Law in transition
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In commerce, as in other spheres of human activity, the interaction among members of society often takes the form of arrangements and agreements that are contained in or underpinned by contracts. As commercial interaction among members of society becomes more complex, so the contracts entered into by the parties become very sophisticated. In this context, the need to provide for appropriate and efficient mechanisms to enforce contractual obligations and resolve any disputes that may arise is acute. These developments have reinforced the importance of the courts as forums where contracts and rights are upheld and enforced. In addition, it has led to the increasingly frequent use of arbitration as the preferred method of solving disputes.

The International Court of Justice (ICJ) stands at the judicial apex of the international legal order’s effort to settle differences among states. International organisations and financial institutions, such as the United Nations, World Bank, the European Bank for Reconstruction and Development (EBRD) and others, are both subjects and promoters of this international legal order. In its agreements involving loans to or guarantees by states, the EBRD typically includes arbitration clauses that name the President of the ICJ as the appointing authority for the purpose of UNCITRAL-based arbitration.

States and international institutions, such as the EBRD, like individuals and all commercial players, are held accountable by society to honour contracts that they freely enter into. Today, most commercial disputes between states, and between states and non-states, are resolved by international arbitration. Indeed, an agreement to arbitrate, whether expressed in a stand-alone document or incorporated into something larger, is itself a contract and one which must be enforced. It is therefore a welcome endeavour for the EBRD to bring the issues of contract enforcement and use of international arbitration to the attention of the legal community in the countries of central and eastern Europe and the Commonwealth of Independent States (CIS) through this publication. In the transition countries entrepreneurship, and with it economic development, will take permanent hold only if those countries adopt the international legal mechanisms and build the domestic institutions necessary to ensure that contracts between parties in different states are honoured and enforced.

The international legal order, in large part through the work of the United Nations, can trumpet as one of its great successes the existence of the New York Convention that fosters the recognition and enforcement of foreign arbitral awards. It is a very encouraging development that most of the transition countries have acceded to this Convention. Slower progress has been made so far in reaching a world-wide treaty for the enforcement of judgements. The Hague Conference on Private International Law has undertaken work in this important area.

This issue of Law in transition provides a number of different perspectives and experiences on the subject of contract enforcement, some from within central and eastern Europe and the CIS, and others from outside the region where a longer experience of market economics may provide useful lessons. No one has a monopoly on wisdom, however. Pacta Sunt Servanda is a universal principle to which societies in transition countries have as much claim as anyone else.

Judge Vladlen S. Vereshchetin, International Court of Justice
Private participation in infrastructure projects: the selection of concessionaires

The EBRD supports concession arrangements in its countries of operations, and sees them as an important instrument in the transition process. The EBRD will finance concessionaires only if the selection process followed by the contracting authority satisfies the Bank’s core criteria of transparency, fairness, compliance with applicable laws and regulations, and absence of fraud and corruption. The EBRD therefore generally expects that contracting authorities adopt formal competitive procedures for the selection of concessionaires.
The involvement of private sector enterprises in the provision of infrastructure services is an important factor in the transition from centrally planned economies to market economies in the EBRD's countries of operations. The Bank supports this positive private sector involvement in infrastructure projects through loans, equity investments and other financial instruments. The EBRD also arranges technical assistance for public authorities considering public-private partnerships and assists in legal reform efforts for the creation of new legislative frameworks facilitating such arrangements.

Private sector participation is desirable in a wide range of infrastructure sectors, including telecommunications, water, natural gas and electricity systems, and in transport infrastructure such as roads, ports, airports and railroads. The involvement of private sector parties in infrastructure projects may take several forms, ranging from simple service contracts to concession arrangements, whereby the private sector party becomes responsible for the infrastructure facility for a set period of time, while the public authority maintains control over the services. In some instances, the public authority abandons involvement with the infrastructure facility altogether, by transferring ownership of the facility to the private sector party, which then assumes full responsibility for its maintenance, rehabilitation, operation, management and expansion.

Under concession arrangements, the public authority (herein referred to as “contracting authority”) leases, or otherwise transfers, infrastructure assets to a private sector operator (herein referred to as “concessionaire”) for a defined period of time. The concessionaire is then responsible for the operation, maintenance and expansion of the infrastructure facility and provision of the service, including meeting the required financing arrangements. The concessionaire is compensated for these activities, at least in part, in accordance with the applicable tariff regime.

The detailed rights and obligations of both the contracting authority and the concessionaire are set out in a complex web of contracts and other legal instruments (referred to herein as the “concession contracts”). Concession contracts outline not only the operation of the infrastructure facility by the concessionaire, but also various other rights and obligations of the concessionaire, such as physical construction, refurbishment or expansion of the facility, and the right to charge a price for the services rendered. The contracting authority undertakes to maintain an adequate regulatory framework, and to adopt a tariff policy following agreed criteria. Concession contracts thus seek to allocate risks and obligations to the party best able to manage them. They include incentives to the concessionaire for the efficient provision of the infrastructure service, and they provide safeguards against undue exploitation of monopoly positions enjoyed by the concessionaire.

Concessions and EBRD Procurement Rules

In all its operations, the EBRD is committed to taking measures to ensure that the financing it provides is used for the intended purpose, and with due regard for economy and efficiency. The Bank’s Procurement Policies and Rules contain detailed procurement procedures to be followed by borrowers under public sector operations, in connection with contracts for goods, works and services that it finances. As for private sector operations, the Procurement Rules do not require that the EBRD’s private sector clients follow a prescribed procurement method, as its concerns for economy and efficiency in procurement will generally be met through established commercial practice. However, the EBRD will satisfy itself that in all operations with private sector clients, sound and cost-effective procurement methods are employed, and that contracts awarded by them are negotiated on a non-partisan basis and are in line with market prices. These principles also apply to procurement actions by private sector concessionaires financed by the EBRD.

As to the selection of concessionaires by contracting authorities, Paragraph 4.4 of the Procurement Rules states that whenever the EBRD provides or arranges for the provision of advice to a contracting authority “with the objective of the Bank ultimately financing the successful candidate", the EBRD will request that the contacting authority adopt “competitive tendering procedures acceptable to the Bank". The Procurement Rules do not explicitly set forth standards for the selection process in cases where the EBRD does not provide advice to the contracting authority on the selection process. However, the Bank will finance concessionaires only if it is satisfied that the concession was

1 The private party is hired to deliver particular services to a public authority which remains responsible for the provision of the infrastructure service.
2 For a more comprehensive discussion of the various arrangements that are available for private sector participation in infrastructure services, see P. Guislain and M. Kerf, "Concessions – The Way to Privatize Infrastructure Sector Monopolies", Public Policy for the Private Sector, the World Bank, Note No. 59 (October 1995), and J. Brook Cowen, "The Private Sector in Water and Sanitation – How to Get Started", Public Policy for the Private Sector, the World Bank, Note No. 126 (September 1997).
3 Agreement Establishing the EBRD, Article 13 (xii).
4 Procurement Policies and Rules for projects financed by the European Bank for Reconstruction and Development, (hereinafter Procurement Rules), Sections 3 and 5 (August 2000).
5 Procurement Rules, Section 4.
6 See Procurement Rules, Paragraphs 4.2, 4.3.
7 See Procurement Rules, Paragraph 4.4.
In all its operations, the EBRD is committed to taking measures to ensure that the financing it provides is used for the intended purpose, and with due regard for economy and efficiency.

awarded in a fair and transparent process that complied with applicable rules and regulations, and was free from fraud and corruption. As a general rule, the EBRD therefore expects that concessionaires approaching the Bank for financial assistance were awarded their concession following formal competitive selection procedures. This approach, which is elaborated more fully in the section on the EBRD’s core selection criteria, is consistent with the general principles and considerations outlined in Sections 1 and 2 of the Procurement Rules.

Selection of concessionaires: rationale for a specific approach

In most cases, standard procedures generally applicable for the procurement of goods, works and services would not be suitable for the selection of concessionaires. These selection procedures must take into account the specific nature of concessions, specifically:

- The preparation and competition for concession arrangements are complex and typically demand rigorous efforts from both the contracting authority and the private sector tenderers. Contracting authorities therefore tend to invite tenders only from a small number of private sector entities that have demonstrated in a prequalification process that they have the capacity and experience required to carry out such projects.

- Tender evaluation criteria may include the charges to be paid by the end-users for the infrastructure service, along with the construction and operation costs.

- Concessions involve long-term continuing obligations on the part of the contracting authority and the concessionaire.

- The infrastructure facilities and services for which the concession is to be awarded often have a natural monopoly character, such as water supply, sanitation and energy delivery. These services are of vital importance to the population of the contracting authority, and have significant social dimensions.

Concession contracts, especially those of long duration, are therefore politically sensitive and may become vulnerable to renegotiation and abrogation, especially if the selection process is not perceived to be fair and transparent.

Recommended selection process – competition

As noted above, in accordance with Paragraph 4.4 of the Procurement Rules, where the EBRD has been involved as an adviser to the contracting authority, it will generally finance only concessionaires that were selected in competitive procedures acceptable to the Bank. These procedures include public invitation to interested firms, prequalification procedures following criteria previously announced in the public invitation, and a structured approach to the request for proposals and their evaluation. The recommended process is similar to the procedures set out in Section 3 of the Procurement Rules for the procurement of goods, works and services by the EBRD’s public sector clients, but it involves greater flexibility and more interaction and negotiation between the parties.

This structured approach should lead to the selection of a concessionaire capable of performing the relevant infrastructure service in a manner consistent with the price, quality and risk-sharing objectives of the contracting authority. The approach should also facilitate the selection of a concessionaire within a reasonable time and at a fair cost both to the contracting authority and to the firms participating in the tender. Furthermore, a structured approach promotes transparency and integrity of the selection process.

The key elements of the recommended approach include the following:

- The contracting authority should adopt and publish clear and concise prequalification criteria that will enable the contracting authority to identify potential tenderers capable of meeting the set performance criteria. A large group of prequalified tenderers will increase the competitive pressure among the interested firms. However, in light of the considerable time and expense involved in the selection process for the participants and the contracting authority, only firms standing a reasonable chance of success should be invited to submit a proposal.

- The contracting authority should issue clear requests for proposals to prequalified tenderers, setting out in detail all tender requirements, procedures for the submission of proposals and evaluation criteria. The tender documents should not be technically flawed or contain excessively detailed technical specifications.

- The contracting authority should follow a structured approach in the evaluation of proposals and in the negotiations with the highest-ranking tenderer.

- The contracting authority should publish the fundamental terms of the concession contracts once final agreement has been reached with the concessionaire.

The structured approach towards the evaluation of proposals and negotiations, referred to in the penultimate point above, typically involves several successive rounds of requests for proposals and subsequent clarification discussions with tenderers. The contracting authority, with the assistance of its expert advisers, will have to determine the following aspects of the process:

- the number of rounds of preliminary, subsequent, and final proposals from tenderers;

- the extent to which negotiations with tenderers will be permissible between rounds;

- negotiable and non-negotiable matters at each round;

- at which point in the process one of the tenderers may be declared preferred tenderer, with whom the contracting authority is entering into final negotiations, with the understanding that it will revert to other tenderers only if the
negotiations with the preferred tenderer break down; and
- detailed methodology to be applied in respect of the evaluation criteria.

The selection process generally involves extensive interactions between the contracting authority and tenderers. It is essential for the integrity of the process that the contracting authority maintains fairness and consistency in all communications with the tenderers. Final negotiations should therefore not touch upon matters that previously had been identified to other tenderers as non-negotiable.

Core selection criteria

Whenever the EBRD advises contracting authorities on the concessionaire selection process, it generally recommends that they adopt and follow a structured, competitive approach consistent with the principles outlined above.

However, it is not always practicable for a contracting authority to adopt structured competitive selection procedures. For example, a structured selection approach may not necessarily be appropriate when there is an urgent need to ensure immediate provision or continuity of the infrastructure service to be provided by the concessionaire. Nor would a structured process be required where only one firm is capable of providing the required service, or where a public invitation initiating competitive procedures has not yielded responses from competent firms.

Furthermore, the EBRD occasionally encounters financing requests from concessionaires that have already been selected without the Bank’s prior involvement, and without formal competitive procedures meeting the criteria set out above. While the EBRD supports the principle that contracting authorities should follow formal competitive procedures when selecting concessionaires, it will consider such financing requests in exceptional circumstances.

Whether or not the concession has been awarded following formal competitive procedures, the EBRD will provide financing to the concessionaire only if it is satisfied that the following core criteria have been met:

1. The selection procedures were transparent, fair, and allowed for sufficient competition, even if the contracting authority did not follow a structured approach. When assessing these criteria, the EBRD will determine whether the contracting authority has ensured that the following conditions have been met:

   (i) The contracting authority has taken adequate steps to identify interested and qualified firms, either by advertising its intentions in suitable media or by consulting independent expert advisers. Furthermore, it must not have excluded potential concessionaires on the basis of arbitrary or irrelevant criteria for the concession at hand. Contracting authorities may, however, exclude interested parties who fail to demonstrate that they would be able to perform all contractual obligations to be performed by the concessionaire in connection with the project.

   (ii) The selection process was subject to public scrutiny in accordance with applicable administrative procedures. Generally, concession projects should be announced to local elected assemblies and administrative bodies, and these bodies should be given the opportunity to review the terms of the concession contracts and to approve the selected concessionaire. The project should also be subject to public review, such as a public consultation process, and provide adequate opportunity for non-governmental organisations and other interested parties to comment on the project.

   (iii) If more than one offer has been received, the various offers must have been evaluated in a consistent manner on the basis of equitable and transparent evaluation criteria.

   (iv) The contracting authority must certify to the EBRD that the selection process satisfied all applicable requirements that have been adopted for the selection.

   (v) The contracting authority must publish the award of the concession, and must disclose all salient terms of the concession contracts.

2. The EBRD will provide financing to a concessionaire only if the selection process has been free from corruption and complied with all applicable laws and regulations. The Bank addresses these concerns through extensive legal due diligence. It also examines all aspects of the project to ensure that the process has

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provided adequate safeguards against corrupt practices on the part of representatives of the contracting authority and the concessionaire. This includes a detailed review of the concessionaire’s qualifications, past experience with similar projects, reputation and business practices.

3. The EBRD will provide finance only if the terms of the concession contracts, such as price, quality standards and allocation of risks between the parties, are fair, reasonable and consistent with market practice. Considerations in this assessment include the following:

(i) The price of the infrastructure service must be in line with independent cost estimates and international benchmarks where available.

(ii) Where the price for the service is set by reference to the costs incurred by the concessionaire, the contract terms should provide appropriate incentives for the concessionaire to construct and operate the infrastructure facility economically and efficiently.

(iii) Risks and rewards associated with the concession contract should be allocated fairly between the contracting authority and the concessionaire. In particular, the concessionaire should bear all commercial risks in respect of design, construction, financing and operation of the infrastructure facility, in accordance with applicable industry standards.

Even where a structured competitive process has been followed, the terms of the concession contracts may not be fair and reasonable. For example: the requirements of the contracting authority may not have been clearly defined; the process may have been flawed or manipulated; or the invitation by the contracting authority may not have attracted enough qualified tenderers to generate significant competitive pressure. However, it is less likely that the terms of the concession contracts will satisfy the EBRD’s fairness requirement in cases where a competitive process has not been followed. In such cases the Bank scrutinises the terms of the concession contracts more closely, even if qualified independent advisers have assisted the contracting authority in the process.

The EBRD will judge the fairness of the terms against international benchmarks where available. In the absence of suitable benchmarks, the Bank will finance a concessionaire only if the following criteria are met:

- a structured selection process has been followed;
- the expected financial returns to the concessionaire seem reasonable in light of the risk profile of the project;
- the project is likely to yield economic benefits to the public at large; and
- environmental concerns associated with the project have been addressed to the EBRD’s satisfaction.

Conclusion

Concession arrangements involving private sector enterprises in the provision of infrastructure services are an important instrument in the transition of the EBRD’s countries of operations to market economies. The Bank supports such arrangements by providing technical assistance to contracting authorities that are interested in implementing concessions, and by financing the private sector concessionaires.

