the Senate.[74] Therefore, the SPP is not a "treaty" as defined by the Constitution.[75] Further, the SPP website claims that it is simply a dialogue between the three member states.[76] This seems to be a semantic maneuver to avoid legal responsibilities and is akin to calling a war a "conflict" in order to avoid the constitutionally necessary Congressional declaration of war. Dr. Jerome Corsi explains that the SPP is claiming to be a dialogue because,

> constraints upon the Executive Branch demand such a labeling . . . [i]f written agreements resulted from the SPP,they would need to be submitted to Congress as legislation, or to the Senate as treaties for ratification, or published in the Federal Register as proposed rules changes.[77]

Is the SPP just a dialogue? A "dialogue" is defined as "1. a talking together, conversation[;] 2. interchange and discussion of ideas, esp[ecially] when open and frank, as in seeking mutual understanding or harmony."[78] A literal interpretation of the word "dialogue" describes much of the work of the SPP. However, the SPP is moving beyond this definition and into something else. After all, the United States, Canada, and Mexico have had open dialogues for many years without ever forming anything so encompassing as the SPP before. As such, the SPP appears to represent something new and more than a simple dialogue. Does the SPP rise to the level of executive agreement?

The very name of the Security and Prosperity Partnership of North America implies an agreement. A partnership implies that the member states will work together accomplishing certain goals, not simply engaging in a dialogue. An "executive agreement" in the context of U.S. law is defined as "[a]n international agreement entered into by the President, without approval by the Senate, and usu[ally] involving

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74. *See* Myths vs. Facts, *supra* note 6.

75. *Id.*

76. *Id.* The SPP website's list of myths and facts includes the following:

> Myth: The SPP was an agreement signed by Presidents Bush and his Mexican and Canadian counterparts in Waco, TX, on March 23, 2005. . . . FACT: The SPP is a dialogue to increase security and enhance prosperity among the three countries. The SPP is not an agreement nor is it a treaty. In fact, no agreement was ever signed.

Id.

77. CORSI, *supra* note 52, at 78.

78. WEBSTER'S NEW WORLD COLLEGIATE DICTIONARY 380 (3d ed. 1997).

routine diplomatic or military matters."[79] The President entered into the SPP without approval by the Senate, fitting the definition of executive agreement if it is in fact an agreement. "Agreement" is defined as:

> 1. A mutual understanding between two or more persons about their relative rights and duties regarding past or future performances; a manifestation of mutual assent by two or more persons . . .[;] 2. The parties' actual bargain as found in their language or by implication from other circumstances, including course of dealing, usage of trade, and course of performance."[80]

Does the SPP fit the legal definition of agreement?

The member states already have certain goals and plans.[81] For example the SPP's "2005 Report to Leaders" asserted that the three countries of the SPP signed a "Framework of Common Principles for Electronic Commerce" in order to develop trans-border online business within North America.[82] They have also reached an "arrangement on the Use of Care symbols on Textile and Apparel Goods Labels" to make uniform acceptance of care symbols in North America.[83] The leaders of the member states also signed a Declaration of Intent for the Conservation of North American birds and their habitats.[84] The SPP was used as a vehicle to modify agreements already in existence such as changing NAFTA to provide mechanisms giving temporary entry to professional workers within North America.[85] The member states also agreed to trilaterally support the World Customs Organization's ("WCO") Framework of Standards to Secure and Facilitate Global Trade.[86]

The "partnership" of the SPP acts much more as an agreement to implement various policies than a simple dialogue. However, it is important to determine whether the SPP operates with Congressional consent. According to the SPP's website, "U.S. agencies involved with [the] SPP regularly update and consult with members of Congress on

79. BLACK'S LAW DICTIONARY 610 (8th ed. 2004). If the executive makes an executive agreement with the consent of Congress the agreement will be a congressional-executive agreement and it will be more binding than a sole executive agreement. *See* JEFFERY L. DUNOFF, STEVEN R. RATNER & DAVID WIPPMAN, INTERNATIONAL LAW NORMS, ACTORS, PROCESS: A PROBLEM-ORIENTED APPROACH 281 (2006).

80. *Id.* at 74.

81. *See* CORSI, *supra* note 52, at 78.

82. SPP.gov, 2005 Report to Leaders, http://spp.gov/report_to_leaders/index.asp?dName=report_to_leaders (last visited Jan. 6, 2008).

83. *Id.*

84. *See id.*

85. *See id.*

86. *See id.*

[the SPP's] efforts and plans."[87] That statement is not completely accurate.

The best example of a lack of Congressional consent is the so-called "NAFTA Superhighway," discussed above. In early 2007, the Subcommittee on Highways and Transit of the Congressional Committee on Transportation and Infrastructure met with Jeffery Shane, the Undersecretary of Transportation for Policy at the U.S. Department of Transportation.[88] Undersecretary Shane was asked by the subcommittee specifically about the "NAFTA Superhighways."[89] He claimed that the "superhighways" were nothing more than an "urban legend."[90] However, following this meeting U.S. House Representative, Ted Poe[91] of Texas, stated that, "Mr. Shane was either blissfully ignorant or he may have been less than candid with the committee."[92] Apparently, Undersecretary Shane is not alone in his denial.

At the November 28, 2008 CNN/Youtube Republican Presidential debates, Presidential candidate and U.S. Congressman from Texas, Ron Paul[93] mentioned the "NAFTA Superhighway."[94] Following the debate,

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87. Myths vs. Facts, *supra* note 6.

88. *See* World Net Daily.com, [hereinafter WND Urban Legend], plan for superhighway ripped as "urban legend," http://www.worldnetdaily.com/news/article.asp?ARTICLE_ID=53950 (last viewed Jan. 6, 2007).

89. NAFTA superhighways are also known as "NAFTA Corridors."

90. WND Urban Legend, *supra* note 88. After Shane denied the existence of the NAFTA Superhighway, Congressman Virgil Goode said,

> let's take Mr. Shane at his word. Let Mr. Shane come over here from the Department of Transportation and endorse House Concurrent Resolution 40 [opposing the NAFTA Superhighway]. . . . If, in his mind he's not doing anything to promote a NAFTA superhighway and he's not doing anything to promote the Security and Prosperity Partnership of North America, then he won't mind joining his voice with ours to be in opposition to any such "urban legend," as he so calls it.

Id.

91. *Id.* Congressman Poe also told World Net Daily that,

> I don't understand why the federal government isn't getting public input on this. . . . We get comments like Mr. Shane's instead of our own government asking the people of the United States what they think about all of this. This big business coming through Mexico may not be good business for the United States . . . the public ought to make this decision, especially the states that are affected, such as Texas, Oklahoma, Kansas, and all the way through up to Canada. The public needs to make input on this. So, I don't understand, unless there's some other motive, why the public isn't being told about these plans and why the public is not invited to make input.

Id.

92. *Id.*

93. During the debate Congressman Paul stated,

> And there is a move on toward a North American Union, just like early on there was a move on for a European Union, and eventually ended up. So we had NAFTA and moving toward a NAFTA highway. These are real things. It's not somebody made these up. It's not a conspiracy. They don't talk about it, and

the LA Times sought to determine whether there were plans for such a superhighway.[95] Ian Grossman, a spokesman with the Federal Highway Administration informed the Times "[t]here is no such superhighway like the one [Paul is] talking about. . . . It doesn't exist, in plans or anywhere else."[96] This statement is incorrect.

The government of Alberta, Canada has a map of four "NAFTA Trade Corridors" including one labeled "NAFTA Superhighway" on its Infrastructure and Transportation website.[97] The map shows the "NAFTA Superhighway" starting at the Mexico-Texas border and traveling up through the United States into Alberta.[98] The Texas route mapped on the Alberta website appears to follow the proposed route of the Trans-Texas Corridor number 35 ("TTC-35").[99] Interestingly, forty-two U.S. Congressmen signed a resolution introduced by House Representative Virgil Goode of Virginia, opposing the "NAFTA Superhighway" the executive branch claims does not exist.[100]

Besides the obvious threats to separation of powers that are involved when the executive branch misleads Congress and the American people, there are other legal problems that arise. While describing the SPP as simply a dialogue lacking any formal agreement, the SPP essentially lacks the legal standing that would be afforded by a formal treaty or executive agreement. This presents international problems for the United States. Without Congressional consent, the

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> they might not admit about it, but there's been money spent on it. There was legislation passed in the Texas legislature unanimously to put a halt on it. They're planning on millions of acres taken by eminent domain for an international highway from Mexico to Canada, which is going to make the immigration problem that much worse.

CNN.COM, CNN/YouTube Republican Debate Transcript, Nov. 28, 2007, *available at* http://www.cnn.com/2007/POLITICS/11/28/debate.transcript/index.html.

94. Stephen Braun, *Paul Believes in Threat of North American Superhighway*, L.A. TIMES, Nov. 30, 2007, *available at* http://www.latimes.com/news/nationworld/politics/la-na-highway30nov30,1,4646522.story?coll=la-news-politics-national&ctrack=2&cset=true.

95. *See id.*

96. *Id.*

97. *See* Infratrans.gov, NAFTA Trade Corridors & State Truck Standards, http://www.infratrans.gov.ab.ca/2760.htm (last visited Nov. 30, 2007).

98. *See id.*

99. *See id.*; *see also* Texas Department of Transportation, Strategic Plan 2007-2011, http://www.keeptexasmoving.com/var/files/File/strategic_plan2007.pdf (last visited Jan. 4, 2008). Even though the map of the NAFTA Superhighway is good evidence that there are at the very least plans to build the highway, some proponents continue to deny such plans. Some even suggest that talk of the superhighway is the work of conspiracy theorists. For example, Tiffany Melvin, executive director of NASCO, a consortium of transportation agencies and business interests, told the *LA Times*, "this is the work of fringe groups that have wrapped a couple of separate projects together into one big paranoid fantasy." Braun, *supra* note 94.

100. *See* Braun, *supra* note 94.

President's authority to act is diminished,[101] and therefore, any plans he or she might make with his or her counterparts in Mexico and Canada through the framework of the SPP could be voided by the Congress or declared unconstitutional by the courts. This could be detrimental to the SPP's goals of increasing North American security and prosperity. However, if the President acts through Congressional consent, then any plans and agreements he or she makes through the SPP would be legally binding. Signing a formal treaty with the advice and consent of the Senate would guarantee U.S. compliance with the SPP's agenda. If a formal treaty is politically unattainable, the President should sign an executive agreement based on congressional authorization if he or she wishes to legally bind the United States to the tri-lateral partnership.

V. NORTH AMERICAN COMPETITIVENESS COUNCIL

A. History and Purpose

A year after founding the SPP, the leaders of the member states realized that to accelerate progress under the SPP it would be beneficial to receive direct advice from the private sector.[102] At the 2006 SPP summit Presidents Bush, Fox, and Prime Minister Harper called for business leaders from their respective countries to form the North American Competitiveness Council ("NACC").[103]

The U.S. Chamber of Commerce and the Council of the Americas jointly serve as the Secretariat for the NACC in the United States.[104] The Canadian Council of Chief Executives ("CCCE") serves as the Secretariat for the NACC in Canada[105] and in Mexico, the Instituto Mexicano para la Competitividad ("IMCO") serves as the Secretariat.[106]

The three heads of state charged the NACC with making recommendations and determining ways the private sector could itself contribute to North American prosperity.[107] In August 2007, the NACC submitted its initial report to the SPP, based on the consultations and deliberations of hundreds of North American companies, sectoral associations, and chambers of commerce.[108]

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101. *See* Dames & Moore v. Regan, 453 U.S. 654 (1981).

102. *See* U.S. Chamber of Commerce, North American Competitiveness Council, http://www.uschamber.com/issues/index/international/nacc.htm (last visited Nov. 3, 2007) [hereinafter Chamber of Commerce].

103. *See id.*

104. *See id.*

105. *See id.*

106. *See id.*

107. *See* Chamber of Commerce, *supra* note 102.