In each case, the EBRD examines whether the contracting authority has adopted appropriate procedures for the selection of the concessionaire, and will finance private sector concessionaires only if it is satisfied that the following core criteria have been met:

- the process adopted by the contracting authority in the selection of the concessionaire was transparent and fair;
- the process was carried out in compliance with all applicable laws and regulations, and was not tainted by fraud or corruption; and
- the terms of the concession contracts meet acceptable fairness standards.

These core criteria are met and safeguarded most effectively when contracting authorities adopt and follow a structured competitive selection process, with the assistance of competent advisers. As a general rule, the EBRD therefore expects that contracting authorities adopt formal competitive procedures for the selection of concessionaires.
Recent trends in secured transactions under Georgian law

This article highlights some of the recent changes in secured transactions and creditors' rights in the legislation of Georgia. It is worth noting that these changes signify more than simple modifications of laws; they are part of an ongoing process of increasing the efficiency of the legal protection of creditors, including national and international financial institutions. It is hoped that this process will lead to improved credit facilities for domestic businesses.
Recent amendments to the Georgian Law of Execution Proceedings reflect the current trends in secured transactions legislation in Georgia. These amendments are of particular significance, and can be seen as a direct response to the EBRD’s core principles for a modern secured transactions law. In substance, these core principles provide that: a) the security right should be paramount, irrevocable and effective, even after bankruptcy and liquidation proceedings have been opened, or in case of enforcement of judicial and/or arbitral awards, which in its turn b) leads to an increased availability of credits on improved terms, particularly for start-up and medium-sized businesses.

Georgian legislation deals extensively with security rights. Those concerning the hypothecation of immovable property and the pledge of movable property are of particular interest. The basic underlying principle is that the right to pledge movable property, or the right to hypothecate immovable property, may be used as the means of securing an obligation in such a way as to entitle a creditor to receive - in preference to other creditors - satisfaction from the value of the pledged or hypothecated property. As far as the pledge is concerned, parties to the pledge agreement may agree on notarising the latter. In this type of case, the pledge takes effect from the moment of its registration in the Public Registry, while the actual transfer of the pledged property is not necessary. In the case of a complete or partial failure on the part of the pledgor to perform his or her obligations to pay the debt, the pledgee shall be satisfied by the sale or disposal of the pledged property. The sale of the pledged property shall be carried out through public auction and the pledgee shall be entitled to participate in the auction. It should be noted that any agreement by which the ownership of pledged property is directly transferred to the pledgee shall be null and void.

Hypothecation is effective from the moment of registration in the Public Registry, which is mandatory under Georgian law. Registration is carried out on a basis of notarised agreement and release of the hypothecated property is necessarily registered in the Registry as well. Should the debtor fail or delay to fulfil his or her obligations secured by hypothecated property, the creditor is authorised to request the sale of the security. In this case, as in the case of pledged property, any agreement providing direct transfer of hypothecated property from the debtor to the creditor shall be null and void.

Considering that Georgia has been found to have some of the most severe impediments to collecting collateral, the recent changes in Georgian legislation on secured transactions are very significant. These impediments include biased valuation of charged property, and the high dependency of local currency exchange on exports and protracted judicial proceedings. In addition, according to the EBRO’s Regional Survey of Secured Transactions, Georgia may be found among the “minor reform” countries in terms of securing progress in collateral law reform. However, recent changes should contribute significantly to the overall improvement of this situation.

Georgian commercial banks have frequently faced the same obstacle when receiving proceeds as a result of the realisation of a charged property. This took the form of an awkward mechanism provided by the Civil Code of Georgia and the then Law on Execution Proceedings in respect of the auction of such a property. According to Article 306 of the Civil Code: “If during the first auction the bid is lower than seventy per cent of the initial sales price of the property as valued by the expert, the auction shall be subject to a second auction. The lowest bid during the second auction must at least cover the auction expenses and the creditor claims. Should these requirements not be met, the auction would be declared not to have taken place and the expenses thereof would be borne by the owner.” However, no answer might be found within such a legal framework to the critical question: what happens if the property would not be realised, even at reduced cost, following a second auction?

In this way, the law has created the conditions for a deadlock through the auction process. On one hand, a liquidator or executor fails to realise a charged property, and, on the other, a creditor fails to receive appropriate proceeds.

This legal deadlock was to some extent resolved by the introduction of a new clause into the Law on Execution Proceeding (Article 771), which is the special law on regulating enforcement of judicial decisions on secured transactions. This law states that “if the second auction also fails to sell the property, then the property may be transferred to the creditor at the creditor’s application”. This legislative approach may not be ideal, but it certainly gives to the bank, as to any creditor, an unambiguous rule as to the method of realisation of the charged property in public auction.

The amendments are more categorical and clear-cut regarding the distribution of recovered proceeds among registered creditors. According to the law, the registration of any charged property is carried on the Public Registry and then by the executor right before public auction. Although the proceeds shall primarily be directed to cover auction fees, court expenses and other expenses: in respect thereof, the remaining proceeds shall be subject to clear ranking order for fulfilment of the creditor’s claims as established by the Law on Execution Proceeding (Article 823). Thus, under the category “Claims of first rank” are included “the proceeds of the sale of hypothecated and pledged property shall primarily be used to satisfy the claims secured by hypothecation and pledge”. All other claims may be fulfilled only after the claims of first rank have been met in full.

It should be noted that an auction is preceded by seizure of all the pledged property. This entails making an inventory of the property, prohibiting the disposal, transfer or further pledging of the property in any form, prohibiting the making of a rent or lease agreement or transferring the property for keeping, and any other arrangements over charged property. The seized property is recorded in the Report of Property Inventory (Article 23 of the Amendments Law into the Law on Execution Proceeding). In addition, before holding the auction, the executor ascertains which of the rights recorded in the Public Registry, which are predominantly hypothecations and pledge for secured transactions, prevail over the claim of the creditor for which the execution is being carried out. Of equal importance for enforcement procedures to enable prompt realisation of the property is the fact that “two weeks after initiating a seizure procedure on the movable property, the executor may appoint an auction for that property” (Article 29 of the Amendments Law into the Law on Execution Proceeding), though the provision deals with immovables.

These amendments send a clear signal from the legislator that its intention is to create legal levers for commercial banks in their lending
activities. From a commercial perspective, however, the amendments are flawed. The amendments state that if the proceeds are not enough to fully satisfy all the claims in one category, then these claims shall be met pro rata to the amounts ascribed to each creditor. However, special norms of the Civil Code intervene here, supplementing on the matter, providing for priority rights among the creditors in respect of the hypothecated property, and eliminating any uncertainty on ranking created by the Law on Execution Proceeding.

The procedure for auction of realised pledged property has significant shortcomings. First, the last bid at the first auction must not be less than 70 per cent of the charged property’s value, and must cover the value of the transitive rights and the auction expenses (Article 74 of the Law on Execution Proceedings in conjunction with Article 306 of the Civil Code). The same law provides that “the highest bidder at the auction must provide a guarantee in the amount of ten per cent of the bid. The executor shall make a decision on the admissibility of the guarantee. Unless the guarantee is forthwith provided, the bid shall become invalid” (Article 74.3 of the Law). Most people who are familiar with the problem of realisation of collateral will agree that this wording poses several crucial questions without giving either explicit or implicit answers to them. These questions are: What kind of guarantee shall be provided in order to be admissible for the executor? Would it be better for the purpose of clarity to define precisely “admissible guarantees”? Why is such wide power granted to the executor, who decides at his sole discretion whether the guarantee is to be considered “admissible” or not? And finally, what shall be understood under the term “immediately” from a legal point of view? If the guarantee in the amount of 10 per cent of the bid is not provided “immediately”, a public auction shall be considered invalid. It is clear that ideally the law should fix a time-limit for providing such a guarantee, given that if the bidder does not provide it “immediately”, the actual right of the creditor for prompt realisation of the assets given as security may be seriously undermined. Another issue is the value of the property to be ascertained. Considerable loopholes still remain in the law on this issue, and as a result, further legislative restructuring is necessary to meet the important requirement that enforcement procedure should enable realisation of the assets given as security at market value.

Particular emphasis has to be given to Article 48 of the amendments to the Law on Execution Proceedings, since this article deals with the rights and privileges of a foreign corporate or financial institution as party to a secured transaction with Georgian counterparts, or when the charged property is located in the territory of Georgia. In this case, a judicial decision duly acknowledged in the territory of Georgia, pursuant to agreements on international private law and interstate mutual legal assistance, and the writ of execution delivered by a competent court of Georgia shall be transferred by the Ministry of Justice to the execution bureau according to the debtor’s location. This right to execute foreign awards, including those on collateral, is further reinforced by the binding force of the 1958 New York Convention of Recognition and Enforcement of Foreign Arbitral Awards, as well as by the Law of Georgia on Private International Law, which reiterates that “Georgia recognises effective judicial awards of foreign states” (Article 68.1 of the Law) and “judicial awards of foreign states shall be enforced only if subject to enforcement” and “at the motion of interested party” (Article 70 of the Law).

In spite of some shortcomings, there is no doubt that these changes described here should be viewed as a step towards further development of the existing framework of Georgian legislation on secured transactions. These changes reflect a positive trend towards the ultimate objective of harmonising the national rules with commonly recognised progressive norms and standards. It is hoped that these developments will lead to more intensive involvement of international business and financial institutions in the Georgian economy, and a further influx of foreign investment into the country.

Recent amendments to the Georgian Law of Execution Proceedings are of particular significance, and can be seen as a direct response to the EBRD’s core principles for a modern secured transactions law.

2. H. Muent and F. Pissarides, “Impact of collateral practice on lending to small and medium-sized enterprises”, Law in transition, EBRD, p.54 (Autumn 2000). This study of collateral-related obstacles state that Georgia had the highest weighted average in a ranking of a number of transition countries.

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Particular emphasis has to be given to Article 48 of the amendments to the Law on Execution Proceedings, since this article deals with the rights and privileges of a foreign corporate or financial institution as party to a secured transaction with Georgian counterparts, or when the charged property is located in the territory of Georgia. In this case, a judicial decision duly acknowledged in the territory of Georgia, pursuant to agreements on international private law and interstate mutual legal assistance, and the writ of execution delivered by a competent court of Georgia shall be transferred by the Ministry of Justice to the execution bureau according to the debtor’s location. This right to execute foreign awards, including those on collateral, is further reinforced by the binding force of the 1958 New York Convention of Recognition and Enforcement of Foreign Arbitral Awards, as well as by the Law of Georgia on Private International Law, which reiterates that “Georgia recognises effective judicial awards of foreign states” (Article 68.1 of the Law) and “judicial awards of foreign states shall be enforced only if subject to enforcement” and “at the motion of interested party” (Article 70 of the Law).

In spite of some shortcomings, there is no doubt that these changes described here should be viewed as a step towards further development of the existing framework of Georgian legislation on secured transactions. These changes reflect a positive trend towards the ultimate objective of harmonising the national rules with commonly recognised progressive norms and standards. It is hoped that these developments will lead to more intensive involvement of international business and financial institutions in the Georgian economy, and a further influx of foreign investment into the country.

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Recent amendments to the Georgian Law of Execution Proceedings are of particular significance, and can be seen as a direct response to the EBRD’s core principles for a modern secured transactions law.

2. H. Muent and F. Pissarides, “Impact of collateral practice on lending to small and medium-sized enterprises”, Law in transition, EBRD, p.54 (Autumn 2000). This study of collateral-related obstacles state that Georgia had the highest weighted average in a ranking of a number of transition countries.

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Building on the past: history and transition in the ‘other’ Europe

In this article the author provides a personal reflection on the somewhat forgotten role that history can play to explain and guide the transition process underway in central and eastern Europe. Both the West and the people and leaders of the transition countries themselves should look back before the recent Communist period to identify positive historical examples in both politics and economics that can serve as positive antecedents for the difficult multiple transitions that these countries are presently undertaking. Building on positive perceptions of history can help the central and eastern European countries overcome an overly pessimistic general perception of their recent past to achieve a successful transition.
They come, they go

European countries stretching from the Baltic to the Adriatic have undergone a profound process of reform and transition over the past decade. The success of this process has been considerable, particularly in the political sphere. Since the electoral defeat or negotiated stepping down of the Communist regimes which previously ruled the region, most states have now passed the ‘double election’ democratic test. This test requires at least two peaceful changes of government. What the French call alternance has now become established practice. Elections now come and go with almost monotonous regularity.

Former Communists in a new democratic, and sometimes even free-market garb, have won free elections in a number of countries and have departed again, without causing political turmoil. Political progress has been heartening, but by no means even. There are variations in the pace of political transition, resulting in different rankings for individual countries in the transition league table. Scores for central Europe are higher than those for south-eastern Europe, while those for both central and south-eastern Europe are above those for the former Soviet republics (the three Baltic states, Estonia, Latvia and Lithuania, which formed part of the Soviet Union for a shorter period, are an exception).

These variations are due to a number of factors including the nature of the policy adopted in each country, the quality of local leadership, and the current situation in the region, in Europe and in the international community. Surprisingly, the individual histories of the transition countries are often ignored when assessing these countries’ progress since 1990.

In analysing transition, it is a mistake to concentrate solely on the common starting point, 1989-90. Consideration of the historical experiences of these countries is very important. On careful reflection, it can be argued that to a large extent, the transition countries are what they are today because of what went before. In order to understand the present better, and to predict the future more accurately, it is beneficial to take into account the individual countries’ very different historical circumstances and experiences, as well as their own perceptions of their past. This is not least because awareness of past success, particularly in the relatively recent past, may foster success in the future.1

By the same token, a sense of national failure, especially if anchored within a ‘victimhood complex’, may stop or at least delay a country from embarking on policies more likely to bring it success.

The argument for taking seriously the historical dimension of countries prior to transition is reinforced by the fact that the region has suffered from an overly pessimistic general perception of its recent history. A closer examination of the region’s very varied record casts serious doubt on the basis for this pessimism. Its history is far more complex than any simplistic interpretation would suggest. Ironically, it is the negative version that many in central and eastern Europe have accepted at face value and, perhaps demonstrating a degree of masochism, even adopted as their own. A fresh look at central and eastern Europe’s much criticised political and economic record is overdue.

Never a monolith

It is worth remembering that from the early years of the Cold War, almost right up to its end, the predominant Western view about Communist-rulled Europe was that the region was monolithic. This simplistic ‘monolith’ myth was dictated by the imperatives of Cold War propaganda. The sole exception for the West was Yugoslavia – a chip that broke off early in 1948. Yugoslavia’s break with Moscow raised hopes among Western policy-makers that others may follow, and therefore at least in the immediate aftermath of the break, the country received excessive praise from the West for propaganda purposes.

Dominated by Moscow, central and eastern Europe may indeed have looked like a monolith to an outside observer seduced by a certain external sameness imposed by Communist style and rhetoric. However, to anybody who knew the area from the inside, the idea that the region was a monolith never carried any weight. Even in the early Stalinist years after 1945, there were quite noticeable differences between and even within individual countries. They arose not so much from explicit policy differences as from a political pragmatism reflecting different national traditions as well as contemporary realities in particular countries.

1 There is a Hungarian word sikerélmény – which literally means ‘success-experience’. The dictionary translation is ‘real experience of achievement’. The German equivalent is Erfolgserlebnis. The existence of these words suggests that while the often negative role of self-perception of a national past as a psychological factor in the politics of individual countries such as Germany has been studied quite extensively, the potentially positive impact of self-perceptions of the past in economic, financial, legal and other spheres has been neglected.
Poland provides a good example of these internal differences. Even at the height of Stalinist rule in the late 1940s and the 1950s, the existence of the Roman Catholic Church and of private agriculture offered a limited but free space, not just for the Catholic clergy and the farmers, but also for the rest of the citizenry. The Communist regime had some success in keeping the private farmer down and in subverting the Church from within, but in the end both proved too strong to be brought entirely under Communist control. Similar instances could be cited from other Communist countries. Of course these pockets of autonomy in what to the outside world looked like a tightly run single camp were not exactly the equivalent of the political pluralism. However, they were significant in the sense that they subsequently proved to be useful bridgeheads from which campaigns for political relaxation and ultimately full liberalisation could be mounted.

In East Germany, the Lutheran Church, though less powerful than the Roman Catholic Church in Poland and despite being hemmed in from all sides by the regime, retained sufficient internal autonomy to provide a base in the late 1980s for what eventually developed into a political movement challenging the regime. In some cases – in East Germany as well as in Czechoslovakia, Poland and Bulgaria – the Communist regime itself created quasi-pluralist enclaves in the shape of a small number of so-called ‘satellite parties’. This was done purely for tactical reasons, chiefly to disarm international criticism in the immediate aftermath of the Second World War. These ‘parties’ played no independent role, being strictly supervised and directed by the Communist Party and the Communist secret police. Yet, the existence of these very small, heavily controlled pockets of ‘autonomy’ provided a valuable base for expanded political activity. This was the case during the “Prague Spring” in Czechoslovakia in 1968 and in East Germany and Bulgaria in the 1980s when, almost overnight, genuine democratic parties grew out of their shells. In Bulgaria, one of those state-sponsored organisations, the Movement for Rights and Freedoms, deliberately created to keep the country’s Turkish minority under control, is a fully-fledged democratic party today.

There was nothing unique about the existence of those ‘pockets of autonomy’ within the apparently solid Communist monolith – it had happened before. Nazi and Fascist Europe had also seemed like a terrifyingly solid monolith to the outside world. Yet, almost right up until the end of the Second World War, there was a considerable variety in the amount of space available to the private citizen to breathe and survive. The case of the courageous and successful defence of Denmark’s Jews by King Christian X during the Second World War is well known.2

View from within

Other examples could be quoted in support of the view that central and eastern Europe, far from being a monolith, was and still is a region of great variety and complexity, whose countries should not simply be lumped together, as they often are in Western accounts even today.3 The reasons for that variety are often complex and not easy to grasp without closer analysis. Below are a few instances that, while not providing full answers, hint at where the answers might be sought.

Some Catholic countries, like Poland, owed their Church’s relative autonomy from the state to the de facto separation – never perfect and often compromised – from the secular state, which was achieved by the Roman Catholic Church in Europe during the Middle Ages. In the Orthodox countries on the other hand, a very different kind of tradition grew out of the old Byzantine Empire. It was that of a Church so close to the state it was virtually an arm of it.4 Intriguingly, though not by any definition a defender of pluralism per se, the Catholic Church in countries like Poland fulfilled such a role objectively in the course of defending itself and promoting its interests and policies as an institution. This was harder for the Lutheran church in the region, particularly in Germany, with its tradition of the Frömigkeit (piety) combined with deep respect for the Obrigkeit (secular authority). However, the experience of Nazi rule had helped change the German Protestants’ outlook, opening the way for them to become more politically active.

Hungary’s relative liberalism, which partially survived into the Second World War period, can at least partially be explained by reference to a deeply ingrained feudal tradition of respect for the constitution and the rule of law, dating back to Hungary’s existence as an independent kingdom before 1527. That tradition was further developed and strengthened after 1527, under the strongly legitimist Habsburg Empire. The Austro-Hungarian Monarchy, as the Habsburg Empire came to be called after the Ausgleich (compromise) between Budapest and Vienna in 1867, never became a democracy, but could claim to have become a Rechtstaat, a state living under the rule of law. Not unlike in the United States, law in Austria-Hungary was an essential tool of governance helping to keep together an extremely varied and complex multinational state. Another element of the Empire’s cohesion supporting its legal system was its disciplined, well paid and, contrary to widespread misperceptions, honest and respected bureaucracy that was open to talent and ability from all the constituent nations.

The tradition of respect for the rule of law and rules in general lingered on, to a varying degree, in Austria-Hungary’s successor states such as Austria, Czechoslovakia, Hungary, Poland and Yugoslavia. However, it was a mixed record, with many shades of grey and some significant black marks. For example, in Hungary in 1919, a Communist revolution led by Bela Kun was followed by a period of severe right-wing repression involving a wave of anti-Semitism, popularly named the ‘White Terror’. In 1920, Hungary introduced the so-called numerus clausus, a milestone in the development of anti-Semitic laws in twentieth century Europe. These laws limited the percentage of Jewish students admitted to universities – an example of central European legalism turned to sinister uses.

No comparable national tradition of the rule of law had existed in those parts of south-eastern Europe that, up to 1918, did not form part of the Austro-Hungarian Monarchy. Most of that region, better known as the Balkans, had for five centuries been under Ottoman rule. In the Ottoman Empire, there was no separation of the state from its official religion, Islam. However, Orthodox Christians and the Jews were allowed a high degree of autonomy as religious communities or millets. These millets subsequently became the framework for the new national states of the Bulgarians, the Greeks, the Romanians and the Serbs. Since the Ottomans had started modernising relatively late, their successor states had little or no native tradition to build on and so on becoming independent, they were obliged to create their political and legal systems in a hurry.

Most of what was the Soviet Union until 1991 was in an even worse situation. The slow
The true standard of comparison is not the prosperous, peaceful and gradually integrating post-1945 non-Communist half of Europe. It is

Cold War distortions

Central and eastern Europeans have been right to stress what their countries were like before being placed under the harsh rule of the region’s latest imperial power. They were, and are today, even more justified in demanding to be judged

against their national historical record taken as a whole. The prevailing view of these societies is one that has been bequeathed to us by the Cold War. This portrait reflects an unhappy amalgam of Communist and anti-Communist views of the region. Putting it bluntly, but hopefully not inaccuracy, the Communists, having taken over in 1944-45, were determined to prove that, whatever had happened before them in the region, they had come to rescue that hotbed of nationalism, xenophobia and anti-Semitism from itself. Ironically, the Communists’ arguably exaggerated and pessimistic view of pre-Communist central and eastern Europe came to be shared by non-Communists and even anti-Communists in the West.

Unwillingness to be likened to the Soviet Union could all too easily be dismissed, perhaps understandably, as a reflection of the resentment invariably felt by former dependencies towards the former imperial master. To a certain extent, this was probably the case, but there was also a difference. Here, the resentment by the locals was much greater because the Soviet Union, the region’s imperial master between 1945 and 1990, was not only disliked – as imperial rulers usually are – but was never even respected, unlike, for example, the Austrian or the German Empires. Was this central and eastern Europe’s wish for Abgrenzung or distancing from the big eastern neighbour, perceived by them to be more backward than themselves and, therefore, in a different, ‘lower’ league, just another case of ‘narcissism of small differences’?

Not so disastrous a record

Law in transition

2 Less well known is the role Bulgaria’s King Boris (1894-1943) played in saving his country’s Jews from deportation to Nazi death camps – though the Jews from parts of Yugoslavia and Greece occupied by Bulgaria, at that time the Nazis’ ally, did not escape that fate. See F. Chary, The Bulgarian Jews and the Final Solution, 1940-44 (1972).

3 There is, for example, the case of Hungary’s ‘exceptionalism’ in the Second World War. I cannot add personal recollection from that period. As a teenager living in neighbouring Croatia under the quisling regime presided over by a former Mussolini-sponsored terrorist, Ante Pavelic, I was struck by the story of a family acquaintance brought back from Budapest in 1943. It sounded incredible: in Budapest cafés it was possible to read English and Swiss newspapers. Years afterwards, I learned that the story was true. The availability of Allied and neutral newspapers reflected a real situation described in a British Foreign Office memorandum about Hungary in early 1944 as follows: ‘There is much greater freedom of thought and expression than elsewhere in Nazi Europe, trade unions continue to function and the Jews are treated humanely.’ See E. Barker, British Policy in South-Eastern Europe, p.258 (1976).

Unfortunately, in March 1944, not long after the above Foreign Office memorandum was penned, Hitler – in order to prevent Hungary from going over to the Allies – ordered its occupation and installed in power there Ferenc Szalasi, leader of the small Fascist Arrow Cross movement, thus clearing the way for Adolf Eichmann’s mass deportations of the Jews to the death camps, in which Hungarian members of the Arrow Cross movement also took part. For a full account and a broader historical perspective, see C. A. Macartney, October Fifteenth: a History of Modern Hungary, 1929-1945 (1956).

4 An excellent scholarly work analysing in detail both the advantages and disadvantages of the close connection between church and nation in Serbia is that of the noted Hungarian Slavist, Professor Laszlo Hadrovics. It is called Le peuple serbs et son Eglise sous la domination turque and was published by Les presses universitaires de France in Paris in 1947. An excellent short work dealing with the Orthodox Church in the post-Communist period is a collection of essays edited by P. M. Kitromilides and T. Veremis entitled The Orthodox Church in a Changing World (1999).

5 One of those honourable exceptions that maintains a proper sense of balance and never loses sight of the broader European perspective is Professor R. J. Crampton’s excellent work Eastern Europe in the Twentieth Century and After (2nd ed., 1997). Three works worth mentioning that focus specifically on central Europe are: L. R. Johnson, Central Europe, Enemies, Neighbours, Friends (1996); P. Stark (Ed.), Mitteleuropa. History and Prospects (1994), and C. Lord (Ed.), Central Europe: Core or Periphery (2000).
the deeply divided, crisis and conflict ridden pre-1939 Europe, which saw the rise of Fascism and Nazism before those phenomena appeared farther east. Spain had a savage, three year long civil war from 1936 to 1939 without parallel in the other half of the continent at that time. Seen in this perspective, central and eastern Europe’s 1918-39 record, which few would reasonably defend as satisfactory, appears much less disastrous. Several of the newly-independent states of this region, those orphans of the empires they had supplanted, had a stab at democratic rule. Democracy took a relatively strong hold in Czechoslovakia, though even there it was not as perfect as it has sometimes been portrayed.

At the same time, it should not be forgotten that during the 1918-39 period, democracy both as an ideal and as a political system was in retreat everywhere in Europe, decried equally from the extreme left and right. Authoritarianism was very much in vogue, tempting many even in those countries in western Europe that had not succumbed to Fascism and Nazism. In the wider European context, the figure of Marshal Pilsudski, the founder of independent Poland who was also its stern, authoritarian ruler from 1926 until his death in 1935, is not so much out of place, as it might be today. Most multiparty systems had collapsed throughout the region by the late 1930s, including that of the relatively liberal Francophile Kingdom. King Carol, under strong pressure from the Fascist Iron Guard, and in order to stop it from gaining power, introduced a new constitution after a plebiscite in February 1938, making the country a corporatist state. Unfortunately, this did not stop Romania’s subsequent slide towards wartime dictatorship. The three Baltic states which had managed, despite considerable political difficulties, to secure a degree of economic independence and viability after 1918, were annexed by the Soviet Union in 1940, under the terms of the Molotov-Ribbentrop Pact of August 1939. Until then, the multiparty system had survived there as well as in Bulgaria, Hungary and Yugoslavia. In Czechoslovakia, it was only extinguished by Hitler’s occupation of Bohemia and Moravia in March 1939, and the setting up of the quisling, one-party state in Slovakia. Poland’s semi-authoritarian political system went down with the Polish state when it was attacked and then divided by Hitler and Stalin in September 1939.

A fact often overlooked in discussions about the transition is that not only between but also before the two world wars, central and eastern Europe already had a capitalist system, functional if imperfect. Reminders of its existence are, among other things, the old stock exchanges in various cities of the region. Pre-1939 Czechoslovakia was one of the richest countries in Europe, economically on par with France. Even Yugoslavia, one of the worst constructed and most poorly functioning post-1918 states in the region, could boast a sound financial system. In the mid and late 1930s, under Yugoslavia’s brilliant Finance Minister and later Prime Minister Milan Stoijadinovic, the gold-based dinar was one of Europe’s most sound currencies, on par with the French franc.

One of central and eastern Europe’s successes in the period between the two world wars was land redistribution. This extremely complex and politically difficult operation was implemented with “ingenuity and good sense”. The objective, which was to ensure social stability and to block the Communists’ attempt to capture local peasantry, was achieved. The agrarian parties played an important and on the whole constructive role in the process, particularly in south-eastern Europe. One of the most successful agrarian parties was the Croatian Peasant Party, founded by Stjepan Radic in 1905. Radic was a student in Prague in the last years of the nineteenth century. He admired and learnt from Thomas Masaryk, a Czech democrat and strong legalist who founded the democratic state in Czechoslovakia in 1918, and remained its president until 1935. After Radic’s fatal wounding at the hands of a fellow deputy in the Belgrade National Assembly in 1928, his party was led by Vlado Macek. Macek, a pacifist and democrat, was interned in Croatia by the Pavelic regime during the Second World War. He ended his life after 1945 in exile in the West. Agrarian parties like Macek’s and its counterparts in Bulgaria and other central and eastern European states were linked to flourishing cooperative movements. The depression of the early 1930s dealt a severe blow to the politics and the economies of predominantly agrarian central and eastern Europe, which resulted in a severe agricultural slump in the region. The need to find outlets for their depressed agricultural exports drove several south-eastern European countries into the arms of Nazi Germany. Unfortunately, the economic relief provided by a revived German economy able to absorb their exports also compromised their political independence.

Lost assets

Those parts of central and eastern Europe that had been under the old empires – particularly the German and Austrian empires – inherited a strong industrial base, a sound financial system and vibrant commerce. Austria-Hungary also made significant investments in infrastructure in the second half of the nineteenth and the first decade of the twentieth century. Some of it has survived to this day in places like Bosnia, which was under Austro-Hungarian rule from 1878 to 1918. There was modest but real industrial progress throughout the region between 1918 and the outbreak of the Second World War. Much of the region’s industry remained untouched during the Second World War. As in other parts of Nazi-occupied Europe, further industrial expansion came as a result of intensive German investment in central Europe, notably in Bohemia and Moravia from 1939 to 1945. Hungary’s industry also benefited from German orders on the eve of and during the Second World War. After 1945, the region suffered as a result of its forcible inclusion into the Soviet block, which in turn resulted in its separation from mainstream industrial areas such as western Europe and the United States.

Between 1918 and 1939, a crucial role in the further development of central and eastern Europe continued to be played by the Jews and Germans of the region. Jews and Germans were regarded both as important economic assets and as the area’s social cement – propelling the region forward and holding it together after 1918 despite new political divisions. Perhaps the most severe long-term blow to the region during and just after the Second World War came from the almost simultaneous forcible elimination of those two groups from it – though for very different reasons and under very different circumstances. The Jews were deported to Hitler’s death camps, and the Germans were forced to leave by Hitler himself, who wanted them in his Grossdeutches Reich, and after 1944-45, by the national governments. Some Germans had fled with Hitler’s armies before actually being expelled. In Romania, the bulk of the remaining, once numerous and extremely capable German-speaking community was literally sold for money by President Ceausescu’s
regime to the post-1945 Federal Republic of Germany whose 1949 Constitution obliged it to take in ethnic Germans from anywhere. The region is recovering only very slowly from this blow, as the places left vacant by the departed Jews and Germans are being filled by new generations of locals.

An even more serious blow to the long-term future of the region, whose effects continue to be acutely felt today, has been the loss of the other bond that had been holding it together: a tradition of respect for the rule of law. An attempt was made in central and eastern Europe - as in the Soviet Union since 1917 - to liquidate the independence of the judiciary under Communist rule. This had its political logic: to a Leninist, a judiciary independent of the Party was a contradiction in terms. The rule of law has had a long and honourable tradition in the region. It was probably the most valuable bequest from the old empires - particularly the Habsburg empire as the Ottoman rule over large part of south-eastern Europe left no such legacy. In the 1920s and 1930s, the tradition of the rule of law had survived and, in some countries, even developed further. However, with the Communist take-over in 1944-45 came the systematic attempt to destroy the old legal tradition.

More than half a century later, it is clear that fortunately the attempt to displace the rule of law has not been completely successful. This is partly because the Communist period did not last long enough in central and eastern Europe for the link with the old legal tradition to be completely broken, but also partly because in the later stages of Communist rule, the regimes in some countries like Hungary, Poland and Yugoslavia became alive to the value of 'legality' as a useful prop of the system's stability.