108. *See id.*

B. *Recommendations and Implementation*

The NACC's initial report included fifty-one recommendations divided into three sections: border-crossing facilitation, standards and regulatory cooperation, and energy integration.[109] The recommendations on border-crossing facilitation focus on measures for improving the efficiency of North American commercial exchange.[110] This section made recommendations for emergency management, post-incident resumption of commerce, expansion and improvements to border infrastructure, the movement of goods and the movement of people.[111]

Since trilateral regulatory cooperation is an essential tool for ensuring compatibility of new regulations, and eliminating or reducing differences in existing rules, the NACC supports working toward a framework for trilateral regulation within the section of standards and regulatory cooperation.[112] The section also emphasized the need for regulators and businesses to actively engage in developing global technical standards, especially in the areas of food and agriculture, financial services, transportation, and intellectual property rights.[113]

The NACC report also set forth integrations in the energy sector. The NACC recommended measures to heighten security of energy supplies by improving cross-border distribution systems, increasing supply of skilled labor in the energy field and joint development of clean and efficient energy technologies.[114] The report also focused on Mexico's need to accelerate the development of energy resources.[115]

Much of the NACC's recommendations have been implemented.[116] For example, on the recommendations of the NACC, border infrastructure improvement has taken place and all three member states have regularly conducted emergency management exercises and disaster planning simulations.[117] These exercises have included private sector participation.[118] The U.S. and Canada are working toward implementation of a new crossing at Detroit-Windsor, with the NACC

109. *See id.*
110. North American Competitiveness Council, Building a Secure and Competitive North America, *available at* http://www.uschamber.com/issues/index/international/nacc.htm (follow "August 21, 2007 Building a Secure and Competitive North America" hyperlink) [hereinafter NACC].
111. *See id.*
112. *See id.*
113. *See id.*
114. *See id.*
115. *See* NACC, *supra* note 110.
116. *See id.*
117. *See id.*
118. *See id.*

participating in the planning of this crossing.[119] The SPP is also implementing the "trusted traveler" program which the NACC claims is an important step toward their long term goal—a single North American identification card or passport.[120]

The SPP is implementing the NACC's recommendations concerning standards and regulatory cooperation.[121] For example, the SPP created a "Regulatory Cooperation Framework."[122] The SPP also developed a trilateral Intellectual Property Rights ("IPR") strategy.[123] The IPR strategy focuses primarily on ways to deter and detect trade in pirated and counterfeit goods, public awareness of the business community, and measurements to access progress in specific sectors.[124]

C. *Does the NACC Violate the U.S. Federal Advisory Committee Act?*

Judicial Watch, Inc., a not-for-profit, conservative, nonpartisan, education foundation filed a suit in U.S. District Court for the District of Columbia against The U.S. Department of Commerce in August of 2007, claiming that the NACC violated the Federal Advisory Committee Act ("FACA").[125] The suit sought a judgment declaring the NACC to be an advisory committee, thus subject to control by the FACA.[126] Judicial Watch also sought to enjoin Defendants from continuing failure to comply with the FACA.[127]

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119. *See id.*
120. *See* NACC, *supra* note 110.
121. *See id.*
122. *Id.*
123. *See id.*
124. *See id.*
125. *See* Complaint, Judicial Watch v. Dep't of Commerce, 501 F. Supp. 2d 83 (D.D.C. 2007) (No. 1:07CV01446), *available at* http://www.judicialwatch.org/archive/2007/SPP.complaint.pdf.
126. *See id.*
127. *See id.*

VI. FEDERAL ADVISORY COMMITTEE ACT

A. The Act

The FACA[128] states that "each advisory committee meeting shall be open to the public . . ."[129] and unless the President determines that national security purposes should prevent it, "timely notice of each meeting shall be published in the Federal Register, and the Director shall prescribe regulations to provide for other types of public notice to insure that all interested persons are notified of such meeting prior thereto."[130] Furthermore, FACA states that "interested persons shall be permitted to attend, appear before, or file statements, with any advisory committee, subject to such reasonable rules or regulations as the Director may prescribe."[131] FACA also specifies that:

> records, reports, transcripts, minutes, appendixes, working papers, drafts, studies, agenda, or other documents which were made available to or prepared for or by each advisory committee shall be available for public inspection and copying at a single location in the offices of the advisory committee or the agency to which the advisory committee reports until the advisory committee ceases to exist.[132]

The FACA defines an advisory committee as any "committee, board, commission, council, conference, panel, task force, or other similar group, or any subcommittee or subgroup thereof . . . established or utilized by one or more agencies, in the interest of obtaining advice or recommendations for the President or one or more agencies or officers of the Federal Government."[133]

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128. The Federal Advisory Committee Act was enacted in 1972 to ensure that advice by the various advisory committees formed over the years is objective and accessible to the public. The Act formalized a process for establishing, operating, overseeing, and terminating these advisory bodies and created the Committee Management Secretariat to monitor compliance with the Act. In 1976, Executive Order 12024 delegated to the administrator of GSA all responsibilities of the president for implementing the Federal Advisory Committee Act (FACA). Secretariat operations are directed at reporting to the president and Congress on the activities of at least 1000 federal advisory committees.

U.S. General Services Administration, Federal Advisory Committee Act Management Overview, http://www.gsa.gov/Portal/gsa/ep/channelView.do?pageTypeId=8203&channelPage=/ep/channel/gsaOverview.jsp&channelId=-13170 (last viewed Feb. 9, 2008).

129. Federal Advisory Committee Act, 5 U.S.C. app. § 10 (2007).

130. *Id.*

131. *Id.*

132. *Id.*

133. Federal Advisory Committee Act, 5 U.S.C. app. 2 § 3 (2007).

B. Specifics of the Judicial Watch Lawsuit

The NACC facilitates actions between the SPP and the private sector.[134] According to Judicial Watch's complaint, the NACC and the U.S. Chamber of Commerce, as well as the governments of Mexico and Canada have committed to annual "ministerial-level" meetings with the NACC, as well as meeting with senior government officials two or three times a year to "engage on an ongoing basis to deliver concrete results."[135]

The NACC Executive Committee is comprised of fifteen large corporations and each member is charged with representing the sector in which its business operates.[136] The Executive Committee meets at least once a year with the Secretary of Commerce and working groups are scheduled throughout the year as needed.[137] The NACC Advisory Committee, made up of 200 large businesses, provides advice for the Executive Committee.[138]

On March 32, 2007, Judicial Watch sent a request to the U.S. Chamber of Commerce, asking to be allowed to "participate in all future meetings of the NACC, to include ministerial, Executive Committee and Advisory Committee meetings."[139] The U.S. Chamber of Commerce replied, stating that only invited officials and members of the Executive Committee could attend ministerial meetings, and membership on the Executive Committee was "only open to companies, sectoral associations, and chambers of commerce."[140]

Judicial Watch then contacted the Commerce Department and requested that they acknowledge that the NACC was an advisory committee and bring the NACC within compliance of the FACA.[141] After the Commerce Department failed to respond to this request, Judicial Watch filed suit in order to force compliance with the FACA.[142] As of this writing the suit is still pending.

C. NACC and Compliance with the FACA

To ascertain whether or not the NACC is violating the FACA, it must first be determined whether the NACC is an advisory committee

134. *See* Complaint, *supra* note 125.
135. *Id.*
136. *See id.*
137. *See id.*
138. *See id.*
139. *See* Complaint, *supra* note 125.
140. *See id.*
141. *See id.*
142. *See id.*

within the meaning of the FACA. To be an advisory committee within the meaning of FACA, the NACC must satisfy two criteria.[143] First, the NACC must be a "committee, board, commission, council, conference, panel, task force, or other similar group, or any subcommittee or subgroup thereof."[144] The NACC was created for the purpose of acting as a council to advise the governments of the SPP.[145] As such, the NACC satisfies part one of the definition.

Second, in order to be an advisory committee under the FACA, the NACC must have been "established or utilized by one or more agencies, in the interest of obtaining advice or recommendations for the President or one or more agencies or officers of the Federal Government."[146] The NACC was established for the purpose of advising and giving recommendations to the Commerce Department and the President of the United States as well as leaders and agents of Canada and Mexico.[147]

Having established that the NACC is an advisory committee within the meaning of the FACA, the next step is to determine whether or not the NACC has violated the provisions of the Act. To determine a violation there are four primary elements.[148]

First, the FACA mandates that meetings of advisory committees must be open to the public.[149] The NACC meetings are not open to the public.[150] According to Judicial Watch's complaint, the U.S. Commerce Department sent Judicial Watch a letter stating that NACC meetings were only open to invited officials and members of the NACC committees.[151] Therefore the NACC violated the first provision.

Second, the FACA states that there shall be timely public notice of such advisory committee meetings so that interested persons may attend.[152] As the NACC considers itself to have closed meetings, the organization has no need to publish its meeting times.[153] However, this is a violation of the second element of FACA.

Third the FACA requires that "interested persons shall be permitted to attend, appear before, or file statements, with any advisory committee. . . ."[154] According to the complaint, Judicial Watch was

143. *See* Federal Advisory Committee Act, 5 U.S.C. app. 2 § 3.
144. *Id.*
145. *See* Chamber of Commerce, *supra* note 102.
146. Federal Advisory Committee Act, 5 U.S.C. app. 2 § 3.
147. *See* Chamber of Commerce, *supra* note 102.
148. *See* Federal Advisory Committee Act, 5 U.S.C. § 10.
149. *See id.*
150. *See* Complaint, *supra* note 125.
151. *See id.*
152. *See* Federal Advisory Committee Act, 5 U.S.C. § 10.
153. *See* Complaint, *supra* note 125.
154. Federal Advisory Committee Act, 5 U.S.C. § 10.

denied permission by the U.S. Commerce Department the right to attend or appear before the NACC.[155] By denying permission the department violated this provision of FACA.

Finally, the Act specifies that "records, reports, transcripts, minutes, appendixes, working papers, drafts, studies, agenda, or other documents which were made available to or prepared for or by each advisory committee shall be available for public inspection and copying. . . ."[156] Judicial Watch's request for certain minutes from NACC meetings was denied.[157]

The NACC clearly violated the FACA by closing the meetings, not publishing the meeting times and places for interested persons, not allowing interested persons to appear before the committee, and not making their records and other information available to the public. This is important because the NACC is made up of private companies, meeting in secret, working for an international purpose, to set policy that could greatly change North America as a whole and the United States specifically.[158] The FACA was enacted for the very purpose of preventing influential private organizations from being able to influence government policy while hidden from the public eye. To allow continued violation of this by an organization that is working on greater integration within the North American continent would greatly undermine the entire purpose of the Act.

VII. CONCLUSION

The Security and Prosperity Partnership of North America is constitutional, as the President has the authority to act in foreign affairs. The SPP is not a formal treaty and thus the President is not required to seek the advice and consent of the Senate. However, by acting without any Congressional consent, the President's power is in "a zone of twilight"[159] in whose authority it is uncertain.[160] Congress or the courts could undo everything the President is working toward with the SPP. If Congress prohibits all or part of the plans of the SPP, such as opposing the "NAFTA Superhighway," the President's authority is at its "lowest ebb."[161] This would make it unlikely for the courts to uphold the President's agreements, if the SPP is challenged by a plaintiff with standing. Furthermore, the NACC's possible violation of the FACA

155. *See* Complaint, *supra* note 125.
156. Federal Advisory Committee Act, 5 U.S.C. § 10.
157. *See* Complaint, *supra* note 125.
158. *See* CORSI, *supra* note 52, at 64-65; NACC, *supra* note 106.
159. *See* Youngstown Sheet and Tube Co. v. Sawyer, 343 U.S. 579, 637-38 (1952).
160. *See id.*
161. *Id.*

leaves the council open to lawsuits that could undo the work it did on the SPP's behalf.

Another issue that is currently taking shape is a new state sovereignty movement.[162] At least fourteen U.S. states have introduced bills into their legislatures to reclaim constitutional powers under the Tenth Amendment to the Constitution that supporters claim have been abrogated by the federal government of the United States.[163] The Texas legislature has already derailed the Trans-Texas Corridor, essentially burying plans for a NAFTA Superhighway.[164] Further assertions of state power may harm the SPP even more. If the SPP were a treaty, however, it would supersede state law.[165]

The final, and possibly largest legal issue with the continuation of the SPP, is that since it is not a treaty or even an agreement, the member states themselves are not bound. Newly elected national leaders could decide not to live up to the goals outlined by the SPP. Recently, for example, Mexican President Felipe Calderon stated that Mexico will not be participating in joint border patrols.[166] He also claimed that United States and Mexican cooperation does not imply joint participation of law enforcement agents.[167]

These problems should be rectified before the SPP's plans go forward to avoid having everything done thus far undone. Newly elected U.S. President Barak Obama has pledged to continue the trilateral partnership that President Bush began, and to further improve U.S. relations with Mexico.[168] To stave off potential future problems, it would behoove President Obama's administration to consider more binding agreements.

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162. *See* Larry Greenley, *Tenth Amendment Movement Taking Off*, THE NEW AM., Feb. 25, 2009, http://www.thenewamerican.com/usnews/constitution/829.

163. *See id.*

164. *See* Lindenberger, *supra* note 57.

165. Missouri v. Holland, 252 U.S. 416 (1920).

166. *See* Rosalba O'Brien, *Mexico Rules Out Joint Border Patrols with U.S.*, REUTERS, Mar. 30, 2009, *available at* http://www.reuters.com/article/topNews/idUSTRE52T5YY20090330?feedType=RSS&feedName=topNews&rpc=22&sp=true.