The old system of the rule of law may have been weakened but its value, even in its diminished form, remains to remind today's generation of what their predecessors once had, lost and presumably can have again. It is a reminder that not that long ago, most of the nations of central and eastern Europe lived under the rule of law and were, by implication, a law-abiding people. People in the region in turn have said that this awareness makes it easier to struggle for the rule of law today. This awareness could be an important factor in the attempt that is under way in the region to build legal transition.

Though this essay is devoted to the political aspects of transition, it is worth widening the scope of the argument by postulating that memories of past economic success must also act as encouragement to present efforts aimed at creating a stable and prosperous economy. In Hungary, it is a point of pride that in the immediate aftermath of the Second World War, as western Europe was close to collapse and needed the Marshall Plan to rescue it, the Hungarian economy, without any external assistance, was relatively quickly back on its feet and functioning again.

In the late 1970s or early 1980s, Professor Jozsef Bognár, a noted reformer during the Communist era in Hungary, told me of his dream for the country. His dream centred on his fellow countrymen sitting in Budapest cafés and scanning the financial pages of their papers to check on their shares - instead of quarrelling about the purity of the nation's language and agonising about its low birth-rate and the sad fate of the Hungarians left outside the country's present borders. As Hungary becomes a share-owning democracy, the Professor's dream is being realised. But the real point about it is that in realising it, Hungary is in some respects returning to its traditional social roots. By the same token, dwelling on the nation's past sufferings - real or imagined - as the Hungarians have done in the past can be deeply demoralising and demobilising and thus detrimental to its future.

No nation is immune to brooding about past wrongs done to it, but it is important to know that it is possible to move past this stage. Those still prone to such reflection - such as, in our time, the Serbs have had nothing but grief from it. They might remind themselves that at the turn of the twentieth century they had King Peter I. Karadjordjevic as their ruler; an honest man who translated John Stuart Mill's essay On Liberty into Serbian and, more importantly, during his decade on the throne preceding the First World War, ruled a somewhat rough-and-ready but essentially democratic polity.

Contrary to conventional wisdom, central and eastern Europe as a whole has had enough past successes to look back upon and draw inspiration for the future. It is important that it does so, and learns to build on them.

6 R. J. Crampton, op. cit., p. 34.
7 For a vivid, well-documented contemporary account of the state of the peasantry and of peasant politics in eastern and central Europe between the two world wars, see H. Hessell Tillman, Peasant Europe (1934).
8 See P. Stark, op. cit., p. 141.
9 Elizabeth Pond, transatlantic editor of Internationale Politik, a Berlin-based magazine, makes the interesting point that today's young people in Poland, widely judged to be a successful transition country, want to be neither victims nor heroes. See The Wall Street Journal, p. 6 (17 May 2001).
10 For a perceptive, well-documented recent study of the Serbs' 'victimhood complex' and its political implications, see B. Arzulovic, Heavenly Serbia: from Myth to Genocide (1999).
Focus on contract enforcement

Contract enforcement is the natural corollary of the axiom “pacta sunt servanda” (agreements must be honoured). When two parties strike a bargain, there must be some mechanism to ensure that each party will stick to the terms. Without such a mechanism, the party who has to perform first would be placed at a disadvantage for it would have no assurance that the other party would subsequently honour its end of the bargain. Over the course of history, societies have developed a number of formal and informal enforcement mechanisms ranging from primitive remedies such as hostage taking, ransom demands and reprisals in ancient times to sophisticated legal frameworks with court enforcement in modern times. Contract enforcement is crucial to economic exchange and hence to economic and industrial development.

The first two articles in this focus section emanate from the Office of the General Counsel at the EBRD. Francis Delaey, Counsel, first examines how contract enforcement and the choice of enforcement mechanisms can influence the economic transition process. The article points out that, in addition to judicial contract enforcement mechanisms, economic agents rely on a wide variety of informal mechanisms to enforce their contractual bargains. The article concludes that a policy to enhance contract enforceability is a prerequisite for the successful implementation of any transition programme and that such policy should focus on both judicial and informal contract enforcement mechanisms. The second article, by Kamen Zahariev, Senior Counsel, outlines some of the techniques used by the EBRD to facilitate the enforcement of its financing agreements. To ensure enforceability, the EBRD typically relies on carefully drafted legal documentation, adequate governing laws and dispute settlement mechanisms, compliance monitoring techniques to mitigate the risk of spurious contractual defences, and a thorough due diligence of domestic legal requirements. The article concludes that despite the use of these techniques, efforts to enforce contracts are often seriously hampered by the weak legal and judicial framework of the EBRD’s countries of operations.

The next two articles focus on arbitration. Over the past two decades, arbitration has gradually superseded litigation as the favourite dispute resolution mechanism in international commercial contracts. Enforceability, party-control, neutrality, privacy and confidentiality, cost effectiveness and speed are often cited as the main advantages of arbitration. Jernej Sekolec, Secretary General of the United Nations Commission on International Trade Law (UNCITRAL), presents an in-depth analysis of the UNCITRAL documents that have helped revolutionise arbitration and conciliation. These documents can assist transition countries in creating an attractive regime for the settlement of commercial disputes through arbitration and conciliation. Adrian Winstanley, Director-General and Registrar of the London Court of International Arbitration, then examines the crucial role played by arbitration institutions in arbitration proceedings and how they safeguard the advantages associated with arbitration.

The next article is by Antonio R. Parra, Deputy Secretary-General of the International Centre for Settlement of Investment Disputes (ICSID). Public-private partnerships between states and international investors play a growing role in economic development. Recognising the need to create an independent and impartial dispute resolution forum for cross-border public-private partnerships, the International Bank for Reconstruction and Development sponsored the establishment of ICSID. In this article, Mr. Parra examines ICSID’s increasing role and its evolving jurisprudence.

The last two articles draw upon the contract enforcement experiences of private practitioners. Michael E. Barrack, Georges P. Racine and Anthony Alexander, partners at McCarthy Tétrault, discuss contractual defences available under English law. When structuring project finance transactions, financiers frequently select English law to govern financing agreements. Potentially valid reasons to prevent enforcement under English law range from denying the validity of the contract to implying unwritten terms. The article examines these and other defences and indicates how parties can mitigate the risk of these defences being raised spuriously. The focus section concludes with an article on contract enforcement in Lithuania written by Giedrius Stasevičius, partner at Lideika, Petrauskas, Valiuñas and Partners, and Giedrė Valentaitė, an assistant in the firm. The article provides an insight into how a foreign investor can enforce a cross-border investment agreement in Lithuania. As in the article by Kamen Zahariev, this piece notes the importance of adequately addressing enforcement issues as early as possible during the contract negotiation stage.
Enforcing contracts in transition countries

For markets to function properly, contracts must be honoured. Development in industrial democracies has been attributed to a long tradition of upholding and enforcing bargains among economic agents. This article looks at how contract enforcement and the choice of enforcement mechanisms can influence the transition process.

Francis Delaey, Counsel, EBRD
Local lawyers’ faith in their commercial courts: How frequently do local courts uphold legal rights?

The EBRD Legal Indicator Survey for 2000 questioned legal practitioners in central and eastern Europe and the CIS on how frequently the courts recognised and enforced a party’s rights against another party. On a scale with five gradations (ranging from “never” to “almost always”) only Slovenia received a rating of “almost always”. In general, EU accession countries scored better than the other countries. In these countries, practitioners estimated that the frequency with which courts upheld a party’s rights ranged from “sometimes” to “frequently”. The fact that practitioners in EU accession countries tend to use EU standards as a benchmark may explain their somewhat conservative rating of “sometimes”. Courts in countries of south-east Europe “sometimes” enforced a party’s rights, except for FYR Macedonia where rights were enforced less frequently. In the CIS the results were more disparate. Courts in Russia, Belarus and in most of the countries of the Caucasus and Central Asia “sometimes” enforced a party’s rights. However, rights in Armenia, Kyrgyzstan, Moldova and Ukraine were “rarely” or “never” upheld.

Low-cost and impartial contract enforcement mechanisms are crucial to economic and industrial development. In the eighteenth century, Adam Smith remarked that “the establishment of perfect justice, of perfect liberty and of perfect equality, is the very simple secret which most effectually secures the highest degree of prosperity”. More recently, a number of studies have established a direct correlation between the level of investment and economic performance in a country and the overall level of confidence in its institutions, including the judicial system.

The need for low-cost and impartial contract enforcement mechanisms is particularly acute in the formerly planned economies of central and eastern Europe and the Commonwealth of Independent States (CIS). Contract enforcement mechanisms were largely irrelevant in planned economies. State-owned enterprises were highly integrated in an industrial network built around an inefficient model of production. Exchange was dictated by central planning edicts. When the Soviet Union collapsed, supply and distribution links were virtually severed overnight. State-owned enterprises, which previously relied on central planning bureaucrats for their production and sales activities, had to restructure from top to bottom. New trading partners had to be found. Industrial and commercial networks inherited from central planning days were dismantled and replaced by new relationships better adapted to cope with market demands. The extent to which formerly planned economies can successfully reap the benefits of transition depends in no small measure on their ability to ensure the enforceability of bargains freely entered into by economic agents. A lack of contract enforceability, whether real or perceived, stifles economic and industrial growth.

Why contract enforcement matters

Enforcement is central to commercial exchange, and therefore to economic and industrial development. The sixteenth century philosopher Thomas Hobbes observed that “there must be some coercive power to compel men equally to the performance of their covenants, by the terror of some punishment greater than the benefit they expect by the breach of their covenant”. Good enforcement procedures enhance the predictability of exchange, and reduce uncertainty by restraining destructive opportunistic behaviour among contracting parties. This, in turn, reduces transaction costs and promotes exchange. If good enforcement procedures are lacking, economic agents will seek to minimise the risk of non-compliance by resorting to structures which economise on enforcement, such as spot-market transactions or vertical integration. As discussed later, these structures not only inhibit the overall volume of transactions but also affect the economic and industrial growth of a country.

Game theorists represent a contractual relationship as a game in which the first mover has to decide whether to enter into a contract without knowing whether the second mover will perform. When contracts are generally enforced (high contract enforceability), all second movers perform because the expected cost of non-performance exceeds its potential benefits, and all first movers enter the contract comforted by the expectation that the second movers will be sufficiently deterred from breaching the bargain. As a result, more contracts are executed between a greater number of economic agents and markets become more efficient. When, on the other hand, contracts are rarely enforced (low contract enforceability), first movers will be extremely cautious. First movers will only enter into the contract, if they know – either directly from personal experience (trust) or indirectly through the community (reputation) – that the
second mover is trustworthy. This caution reduces the likelihood of exploitation for the first mover and makes trustworthy second movers more successful than others, because on average, they will get more contracts than others. Conversely, first movers will refrain from entering into contracts with second movers whose trustworthiness cannot be sufficiently established.4 The reluctance of economic agents to deal with strangers in a low contract enforceability environment entails a significant cost. In a 1997 survey,5 managers of privately owned manufacturing firms in Russia, Ukraine, Poland, Romania and the Slovak Republic were questioned on whether they would abandon a current supplier to purchase instead from a new, previously unknown supplier offering a 10 per cent lower price. The survey found that firms who expressed doubts about the capacity of the courts to enforce contracts were reluctant to deal with new suppliers even if it meant continuing to deal with a more expensive supplier. Accepting the lower-priced offer from an unknown supplier carries a risk. If the new supplier delivers low-quality goods or fails to deliver, production may be delayed and a firm’s reputation jeopardised.

Furthermore, if the new relationship fails, the firm will have to switch supplier and incur search and screening costs to find another trustworthy supplier. The study found that persisting with a high-priced supplier because of the trust that has developed generates inefficiencies: “If firms routinely reject lower-priced deals, low cost suppliers will find it difficult to get new customers and high-cost producers will not be driven out.” In other words, when contract enforceability is poor and transactions are based on trust, the rewards to (and incentives for) low-cost suppliers will be smaller and new entrants will find it harder to enter the market. The same survey examined the incidence of contract enforceability on trade credit. Suppliers will only offer trade credit if they believe the customer will (or can be made to) repay it. Of the five countries surveyed, the study found that in Russia and Ukraine — where respondents were least likely to express confidence in the capacity of courts to enforce contracts — only 12 per cent and 38 per cent respectively of the firms interviewed declared that they could settle their bills after delivery. This starkly contrasts with Poland and the Slovak Republic, where respondents expressed greater confidence in judicial contract enforcement and where up to 84 per cent and 70 per cent respectively of the firms interviewed received trade credit.

Fewer contracts, sub-optimal exchange, higher search and screening costs and less trade specific financing are not the only consequences of poor contract enforceability. Weak contract enforcement procedures also affect industrial growth. When contracts are rarely enforced, suppliers are reluctant to produce goods to order, and will instead gear their production line to standard goods. The reason for this is that the more specialised the good, the lower its value for another user, and the higher the risk for the supplier in case of non-compliance of the counterpart. Standard goods, on the other hand, can be sold to a multitude of users and as a result, present a lower risk in case of non-compliance. These empirical findings are confirmed in another comparative study of Russia, Ukraine, Poland, Romania and the Slovak Republic.6 The study found that Russia and Ukraine, two countries with low levels of contract enforceability, produced substantially fewer specialised goods than Poland, Romania and the Slovak Republic, which scored better on contract enforcement. The result is a production process where less value is added.

Likewise, in a poor contract enforceability environment, producers whose production process depends on the regular supply of specialised goods will frequently opt for vertical integration (either by acquiring the supplier or by duplicating the supplier’s production line) rather than relying on a supplier. Vertical integration circumvents the issue of contract enforcement and ensures timely and qualitative performance by hierarchical control. It also entails an inherent risk of sub-optimal resource allocation and reduced product diversity.7 Economic agents also economise on enforcement by eschewing long-term (where the quid and the quo are continuously exchanged over a period of time) and inter-temporal contracts (where a lapse of time passes between the exchange of the quid and the quo) in favour of spot-market transactions (where exchange of the quid and the quo is simultaneous). In contrast to long-term contracts and inter-temporal contracts which leave ample scope for opportunistic behaviour, spot-market transactions are by and large self-enforcing because goods are simultaneously exchanged against cash payment. They enhance certainty by excluding the inter-temporal element between the exchange of the quid and the quo. Since exchange is simultaneous, there is less scope for opportunistic behaviour.

Like the standardisation of the product line and the vertical integration of the production process, the bias for spot-market transactions has economic implications. The fluctuating income stream intrinsic to spot-market transactions is less likely to encourage manufacturers to make long-term capital investments than the steady and predictable income stream resulting from long-term contracts. In addition, while spot-markets are

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7. Consider, for instance, a laptop manufacturer. For simplicity we assume that laptops consist of a keyboard component with a processor and an LCD-screen. If the quality of the LCD-screen is insufficient or its delivery behind schedule, the laptop manufacturer may incur sizeable losses. In an environment where contract enforceability is low, the laptop manufacturer may be tempted to acquire the LCD-screen manufacturer. By doing so, the laptop manufacturer would be able to control the quality and the timely delivery of the LCD-screens. Vertical integration, however, entails an economic cost. The laptop manufacturer, for one, would have to tie up substantial resources in the acquisition and operation of the LCD-screen manufacturing plant. These resources could be allocated more efficiently elsewhere. But vertical integration does not only affect the manufacturer: it also affects the consumer. By developing its technological expertise, the LCD-screen manufacturer could have produced LCD-screens for other applications at a cheaper price.
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Judicial contract enforcement procedures

Market-friendly laws and an independent and competent judiciary to implement them have long been credited for fostering economic and industrial development. On the other hand, poor laws or a weak judiciary can undercut even the most ambitious efforts to develop a modern market-oriented economy.\textsuperscript{9}

Adequate judicial contract enforcement procedures are crucial because they support impersonal (as opposed to personal) and inter-temporal (as opposed to spot-market) exchange – a condition sine qua non for market expansion and hence economic and industrial development. In addition to enhancing economic and industrial development, judicial contract enforcement procedures can also have strong equality-promoting effects. Powerful actors often have other (informal and sometimes illegal) means of ensuring performance. As discussed below, the sheer size of their orders combined with the threat of withdrawing future business or their extensive network of contacts combined with the threat of a collective boycott are often enough to deter their counterparts from “redefining” their contractual obligations. Less powerful actors cannot avail themselves (or at least not to the same extent) of such alternative means and as a result are more vulnerable. Impartial and predictable contract enforcement procedures can create a level playing field and increase competition among economic agents by providing a viable alternative to size or purchasing power to enforce contractual arrangements.\textsuperscript{10}

Paradoxically, despite their undeniable importance, judicial contract enforcement procedures only play a minor role in day-to-day business transactions. Generally, they constitute a measure of last resort in whose shadow commercial relationships evolve more or less informally. A number of studies argue that the parties’ reliance on judicial contract enforcement procedures decreases over time. As the relationship progresses and trust builds up, parties tend to switch to informal means and reserve judicial contract enforcement procedures for situations where monetary stakes are high or to signal the end of a business relationship. A survey of manufacturing firms in Russia, Ukraine, Poland, Romania and the Slovak Republic found that the importance of courts is greatest at the start of a relationship and declines as the relationship matures. Moreover, the survey indicates that the measured effects of courts are smaller than the measured effects of relational contracting. It found, for instance, that the estimated likelihood of granting trade credit increased by more over the course of the first year of a relationship than it increased if the courts become available.\textsuperscript{11}

Informal contract enforcement mechanisms

Informal means of enforcement often complement and sometimes supplement judicial contract enforcement procedures in transition and market economies alike. Relational contracting is the most frequently cited informal mechanism. The underlying premise is that the long-term benefits of a business relationship outweigh the one-off gains brought about by breach of contract. Or, as one scholar puts it, “the discounted present value of the earnings stream that can be realised from future transactions exceeds the one-time wealth increase realisable from breaching the current agreement.”\textsuperscript{12} This also highlights the limitations of relational contracting as an enforcement mechanism; if the discounted present value of the earnings stream is less than the one-time wealth increase realisable from breaching the agreement, the relationship is not worth preserving and the threat to terminate in case of breach will not constitute a sufficient deterrent.

Closely related to relational contracting and based on a similar premise is reputational contracting. Reputational contracting is based on the assumption that over time one’s good name is worth more than the one-off gains resulting from reneging on one’s contractual obligations. Economic agents with a good reputation will in the long run be more successful than others because on average they will get more contracts than others. Unlike relational contracting, the value of a particular relationship is irrelevant, because even in an insignificant relationship the breach of contract will affect the reputation of the party breaching it. Medieval judges played an important role in facilitating trade across Europe by supplying information on the past behaviour of merchants. More recent examples of reputation-based enforcement institutions include credit bureaus that record and disseminate information on payment defaults, and trade associations who exchange information about their members.\textsuperscript{13}

Multilateral Punishment Systems (MPS) are an extension of reputational contracting. MPS relies on the threat of a collective boycott to deter a party from reneging on its contractual undertakings. The underlying premise is that a party duped by its counterpart will inform others of its misfortune who – in solidarity with the victim – will refuse to deal with the renegade. Medieval merchants relied on a form of MPS to deter their agents from double-crossing them. Agents did not double-cross their masters on their trans-Mediterranean voyages because they anticipated a boycott by other merchants in case of misconduct.

Economists examined whether MPS was a viable enforcement mechanism in transition countries such as Russia. They found that the threat of a future boycott only deters if the potential renegade is unable to post sufficient collateral at a later time for another transaction. If the renegade can post sufficient collateral, economic agents will accept to transact with the renegade and the boycott crumbles.\textsuperscript{14} More generally, because boycotts are only as strong as the coalition among the individual members imposing them, MPS is only effective when wielded by close-knit financial-industrial groups in respect of counterparts who have only a limited number of alternative trading partners. Lastly, MPS can also raise anti-trust considerations, for instance, when one of the boycotting firms is a competitor of the boycotted party.

Relational contracting, reputational contracting and MPS frequently complement judicial contract enforcement procedures and can in certain cases supplement them. This is the case, for instance, when the relative cost of judicial contract enforcement procedures makes them uneconomical as an enforcement mechanism,
or when goods have such subtle quality characteristics (e.g., software programs) that it is difficult or impossible for a third party to verify that the contract has been breached. Yet, these informal enforcement mechanisms suffer some significant drawbacks. First, relational contracting, reputational contracting and MPS can only function properly when there is repeated interaction and parties are able to verify the past behaviour of prospective counterparts. As a result, these mechanisms are not suited to support impersonal exchange. Second, the need to screen prospective trading partners also increases transaction costs. Lastly, the intrinsic bias of these informal enforcement mechanisms to existing relationships generates—as discussed above—inefficiencies by making it more difficult for new participants to enter a market.

Does this mean that impersonal exchange is impossible in an environment lacking judicial contract enforcement procedures? Not quite, at least in close-knit and well defined communities, according to some scholars. These scholars contend that from as early as the twelfth century, Community Responsibility Systems (CRS) supported impersonal and inter-temporal exchange in medieval Europe, despite the lack of appropriate contract enforceability provided by the state. A 1997 research paper argues, “by holding all members of a community responsible for the default of a particular member, the community is provided with the incentive to support impersonal exchange. Second, the need to screen prospective trading partners also increases transaction costs. Lastly, the intrinsic bias of these informal enforcement mechanisms to existing relationships generates—as discussed above—in inefficiencies by making it more difficult for new participants to enter a market. Relational contracting, reputational contracting and MPS are not the only informal means to ensure performance, but they are by far the most common. Other informal means include the media, traditional authorities, social norms, ostracism and private protection rackets.

Designing a contract enforceability enhancing policy

As discussed above, contract enforcement mechanisms, whether formal or informal, are critical to commercial exchange, and hence to economic and industrial development. In a survey of 27 transition countries of Asia and Latin America, a World Bank paper found that “a developed legal and regulatory framework, good enforcement and low administrative barriers affect the industrial growth not only by increasing the amount of investments made available in the economy but also by improving the efficiency of resource allocation.” The paper recommends that “policy makers should devote resources and efforts to reducing corruption, eliminating bureaucratic barriers, improving contract enforcement and the legal environment... as an essential complementary measure to accompany large scale privatisation, flow of public and private investments in education and R&D and measures promoting Foreign Direct Investment.” Put differently, designing and implementing a contract enforceability enhancing policy is a necessary prerequisite of any transition programme.
Designing an effective contract enforceability enhancing policy poses several challenges:

- Due consideration should be given to the social, political, and cultural contexts in which contracts must be enforced. Contract enforcement mechanisms do not operate independently, but are part of a larger framework of norms and values that organise a society. CRS, for instance, was a viable enforcement mechanism in medieval Europe because commercial exchange mainly evolved around corporations, and the social and economic cost of leaving one’s corporation was relatively high. When corporations lost their primordial role in commercial exchange, however, CRS was no longer practicable and fell into disuse. More recently, the ease with which information can be disseminated through the Internet has revolutionised reputation-based contract enforcement mechanisms. Some Internet sites provide their users with a novel platform to exchange opinions on a wide range of products and services, from computers and ski resorts to insurance and brokerage services. Potential buyers can read opinions of other users of a particular product or service, and can rate each opinion according to its usefulness. Registered users can also write their own opinions and receive a modest compensation every time their opinion is read. The more useful the opinion, the more it will be rated and read and the higher the compensation for its author. Where previously only a limited number of consumers could relate their experiences in consumer testing magazines with a limited readership, the Internet empowers an infinite number of users to read and voice their opinions on a web site with a potentially unlimited readership. However, the benefits of the Internet are not unmitigated. Just as the Internet facilitates the exchange of bona fide opinions, it also increases the ease with which false or slanderous information can be distributed. Disreputable firms can abuse reputation-based web sites by either writing complimentary opinions of their own products or disparaging reviews of those of their competitors.

- Policy makers should also take care that their contract enforceability enhancing policy does not have unintended consequences. For instance, with the introduction of judicial enforcement, impersonal exchange gradually becomes more important than personal exchange. As the volume of personal exchange reduces, the benefits of intra-community trade diminish and as a result the community could begin to break up. While this is neither good nor bad of itself, policy makers should examine whether other community benefits are lost as well and, if so, how this can be mitigated. A study of rural credit markets in India exemplifies the potentially adverse impact of the introduction of judicial enforcement procedures. Prior to their introduction, moneylenders relied on informal mechanisms to ensure loan repayments. As a result, competition was lax and interest rates remained high, providing the lenders with a financial cushion allowing them to extend payment terms and otherwise accommodate borrowers experiencing difficulties. The introduction of courts increased the competition and interest rates came down. When the region was hit by drought, borrowers defaulted and lenders, deprived of their financial cushion, went to court to foreclose on farmers’ land. Widespread social unrest followed. This does not mean that the introduction of judicial enforcement procedures is inappropriate (after all the increase of competition and the reduction of interest rates are important benefits) but merely that policy makers should endeavour to identify and avoid undesired side-effects by ensuring that adequate safeguards are in place (such as insurance coverage for instance).

- Policy makers should address judicial reform in conjunction with informal enforcement mechanisms. According to one study, “judicial reform projects that build upon or enhance the operation of such informal enforcement mechanisms will yield greater returns than those that do not. As a minimum, designers of reform projects must take the presence of these informal mechanisms into account. Otherwise ... the projects could backfire”. Policy makers should endeavour to maximise the synergies between judicial and informal contract enforcement mechanisms. Reputation based enforcement mechanisms can be reinforced, for instance, by promptly publicising court decisions (including the identity of the parties to the lawsuit), by assisting business communities to develop systems to share information about suppliers and customers, and by fostering the growth of credit reporting agencies and central company registers. Judicial reform projects can further enhance contract enforceability by ensuring that impartial and predictable judgements are issued, cases are heard within a reasonable timeframe, and the judicial process is transparent and cost-effective. Only when these conditions are met, is the threat of judicial enforcement sufficiently credible to curb destructive opportunistic behaviour. The overhaul of filing procedures to minimise delays, the creation of small claims courts and specialised commercial courts, the professionalisation of the bench and the bar, and the transfer of non-contentious matters (such as registration of property) to administrative agencies to reduce case backlogs are some of the measures that can be implemented to achieve this goal. Policy makers in transition countries can also enhance contract enforceability by actively endorsing the use of arbitration and conciliation. In this respect, policy makers will find the groundbreaking work of the United Nations Commission on International Trade Law (UNCITRAL) - and in particular the 1958 New York Convention and the UNCITRAL Model Law on International Arbitration - particularly useful.

Designing and implementing an effective policy to enhance contract enforceability is a long and arduous task fraught with numerous obstacles. It touches the core of society and its values. Yet transition economies have no option but to persevere and discharge it successfully, for without it, even the most modest transition programme is unlikely to achieve its objectives.

Law in transition – Focus on contract enforcement

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Mitigating structural and jurisdictional risks in the enforcement of commercial contracts: the EBRD’s experience

This article outlines some of the policies, practices and techniques that the EBRD uses to mitigate the structural and jurisdictional risks inherent in its investments. The EBRD has adopted a comprehensive approach to the drafting and structuring of legal documentation in relation to these investment activities. Despite the use of such mitigation techniques and practices, the EBRD’s experience in enforcing commercial contracts shows that such efforts by foreign investors to enforce contracts are often seriously hampered by the existing weaknesses of the legal and judicial environment in the EBRD’s countries of operations.
The EBRD’s mandate is to foster the transition to market economies and to promote private and entrepreneurial initiative in central and eastern Europe and the Commonwealth of Independent States (CIS). It does so through offering a wide range of investment products, from simple corporate loans to complex limited recourse project financings and venture capital investments. Documenting contractually and, if necessary, enforcing such a wide array of cross-border investment products in the EBRD’s countries of operations presents a significant challenge, given the need to balance several, sometimes conflicting, requirements. When negotiating and structuring its legal documentation, the EBRD has to ensure the protection of its interests as lender and/or equity investor, and take into account the expectations and risk perceptions of the investment partners in the projects financed by it - participating banks, co-investors and project sponsors. The Bank’s approach to structuring and enforcing the contracts to which it is a party is also influenced to a large extent by the current state of the legal environment in transition countries. These countries continue to undergo rapid and extensive change, and sometimes fail to offer an acceptable degree of legal and judicial certainty of contract enforcement.

There are a number of commercial risks associated with medium and long-term project financing and venture capital investments in the volatile emerging markets of central and eastern Europe and the CIS. The EBRD is also faced with another two categories of legal risk: those associated with the complex, multi-party, cross-border and long-term nature of its investment products (structural risks); and those arising from the relatively underdeveloped local legal infrastructure in the jurisdictions where its investee companies are located (jurisdictional risks).

The EBRD employs a range of policies and practices to mitigate these risks. These include: a careful choice of the law governing its investment agreements and of the mechanisms used to resolve disputes; a comprehensive approach to the drafting and structuring of legal documentation; the adoption of adequate compliance monitoring techniques to prevent the use of unmeritorious contractual defences by defaulting borrowers; and a careful analysis of the domestic legal requirements in the host country to ensure local enforceability of financing documentation.

Approach to documentation

Businesspeople and other parties sometimes question the length and complexity of cross-border project finance documentation. However, with the possible exception of some purely domestic projects in advanced continental jurisdictions, there has been no widely accepted alternative to the approach of comprehensively documenting the arrangements between the parties of complex cross-border financings so far.

Given the EBRD’s mandate to advance transition in all of its countries of operations, the Bank is frequently taking high risks in the markets in which it operates. On the other hand, as a publicly funded institution, the EBRD is also accountable for ensuring that its investments are made with appropriate safeguards so that it observes “sound banking principles” in all its operations.

In order to balance these objectives and improve the chances for successful enforcement of its contractual rights, the EBRD’s preferred approach is to prepare and negotiate comprehensive, self-contained documents on a project by project basis. The Bank incorporates a range of safeguards in its legal documentation (for instance, security arrangements, financial ratio covenants, project performance undertakings, environmental and procurement covenants and exit arrangements). Setting out the commercial arrangements of the parties in detail and appending the background analysis and assumptions of the parties to legal agreements lessens the risk of the parties entering into the transaction with differing beliefs about what is intended. This is a distinct risk in cross-border transactions, where legal and commercial expectations can vary extensively between jurisdictions. The approach also improves the chances of successful enforcement of contracts by making it easier to prove the commercial background of the original bargain struck by the parties. In addition, it reduces the chances of defaulting parties to invoke unmeritorious defences such as implied terms, error of fact or law, or change of circumstances.\(^1\)

Choice of governing law

Typically, the recipient of EBRD funding is a company or joint venture incorporated in one of the Bank’s countries of operations and its main operating assets are also located there. Investment partners, whether as lenders, participants in the EBRD’s loans, or fellow shareholders, are typically from a range of countries. In an ideal world, the law and jurisdiction where the project assets were located would be a logical choice which should facilitate speedy enforcement. However, in practice, foreign investors almost invariably choose the laws of an established foreign jurisdiction to govern their relations with local partners. Their choice is influenced by the fact that the legal environment in the local jurisdictions is still in the process of transition to being more market-oriented.

Ten years into the process of transition to market economies, most countries of the region have developed and passed the basic commercial laws necessary for private sector development - company, commercial, foreign investment, insolvency, concessions and secured transactions. However, few of them have successfully passed the test of practical implementation. Successive surveys conducted by the EBRD’s Office of the General Counsel throughout the region have consistently shown that the effectiveness of the implementation of local laws lags significantly behind its extensiveness. In other words, notwithstanding that basic legislation is in place, investors in some countries in the region may be confronted with a combination of the following:

■ Local laws remain subject to unpredictable changes, sometimes followed by dramatic reversals, depending on political developments.

■ Local legislation may contain “grey areas” which are not expressly addressed in the law, and for which there is no established administrative or judicial practice. In a region where legal education and thinking have been dominated for decades by administrative methods, tight bureaucratic regulation and the downplaying of the contractual freedom of economic players, this contributes to an uncertain legal environment and, almost invariably, causes implementation problems for foreign and local investors and financiers alike.

■ Implementing regulations might be passed long after the basic legislation has been passed, and/or might contain provisions which contradict the spirit of the laws they are designed to implement.
■ Enforcement procedures are often regulated by unreformed codes of civil procedure, which provide for court-led enforcement mechanisms that are slow, expensive and leave room for defaulting parties to drag out the process.