167. *See id.*

168. *See Barack Obama: I will repair our relationship with Mexico*, Op-Ed., THE DALLAS MORNING NEWS, Feb. 20, 2008, http://www.dallasnews.com/sharedcontent/dws/dn/opinion/viewpoints/stories/DN-obama_20edi.ART.State.Edition1.464da8e.html.

Mindblindness: Three Nations Approach the Special Case of the Criminally Accused Individual with Asperger's Syndrome

Brian Wauhop*

I. INTRODUCTION

Imagine moving through life without the ability to comprehend that other people possess different emotional states, cognitive experiences and perceptions than you do. You have a compulsive need to create routines that affect all aspects of your everyday life. You pursue narrow interests, excluding other people and activities. While you communicate the best you can, you always feel misunderstood by others, and you always feel like you cannot understand what others mean when they speak. Imagine the confusion you would experience when faced with the constant reality that your own conduct, while appropriate from your perspective, is often socially unacceptable to others. This is a rough description of the social experience of an individual with Asperger's Syndrome ("AS").[1]

AS is a pervasive developmental disorder[2] closely related to autistic spectrum disorders.[3] According to the Center for Disease Control, one out of every 150 children has some form of autism.[4] While AS was first studied and described over sixty years ago, only recently has the

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1. *See* TONY ATTWOOD, THE COMPLETE GUIDE TO ASPERGER'S SYNDROME 36, 37 (Jessica Kingsley Publishers 2006).

2. *Id.* at 350 (defining "pervasive developmental disorder" as "a severe impairment in reciprocal social interaction skills and communication skills and the presence of repetitive behavior, interests and activities").

3. *See* AMERICAN PSYCHIATRIC ASSOCIATION, DIAGNOSTIC AND STATISTICAL MANUAL OF MENTAL DISORDERS (text revision 2000) (DSM-IV-TR) (hereinafter DSM-IV).

4. *See* Ranit Mishori, *More Children Are Affected and Controversies Rage: What Do We Know About Autism?*, PARADE, Jan. 27, 2008, at 4.

diagnosis gained widespread acceptance.[5] Current estimates put the prevalence rate of AS possibly as high as one in 250 individuals (.4 percent of the population).[6] AS individuals experience difficulties coping with everyday life and society and frequently require lifelong coaching.[7] The social impairment appears to continue into adulthood.[8] Research suggests that AS sufferers are no more likely to commit crime than neurotypical[9] individuals.[10]

However, studies reveal the prevalence rate of AS individuals in prison populations is much higher, ranging between 1.5 percent and 2.4 percent.[11] This overrepresentation suggests that AS individuals are slipping through the cracks in criminal prosecutions.[12] This overrepresentation suggest that an AS individual might be convicted and incarcerated because of the peculiar manifestation of their disorder rather than on any legally culpable conduct.[13] With a potential prevalence rate of one in 250,[14] the disorder has implications for criminal law systems throughout the world.

The following discussion will analyze how criminal law systems in the United States, England, and Australia currently deal with the criminally accused AS individual. Courts in each of these nations have decided cases wherein criminal defendants have raised the diagnosis of AS in their defense. AS and the legal significance of its characteristic traits, including mindblindness, will be explained, followed by a brief history of criminal culpability requirements. Next, an analysis of recent English, United States and Australian cases will explore the current legal landscape for the AS criminal offender. The discussion will conclude by suggesting potential reforms in criminal law in order to improve the AS offender's access to justice.

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5. *See* ATTWOOD, *supra* note 1, at 14.

6. *Id.* at 46.

7. *Id.* at 57-92.

8. *See* Ami Klin, *Autism and Asperger Syndrome: An Overview*, 28 REV. BRAS. PSIQUIATR. S3, S10 (2006) (noting that many AS children are able to attend regular education classes with additional support, but the social impairment appears to be lifelong).

9. "Neurotypical" describes people whose neurological development and current neurological state allow for what most people would agree is the "normal" ability to process social cues and language. *See* Jim Sinclair, *A Note About Language and Abbreviations*, http://web.syr.edu/~jisincla/language.htm (last visited Feb. 11, 2008).

10. *See* ATTWOOD, *supra* note 1, at 335.

11. *See* Barbara G. Haskins, M.D. & J. Arturo Silva, M.D., *Asperger's Disorder and Criminal Behavior: Forensic-Psychiatric Considerations*, 34 J. AM. ACAD. PSYCH. L. 374, 377, 382 (2006).

12. *See generally id.*

13. *See* Haskins & Silva, *supra* note 11, at 378.

14. *See* ATTWOOD, *supra* note 1, at 46.

II. ASPERGER'S SYNDROME

Asperger's Syndrome was first described by Austrian psychiatrist Dr. Hans Asperger in 1944.[15] Dr. Asperger studied four children who were otherwise intelligent but had difficulty with social interactions.[16] He called the condition "autistic psychopathy" to indicate a stable personality disorder marked by social isolation.[17] Dr. Asperger's research was published primarily within German literature,[18] and while his original descriptions of the condition were very clear, he did not articulate diagnostic criteria for the disorder.[19]

As a result, widespread application of Dr. Asperger's research was delayed until 1981 when British psychiatrist Dr. Lorna Wing published a review of Dr. Asperger's work.[20] The title of Wing's article popularized the term "Asperger's syndrome."[21] That article spurred interest in Dr. Asperger's work, and new studies on the disorder began.[22]

A. Diagnostic Criteria

Gillberg and Gillberg[23] published the first diagnostic criteria ("Gillberg criteria") for AS in 1989, and later revised it in 1991. The criteria identified six traits that must be present in a child to warrant a diagnosis of AS: 1) social impairment; 2) narrow interest; 3) compulsive need for introducing routines and activities; 4) speech and language peculiarities; 5) non-verbal communication problems; and, 6) motor clumsiness.[24] Within each trait, one or more of a list of specific characteristics must be present to establish that trait.[25]

By the mid-90s, AS was starting to become recognized as a legitimate disorder among global health organizations.[26] In 1993, the

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15. *See* Hans Asperger, *'Autistic Psychopathy' In Childhood*, *in* UTA FRITH, AUTISM AND ASPERGER SYNDROME 37-62 (Cambridge University Press 1992).

16. *See* Klin, *supra* note 8, at S8.

17. *Id.*

18. *See generally* Lorna Wing, *Asperger's Syndrome: A Clinical Account*, 11 PSYCH. MED. 115 (1981).

19. *See* ATTWOOD, *supra* note 1, at 36.

20. *See* Nachum Katz & Zvi Zemishlany, *Criminal Responsibility in Asperger's Syndrome*, 43 ISRAEL J. PSYCH. & RELATED SCI. 166, 166 (2006).

21. *See* Wing, *supra* note 18, at 115.

22. *See* Katz & Zemishlany, *supra* note 20, at 166.

23. *See* ATTWOOD, *supra* note 1, at 37 (citing the research of Carina Gillberg and Christopher Gillberg, *Asperger Syndrome - Some Epidemiological Considerations: A Research Note*, 30 J. CHILD PSYCHOL. PSYCHIATRY 631, 631-38 (1989)).

24. *Id.*

25. *Id.*

26. AS was not listed in the World Health Organization's classification manual until 1993, and AS did not appear in the DSM until 1994. *See* WORLD HEALTH ORGANIZATION, INTERNATIONAL STATISTICAL CLASSIFICATION OF DISEASES AND RELATED

World Health Organization acknowledged AS for the first time in its diagnostic manual, the International Statistical Classification of Diseases and Related Health Problems ("ICD-10").[27] The ICD-10 distinguishes AS from autism by stating that unlike autistic people, AS individuals have "no general delay [] or retardation in language or in cognitive development."[28]

In 1994, the American Psychiatric Association included AS in the Diagnostic and Statistical Manual of Mental Disorders ("DSM-IV").[29] Because Asperger's Syndrome was not listed in the DSM-IV prior to 1994, many United States clinicians (and those foreign clinicians using the DSM-IV as diagnostic criteria) were not formally trained to diagnose this condition in adults.[30] The diagnostic criteria for Asperger's Syndrome in the DSM-IV and ICD-10 are remarkably similar,[31] though both have been criticized as too restrictive and unworkable in clinical practice.[32]

The Gillberg criteria appear to more accurately represent the traits described by Dr. Asperger.[33] Many clinicians in Europe and Australia use the Gillberg criteria when diagnosing AS; clinicians in the United States use the DSM-IV criteria.[34] In the view of one expert, clinicians currently detect and diagnose only fifty percent of children who have AS.[35] The remaining undiagnosed children with AS are either able to conceal their AS traits during evaluation or are completely misdiagnosed through clinician error.[36]

The novelty surrounding AS has yet to yield an international diagnostic standard. Current, official diagnostic standards are a "work in progress" with no existing international standard.[37] Depending on the criteria used for diagnosis, the prevalence rate for AS may be as high as

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HEALTH PROBLEMS (10th ed.) (2006) (hereinafter ICD-10); *see also* DSM-IV, *supra* note 3.

27. *See* ICD-10, supra note 26.

28. *Id.*

29. DSM-IV, *supra* note 3.

30. *See* Haskins & Silva, *supra* note 11, at 374.

31. *See* ATTWOOD, *supra* note 1, at 36; *see also* Haskins & Silva, *supra* note 11, at 374 (comparing the diagnostic criteria used by the DSM-IV-TR, ICD-10 and the Gillberg criteria).

32. *See* ATTWOOD, *supra* note 1, at 44-45. The DSM-IV-TR criteria require a diagnosis of autism if those criteria are concurrently satisfied with AS. Attwood notes that based on this hierarchical system, a diagnosis of AS is "almost impossible." *Id.*

33. *Id.* at 46.

34. *Id.*

35. *Id.*

36. *Id.*

37. *See* ATTWOOD, *supra* note 1, at 45-54.

one in 250.[38] With no existing universal diagnostic standard, it is likely that a large number of people with AS remain undiagnosed.[39]

B. Legal Significance of the Traits of Asperger's Syndrome

Despite their differences, the DSM-IV, ICD-10 and the Gillberg criteria all contain references to essentially the same sets of traits. The list below follows the major headings in the Gillberg criteria and explains the legal significance of each trait.

1. Social Impairment

The social impairment typical of AS is satisfied when two of the following characteristics are present: 1) difficulty interacting with peers; 2) indifference to peer contacts; 3) difficulty interpreting social cues; or 4) socially and emotionally inappropriate behavior.[40] Mentally healthy individuals can be described as neurotypical.[41] Generally, a neurotypical individual possesses the ability to infer the cognitive, perceptual, and affective life of themselves as well as others.[42] Dr. Simon Baron-Cohen coined the term "mindblindness" to describe the impairment of people who do not have this ability.[43]

People with Asperger's Syndrome are said to have mindblindness because they frequently misunderstand social cues and cannot comprehend that other people can have different emotional reactions to the same event.[44] Mindblindness is legally significant because it prevents individuals from perceiving and understanding the effect their conduct has on the emotional and cognitive states of others.[45] For example, suppose an AS individual completed the physical elements of a particular crime. But because of mindblindness, the individual had no idea how their conduct might affect others. Thus, the individual neither anticipated nor intended to achieve the particular outcome their conduct produced.