Under these conditions, foreign investors and financiers, when given a choice, frequently opt for the laws of an established jurisdiction to govern their contractual relations and disputes with their local partners. The EBRD’s practice is to have its private sector loan agreements governed by the law of an established jurisdiction whose laws are recognised by participant banks as supportive of international financiers’ interests. The main reason for this is to mitigate the jurisdictional risks outlined above, as the law of a developed jurisdiction provides a high degree of legal and judicial certainty in its application and interpretation. As such, it is also a safeguard against the structural risks involved in structured finance products.

Choice of dispute settlement mechanism

In multi-party, cross-border project financings, the parties normally face the choice between opting to submit to the jurisdiction of local or foreign courts, or to have their disputes resolved by arbitration (foreign or local). In many cases, this decision may have far-reaching consequences for the parties and the chances of enforcing their rights. Thus, the choice of appropriate dispute settlement mechanisms is an important tool in legal risk management.

It is the EBRD’s practice to submit disputes to ad hoc arbitration under the United Nations Commission on International Trade Law (UNCITRAL) Arbitration Rules. In addition, the EBRD reserves the right to enforce its rights in the English courts, or in any other courts having jurisdiction. The reasons for this policy choice are to a large extent the same as those determining the choice of governing law outlined above. In addition, the choice of international arbitration as the main dispute settlement mechanism is influenced by the fact that while most countries of central and eastern Europe and the CIS are not parties to bilateral or multilateral treaties on the mutual recognition of judgements, almost all of them have ratified the 1958 New York Convention on the Recognition and Enforcement of Arbitral Awards.

Contract enforcement, due diligence and local law

The freedom of the parties to a cross-border financing to choose a foreign law to govern their contract is not unrestricted. Using a foreign law to govern cross-border lending agreements for private sector projects does not mean that the law of the borrower is either ignored or forced to yield to an alien system. Many important aspects of the project will invariably be governed by, or subject to, the laws and regulations of the host state.

For instance, the choice of a law other than the law of the borrower does not in general affect property rights or security interests to the extent that these are mandatorily treated under local law as a matter of public policy. In order to be enforceable, security arrangements must be valid under the laws of the jurisdiction in which the collateral is located, and therefore security arrangements are almost invariably governed by, and subject to, local law. Similarly, when the EBRD invests in the equity capital of a local company, its rights in relation to the investee company and its shareholders and directors are reflected in the company’s charter and other documents (e.g., the subscription agreement), which are governed by the laws of the country under which the investee entity was formed.

Even those financing agreements which are governed by a foreign law (e.g., loan agreements, inter-creditor agreements or agreements between shareholders) may ultimately have to be enforced in the local jurisdiction of the borrower or investee company (if this is where its assets are located), and must therefore be consistent with, and enforceable under, the laws of the country of operations of the investee company.

In order to ensure the enforceability of its agreements, in the process of so-called “legal due diligence”, the EBRD carefully evaluates the local legal environment affecting the investment. In particular, it will review whether:

■ the financing agreements have been duly authorised and executed by the relevant counterparties and constitute valid and legally binding obligations, enforceable in accordance with their terms;

■ any local law or regulation has been or will be violated by the execution of the financing agreements or by their performance;

1 For a more detailed discussion on this subject, see infra M. E. Barrack, G. P. Racine and A. Alexander, “Lender beware: an overview of contractual defences”, Law in transition, Autumn 2001, p. 44
2 For a more detailed discussion on this subject see M. E. Barrack, op. cit., p. 44

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all local law consents, licences and authorisations have been obtained;

the security has been validly created in order to be effective against third parties and enforceable against the borrower; and

the choice of governing law and the mechanism for settlement of disputes are valid and enforceable under the law of the country of operations.

Monitoring of contract conditions after signing

Given the complex nature of project finance agreements and the long implementation time, during the course of implementation it sometimes becomes necessary to revisit certain conditions of disbursement of the loan or to waive or amend (temporarily or permanently) certain terms of the original documentation. This is necessary to take into account changed circumstances or new legal and commercial developments which have led to a change in the original risk perceptions of the parties.

The EBRD has a developed system of monitoring the fulfilment of conditions of disbursement and contract compliance. The Bank’s practice is to carefully document any waivers or amendments to the original documentation. Such waivers and amendments are always made and ratified in writing, specify in detail any terms and conditions attached, and state the duration for which they are granted. Waivers and amendments also contain appropriate clauses aimed at reserving the EBRD’s rights and remedies. This practice has an important “demonstration effect” in many countries of the region, as it requires local borrowers to adopt advanced accounting and management practices in the context of implementing projects financed by the EBRD. It also protects the rights of the EBRD and mitigates the risks which might otherwise arise at enforcement stage, such as the risk of making it easier for defaulting borrowers to avail themselves inappropriately of contractual defences such as promissory estoppel, acquiescence, waiver by conduct or forbearance.2

EBRD experience and challenges for transition countries

As a leading foreign investor in central and eastern Europe and the CIS, the EBRD has gained considerable experience in enforcing commercial contracts related to various aspects of banking, capital markets and venture capital. The EBRD’s experience shows that efforts by foreign investors to enforce contracts are often seriously hampered by the existing deficiencies in the legal environment of the EBRD’s countries of operations. Many of these deficiencies are caused by the weaknesses of a judiciary which in many countries is underfunded, lacks commercial experience and is prone to being influenced by powerful local interests. The reluctance of the courts in some countries, especially Russia and some CIS countries, to enforce validly issued international arbitral awards based on an overly expansive interpretation of domestic public policy is of particular concern, as is their apparent willingness to invalidate commercial contracts on highly formalistic grounds at the request of local parties who are unwilling or unable to fulfil their contractual obligations.

In its investment activities, the EBRD has adopted a comprehensive approach to the drafting and structuring of legal documentation, and pays particular attention to the choice of appropriate governing law and dispute settlement mechanisms to resolve disputes. The EBRD also employs compliance monitoring techniques aimed at preventing the use of contractual defences by defaulting borrowers. The EBRD also conducts a careful analysis of the domestic legal requirements in the host country to ensure local enforceability of its financing documentation.

For their part, transition countries can help attract foreign investment, particularly from commercial sources, by improving their legal systems so that the law and judicial attitudes collectively foster a culture that sees the enforcement of contracts freely entered into by commercial parties. Much progress has been made in many countries, particularly those with EU membership aspirations. However, much remains to be done. 26
UNCITRAL texts on international commercial arbitration

The United Nations Commission on International Trade Law (UNCITRAL) has long been at the forefront of international arbitration and conciliation. The 1958 New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards, one of the world’s most successful treaties in terms of number of ratifications, has revolutionised arbitration and made it the most common dispute resolution mechanism in international transactions. This article explores five UNCITRAL documents that have helped shape contemporary dispute resolution mechanisms that can be used in transition countries.
UNCITRAL\(^1\) is a prominent organisation in the area of arbitration and conciliation. It has formulated contract rules, practice notes as well as legislative provisions on this topic. The Commission is currently preparing further texts of this nature.\(^2\) The significance of UNCITRAL texts is evident when examining the ways in which they are utilised by parties involved in arbitration. Usually, after the parties have agreed on the substance of an international transaction, they turn their attention to a dispute settlement clause. Parties often prefer to use a standard arbitration clause and complete it with a few additional elements suited to the transaction – particularly the place of arbitration, the number of arbitrators, the appointing authority and the language of the proceedings. If such an arbitration agreement is to be effective and free of risks and uncertainties, the parties must operate against the background of an acceptable and widely understood legislative and contractual procedural regime.

The parties should be able to expect the following from a procedural regime on international arbitration:

- that the arbitration agreement entered into by the parties will be recognised and given effect under law;
- that the parties may agree on a set of arbitration rules and that the mandatory rules of the applicable procedural regime will not present obstacles to the effectiveness of such chosen rules;
- that the law will provide a minimum set of procedural solutions if the parties have not agreed on a set of arbitration rules, or if the agreed rules do not provide a solution;
- that the arbitral tribunal may, subject to certain acceptable limits, conduct the arbitration in such manner as it considers appropriate (unconstrained by technicalities applicable in national procedural systems);
- that the courts at the place of arbitration will provide efficient assistance (in matters such as the appointment of or challenge to an arbitrator), if the parties have not provided themselves with such assistance;
- that, in the interest of the parties and the public interest, a court will ensure judicial supervision when the arbitral tribunal has overstepped its jurisdiction or a party has been treated unfairly;
- that the winning party will be able to enforce the award, should the defendant refuse to comply with it.

It is for the legislative regime governing arbitration to ensure that the above expectations of the parties are fulfilled. Such a regime is incorporated in the UNCITRAL Model Law on International Commercial Arbitration (discussed below). The Model Law provides well-balanced and universally known solutions to the issues listed above. The 1958 New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards adds another layer of rules providing certainty and predictability regarding the recognition of arbitration agreements and the enforcement of foreign arbitral awards.

The parties have a wide range of arbitration rules to choose from, due to the numerous arbitral institutions offering to administer arbitrations on the basis of their rules. If the parties prefer arbitration without the involvement, or with limited involvement, of an arbitral institution, they may agree upon the applicability of the UNCITRAL Arbitration Rules (discussed below). These Rules have become so widely known and accepted that any arbitral institutions have modelled their rules on them, or are offering the parties an option to administer their case under the Rules.

### 1958 New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards

The main purpose of the 1958 New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards is to establish an obligation to enforce foreign awards and limit the reasons for which a national court may refuse to recognise or enforce a foreign arbitral award. A “domestic” award, i.e. an award made in the state in which it is to be recognised, is not covered by the Convention.\(^3\) In addition, the Convention deals with some issues concerning the validity of the arbitration agreement.

Without discussing the solutions of the Convention in detail, it may be said that it has passed two important tests. First, the Convention is acceptable in different legal, political and economic systems, including those of most of the transition countries of central and eastern Europe and the Commonwealth of Independent States (CIS). Secondly, the provisions continue to be acceptable, even though the Convention has been in existence for more than 40 years. This is illustrated by the fact that the provisions on the recognition and enforcement of awards in the UNCITRAL Model Law closely follow the main provisions of the Convention, and that the solutions of the Convention have been incorporated into a number of multilateral and bilateral international treaties.

There are currently 126 states party to the Convention, and the number continues to grow. The expanding membership in the New York Convention enables commercial entities in member states to rely on the growing network of the regime for recognition and enforcement of awards. There are several reasons why it continues to be in the interest of states to join the Convention:

- Participants in international trade need reasonable confidence that in case of a dispute, the decision of the arbitral tribunal will be complied with. Without this confidence, it is difficult to expand trade to non-traditional markets and establish trade ties with untested partners. In addition, export credit insurers are likely to regard the non-payment risk as higher without the protection of the Convention, which adversely affects the availability of export credit insurance.
- The adoption of the Convention does not mean that the state forfeits its role in arbitration and is therefore compelled to recognise and enforce all foreign awards. The Convention offers a reasonable scope for refusing to recognise an award in cases where there has been disregard for rules relating to jurisdiction, arbitral procedure, arbitrariness, and public order of the enforcing state.
- Parties are usually more willing to accept the place of arbitration in a state that is a party to the Convention because of the international enforceability of an award.
- By adopting the Convention, the state provides a legal basis for enforcement of awards made in its territory in those contracting states that have adopted the Convention with the reciprocity reservation.
- It is usually short-sighted for a party to refuse to comply with an award since the winning party can obtain enforcement of the award on the basis of the Convention in a third state where the party in default has assets. Such enforcement is possible for many years after the award has been made.

The UNCITRAL Secretariat continues to actively promote the Convention. Recently the Secretariat, in cooperation with the International Bar Association, has been paying particular attention to the manner in which the Convention has been incorporated into the laws of the contracting states, and may propose to the Commission that a discussion be held on this matter.

### UNCITRAL Model Law on International Commercial Arbitration

The Commission adopted the Model Law in 1985, after several years of extensive preparatory work and consultations with interested parties. Legislation based on the Model Law has been enacted in many states. In other states, its provisions have influenced almost all recent national revisions of arbitration laws. It is clear that the number of enactments of the Model Law will continue to grow.\(^4\)
The main purpose of the Model Law is to assist legislators when they draft or revise national laws on arbitration. One of the many benefits of enacting the Model Law is that the legislation being introduced is already widely known and universally acceptable. When negotiating arbitration agreements, parties are increasingly conscious of the need for a modern arbitration procedural system in the country where an arbitration might take place. If the parties are not comfortable or are unfamiliar with the procedural law in that country, they are likely to avoid arbitrating there, even if that country would be most appropriate for other reasons.

Model legislation
The form of a model law was chosen because it provides flexibility to the enacting state when it incorporates the text into the national legislation. A model law allows a legislator to deviate from the model if it considers that a particular model provision is unacceptable to its legal system. By comparison, a convention may allow such flexibility only to a limited extent, by way of reservations, which in commercial law conventions are typically rather restricted.

Nevertheless, in view of the reasons for undertaking the preparation of the Model Law, and in view of the practical advantages of having a universally known and acceptable law on arbitration for a state, it is advisable not to deviate from the uniform text.

Special regime for international commercial arbitration
According to Article 1 (1), the Model Law presents a special legal regime for international commercial arbitration, as opposed to domestic arbitration. Nevertheless, there is nothing in the Model Law that would not also be suitable for domestic arbitration. Several states have enacted it for both international and domestic arbitrations.

Territorial scope of application of the Model Law
According to Article 1 (2), the Model Law (with the exception of specified articles) would apply only if the place of arbitration is in the enacting state. The Model Law does not recognise a right of parties to submit their arbitration to a procedural legal system other than that of the place of arbitration. However, the determination of the place of arbitration in the state leaves the arbitral tribunal free, unless otherwise agreed by the parties, to meet at any place it considers appropriate for consultations among its members, for hearing witnesses, experts or the parties, or for inspection of goods, other property or documents (Article 20). The combined result of these provisions is that the parties determine the procedural law governing the arbitration (and also the competence of the courts for interventions in the arbitration) by agreeing on the place of arbitration, even if in fact the proceedings take place in another country or countries. Such a concept of territorial application of the Model Law is also suited to the increasing use of electronic communications in international arbitrations.

Autonomy of the parties
An important principle of the Model Law is the freedom of the parties to agree on how an arbitration should be carried out. Typically the parties would exercise this autonomy by incorporating into their agreement a set of arbitration rules such as the UNCITRAL Arbitration Rules. The parties may also submit the case to an arbitral institution, which would normally proceed on the basis of its arbitration rules.

Minimum set of non-mandatory rules and discretion of arbitral tribunal
The parties may fail to agree on a set of arbitration rules, or the agreed rules may not give all the answers. For such cases, the Model Law contains elementary non-mandatory provisions, which ensure that the proceedings may commence and continue until the making of the award.

Subject to the agreed rules and the Law, the arbitral tribunal may conduct the arbitration in a manner it considers appropriate. This combination of the freedom of the parties, the system of non-mandatory rules, and the discretion of the arbitral tribunal makes it possible to conduct an international commercial arbitration independently from local rules governing the conduct of proceedings in a domestic arbitration. This approach is welcomed in international arbitrations, in which it would be cumbersome if the participants, often foreigners at the place of arbitration, would have to research and adhere to local rules of civil procedure or rules of evidence.

Limits to autonomy of parties and to discretion of arbitral tribunal
The Model Law provides limits to party autonomy and the discretion of the arbitral tribunal. The limits, designed to prevent abuses in arbitral proceedings, are provided in the interest of the parties and also in the interest of the state, which may be expected to enforce the award if the arbitral procedure is conducted in accordance with the principles of justice.

The general rule is contained in Article 18, according to which each party must be treated equally and be given a full opportunity to present its case. This general principle is implemented and expressed in a more specific manner in some other provisions of the Model Law.

Extent of court assistance and supervision
The state enacting the Model Law is called upon to indicate in its law the courts or courts that will be competent to perform the functions of assistance and supervision, particularly with regard to: the appointment of arbitrators; termination of an arbitrator’s mandate as a result of a challenge or of his or her failure or inability to act; court control over a decision of the arbitral tribunal on its jurisdiction; setting aside of the arbitral award; and recognition and enforcement of the award.