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38. *Id.* at 46.
39. *Id.*
40. *Id.* at 37.
41. *See* Sinclair, *supra* note 9.
42. *See* Haskins & Silva, *supra* note 11, at 378 (referring to this ability as "Theory of Mind" (ToM)).
43. *See* SIMON BARON-COHEN, MINDBLINDNESS: AN ESSAY ON AUTISM AND THEORY OF MIND 51 (The MIT Press, 1996) (1995). Baron-Cohen coined the term "mindblindness" to describe the inability to utilize ToM abilities. *Id.*
44. *See* Haskins & Silva, *supra* note 11, at 378.
45. *Id.*

2. Narrow Interest Fixations

The presence of at least one of the following characteristics establishes the narrow interest trait of AS: 1) exclusion of other activities; 2) repetitive adherence; or, 3) repetition that is more rote-routine than meaning.[46] Individuals with AS are likely to gather large amounts of data on narrow topics (for example, "snakes, names of stars, deep fat fryers, weather information, personal information on members of Congress"[47]) in an intense fashion "without genuine understanding of the broader phenomenon involved."[48]

While there is little research on the origin of the narrow interest compulsion associated with AS, these interests appear to serve several functions for AS individuals.[49] The narrow interest fixations may help AS individuals overcome anxiety and help them achieve coherence in life.[50] In addition, a narrow interest fixation may help AS individuals understand the physical world and perceive a sense of identity.[51] Finally, the fixations may help AS individuals relax and serve as a source of happiness and discussion.[52]

Narrow interest fixations are legally significant because in the event that an AS individual gets into trouble, the narrow interest fixation could be used as extrinsic evidence against them. The individual's unusual, detailed and extensive narrow interest could be used to show cognizance and comprehension—that the individual is able to interpret and understand things on an advanced level.[53] AS individuals are intelligent and have comprehension skills;[54] but proving intelligence and organization through the conduct surrounding a narrow interest does not necessarily equate to comprehension in other areas.[55]

Further, if a criminal offense parallels or appears to stem from a narrow interest fixation, the likely inference facing the AS defendant is that the crime was premeditated. However, the presence of large amounts of data or material on a specific topic is not dispositive on the

46. *See* ATTWOOD, *supra* note 1, at 37.
47. *See* Klin, *supra* note 8, at S9.
48. *Id.* at S10 (noting that while this trait is not easily discernable in children, eventually the interests become more unusual and narrowly focused).
49. *See* ATTWOOD, *supra* note 1, at 182.
50. *Id.*
51. *Id.*
52. *Id.*
53. *See* ATTWOOD, *supra* note 1, at 182-88.
54. *Id.*
55. *Id.*

issue of whether an AS individual is planning to commit a crime related to the narrow interest fixation.[56]

3. Compulsion to Routines

AS individuals have a compulsion to establish routines that affect all aspects of the individual's life, and may affect others.[57] Individuals with AS have poor intuition and lack the ability to spontaneously adapt in social situations.[58] They have a tendency toward very literal interpretations of what people say.[59] As a result, they rely on rigid social conventions or formalistic rules of behavior for guidance in social situations.[60] This reliance gives the impression of social naïveté.[61]

The appearance of naïveté makes the AS individual susceptible to suggestion.[62] Such naïveté, when combined with the social impairment explained above, makes an AS individual especially vulnerable to getting tricked into committing crimes because they were told that the conduct in question was acceptable.[63] Interpreting the command literally, the AS individual might follow an order without regard to its inappropriate or illegal nature.[64]

Furthermore, individuals with AS are more likely to overreact when their routines are interrupted.[65] The overreaction may lead to the commission of a crime that the individual had not contemplated.[66] Here again, the result is not one that the individual intended.

4. Speech Irregularities

The speech peculiarities associated with AS typically involve at least three of the following characteristics: 1) delayed speech development; 2) superficially perfect expressive language; 3) formal pedantic language; 4) odd prosody, or peculiar voice characteristics; or 5) impairment of comprehension including misinterpretation of literal or implied meanings.[67] Typically, people with AS lacks inflection and

56. *See* State v. Boyd, 143 S.W.3d 36, 45 (Mo. 2004) (explaining that psychologist testifying that defendant's interest in "odd subjects" does not increase likelihood that defendant would engage in conduct related to the "odd subject").
57. *See* ATTWOOD, *supra* note 1, at 37.
58. *See* Klin, *supra* note 8, at S9.
59. *See* ATTWOOD, *supra* note 1, at 115.
60. *See* Klin, *supra* note 8, at S9.
61. *Id.*
62. *Id.*
63. *See* Haskins & Silva, *supra* note 11, at 382.
64. *See* ATTWOOD, *supra* note 1, at 335.
65. *Id.*
66. *Id.*
67. *Id.* at 37.

intonation in their voice, making them sound almost monotone when they speak.[68] Their conversations sound tangential or without context, giving the general impression of incoherence.[69] Individuals suffering from AS are often long-winded, and sometimes fail to make a point even after long discourse.[70]

Speech irregularities are legally significant when considering communication between AS sufferers and law enforcement officials, during hearings, or before a jury or parole board.[71] Undoubtedly, the AS individual will not communicate with others in what is considered "normal" or anticipated styles[72] (for example, showing "signs of boredom, haste to leave, and [a peculiar] need for privacy").[73] As a result, their odd intonation and flat affect might convey a lack of remorse.[74] Further, AS individuals have a pattern of immediate confession to crimes.[75] Believing their conduct is justified, they "cannot understand what all the fuss is about."[76] These communication irregularities may serve to reinforce criminal justice officials' notions of culpability in the person.

5. Nonverbal Communication Problems

The presence of any one of the following characteristics establishes nonverbal communication traits peculiar to an AS individual: 1) limited use of gestures; 2) clumsy/gauche body language; 3) limited facial expressions; 4) inappropriate facial expression; or, 5) peculiar, stiff gaze.[77] Individuals with Asperger's Syndrome may react inappropriately or fail to comprehend the context of a social interaction.[78] Miscues, flat

68. *See* Klin, *supra* note 8, at S9. AS individuals might exhibit jerky speech or appear to speak too fast with little appreciation for the communicative effect or social perception of the volume of their speaking voice.

69. *Id.* (explaining that the appearance of incoherence is a result of "one-sided egocentric conversational style").

70. *Id.* (explaining that in spite of verbose conversations, individuals may never come to a point or conclusion).

71. For a thorough and thoughtful analysis of interactions between law enforcement officials and people with autistic spectrum disorders like AS, *see generally* Elizabeth Hervey Osborn, *"What Ever Happened To Paul's Law"?: Insights On Advocating for Better Training and Better Outcomes In Encounters Between Law Enforcement And Persons With Autistic Spectrum Disorders*, 79 U. COLO. L. REV. 333 (2008).

72. *See* Klin, *supra* note 8, at S9.

73. *Id.*

74. *See* Haskins & Silva, *supra* note 11, at 382.

75. *See* ATTWOOD, *supra* note 1, at 339.

76. *Id.*

77. *Id.* at 37.

78. *See* Klin, *supra* note 8, at S9.

facial expression, and the overall distant affect of AS individuals are often interpreted by other people as insensitivity or a lack of empathy.[79]

The perceived lack of empathy or remorse is legally significant because it might be mistaken as an indicator of psychopathy.[80] Psychopaths are human predators, while AS individuals are socially naïve and immature.[81] While both give the impression of a lack of empathy, the psychopath actually has no remorse, whereas the AS individual's outward communicative cues simply do not express remorse in expected and anticipated ways.[82]

6. Motor Clumsiness

Poor performance in a neurodevelopmental test establishes the motor clumsiness criteria associated with AS.[83] Individuals with Asperger's Syndrome are often visibly uncoordinated or walk with a stilted or bouncy gait.[84] They may have been delayed in acquiring motor skills such as riding a bicycle or catching a ball.[85]

Poor motor skills could operate to negate the physical elements, or *actus reus*, of a crime. If the motor clumsiness associated with AS renders a person physically incapable of completing the crime, criminal culpability could not be assigned to that person.

In summary, the AS individual is usually an intelligent and high-functioning person whose developmental disorder hinders their social interactions.[86] Under certain conditions, the way that the developmental disorder inhibits their cognitive and behavioral abilities may make the AS individual susceptible to criminal prosecutions.[87] The developmental disorder further compounds their situation once taken into custody, where most law enforcement officials lack training in recognizing AS.[88]

III. CRIMINAL LIABILITY OF THE AS INDIVIDUAL ACCUSED OF A CRIME

Does the presence of AS in an individual effectively negate culpability? If not a complete bar, to what degree is an AS individual liable for criminal conduct? Criminal liability in the United States,

79. *Id.*
80. *See* ATTWOOD, *supra* note 1, at 339.
81. *Id.*
82. *Id.*
83. *Id.* at 37.
84. *See* Klin, *supra* note 8, at S10.
85. *Id.*
86. *See* ATTWOOD, *supra* note 1, at 32.
87. *E.g.*, *id.* at 335; Haskins & Silva, *supra* note 11, at 374; Katz & Zemishlany, *supra* note 18, at 166.
88. *See* ATTWOOD, *supra* note 1, at 338-39.

Australia and England requires the physical performance of the illegal act (*actus reus*) combined with the mental will to engage in that conduct (*mens rea*).[89] A brief examination of these components of criminal law will help reveal how AS individuals can fall through the cracks of the criminal justice system.

A. Actus Reus—The Physical Conduct Element of Criminal Culpability

Criminal culpability in the United States, Australia and England flows from the completion of the physical act of crime accompanied by a required mental state.[90] However, if an individual has a handicap that renders them physically incapable of acting, this handicap could operate as a complete bar to criminal culpability depending on physical conduct.

Some level of motor skills delay is a recurring trait of AS individuals.[91] In general, AS does not affect motor function in a way that would impair an individual from completing the physical element of a crime.[92] AS may make completion of some tasks more difficult, depending on the level of motor skill coordination the task requires.[93] However, there is no evidence to suggest that the motor skills delay renders an AS individual physically incapable of committing a crime.

B. Mens Rea—The Mental Element of Criminal Culpability

Criminal law theory in the United States and Australia has been heavily influenced by the English common law model. The following is a brief sketch of the origins of *mens rea* theory in England, and the ways in which the United States and Australia have adopted and modified the theory.

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89. *See* COMMONWEALTH CRIMINAL CODE ACT, 1995, c. 1, div. 4-5 (Austl.) (providing the physical and fault elements for criminal conduct in Australian Commonwealth Criminal Code); *see* MODEL PENAL CODE §§ 2.01, 2.02 (1962) (providing the physical and mental culpability requirements for crimes as has been adopted in almost forty United States' jurisdictions); *see generally* R v. Bateman, (1925) 19 Crim. App. 8 (Eng.) (providing a test for conduct and mental state resulting in criminal liability).

90. See Commonwealth Criminal Code Act, 1995, c. 1, div. 4-5; *see* MPC §§ 2.01, 2.02; *see generally Bateman*, 19 Crim. App. 8.

91. *See* ATTWOOD, *supra* note 1, at 335.

92. *See id.*

93. *Id.* at 259-61.

1. The English Approach to *Mens Rea* in Criminal Law[94]

English statutory law and common law applies the common law maxim "the deed does not make a man guilty unless his mind be guilty."[95] In his thirteenth-century treatise, legal scholar Henry Bracton wrote that "[it] is will and purpose which mark *maleficia*" and "a crime is not committed unless the intention to injure exists."[96] Bracton's writings reveal the view that criminal culpability required a culpable state of mind accompanying prohibited conduct.[97] Further, the criminal's state of mind must intend injury to occur.[98] As such, an individual acting with a free mind, when choosing evil over good, was deemed morally blameworthy.[99]

Bracton's discussions of the culpability of children and the insane further clarify the "willful" component of intent.[100] According to Bracton, infants and the insane are excluded from culpability due to their inability to make rational choices between right and wrong.[101] In Bracton's view, infants are capable only of innocent designs while the insane are considered to be without reason altogether.[102] These observations are known in modern criminal law as "excuse defenses." In an excuse defense, blameworthy conduct by the actor is excused due to the absence of the requisite state of mind.[103]

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94. For an excellent, in-depth study of the evolution of the doctrine of *mens rea* in English criminal law, *see* Martin R. Gardner, *The Mens Rea Enigma: Observations on the Role of Motive in the Criminal Past and Present,* 1993 UTAH L. REV. 635, 651-681 (1993).

95. *See* R v. Tolson (1889) 23 Q.B. 168, 187 (Eng.) (Stephen, J., dissenting). Lord Stephen's impression of the maxim is

> The full definition of every crime contains expressly or by implication a proposition as to a state of mind. Therefore, if the mental element of any conduct alleged to be a crime is proved to have been absent in a given case, the crime so defined is not committed; or, again, if a crime is fully defined nothing amounts to that crime which does not satisfy that definition.

Id.

96. 2 HENRY D. BRACTON, ON THE LAWS AND CUSTOMS OF ENGLAND 384 (Samuel E. Thorne trans., 1968). Presumably, a royal pardon was no longer required to negate the strict liability punishment of death for accidental killings or self-defense. *Id.*

97. *Id.* at 984-85.

98. *See* 2 BRACTON, *supra* note 96, at 340-41. Bracton wrote that a person who kills another to save his family from death was not punished for homicide, since the act of killing was unavoidable and performed with "sorrow of heart."

99. *See* Francis E. Sayre, *Mens Rea*, 45 HARV. L. REV. 974, 1019 (1932).

100. *Id.* at 985-86.

101. *See* 2 BRACTON, *supra* note 96, at 424.

102. *See* Sayre, *supra* note 99, at 985-86.

103. *See, e.g.*, MODEL PENAL CODE art. 3 (1962) (providing the "justification" defenses of self-defense and choice of evils, justifying otherwise blameworthy conduct in the actor due to surrounding circumstances); MODEL PENAL CODE art. 4 (1962) (providing

In the centuries following Bracton's time, the principle of *mens rea* has been more precisely refined.[104] General requirements of "evil intent" eventually gave way to specifically defined mental states for crimes and common law felonies.[105] By the seventeenth century, convictions for burglary, larceny and arson required a showing of specific intent.[106] These basic *mens rea* principles endure to the present day in English criminal law.[107]

Currently, England is one of the very few developed countries without a criminal code.[108] Criminal behavior is defined and prohibited through a combination of legislative action and common law offenses.[109] *Mens rea* requirements for offenses are described in legislative enactments describing and outlawing conduct.[110] The specific mental states required for common law offenses have been defined through judicial decisions.[111] Assessment of *mens rea* is provided for in Section

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the "excuse" defenses of mental defect and immaturity to exclude actors from culpability).

104. *See* Sayre, *supra* note 99, at 989.

105. *Id.* at 994.

106. *Id.* at 994-1004.

107. *See id.* at 1003. Sayre notes that the mental state required for a common law arson conviction has not changed since the seventeenth century, but the general requirement of "malice" has narrowed to a specific intent to burn a building. *Id.*

108. *See* P.R. GLAZEBROOK, BLACKSTONE'S STATUTES ON CRIMINAL LAW 2004-2005 xxvi (14th ed.) (2004).

109. *Id.*; *see also* PAUL H. ROBINSON, CRIMINAL LAW CASE STUDIES AND CONTROVERSIES 48 (2d ed. 2005).

110. *See* GLAZEBROOK, *supra* note 108.

111. *See, e.g.*, R v. Bateman, (1925) 19 Crim. App. 8 (Eng.) The *Bateman* court explained that in order to establish *mens rea* for criminal liability:

> The facts must be such that, in the opinion of the jury, the negligence of the accused went beyond a mere matter of compensation between subjects and showed such disregard for the life and safety of others as to amount to a crime against the State and conduct deserving punishment.

Id. at 11-12; *see* R v. Cunningham, [1957] 2 Q.B. 396 (Eng.) The court in *Cunningham* stated the *mens rea* standard for recklessness as follows:

> In any statutory definition of a crime, malice must be taken . . . as requiring either: (1) an actual intention to do the particular kind of harm that in fact was done; or (2) recklessness as to whether such harm should occur or not (i.e. the accused has foreseen that the particular kind of harm might be done and yet has gone on to take the risk of it).

Id. at 399-400; R v. Mohan, (1976) Q.B. 1, 8 (Eng.) The *Mohan* court provided the *mens rea* standard for direct intention: an "aim or purpose"—"a decision to bring about, insofar as it lies within the accused's power, the commission of the offence . . . no matter whether the accused desired that consequence of his act or not." *Id.* (quoting R. v. Hyam [1975] A.C. 55, 74); *see also* 17 ARCHBOLD: CRIMINAL PLEADING, EVIDENCE, AND PRACTICE §§ 34-66a (James Richardson, ed., Sweet & Maxwell, Ltd. 2004) (describing the requirements needed to establish the specific mental states of with intent to, attempts to, negligently, unlawfully, maliciously, willfully, knowingly, suspects, recklessly, fraudulently, dishonestly, causes, and permits, in English criminal law contexts).

Eight of the Criminal Justice Act of 1967.[112] That assessment calls for a "totality of the circumstances" evaluation of what harm the offender intended as opposed to what harm he actually caused.[113]

2. Australian Approach to *Mens Rea* in Criminal Law

Like England, Australia's criminal law system has evolved through Australian judicial decisions and legislative activity. As a former British colony, English criminal statutes became the basis for state and territorial criminal law in Australia.[114] The Commonwealth of Australia (or federal government) has its own criminal jurisdiction and criminal code for federal offenses.[115] Of the eight Australian states within the Commonwealth of Australia, five have adopted criminal codes.[116] The other three are common law jurisdictions that have passed crimes acts listing offenses and punishments.[117]

One of the eight Australian states, Queensland, has adopted a criminal code that assigns the *mens rea* requirement directly into the offense description.[118] Therefore, when no *mens rea* component is listed, the mental state required is irrelevant.[119] In contrast, The Commonwealth Criminal Code separates offense elements into "Physical Elements" and "Fault Elements."[120] The Physical Elements correspond to *actus reus* requirements and the Fault Elements correspond to *mens rea* requirements.[121] Further, the Commonwealth Code, very similar to

112. *See* Criminal Justice Act, 1967, c. 80, § 8 (U.K.). The act provides as follows:

> A court or jury, in determining whether a person has committed an offence,
>
> (a) shall not be bound in law to infer that he intended or foresaw a result of his actions by reasons only of its being a natural and probable consequence of those actions; but
>
> (b) shall decide whether he did intend or foresee that result by reference to all the evidence, drawing such inferences from the evidence as appear proper in the circumstances.

113. *See* Criminal Justice Act, 1967, c. 80, § 8 (U.K.).

114. *See* Ian Leader-Elliot, *Benthamite Reflections on Codification of the General Principles of Criminal Liability: Towards the Panopticon*, 9 BUFF. CRIM. L. REV. 391, 392 (2006).

115. *See* Crimes Act, 1914 (Austl.) and Commonwealth Criminal Code Act, 1995 (Austl.).

116. *See* Criminal Code Act, 1899 (Queensl.) (Austl.); Criminal Code Act, 1902 (W. Australia); Criminal Code Act, 1983 (N. Terr.) (Austl.); Criminal Code Act, 1995 (Austl. Cap. Terr.) (Austl.).

117. *See, e.g.*, Crimes Act, 1900 (N.S.W.) (Austl.).

118. *See* Criminal Code Act, 1899, c. 5 § 23, § 2 (Queensl.) (Austl.) The subsection provides in pertinent part that "[u]nless the intention to cause a particular result is expressly declared to be an element of the offence constituted, in whole or part, by an act or omission, the result intended to be caused by an act or omission is immaterial." *Id.*

119. *Id.*

120. *See* Commonwealth Criminal Code Act, 1995, c. 1, div. 4-5 (Austl.).

121. *Id.*

the American Law Institute's Model Penal Code, provides definitions for each of the *mens rea* elements for crimes under the Commonwealth Code.[122]

3. United States' Approach to *Mens Rea* in Criminal Law

Following the Revolutionary War, American colonies adopted a criminal law system modeled after the English system.[123] Building on the summaries of existing English common law and criminal law in Blackstone's *Commentaries on the Laws of England*,[124] American courts developed and refined criminal law.[125] Because each state has lawmaking autonomy, legislatures crafted their own criminal legislation resulting in great disparity in criminal law across the United States.[126]

Ultimately, the American Legal Institute drafted the Model Penal Code.[127] This code sets out an analytical framework for the physical and mental elements for specific crimes.[128] The Model Penal Code provides four levels of intentional conduct: negligent, reckless, knowing and purposeful.[129] By 2002, forty states adopted the Model Penal Code.[130]

In summary, all three nations' legal systems require an individual to have a certain mental state during the commission of a crime to be found criminally culpable. *Mens rea* doctrine has evolved to require specific intent for certain crimes.

IV. DISCUSSION OF RECENT CASE DEVELOPMENTS

The peculiar impairments associated with AS, particularly mindblindness, interfere with an individual's ability to understand other people's emotional or mental states.[131] As a result, people with AS may engage in criminal violations without the *mens rea* required for the assessment of criminal culpability. Most United States cases where AS is raised to negate *mens rea* end unfavorably for the defendant.[132] In

122. *Id.*
123. *See* ROBINSON, *supra* note 109, at 23.
124. *See* WILLIAM BLACKSTONE, COMMENTARIES ON THE LAWS OF ENGLAND (1803, reprinted in 1969).
125. *See* ROBINSON, *supra* note 109, at 23.
126. *Id.* at 25.
127. *See* MODEL PENAL CODE (1962).
128. *Id.* §§ 2.01, 2.02.
129. *Id.* § 2.02.
130. *See* MARKUS D. DUBBER, CRIMINAL LAW: MODEL PENAL CODE 50 (2002).
131. *See* BARON-COHEN, *supra* note 43; Haskins & Silva, *supra* note 11, at 378.
132. United States cases where AS has been unsuccessfully raised as a defense or mitigating factor include: Martlett v. State, 2007 WL 4555274, at *4 (Ind. App. Dec. 28, 2007) (explaining that impairments attributed to AS do not warrant overwhelming weight in assessment of his character); United States v. Lange, 445 F.3d 983, 987 (7th Cir. 2006)

England, the courts consider AS a factor that can mitigate sentencing or result in an order for new trial.[133] Courts in Australia have very seldom dealt with AS in criminal contexts, but the cases they have decided are revealing. To better understand the legal implications of AS, this section will explore a number of cases involving defendants with AS and how that factor was considered at trial.

A. United States Cases

According to the Autism Society of America, only twenty-two cases exist in the United States where AS was raised to show diminished capacity and avoid conviction of a criminal offense.[134] One notable example involved Robert Durst, a wealthy eccentric with AS, who was acquitted of murder charges for killing his neighbor.[135] The following cases involve defendants with AS and how that factor was considered at trial.

1. *State v. Boyd*: AS Offered as Evidence Defendant Did Not Commit the Crime

In June 2004, the Missouri Court of Appeals ordered a new trial for an AS defendant convicted of murder.[136] In *State v. Boyd*, James Boyd was accused of murdering a sixteen-year-old boy.[137] Boyd denied

(explaining that AS impairment held insufficient to prove lack of volition necessary for establishment of diminished capacity defense); Schoenwetter v. State, 931 So.2d 857, 875 (Fl. 2006) (explaining that AS impairment rejected as a mitigating factor in multiple homicide); People v. Youngerman, 838 N.E.2d 103, 111-13 (Ill. 2005) (explaining that defendant's diagnosis of AS subsequent to involuntary commitment insufficient to warrant release from commitment); State v. Santiago, 634 S.E.2d 23, 28-29 (S.C. App. 2006) (holding that expert testimony that defendant had AS not admissible to establish that defendant did not have requisite mens rea to commit murder; South Carolina does not recognize diminished capacity defense).

133. *See, e.g.*, R v. Dusic, [2006] EWCA(Crim) 2511, ¶¶ 29, 30 (Eng.); R v. Malik [2006] EWCA(Crim) 2349, ¶¶ 13, 14, 21 (Eng.); R v. Smith, [2004] EWCA(Crim) 2531, ¶¶ 5, 8, 9 (Eng.); R v. Grey, [2004] EWCA(Crim) 1446, ¶¶ 8, 11, 14, 17 (Eng.); R v Reynolds, [2004] EWCA(Crim) 1834, ¶¶ 6, 17, 18 (Eng.) (reducing sentences in each case due to introduction of evidence showing defendants had AS). One recent case presented evidence of AS as part of a diminished capacity defense to homicide. *See* R v. Jama, [2004] EWCA(Crim) 960, ¶ 33 (Eng.) (ordering new trial for defendant due to improper instructions by trial judge on the relationship between provocation and AS in diminished capacity defense).

134. *See* Brian R. Ballou & Michael Levenson, *School Killing Stuns Suburbs*, BOSTON GLOBE, Jan. 20, 2007, at 1A.

135. *See* Lucy Bannerman, *Millionaire who cut up body is freed; Killing was an accident, says eccentric*, THE HERALD (Glasgow), Nov. 12, 2003, at 10.

136. *See* State v. Boyd, 143 S.W.3d 36, 38 (Mo. 2004).

137. *Id.*

participation in the crime altogether.[138] At trial, Boyd sought to introduce evidence that he suffered from AS to prove four points relevant to his claim of innocence.[139] First, he argued that he was too uncoordinated to overpower and subdue a victim twice his size.[140] Second, he argued that he could not have navigated the forty-acre tract of woods to lead other people to the location of the body.[141] Next, he argued that AS offered an innocent explanation for his unusual interest in violent books.[142] Last, he argued that AS made him particularly gullible and susceptible to manipulation by others.[143] The trial court excluded the expert testimony because it related to a mental illness.[144] Such evidence is barred in Missouri when introduced to establish a diminished capacity defense.[145] As a result, Boyd was convicted.[146]

On appeal, the appellate court noted that Boyd was not seeking to enter the evidence under a diminished capacity defense.[147] Such a tactic would have invoked the legislation and case law relied on by the trial judge.[148] Instead, Boyd claimed he did not commit the murder,[149] and presented evidence of AS to support this defense theory.[150] As such, the appellate court found the trial court's determination that the evidence had to be evaluated according to Missouri diminished capacity evidence rules was erroneous.[151] The appellate court held that the trial judge's decision to exclude the evidence was erroneous.[152] The case was reversed and a new trial ordered.[153]

2. *State v. Burr*: Evidence of AS Relevant to Show that Defendant Did Not Understand Social Cues and Acts Inappropriately as a Result

In *State v. Burr*, the New Jersey Superior Court ordered a new trial for Franklin Burr.[154] Burr had been convicted of second-degree assault

138. *Id.*
139. *Id.* at 39.
140. *Id.*
141. *Boyd*, 143 S.W.3d at 39.
142. *Id.*
143. *Id.*
144. *Id.*
145. *Id.*
146. *Boyd*, 143 S.W.3d at 36.
147. *Id.* at 44.
148. *Id.*
149. *Id.*
150. *Id.* at 39-40.
151. *Boyd*, 143 S.W.3d at 39.
152. *Id.* at 47.
153. *Id.*
154. *See* State v. Burr, 921 A.2d 1135, 1159 (N.J. Super. 2007).

and third-degree endangering the welfare of a child for inappropriately touching one of his pupils.[155] At a preliminary hearing, Burr appeared in court with bag draped over his head.[156] When questioned about his appearance, he replied with quotations from the book of Deuteronomy.[157] Subsequently, Burr underwent a psychiatric evaluation and was diagnosed with Asperger's Syndrome.[158] At trial, Burr attempted to introduce expert testimony about the AS diagnosis to help the jury understand why he might act in a way that appears socially unacceptable or inappropriate to others.[159] The trial judge refused to admit the testimony, opining that it was not relevant to the issue of culpability.[160]

On appeal, the Superior Court reversed, holding that evidence showing Burr suffered from AS was relevant in determining how Burr thought about his actions, and that such evidence could have impacted the jury's decision.[161] The appellate judge ordered a new trial.[162]

B. English Cases

The following English cases involve appeals where the particular impairments of AS were raised as mitigating or exculpating factors.