Waiver of right to object
During arbitral proceedings a party or the arbitral tribunal may act in a way that is contrary to the agreed arbitration rules or the non-mandatory provisions of the Model Law. If a party objects, remedial action must be taken or the award might be called into question. If, however, nobody objects, it might be uncertain as to what the consequence of the deviation from the rules is. In order to avoid any doubt, Article 4 provides that a party who knows that any non-mandatory provision of the Model Law, or any requirement under the arbitration agreement, has not been complied with, and yet proceeds with the arbitration without objecting without undue delay, is deemed to have waived its right to object. This important presumption produces effects not only during the arbitration proceedings, but also in any recourse proceedings against the award, or in recognition and enforcement proceedings.

Arbitration agreement
Article 7, which covers the form of the arbitration agreement and has been modelled on the 1958 New York Convention, contains additional provisions designed to eliminate some uncertainties noted in the application of that Convention. The additional provisions concern arbitration agreements entered into by an exchange of means of telecommunication, which provide a record of the agreement, or by an exchange of statements of claim and defence, in which the existence of an agreement is alleged by one party and not denied by another. In addition, Article 7 addresses the question of arbitration clauses in general contract conditions that may be incorporated in a written contract by reference. Currently, the Commission is preparing a model legislative provision designed to promote a liberalisation of the form requirement for arbitration agreements.
Jurisdiction of arbitral tribunal

Article 16 expresses the principle that the arbitral tribunal may rule on its own jurisdiction, including any objections with respect to the existence or validity of the arbitral agreement.

The arbitral tribunal’s decision affirming its jurisdiction is subject to court review. If such a decision is taken as a preliminary question, a party may request court review immediately, during the arbitral proceedings. If, however, the arbitral tribunal decides to rule on its jurisdiction, together with the award on the merits of the case, the ruling affirming the jurisdiction can be challenged in the recourse against the arbitral award.

Recourse against award

The Model Law establishes the setting aside of an arbitral award as the exclusive means of recourse against the award, and unifies the grounds on which an award may be set aside. The grounds for setting aside an award are essentially the same as the grounds for refusing recognition and enforcement of an award under the 1958 New York Convention.

Thus, a party objecting to the award is given a choice by the Model Law, between requesting either its setting aside at the place where the award was made, or opposing its enforcement. This dual system of defence against an award is reasonable in view of the difference in nature, effects and time frames of the two means of defence. On the one hand, the setting aside procedure is set in motion on the initiative of the losing party, and unifies the grounds on which an award may be set aside. The grounds for setting aside an award are essentially the same as the grounds for refusing recognition and enforcement of an award under the 1958 New York Convention.

The UNCITRAL Arbitration Rules

The UNCITRAL Arbitration Rules were adopted in 1976. One of the main reasons for the elaboration of the UNCITRAL Rules was to provide modern contractual rules suitable for ad hoc arbitrations, i.e., arbitrations organised by the parties themselves without the administrative assistance of an arbitral institution. Such arbitrations were often commenced without the parties having agreed on the rules of procedure, which was a source of difficulty when the participants in the arbitration had different views on how to proceed. The existence of the UNCITRAL Rules offers the possibility of avoiding such difficulties in ad hoc arbitrations.

Another reason for preparing the UNCITRAL Rules was to offer a model to arbitral institutions. With the growing number of institutions that have adopted the Rules as their single or optional institutional rules, or modelled their institutional rules on the UNCITRAL Rules, the parties have a better opportunity to combine the benefits of an administered arbitration with the benefits of a universally known and acceptable set of arbitration rules. This orientation of the UNCITRAL Rules to different types of arbitration is possible, in view of the fact that as regards the procedural role of the arbitral tribunal, there is no essential difference between an ad hoc arbitration and an arbitration administered by an institution.

The UNCITRAL Rules are among the most successful international trade law texts. They have become universally known and are widely regarded by merchants in different parts of the world as being well suited to the settlement of international commercial disputes. The UNCITRAL Rules are written in clear language using expressions that are recognisable in different legal systems. The UNCITRAL Rules have proven to be effective in arbitrations in which the participants come from states with different legal or social traditions. Indeed, negotiations for the conclusion of an arbitration agreement are often short and simple if the rules agreed upon are the UNCITRAL Rules.

In view of the international standing enjoyed by the UNCITRAL Rules, it is advisable for arbitral institutions to offer to administer cases governed by the UNCITRAL Rules or to adopt the Rules, with necessary adaptations, as the rules of the institution.

The UNCITRAL Rules, as is the case with any contractual rules, function against the background of the law applicable to the arbitral procedure. That law will be the law in force at the place of arbitration. To the extent that law is mandatory, it will prevail over the Rules. If it is non-mandatory, the Rules will override the law because the parties agree to them.

The UNCITRAL Rules generally exclude the obligation to follow the non-mandatory provisions of law governing the conduct of the arbitral proceedings. This is expressed by Article 15 (1):

“Subject to these Rules, the arbitral tribunal may conduct the arbitration in such manner as it considers appropriate, provided that the parties are treated with equality and that at any stage of the proceedings each party is given a full opportunity of presenting his case.”

However, the formulation of Article 15 (1) also indicates the limits of the discretionary right of the arbitral tribunal to “conduct the arbitration in such manner as it considers appropriate”. The limit is defined by the introductory phrase: “Subject to these Rules”, which means that the arbitral tribunal’s discretion does not extend to questions that are settled in the Rules. If the tribunal considers that it would be appropriate to deviate from a provision of the Rules, it may suggest to the parties to agree to a modification of the Rules.

The principle of independence of the arbitral procedure from non-mandatory law on the conduct of proceedings has a significant practical value in international commercial arbitration. In such arbitrations, it is not uncommon that some or all participants are unfamiliar with all aspects of the law of the place of arbitration. It is important that such participants, who often do not know the language of the applicable law, are not obliged to undertake extensive research on the local law.

UNCITRAL Notes on Organizing Arbitral Proceedings

In discussing legislative and contractual arbitration regimes, it is useful to mention the UNCITRAL Notes on Organizing Arbitral Proceedings, a text that is neither legislation nor contract. The aim of the Notes, adopted in 1996,
is to give arbitration practitioners an aide-mémoire, or a checklist, for organising and planning arbitral proceedings.

In the introduction to the Notes, it is stressed that the text is in no way binding on the arbitrators or the parties. The expression “notes” (“aide-mémoire” in French) is used in the title in order to reflect its non-binding nature. If anyone decides to refer to the Notes, this leaves the discretion of the arbitrators and the autonomy of the parties unfettered. The Notes are a source of ideas, and practitioners remain free to adapt those ideas to the proceedings at hand. Thus, the text may be used in the context of any type of arbitration – an arbitration administered by an arbitral institution or the so-called ad hoc arbitration – and irrespective of the type of arbitration rules governing the proceedings.

Many arbitrators have developed their own personal methods for organising arbitral proceedings based on their individual experience, including personal checklists or notes. Experienced counsel also tend to follow procedural patterns that they are used to. Some practitioners have a tendency to model their actions in arbitral proceedings on procedures and habits used in courts, while others tend to adopt eclectic procedural styles, depending on their own view as to which procedures are most effective in arbitration.

To some extent the tendency to use principles of court procedures in arbitration is understandable, because the ultimate purpose (a binding resolution of the dispute) and the basic procedural principles in both types of proceedings are the same. However, arbitration procedures may be shaped more freely and are therefore better adapted to the circumstances of the case. This flexibility of arbitral procedures is possible because of the absence of detailed legislative regulation of arbitration, and is one of the reasons for the appeal of arbitration in international trade. Nevertheless, the inspiration that arbitration practitioners draw from methods used in court proceedings remains considerable.

The preferred procedural styles in international arbitration differ widely, and often depend on the experience and legal backgrounds of arbitrators. This makes it advisable for the arbitral tribunal to make sure that all participants understand how the proceedings will be conducted, and that they are able to prepare themselves accordingly for the various stages of the proceedings. If the parties are surprised by the manner in which the proceedings are conducted, or are unprepared because they have not received sufficient guidance from the arbitral tribunal, the quality of the proceedings is bound to suffer and there will be delays and extra costs. By organising the proceedings sensibly, such difficulties may be avoided or reduced. It is in this important organisational and explanatory work of the arbitral tribunal that the Notes are helpful.

An important principle underlying the Notes is that they do not seek to unify different arbitration practices or methods or give value judgements about them. The text is also not meant to be a manual on how to conduct an arbitration. The Notes are limited to a brief list with annotations of procedural matters that may come up during arbitral proceedings and on which the arbitral tribunal may wish to take appropriately timed decisions.

**UNCITRAL Conciliation Rules**

The consideration of the texts governing arbitration would not be complete without mentioning conciliation as a complementary method of settlement of commercial disputes. The term “conciliation” is used here broadly to refer to various proceedings in which a person assists the parties in dispute in an impartial manner in their attempt to reach an amicable settlement. Conciliation differs from negotiations between the parties in dispute, in that conciliation involves impartial assistance from a third party to settle the dispute. The difference between conciliation and arbitration is that a conciliation ends either in a settlement of the dispute or it ends unsuccessfully; in arbitration the arbitral tribunal imposes a binding decision on the parties. In addition to “conciliation”, other terms are used in practice for such proceedings, including “mediation” and “neutral evaluation”. These terms are often used interchangeably without an apparent difference in meaning.

Conciliation is increasingly used in the commercial world, because in many circumstances it is seen as a promising alternative to arbitration. It is cheaper, less time consuming, free of formalities and, if it ends successfully with a settlement, the result is preferable to a binding arbitral decision.

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1. UNCITRAL was established in 1966 by the UN General Assembly to promote the harmonisation and modernisation of the law of international trade. It is a universal organisation with 36 state members from diverse geographic, economic and political areas. Legal texts elaborated by the Commission may take the form, for example, of a convention, model law, model normative rule, recommendation to the legislators or contract parties, model contract clause or legal guide. All UNCITRAL texts and preparatory materials are available in the six languages of the United Nations (Arabic, Chinese, English, French, Russian and Spanish). The International Trade Law Branch functions as the substantive secretariat of the Commission.

2. The UNCITRAL Working Group on Arbitration is preparing model legislative provisions on the requirement of written form for arbitration agreements, the enforceability of interim measures of protection ordered by an arbitral tribunal, and the settlement of commercial disputes by conciliation/mediation. Current information on this work may be obtained for the UNCITRAL Secretariat or at www.uncitral.org under “Working Groups” (document A/CN.9/487 of June 2001).

3. Recognition and enforcement of both foreign and domestic awards made in international commercial cases are covered by the 1985 UNCITRAL Model Law.

4. Legislation based on the Model Law has been enacted in Australia, Bahrain, Belarus, Bermuda, Bulgaria, Canada, Cyprus, Egypt, Germany, Greece, Guatemala, Hong Kong Special Administrative Region of China, Hungary, India, Iran (Islamic Republic of), Ireland, Kenya, Lithuania, Macau Special Administrative Region of China, Madagascar, Malta, Mexico, New Zealand, Nigeria, Oman, Peru, Republic of Korea, Russia, Singapore, Sri Lanka, Tunisia, Ukraine, Zimbabwe, within the United Kingdom of Great Britain and Northern Ireland: Scotland; within the United States of America: California, Connecticut, Oregon and Texas.

5. See supra note 3.

6. See supra note 3.

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Conciliation may be a useful method where the disagreement is partly due to a deficient or incomplete contract. In such a case, both parties may feel that a more precise contract would eliminate the difficulty, but at the same time they may not be able to agree on how to amend the contract. In this case, the contract may not yet have been breached and even if it had been breached, the best solution for the case often requires a future-oriented decision on the modification of the contract, in addition to any monetary damages payable as a result of the breach of the contract.

Arbitration proceedings may not be appropriate for this type of modification of the contract because arbitrators tend to limit their role to the claim arising from a breach of contract. Arbitrators are reluctant to conduct discussions on future relations between the parties, even if according to the applicable law it would be possible to empower them to assume such a role. Moreover, the applicable law may not allow the arbitrators to determine a contract term even if both parties wish them to do so, or the applicable law may be unclear on the point, which may make the nature and status of such an arbitration legally uncertain.

When conciliation seems like an appropriate method to deal with a dispute, a growing number of institutions are prepared to assist in the organisation of the process. In many instances, the rules of those institutions have been modelled on or influenced by the UNCITRAL Conciliation Rules (1980). These Rules, which present a modern conciliation regime suitable for resolving international commercial disputes, may also be agreed upon by the parties directly, particularly when they wish to organise the conciliation proceedings themselves.

An important characteristic of the Conciliation Rules is contained in the provisions directing the conciliator to be independent from the parties, and to be active in the conduct of the proceedings. Such provisions emphasise the difference between conciliation and negotiations between the parties and their representatives, which normally take place in connection with a dispute.

Several provisions are designed to deal with potential apprehension that proposals, concessions, submissions of evidence, or similar statements by a party during a conciliation that failed, might be used against that party in subsequent court or arbitral proceedings.

According to Article 19, the parties and the conciliator undertake that the conciliator will not act as an arbitrator or as a representative or counsel of a party in any arbitral or judicial proceedings in respect of a dispute that is the subject of the conciliation proceedings. The parties also undertake that they will not present the conciliator as a witness in any such proceedings.

According to Article 20, each party undertakes not to rely on or introduce as evidence in arbitral or judicial proceedings: (a) views expressed or suggestions made by the other party in respect of a possible settlement of the dispute; (b) admissions made by the other party in the course of the conciliation proceedings; (c) proposals made by the conciliator; (d) the fact that the other party had indicated its willingness to accept a proposal for settlement made by the conciliator. The scope and effect of Article 20 is broadened by the rule that the parties’ decision not to rely on this type of evidence applies whether or not the court or arbitral proceedings relate to the dispute that is the subject of the conciliation proceedings.

It is of practical importance that the Conciliation Rules leave the parties free to conduct the proceedings in an informal, flexible and pragmatic manner. The Rules outline only essential features of the proceedings and leave the parties and the conciliator free to adapt the other aspects of the proceedings to the circumstances of the case.

The pragmatism of the UNCITRAL Conciliation Rules is reflected, for example, in the provision that allows the conciliator to meet or communicate separately with a party. It is also reflected in the provision according to which the arbitrator, when a party gives information to the conciliator subject to a specific condition that it be kept confidential, does not disclose that information to the other party.

Conclusion

Participants in international trade are becoming increasingly conscious of the quality of procedural regimes for the settlement of commercial disputes. They are willing to engage in dispute settlement proceedings in a particular country only if they are confident that the applicable regime is well suited to international cases, and is easily understood by the participants. As the transition countries integrate more fully into the international economy, they will need to ensure that they have created such a procedural regime. UNCITRAL has prepared several texts that may be used in constructing an acceptable regime.

A well functioning system of settlement of commercial disputes requires legislative texts suited to the needs of international arbitration. A universally acknowledged and accepted regime is contained in the UNCITRAL Model Law on International Commercial Arbitration and the 1958 Convention on the Recognition and Enforcement of Foreign Arbitral Awards. In addition to relying on legislation, it is highly advisable for the parties to agree on a set of arbitration rules to increase the predictability of the arbitral process. The parties may choose rules of an arbitral institution, or may decide to organise the proceedings themselves, in which case the UNCITRAL Arbitration Rules are an excellent choice. These Rules are among the most successful instruments not only in the area of arbitration, but also in the entire field of trade law. They have fostered good arbitration practices, contributed to a more uniform understanding of arbitral procedures and are proven to function well between parties from different legal traditions. In carrying out arbitral proceedings, irrespective of the law governing the proceedings and regardless of the arbitration rules chosen by the parties, the arbitrators and the parties may wish to use the UNCITRAL Notes on Organizing Arbitral Proceedings as a checklist in preparing the arbitral process.

Increasingly, conciliation (or mediation) is used in settling international commercial disputes. Such proceedings are likely to be more effective and efficient if the process is clear and the rules are agreed upon from the outset. Such rules may be the rules of an arbitral institution, many of which have been inspired by or modelled on the UNCITRAL Conciliation Rules. If the parties organise the proceedings themselves, the UNCITRAL Conciliation Rules provide a useful, proven and widely acceptable text to agree upon.