1. *R v. Heather*: Reduction in Culpability for Arson Resulting from Narrow Interest Fixation

On February 4, 2000, John Heather was sentenced to three years imprisonment for setting a garbage dumpster on fire.[163] Heather had

155. *Id.* at 1137-38.
156. *Id.* at 1142, n. 5.
157. *Id.*
158. *Id.* at 1142. The court went on to paraphrase the American Psychiatric Association's diagnostic criteria for AS:

> The American Psychiatric Association recognizes Asperger's Disorder as a distinct diagnosis. According to the DSM-IV, the "essential features" of the disorder are "severe and sustained impairment in social interaction . . . and the development of restricted, repetitive patterns of behavior, interests, and activities." In order to constitute Asperger's Disorder, the "disturbance must cause clinically significant impairment in social, occupational, or other important areas of functioning."

Id. (quoting the American Psychiatric Association, *Diagnostic and Statistical Manual of Mental Disorders,* 75-77 (4th ed. 1994) (DSM-IV)).
159. *Burr*, 921 A.2d at 1143.
160. *Id.*
161. *Id.* at 1149.
162. *Id.* at 1159.
163. *See* R v. Heather, 2000 WL 1421166, ¶ 2 (Eng. July 31, 2000). The defendant pled guilty to one count of simple arson and not guilty to arson with reckless endangerment to life. *Id.*

been convicted of arson three times in the past,[164] and he was punished with probation for each conviction.[165] Heather had been diagnosed with AS,[166] and one of his AS-related behavior patterns was a compulsion to start fires.[167] The sentencing judge reviewed reports from a consulting psychiatrist and a consulting psychologist regarding Heather's mental condition.[168] The sentencing judge concluded that a three-year sentence would both protect the public and minimize the time Heather would be incarcerated.[169]

After serving almost twelve months of his sentence, Heather's case was heard by the appellate court.[170] The appellate court quashed the prison sentence in exchange for a three-year probation order and released Heather subject to certain conditions, including receiving treatment and obeying a curfew for six months.[171]

2. *R v. Gibson*: Recent AS Diagnosis Contributes to Reduction in Sentence

On December 15, 2000, Simon Gibson was sentenced to eighteen months imprisonment for burglary in a cemetery and disinterring a body.[172] Gibson and two accomplices had entered and disturbed a crypt three separate times at the Arnos Vale Cemetery in Bristol, England.[173] Gibson admitted to taking pieces of bone, a skull and a memorial vase out of the cemetery and opening a coffin to view its contents.[174] The trial judge heard evidence that Gibson suffered from AS.[175] However, the trial judge sentenced him to eighteen months in jail.[176]

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164. *Id.* ¶ 5. The defendant was known in his neighborhood as the "fire-lighter" for his tendency to start fires. *Id.*

165. *Id.*

166. *Id.* ¶ 4.

167. *Id.*

168. *Heather*, 2000 WL 1421166, ¶ 6.

169. *Id.* Heather had lived all his life at home with his mother, who was over eighty years old at the time of sentencing. She indicated at sentencing that having John live with her was becoming too great a responsibility for her, and the sentencing judge indicated that the Court of Appeal may have "greater powers than he" to place Heather in a group residence. *Id.* ¶ 7.

170. *Id.*

171. *Id.* ¶ 9. In summary, the conditions were that Heather receive psychiatric services and care as instructed by the probation team, that he reside where the probation officer instructs him to and that he abide by an electronically monitored curfew for six months. *Id.*

172. *See* R v. Gibson, [2001] EWCA (Crim) 656, ¶ 1 (Eng.).

173. *Id.* ¶ 3.

174. *Id.*

175. *Id.* ¶¶ 10, 12. When the defendant was four years old, his father committed suicide. The defendant lived at home with his mother and younger brother. The brother

On appeal, the appellate court noted that even though the punishment was correct in principle, Gibson's exceptional circumstances should have produced a different sentence.[177] The appellate judge focused on the defendant's narrow interest in bones and death.[178] A report from a psychiatrist who examined Gibson stated that his continuing obsession with death is a "manifestation of Asperger's Syndrome."[179] This obsession with death made Gibson unable to resist the temptation to take the bones.[180] Further, expert analysis also revealed that Gibson's death obsession had led him to make several attempts against his own life.[181] The consensus among people evaluating Gibson was that a prison sentence would carry with it a very high risk of suicide for him.[182]

After considering these issues, the appellate court concluded that a probation order conditioned on treatment would have been the appropriate sentence.[183] Accordingly, the court reduced the sentence to six months which effectively released Gibson for time served.[184]

3. *R v. TS*: AS Presented as Fresh Evidence of Cognitive Impairment Results in New Trial

On August 12, 2005, a defendant identified as "TS" was convicted of rape and indecent assault.[185] TS had engaged in sexual conduct with his ex-wife, which he claimed was consensual.[186] His ex-wife claimed that the encounter was not consensual, amounting to assault and rape.[187] When instructing the jury on the *mens rea* element of rape, the judge mentioned the possibility for misunderstanding in a situation where a woman did not make clear that she did not consent to the sexual activity.[188] However, the judge instructed the jury that there was no

had Downe's Syndrome. The defendant spoke of attempting suicide again in the future, stating that he felt life had "nothing to help him." *Id.*

176. *Gibson*, EWCA (Crim) 656, ¶ 1.
177. *Id.* ¶ 7.
178. *Id.* ¶¶ 9, 16.
179. *Id.* ¶ 16.
180. *Gibson*, EWCA (Crim) 656, ¶ 9.
181. *Id.*
182. *Id.* ¶¶ 14, 16, 18.
183. *Id.* ¶ 19.
184. *Id.* ¶ 20.
185. *See* R v. TS, 2008 WL 168748, ¶ 1 (2008) (Eng. Crim Jan. 23, 2008).
186. *Id.* ¶ 7.
187. *Id.* ¶ 6.
188. *Id.* ¶ 9.

room for doubt or misunderstanding in this case.[189] The jury found TS guilty.[190]

TS's *pro se* appeals were denied,[191] and his mental and physical condition began to deteriorate as he began to serve his prison sentence.[192] An application from a legal aid worker and a letter from the diagnosing physician was sent to the judge on behalf of TS, explaining the recent diagnosis of AS.[193] Counsel was appointed to the defendant and a new appeal was allowed.[194] During the appeal, TS argued that AS impaired his ability to accurately determine other people's intentions, beliefs or desires "in ambiguous situations."[195] He also argued that AS impaired his ability to understand signs and straightforward indications from other people.[196]

The appellate court held that the new evidence could have affected the trial in one or more of the following ways.[197] First, it would have enabled a defense based on the requirements of *mens rea*.[198] Second, the evidence showing TS suffered from AS would have helped the jury understand why he acted under an honest and reasonable belief in what he believed the situation to be, even if the facts were otherwise.[199] Finally, the AS diagnosis could have helped the jury understand why TS acted strangely at trial.[200] As a result, the appellate court ordered a retrial.[201]

189. *Id.*
190. *TS*, 2008 WL 168748, ¶ 1.
191. *Id.* ¶ 12. The defendant's grounds for appeal included ineffective counsel, improper suppression of evidence by the trial judge of the defendant's psychological problems and fresh evidence from the defendant's sister to the effect that the victim told her no rape had occurred. *Id.*
192. *Id.* The defendant refused to take the anti-psychotic medicine he was prescribed and denied he had any mental health problems. He claimed he was wrongfully imprisoned because he believed he had prevailed in his *pro se* appeals. He was transferred to a medium security forensic hospital where he was diagnosed with AS. *Id.*
193. *Id.* ¶¶ 14-16.
194. *Id.*
195. *TS*, 2008 WL 168748, ¶ 22.
196. *Id.*
197. *Id.* ¶ 34.
198. *Id.*
199. *Id.*
200. *TS*, 2008 WL 168748, ¶ 34.
201. *Id.* ¶ 1.

C. *Australian Cases*

1. *R v. Wood*: Impairments of AS Reduce Objective Criminality

On November 28, 2002, George Wood was convicted of manslaughter by criminal negligence in the death of his mother.[202] Wood was sixty years old with no prior criminal record when he was convicted.[203] Wood lived his whole life with his mother and sister and had little outside social contacts.[204] In 1998, the defendant's mother was hospitalized twice for various medical problems including mild dementia.[205] Her assessment upon discharge called for constant care including regular hospital appointments or home visits.[206] The mother was a domineering person who insisted on having things her way.[207] In the past, she resisted all efforts to arrange home care or hospitalization.[208] The family situation from 1998 onward left Wood in charge of taking care of his mother.[209]

In April 2000, Wood called an ambulance to take his mother to a hospital.[210] When emergency personnel arrived at the scene, they found the home in a state of utter disrepair.[211] They also found Wood's mother bedridden, covered with human waste and other body fluids, and suffering from serious bedsores.[212] Wood had not been taking proper care of his mother which resulted in her condition. Despite hospital treatment, the woman died.[213]

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202. *See* R v. Wood, (2004) 149 A. Crim. R. 38, 40 (Austl.).

203. *Id.*

204. *Id.* The defendant's sister was developmentally disabled. Evidence showed the defendant had dropped out of school and had only recently gained employment; he had a short-lived relationship with a woman; he recently became involved at a local church; and he had an obsessive interest with trains. *Id.*

205. *Id.*

206. *Id.*

207. *Wood*, 149 A. Crim. R. at 40.

208. *Id.*

209. *Id.*

210. *Id.*

211. *Id.* The appellate court recounted the scene at the homestead:

> There was evidence to the effect that the garden was seriously overgrown and unkempt, and that the interior was a mess with rubbish and papers, some of which were kept in bags, piled up in many rooms. The shower had not worked for some time and it appeared that the bath was not working either. Newspapers were stacked in the shower recess. The toilet leaked. Thick dust and cobwebs were evident throughout.

Id.

212. *Wood*, 149 A. Crim. R. at 40.

213. *Id.*

At a bench trial, Wood offered the testimony of a doctor whose examination of the defendant revealed the presence of nearly all the diagnostic criteria for AS.[214] This evidence was offered to explain why Wood would have a lack of understanding of the consequences of his acts or omissions and an inability to show remorse.[215] The doctor also testified that Wood did not appear to appreciate the effect his actions had on his mother.[216]

The judge evaluated the culpability of the defendant according to the standard for criminally negligent manslaughter, which requires reckless conduct combined with the realization that serious injury or death are possible outcomes from such conduct.[217] Applying that standard, the judge found Wood criminally responsible for creating the circumstances which "caused, contributed or accelerated" his mother's death, and that he owed her a duty of care.[218] The trial judge stated that he did not believe Wood to have impaired intellectual capacity and "[did not] regard him as having suffered from any serious psychiatric or personality disorder."[219] The judge further stated that Wood was "in complete denial concerning the pain and distress that his mother must have experienced over an extended period," and that he displayed "no remorse for his actions whatsoever."[220] The judge found Wood guilty of manslaughter by criminal negligence and sentenced him to seven years imprisonment.[221] Wood appealed the sentence, claiming that the judge had failed to give adequate weight to the evidence regarding the defendant's possible AS diagnosis, and that the sentence was manifestly excessive under the circumstances.[222]

On appeal, the appellate court reasoned that the evidence of a mental abnormality tending to explain the offense or "the offender's

214. *Id.* at 43.

215. *Id.* Another doctor (presumably from the government) testified that in her opinion, the defendant did not present any symptoms warranting a diagnosis of AS. The defendant presented with a "mood disorder" resulting from his socialization. However, in her final conclusion, she does mention that the defendant's psychopathology was "possibly complicated by some variant of autism." *Id.*

216. *Id.*

217. *Wood*, 149 A. Crim. R. at 42. The trial judge applied this standard of criminal negligent manslaughter:

> The degree of criminal culpability is set by saying that the accused, having realised that death or serious injury are possible, must then act recklessly in relation to those consequences. Further, the test is subjective so far as concerns the omission to act.

Id. (quoting R v. Stone, [1977] Q.B. 354, 357 (Eng.)).

218. *Wood*, 149 A. Crim. R. at 40.

219. *Id.* at 43.

220. *Id.*

221. *Id.*

222. *Id.* at 44-46.

inability to understand the wrongfulness of his actions, or to make reasonable judgments, or to control his or her faculties and emotions, will impact on the level of culpability of the offender, even where the [mental] illness does not amount to an excuse at law."[223] The court found Wood's disorder "impaired his capacity to respond to his responsibilities," and that this made the defendant less criminally culpable.[224] The appellate court found the trial judge to be in error for failing to give adequate consideration to the defendant's mental abnormality. In addition, the appellate court reasoned that punishment exacted against persons with mental disabilities does little to personally deter them from future wrongdoing if they are unable to appreciate the wrongfulness of their actions.[225] Accordingly, the appellate court reduced Wood's sentence to three years and six months.[226]

2. *Hopper v. The Queen*: Social Cues Clear Enough that AS Cannot Be Raised to Mitigate Conduct

On March 10, 2003, Bradley Hopper was convicted of several sexual offences and sentenced to four years imprisonment.[227] Hopper, a teenager from England, was in Australia for a vacation with his family.[228] One night he went out with his cousins and a female friend and became intoxicated.[229] When his female friend mentioned she was ready to go, Hopper offered to walk her home.[230] As the two walked down a street, Hopper kissed her.[231] He then attempted to have intercourse with her, despite her repeated objections.[232] Hopper continued his advances for about five minutes before he stopped.[233] Under interrogation the next day, Hopper provided the following explanation for his actions: "Once I realised what I was doing, I stopped. I thought, 'what the hell am I doing?'"[234] A medical examination confirmed that the woman had been sexually assaulted.[235]

223. *Wood*, 149 A. Crim. R. at 45. (quoting R v. Israil, 2002 WL 1435905, ¶ 23 (Austl.)).
224. *Id.*
225. *Id.*
226. *Wood*, 149 A. Crim. R. at 45.
227. *See* Hopper v. The Queen, 2003 WL 21694438, ¶ 32 (Austl. Ct. Crim. App. July 18, 2003).
228. *Id.* ¶ 37.
229. *Id.* ¶ 34.
230. *Id.*
231. *Id.*
232. *Hopper*, 2003 WL 21694438, ¶ 34.
233. *Id.*
234. *Id.* ¶ 35.
235. *Id.*

At trial, Hopper offered evidence showing he suffered from various psychological disabilities including difficulty understanding social cues.[236] He argued that the effects of alcohol aggravated his misunderstanding of social cues.[237] Hopper had not yet obtained a diagnosis of AS.[238] He was found guilty of two counts of sexual penetration without consent and one count of indecent assault.[239] The judge adjourned the court for ten days to consider the appropriate punishment.[240] At sentencing, the judge stated that his decision was based on the demeanor of the defendant that he observed in the videotaped police interview.[241] The judge considered the other evidence tending to show Hopper's disabilities, but concluded that the mitigating effect of these disabilities was "only peripheral."[242] The judge found the offences to be serious enough to warrant a prison sentence.[243]

Hopper appealed, alleging error on the part of the trial judge for failing to make inquiries into how the defendant's disabilities could be a mitigating factor.[244] Further, Hopper argued that the trial judge erred by failing to adequately consider other mitigating factors.[245] Hopper also offered new evidence that after sentencing, he was suffering from AS.[246] However, the appellate court found that despite the defendant's impairments, the victim had been clear and unambiguous about her wishes not to have sex with Hopper.[247] Accordingly, the appellate court dismissed the defendant's appeal against the sentence.[248]

D. Analysis

As demonstrated above, defendants have tried to use AS as a defense to criminal charges in a number of ways. The recurrent themes

236. *Id.* ¶ 38.
237. *Hopper*, 2003 WL 21694438, ¶ 38. In addition to the social cues comprehension problem, the defendant introduced evidence that he had "impairments in cognitive functioning," dyslexia, his reading level was equivalent to a ten year old, he had memory problems, and he has difficulty understanding and interpreting verbal instructions. There was also evidence that showed the defendant to be shy, immature and anxious, and gullible. He had been bullied and had difficulty functioning in a group setting. *Id.*
238. *Id.* ¶ 40.
239. *Id.* ¶ 32.
240. *Id.* ¶ 41.
241. *Id.* ¶¶ 43-44.
242. *Hopper*, 2003 WL 21694438, ¶ 44.
243. *Id.* ¶¶ 45, 46.
244. Id. ¶ 47.
245. *Id.* ¶ 47.
246. *Id.* ¶ 40.
247. *Hopper*, 2003 WL 21694438, ¶ 55.
248. *Id.* ¶ 72.

can best be organized as failure of proof defense, mistake in fact defense, and mitigation of offense level.

1. Failure of Proof Defense

AS has been advanced as evidence proving that the defendant cannot satisfy the *mens rea* element for the charged offense. In one case, the physical impairments associated with AS were raised to cast doubt on the defendant's capacity to satisfy the *actus reus* element. In this context, the impairments of AS operate as a failure of proof defense to criminal culpability.[249]

In *R v. Wood*, discussed *infra*, the defendant was ignorant of the consequences of his conduct on many levels: he was not capable of keeping a house clean, much less caring for his elderly, invalid mother. Considering that the defendant's mother was a domineering person and the defendant was prone to literal interpretations of her commands, the defendant's care of his mother can hardly be termed intentional. How can someone be held morally blameworthy for a result they could not conceive of because they did not know the underlying facts necessary to form such a conception? Both the trial judge and the appellate court missed this essential point. The defendant was less than negligent because he did not possess enough commonsense facts about health and hygiene to understand how to apply those facts to his situation. He simply had no mental state regarding the condition of his mother. As such, the defendant's lack of understanding negates any finding of culpability necessary to prove the *mens rea* elements of the crime.

Conversely, in *State v. Boyd*, the trial court overlooked the effects AS may have on the defendant's physical ability to carry out a crime. In *Boyd*, the defendant tried to introduce expert testimony that the physical impairments associated with AS made it impossible for him to have committed the murder.[250] Part of the testimony included assertions that it would be "impossible" or "inconceivable" for someone with AS to lead people to the site where the body was found in the middle of a forty-acre tract of woods.[251] Further, the defendant openly advanced the notion that the motor skill delay associated with AS prohibited the defendant from physically completing the crime. This is a failure of proof defense to *actus reus*, a claim that the defendant could not have physically

249. *See, e.g.*, MODEL PENAL CODE § 1.2(1) (requiring all elements of an offense be proved beyond a reasonable doubt for a person to be held criminally responsible); Commonwealth Code 1995 § 3.2 (providing that all physical and fault elements of an offense must be proved to create guilt for criminal conduct).

250. *See* State v. Boyd, 143 S.W.3d 36, 38 (Mo. 2004).

251. *Id.* at 45.

performed the accused criminal act. The expert testimony did not actually state that the defendant was physically incapable of overpowering the victim. Instead, in the expert's opinion, the defendant's ability to navigate the forest to lead others to the crime scene was too complex a task to expect an AS individual to complete.[252]

Yet, other courts have held that new evidence of an AS diagnosis could negate culpability for lack of the requisite *mens rea*. By granting a new trial in *R v. TS*, the appellate court essentially agreed with the defendant's failure of proof argument. The defendant maintained a consistent version of events throughout the trial and appeal, claiming that the sexual encounter was consensual, not a sexual assault or rape.[253] If the defendant believed the encounter was consensual, and the impairments of AS contributed to this mistaken belief, then evidence of AS could negate the presence of the culpable mental state required for the defendant's convictions. The appellate court held that new evidence of the defendant's recent AS diagnosis could prove the absence of requisite *mens rea*, and a new trial should be held to determine the mental state of the defendant at the time of the offense.[254]

The appellate court in *R v. Wood* explained the futility of punishing defendants like those found in *Wood* and *R v. TS*. First, punishing someone who fails to understand the potential consequences of his conduct and is unlikely to re-offend is of little value as a means of personal deterrence.[255] Second, punishing those who have a limited appreciation for the wrongfulness of their conduct make them poor examples for the general deterrence of crime.[256] A prison sentence is essentially meaningless to an individual such as this; assigning criminal culpability and punishment does not serve the needs of the offender or society.

2. Mistake in Fact

The effects of AS (especially mindblindness) can result in conduct based on an honest and reasonable but mistaken belief of facts. Individuals who engage in criminal conduct based on such a "mistake-in-fact" are sometimes excused from culpability.[257]

252. *Id.* at 46.
253. *See* R v. TS, 2008 WL 168748, ¶ 33 (2008) (Eng. Crim Jan. 23, 2008).
254. *Id.* ¶ 34.
255. *See* R. v George, (2004) 149 A. Crim. R. 38, 45 (Austl.).
256. *Id.*
257. *See* 21 AMJUR 2D CRIMINAL LAW § 152 (2007); 17 ARCHBOLD: CRIMINAL PLEADING, EVIDENCE, AND PRACTICE § 10 (James Richardson, ed., Sweet & Maxwell, Ltd. 2008); CRIMINAL CODE OF THE NORTHERN TERRITORY §§ 31(1), 32 (Austl.). Each of these materials relate the contours of United States, English and Australian mistake-of-

In *State v. Burr*, evidence of the defendant's AS diagnosis was introduced to show that the defendant did not know the inappropriateness of his behavior.[258] In other words, the defendant was operating under the mistaken belief that what he was doing was acceptable.[259] The defendant did not argue that his AS diagnosis provided support for a diminished capacity defense.[260] Instead, the evidence was offered to rebut the prosecution's allegation that the defendant was engaging in "grooming" behavior designed to lower the victim's social barriers in preparation for molestation.[261] This defense strategy effectively sneaks the evidence of AS in through "the back door." Presented this way, the evidence is not offered for a diminished capacity defense, but the jury still gets to hear how AS "diminishes" the defendant's "capacity" to comprehend social cues and what types of behavior are appropriate. This avenue avoids the tangled evidence rules often associated with the presentation of a diminished capacity defense.

However, AS cannot shield a defendant from criminal culpability in all cases. In *Hopper v. The Queen*, the appellate court agreed that AS could impair a defendant's ability to correctly interpret social cues.[262] But, the court rejected the defendant's assertion that his impairment prevented him from understanding that the victim wanted him to stop what he was doing.[263] The court noted that the victim had resisted the defendant's advances for five minutes, telling him "no," "go away," and "stop it."[264] The appellate court concluded that the victim was clear and unequivocal in declining the defendant's advances, such that there was no room for any kind of misinterpretation of her wishes.[265] The court effectively ruled that the victim's rejections were clear enough to penetrate this defendant's cognitive impairment.[266] At minimum, *Hopper v. The Queen* stands for the proposition that the impairments

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fact doctrine, which generally provides that a person is excused from criminal responsibility for an act if it is completed under an honest and reasonable but mistaken belief that other facts are in existence, and if that belief were correct, the conduct would not be criminal. The doctrine holds that an actor is held no more culpable for the criminal conduct completed under this mistaken view than if the facts actually were as the actor believed them to be.

258. *See* State v. Burr, 921 A.2d 1135, 1143 (N.J. Super. 2007).
259. *Id.* at 1142-43.
260. *Id.* at 1146-47.
261. *Id.* at 1143.
262. *See* Hopper v. The Queen, 2003 WL 21694438, ¶¶ 40, 54, 55 (Austl. Ct. Crim. App. July 18, 2003).
263. *Id.* ¶¶ 16, 17, 55.
264. *Id.*
265. *Id.* ¶ 55.
266. *Id.* ¶¶ 54, 55.

attributable to AS cannot shield a defendant from mistaking clear, unequivocal and repeated commands to stop.

Conversely, the court in *R v. TS* held that evidence showing the defendant suffered from AS would have helped the jury understand why the defendant acted under an honest and reasonable belief in what he believed the situation to be, even if the facts were otherwise.[267] Like the defendant in *Hopper v. The Queen*, the defendant in *R v. TS* was allegedly told to stop what he was doing.[268] The defendant consistently maintained that the encounter was consensual.[269] However, in *R v. TS*, the appellate court found the situation sufficiently vague enough that AS could compromise the defendant's ability to adequately understand the intention of the victim.[270] At maximum, *R v. TS* stands for the proposition that AS can operate to justify a mistake in fact defense when the intention of the parties is unclear.

3. Reduced Responsibility Resulting in Mitigation of Sentence

Some courts have considered the impairments associated with AS to be mitigating factors at sentencing. English courts have embraced this trend- AS defendants commonly have their sentences reduced on appeal.[271] In contrast, United States courts rarely reduce sentences based on impairments associated with AS.[272]

In *R v. Heather*, the trial judge recognized that the defendant was less culpable for his actions as a result of the narrow interest fixation and lack of foresight, impairments associated with AS. Interestingly, the trial judge seemed to leave the door open for the appellate court to quash and modify the sentence in the event that appropriate living arrangements and care could be arranged for the defendant.[273]

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267. *See* R v. TS, 2008 WL 168748, ¶ 34 (2008) (Eng. Crim Jan. 23, 2008).

268. *Id.* ¶¶ 6, 7, 17. There was conflicting evidence as to whether the victim had consented to the intimacy. The victim claims to have told the defendant, "[t]here's no point, you're not going to have sex with me. Don't even try because it's not going to happen." *Id.*

269. *Id.* ¶ 33.

270. *Id.* ¶ 34.

271. *See* cases cited *supra* note 133.

272. *See, e.g.*, United States v. Kamen, 491 F.Supp.2d 142 (D. Mass. 2007) (considering AS diagnosis in decision to vacate original guilty verdict of knowing receipt of child pornography and substitute lesser included sentence of receipt of child pornography); Martlett v. State, 2007 WL 4555274 (Ind. App. Dec. 28, 2007) (factoring AS into decision to reduce prison sentence from seventeen to fifteen years).

273. *See* R v. Heather, 2000 WL 1421166, ¶ 6 (Eng. Crim July 31, 2000). The trial judge appeared to only grudgingly send Heather to prison; the trial judge wondered whether the appellate court "might have greater powers than he" to find an alternative residence for Heather. *Id.*

The court in *R v. Gibson* reduced the sentence partly for a lack of culpability, but mainly for humanitarian reasons. First, the court recognized the actual offense was driven not by a criminal desire but by an obsession beyond the control of the defendant.[274] Second, the court concluded that the defendant's narrow interest fixation on death, combined with his other impairments, could effectively push him to suicide in a prison setting.[275]

The crimes in both *R v. Heather* and *R v. Gibson* involved damage to property. Mitigation in these cases could be explained due to the fact that the crimes did not involve personal injury. However, English courts have considered AS a mitigating factor that can justify reduced sentences for property crimes and crimes involving harm to individuals.[276]

V. CONCLUSION

In summary, each nation is experiencing an increase in criminal defendants with AS. This is no doubt another result traceable to the global shift away from institutionalization of the mentally disabled.[277] More importantly, medical and legal communities are gaining awareness of the diagnosis. Will this awareness generate an evolution in criminal law to deal with people who have mindblindness?

The unique facts of each case will have a big impact on the outcomes, but several things seem to be clear. First, English courts are more tolerant of AS-based defenses. This could be the result of the way that forensic psychology and psychiatry are employed in the English criminal justice system, or it could be the result of the concentration of researchers in England who are studying Asperger's Syndrome. Whatever the cause, the English are leading the way in unlocking the riddle of culpability in the AS offender. For example, in *R v. Heather*, the appellate court observed that AS is a developmental disorder, not a mental illness.[278] This moves people who have AS outside the scope of the Mental Health Act of 1983 which provides for treatment of individuals who undergo commitment and treatment for mental illness.[279] If AS is not treatable like mental illness, yet AS offenders are not morally blameworthy for certain crimes, what is the appropriate disposition for an AS individual charged with a crime? One answer

274. *See* R v. Gibson, [2001] EWCA (Crim) 656, ¶ 9 (Eng.).
275. *Id.* ¶ 20.
276. *See* cases cited *supra* note 133.
277. *See* JAMES R. P. OGLOFF, ET AL., IDENTIFICATION OF MENTAL DISORDERS IN THE CRIMINAL JUSTICE SYSTEM 9 (2006), *available at* http://www.aic.gov.au/crc/reports/2006-ogloff.pdf.
278. *See* R v. Heather, 2000 WL 1421166, ¶ 4 (Eng. Crim July 31, 2000).
279. *Id.*

emerging from the English trend is that an AS diagnosis may be sufficient to warrant a reduction in sentence when the crime matches the peculiar traits of the AS defendant.

Second, the defenses of mistake in fact, failure of proof, and diminished capacity are employed in United States, English and Australia courts with mixed results. This inconsistency signals the need for a clear, cohesive approach to the AS individual accused of a criminal offense. Two solutions may allow criminally accused AS individuals greater access to justice. One is the responsibility of the criminal justice system and the other is the responsibility of the global AS community.

A. Prophylactic Measures for Persons with Mindblindness.

The crimes AS offenders are likely to commit are predictable, but not preventable at this point. Each AS offender's understanding of the consequences of their conduct will vary based on the extent of their socialization. Two possible scenarios could cause an AS individual to run afoul of criminal law. First, with knowledge or comprehension of the underlying facts essential to completing a criminal act, they intentionally do something that they know is wrong. Second, without knowledge or comprehension of the underlying facts essential to completing a criminal act, they intentionally do something not knowing it is wrong. In the first instance, there is no question on the course of action: prosecute and punish the individual. The second instance is much more complicated. To separate the culpable AS individuals from the non-culpable, a two-prong test should be used. Individuals who satisfy the two prongs of the test would be either exempt from criminal prosecution or subject to reduced punishment.

The first prong involves screening to detect AS individuals upon arrest. While in custody, if the offender presents behaviors that satisfy three of the six Gillberg criteria, that person would qualify for a full AS screening. If the screening results in an AS diagnosis, the first prong has been satisfied. The first prong is automatically satisfied if the offender has been diagnosed with AS prior to arrest. This prong serves a channeling function by identifying AS individuals accused of crime within the criminal justice system.

The second prong evaluates the AS offender's knowledge and comprehension of the consequences of personal conduct. If the AS offender demonstrates understanding of the basic, common sense facts (factual knowledge which would be essential to complete the crime) and the consequences of their conduct, then that individual could be prosecuted for the charged offense. In this instance, AS would not be considered a bar to criminal prosecution or an imposition of criminal

culpability. If the offender cannot demonstrate knowledge of basic underlying facts and an understanding of the consequences of personal conduct, then criminal culpability would not attach. Such individuals would receive the "Mindblindness Exemption"[280] from criminal prosecution, which would substantially mitigate punishment or eliminate criminal culpability altogether. This is a classification function, designating which AS offenders are subject to reduced punishment.

For example, consider that the defendant in *R v. Wood* did not know what a bedsore was or what conditions could create life-threatening bedsores.[281] If the defendant in *R v. Wood* had no knowledge of a potential injury and did not understand how his conduct would cause it, he simply lacked the subjective knowledge required to prevent himself from acting either recklessly or negligently. Punishing lack of foresight based on honest ignorance of facts is not an acceptable goal for criminal law.[282]

This analysis amounts to a subjective test of a person's commonsense, "worldly" knowledge. Critics would argue that extending the Mindblindness Exemption would result in unwarranted acquittals for AS individuals who intended criminal conduct. AS individuals are capable of and do commit criminal conduct. Within the group of children Dr. Asperger studied, he identified a small subgroup that acted with intentional malice and deliberation.[283] Dr. Tony Attwood, a leading AS researcher, postulates that these individuals utilized threats of violence to gain superiority in social situations in an effort to compensate for the social alienation they experience do to AS.[284] The Mindblindness Exemption would not be available to these individuals because they have acted with intentional malice. Critics would also point out that some people could pass the two-pronged test by feigning the traits of AS. However, the test would ferret out those who fake AS traits to avoid prosecution; it requires both a legitimate AS diagnosis *and* a demonstrated lack of underlying facts and comprehension. In addition, AS individuals' eagerness to please and inability to read what the tester is truly trying to measure would likely expose any ruse.

The lack of objective "worldly" factual knowledge, combined with mindblindness, results in conduct that would be immoral to punish as criminal. Society and criminal justice do not benefit by punishing individuals who are truly without blame. The challenge for the AS

280. The "Mindblindness Exemption," used as a term to denote immunity from criminal prosecution, was coined by the author on January 21, 2008.

281. *See* R v. Wood, (2004) 149 A. Crim. R. 38, 46 (Austl.).

282. *See* VICTOR TADROS, CRIMINAL RESPONSIBILITY 251 (Oxford Univ. Press 2005).

283. *Id.* at 335.

284. *Id.*

individual is twofold. First, they must try to get along in social situations in an intuitive vacuum,[285] and second, to know enough of "the facts of life" to keep from unintentionally hurting others or their property. AS sufferers carry a higher burden to carry than the average citizen, because the average citizen is assumed to know those two things AS individuals often do not understand. Therefore, it is necessary to protect AS individuals from unjust criminal prosecutions. The Mindblindness Exemption would properly identify AS offenders who do not possess the *mens rea* necessary to assess criminal culpability.

B. Early Intervention

Dr. Asperger studied children instead of adults. The identification of diagnostic criteria for adults is a recent development.[286] AS is not a mental illness; it is a developmental disorder.[287] That means that treatment takes the form of instruction and life skills coaching from an early age.[288] If a child with AS is not properly diagnosed and coached through childhood and adolescence, the impairment of AS on adult functioning will be more pronounced.[289]

Dennis Debbault is a former police officer who has been researching the interactions of offenders with autistic spectrum disorders and the criminal justice system since 1991.[290] It is his experience that most offenders do not know they have AS until after they have been arrested and charged with an offense. Thus, the diagnosis comes later.[291] Further complicating the issue is the relatively low public understanding

285. *See* ATTWOOD, *supra* note 1, at 91.

286. *See* Simon Baron-Cohen, et al., *The Adult Asperger Assessment (AAA): A Diagnostic Method*, 35 J. OF AUTISM AND DEV. DISORDERS 807, 808-09 (2005). Diagnostic criteria for evaluating Asperger's Syndrome in adults was not available before 2005.

287. *See, e.g.*, WORLD HEALTH ORGANIZATION, INTERNATIONAL STATISTICAL CLASSIFICATION OF DISEASES AND RELATED HEALTH PROBLEMS (10th ed. ICD-10) (2006); AMERICAN PSYCHIATRIC ASSOCIATION, DIAGNOSTIC AND STATISTICAL MANUAL OF MENTAL DISORDERS (text revision 2000) (DSM-IV-TR).

288. *See* ATTWOOD, *supra* note 1, at 91-92.

289. *See id.*

290. Telephone Interview with Dennis Debbault (Jan. 21, 2008). Debbault is the author of AUTISM, ADVOCATES AND LAW ENFORCEMENT PROFESSIONALS: RECOGNIZING AND REDUCING RISK SITUATIONS FOR PEOPLE WITH AUTISM SPECTRUM DISORDERS (Jessica Kingsley Publishers 2002) and AVOIDING UNFORTUNATE SITUATIONS: A COLLECTION OF EXPERIENCES, TIPS AND INFORMATION FROM AND ABOUT PEOPLE WITH AUTISM AND OTHER DEVELOPMENTAL DISABILITIES AND THEIR ENCOUNTERS WITH LAW ENFORCEMENT AGENCIES (Way/SAC 1994). Debbault's website provides advice for the AS community to better cope with law enforcement officials. *See* Avoiding Unfortunate Situations http://policeandautism.cjb.net (last visited Feb. 14, 2009).

291. *Id.*

of AS.[292] Once the AS offender has been diagnosed, "society wants to know why [they have AS] and who gave them the diagnosis."[293] Debbault's website encourages parents and families of people with AS to prepare for potential encounters with law enforcement.[294] It is Debbault's belief that the AS community must demonstrate its willingness to be proactive in educating and guiding AS individuals in order for society to make exceptions for the AS community.[295]

In the words of Dennis Debbault, "if it is not possible for these people to learn, everything I am doing is for nothing."[296] This statement applies equally to criminal law. *Mens rea* theory continues to evolve over time. Criminal law must learn to accommodate AS offenders and punish only those who satisfy the *mens rea* element required to assess criminal culpability.

292. *Id.*
293. *Id.*
294. *See* Dennis Debbault, Police and Autism: Avoiding Unfortunate Situations, http://policeandautism.cjb.net (follow "B. Avoiding Unfortunate Situations" hyperlink) (last visited Feb. 14, 2009).
295. Telephone interview with Dennis Debbault (Jan. 21, 2008).
296. *Id.*