Currently, the UNCITRAL Working Group on Arbitration is preparing a model law on the settlement of commercial disputes by conciliation or mediation. Another current project concerns provisions presenting more modern and liberal solutions regarding the requirement of written form for arbitration agreements. A further project is to prepare model legislative provisions on the enforceability of interim measures of protection ordered by an arbitral tribunal. As a result, all countries, including the transition countries of central and eastern Europe and the CIS, will need to continue to review and improve their legal framework for promoting the settlement of commercial disputes.

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Why arbitration institutions matter

Over the last two decades arbitration has gradually superseded litigation as the preferred dispute resolution mechanism in international commercial contracts. Enforceability, party-control, neutrality, privacy and confidentiality, cost effectiveness and speed are often cited as the main advantages of arbitration. In this article, the author examines the crucial role played by arbitration institutions in arbitration proceedings, and how they safeguard the advantages associated with arbitration.
There is little doubt that arbitration is now the first-choice method of binding dispute resolution in the widest range of international commercial contracts, having largely taken over litigation.

In a nutshell, the reason for the significant growth in the use of arbitration is that it offers contracting parties the freedom to choose a method of private dispute resolution tailored to their particular needs. This freedom extends to the choice of applicable law, the venue, the language, and the choice of arbitration procedures, whether under institutional rules, stand-alone procedures, like the UNCITRAL rules, or entirely ad hoc.

Parties may also choose their arbitrators, thus ensuring the constitution of a tribunal with precisely the right qualifications and experience.

This article looks at the place of the arbitration institutions in the ever-more sophisticated field of international commercial arbitration, where ad hoc procedures may, at first sight, appear an increasingly appealing option. The author argues that abandoning the administering body is at best a false economy and at worst may jeopardise the process itself.

Why arbitral institutions matter

As arbitration becomes the norm, so parties to commercial contracts and their legal advisers become more familiar with arbitral procedures, and more confident in the process. In these circumstances, it is sometimes asked why parties should bother with administered arbitration at all, when: there are effective arbitration laws in place in the jurisdictions of most, if not all, of the important trading regions of the world; when there are good stand-alone procedures, like the UNCITRAL rules; and when there is a body of highly experienced arbitrators, whose identities and qualifications may already be known to parties in dispute and/or to their legal advisers.

Yet the major international arbitration institutions, such as the International Chamber of Commerce (ICC), the American Association of Arbitration (AAA), LCIA and the Arbitration Institute of the Stockholm Chamber of Commerce, continue to see a steady growth in their casework.

Reasons why administered arbitration is more relevant than ever are best given in the context of the most often cited underpinnings of international commercial arbitration - enforceability, party-control, neutrality, privacy and confidentiality, cost-effectiveness and speed.

Enforcement of awards

For the many parties for whom a final and binding settlement is paramount, the enforcement argument is, perhaps, the most persuasive and enduring.

In the event that a losing party fails to comply with an award against it, enforcement may be considerably easier to achieve than the enforcement of a judgement of a national court in another jurisdiction would be. In the majority of cases, the successful party will be able to rely on the provisions of the New York Convention, now ratified or acceded to by some 120 states.

Parties wishing to have the reassurance that an award will be enforceable must, of course, ensure that the arbitration takes place (and that the award is made) in a Convention State, and that the enforcement is against assets of the losing party which are located in another Convention State.

Where the institution counts

There is no reason why the use of institutional rules, and the use of the administrative services of an institution, should in any way undermine the parties’ control over the process. On the contrary, most institutional rules are drafted to provide an extremely effective framework for the proceedings, while expressly encouraging the parties to agree on the specific steps and the timetable themselves.

Ad hoc clauses are frequently either inadequate or overly complex. In comparison, the incorporation of institutional rules by a simple standard clause takes care of the fundamentals and does so without recourse to the national courts. By incorporating institutional rules into their contract, parties have the comfort of a comprehensive and proven set of terms and conditions upon which they can rely, regardless of the seat of the arbitration. This minimises the scope for uncertainty and the opportunity for delaying or wrecking tactics that amount not to the legitimate exercise of party control but rather to an abuse of the process.

The incorporation of a set of established rules will take care of the essential steps, including: the mechanism and timeframe for the appointment of the tribunal; determining challenges to arbitrators; default provisions for the seat and language of the arbitration; interim and conservatory measures; and control of the costs of the arbitration.
This article looks at the place of the arbitration institutions in the ever-more sophisticated field of international commercial arbitration, where ad hoc procedures may, at first sight, appear an increasingly appealing option.

Though the procedural law applicable at the seat of the arbitration may also provide for these matters, it can be cumbersome, time-consuming and costly to invoke the jurisdiction of national courts at every procedural impasse. Court intervention may also jeopardise the confidentiality of the process.

**Party-nominated arbitrators**

With arbitration, parties are in the position of being able to choose the judges who will determine their dispute.

Where they say so in their contracts, or subsequently agree, each side may nominate an arbitrator to be one of a panel of three. Where no institution is involved, the third and presiding arbitrator will be nominated by the parties, or by the party-nominated arbitrators.

Each side may satisfy itself that the arbitrator it nominates has the requisite experience and knowledge in the field relating to the dispute which has arisen. An arbitrator may also be nominated because of his or her knowledge of a particular national or state law and/or of a language pertinent to the dispute.

Similarly, it may be expressly provided, or agreed by the parties, that arbitrators should not be of the same nationality as the parties, and/or that if two are, then the chairperson will not be.

Where the institution counts

Despite greater experience and understanding of the process among users, the selection of arbitrators can lead to considerable difficulties where there is no institution to assist. For example, many parties lack detailed information about suitably qualified arbitrators. The institutions’ information will invariably be more complete and comprehensive than that of individual parties, and institutions will frequently be willing to put forward a number of names for the parties’ consideration, where the arbitration clause provides for party nomination.

Parties may also be tempted to seek to have appointed someone who will be, if not an advocate for their cause, at least predisposed towards their point of view. This flies in the face of the principle of impartiality and the independence of arbitrators. The rules and practices of the major institutions minimise the risk of any such bias.

The so-called “Dutco problem” can also cause considerable difficulties, where multiple parties cannot be clearly divided into two sides in the dispute. Though joint claimants identify themselves as one side in submitting a single request for arbitration, joint respondents may deny that they have commonality of interest and object to having to nominate jointly one arbitrator. Careful drafting is required at the transactional stage of multi-party contracts if this potential problem is to be avoided. The major institutions have sought to address this problem in their rules by providing that, in the event of any such difficulty, the institution will select all three arbitrators, without regard to a party’s nomination.

In short, parties have an important role in the selection of arbitrators, but it is a responsibility to be exercised with due care. Most institutions reserve the right not to appoint a party nominee if he or she is considered not to be suitable or impartial or independent.

The institutions have detailed knowledge of, and ready access to, the most eminent and appropriately qualified arbitrators. The LCIA, for example, operates a database of some 600 arbitrators, mediators and experts from many different jurisdictions, possessing the widest range of legal and non-legal experience and expertise. The database is not, however, a closed list and parties are free to nominate arbitrators who are not on the database. Similarly, the LCIA will look outside its own database when necessary. In all cases, the LCIA court alone may appoint arbitrators, whether or not the parties nominate the arbitrators.

Institutions also actively keep abreast of developments and individual progress within the pool of arbitrators and have tried and tested procedures for checking conflicts and availability, and for agreeing tribunals’ fee rates.

**Neutrality**

Parties to international agreements may be concerned that the national courts of the party with which they are contracting may have an instinctive, or even a manifest, bias towards a party of the same nationality. Whether or not such concerns are well founded, arbitration may be seen as offering greater neutrality than the courts.
Contracts are generally expressed to be governed by the substantive law of the jurisdiction of one of the parties. An arbitration venue in a third country, with which neither party has links and which might be considered by the other to be influential, will provide a neutral environment within which to resolve disputes.

Similarly, if the chosen venue is located within the country of one of the parties, the different nationalities of the arbitrators may remove any perceived bias.

Where the institution counts
Neutrality can be most effectively reinforced by subscribing to the rules of an independent international arbitration institution which requires all arbitrators to sign declarations of independence and impartiality, and which exclude any potential bias which may arise from the common nationality of party and arbitrator. In many cases there is not a balance of knowledge, experience, expertise and sophistication in the arbitral process, either on the part of the parties or their attorneys. The major institutions, not only through their rules but also in their ethos and modus operandi, are wholly focused on the fairness and neutrality of the arbitral proceedings. Institutional rules can therefore act effectively to safeguard due process, the quality and enforceability of awards, and the reputation of the arbitral process.

Privacy and confidentiality
Litigation in national courts is generally open to the public and to the media. In contrast, arbitral proceedings are conducted in private so that the identities of the parties and of the tribunal, and the nature of the dispute, should remain confidential. This confidentiality may assist to preserve trade secrets and, in some cases, even to re-build commercial relations. Due to the private and confidential nature of arbitration, proceedings are conducted in a less formal atmosphere than is generally the case in the courts. This provides an environment that may be more conducive to reaching a settlement.

Where the institution counts
Most institutions are well equipped to assist the parties and the tribunals to maintain these key elements of the process. This extends from the discretion of their case-handlers, through the observation maintained to safeguard confidentiality, to such practical assistance as the provision of private hearing rooms and support facilities.

The LCIA has, at Article 30 of its rules, an express provision that the parties and the tribunal are bound to keep the proceedings, the deliberations and all materials created for the arbitration, confidential. This provision is unique among the major arbitration institutions.

Cost-effectiveness and speed
Despite claims to the contrary by some proponents of litigation, there is a strong case for international arbitration as the cost-effective alternative to litigation across different jurisdictions, particularly when costs are considered within the proper framework of cost/benefit analysis.

It may be easier to get parties of different nationalities into a neutral arbitration venue at the outset rather than into the national courts of one of them. Therefore, the costs of initiating proceedings, and of preparing the case, are less likely to be wasted than they would be in court litigation.

Crucially, at the end of the proceedings (assuming no settlement), an award may be more likely to be complied with or enforced than would be the award of the courts of one jurisdiction in the courts of another. So, the successful party to arbitration is less likely to experience the hollow victory that often besets international litigation.

The issuing of a final award is most likely to be the conclusion of the proceedings, in contrast to the judgement of a court of first instance, from which there may be several levels of appeal, each involving considerable legal costs and making unwelcome demands on the parties’ management time.

Time is money (though undue haste may be more costly in the long run) and the inherent flexibility and party control of arbitration enables parties and tribunals to adopt as tight a procedural timetable as they wish, with potentially substantial cost savings.

Where the institution counts
An established institution provides a professional and cost-effective administrative service, which an ad hoc tribunal, with or without the cooperation of the parties, frequently cannot ensure.

Ad hoc arbitrations do not run themselves. If the task is allocated to a member of the arbitrator’s own staff, to members of the parties’ legal teams, or to the parties themselves, there will be considerable direct and indirect cost incurred, and rarely will the job be done as well as it would be by specialists.

The institutions encourage parties to adopt as expeditious an approach as possible, and many of the institutional rules include all that is required for “fast-track” procedures, which can dispose of a matter in a fraction of the time that would be spent in litigation.

A significant number of arbitrations are commenced with a view to forcing or crystallising settlement discussions, and/or to “testing the water”. With the backing of an institution, that objective may be achieved more easily and less expensively than by taking the ad hoc route, with its associated vagaries. A request for arbitration need only be a brief submission, which, together with the registration fee, is all that is formally required by the institution to set the proceedings in motion.

While it is not the role of an institution to interfere with the conduct of the proceedings (as agreed between the parties, directed by the tribunal or prescribed by the rules), institutions do have an important role in monitoring the process, in lending support to parties, counsel and arbitrators, and in keeping the process moving.

Even the most experienced of arbitrators frequently turns to the institutions for guidance and support. Equally, parties may be hesitant to prompt their tribunals if they feel that matters are not proceeding quickly or smoothly enough. Institutions will do so on their behalf. A good Secretariat will also provide a valuable sounding board on procedural matters.

There is also anecdotal evidence that the conduct of ad hoc arbitrations in certain jurisdictions may be more likely to mimic local litigation procedures than institutional arbitration, with all the ponderous, complex and costly procedures that a well-run institutional arbitration will avoid.

The rules of the major institutions seek to combine the best of civil and common law procedures, and to provide a framework for fast and cost-effective dispute resolution wholly independent of the culture and procedures of court litigation.

An institution will have in place a framework of charges, both for its own administrative services and for its arbitrators, and will monitor the costs as the proceedings progress. Contracting parties will want to consider the different charging policies of the institutions when drafting their arbitration clauses. Some institutions, like the ICC, charge for their own administrative services and for their tribunals’ fees on an ad valorem basis, related to the sums in issue. Others, like the LCIA, charge hourly and daily rates.

The major institutions also act as secure and independent fundholders of sums deposited by the parties, disbursing these funds as required and, at all times, accounting to the parties for sums held and disbursed.
Other services

UNCITRAL

Users and their counsel should look beyond the primary function of the arbitration institutions in administering cases under their own rules. For example, a number of institutions will act as appointing authority under ad hoc procedures, such as the UNCITRAL arbitration rules, which are frequently chosen by parties who do not wish to opt for the rules of any specific institution. The Secretary-General of the Permanent Court of Arbitration in The Hague may designate the institution as the appointing authority, upon the application of a party. Alternatively, parties may provide in their contract for an appointing role for the institution.

In such cases, parties will have the benefit of: the institution’s experience in selecting the members of the tribunal; an established body to decide any challenge to an arbitrator; and the guidelines of the institution’s schedule of fees.

Many of the recognised international institutions will only act as appointing authority under the UNCITRAL rules. Some will also act as administrator, with all the advantages for the parties that have been set out earlier in this article.

Scheme-specific procedures

While most recognised institutional arbitration rules are considered to be universally applicable, parties to certain major multiparty contracts or schemes may prefer to put in place contract or scheme-specific dispute resolution procedures. Again, parties will wish to consider the desirability of an appointing and/or administering body for such procedures.

Institutions may also be prepared to take on other tailor-made dispute-resolution services. Examples of this include: where an appointing authority is required where there is provision for expert determination of a dispute; for the appointment of an adjudicator; or for the establishment of a standing dispute-review panel.

Mediation

Many of the major arbitration institutions, including ICC, AAA and LCIA, also offer other forms of alternative dispute resolution (ADR), including mediation, and bringing to these additional services all the professionalism and expertise for which their arbitration services are renowned.

Mediation procedures may be used both by parties who are already committed to mediate, by virtue of contractual dispute resolution provisions, and by parties who have not provided for mediation, but who wish to mediate their dispute, either during the course of, or in an attempt to avoid, litigation or arbitration.

Permanent information service

Finally, subscribing to the services of an arbitral institution, whether or not those services are ever employed “in anger”, brings to parties and their legal advisers, to academics, and to the next generation of practitioners, an invaluable and permanent source of information and assistance, be it for theoretical or for practical purposes.

In summary, the major, internationally recognised institutions have an increasingly important role to play, not only in providing effective frameworks and professional administration for arbitration and other forms of ADR, but also in the further development of arbitration and ADR techniques.

5 See, for example, Articles 5.2, 5.3 and 6 of the LCIA Rules, or Articles 9.1, 9.2 and 9.5 of the ICC Rules.
6 See, in particular, Article 6.2(a) of the UNCITRAL Rules.
7 See Article 12.1(a) of the UNCITRAL Rules.
8 See Article 39.2 of the UNCITRAL Rules.

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Public private partnerships between states and international investors play a growing role in economic development. Yet when entering into an agreement with a state (or a subdivision or agency of a state), international investors may be reluctant to submit any disputes that arise under the agreement to the courts of the state. Likewise, states may resist the jurisdiction of foreign courts or arbitral tribunals sitting outside of their jurisdiction. Recognising the need to create an independent and impartial dispute resolution forum for cross-border public private partnerships, the International Bank for Reconstruction and Development sponsored the establishment of the International Centre for Settlement of Investment Disputes (ICSID) to address these issues. In this article, the author examines ICSID’s increasing role and its evolving jurisprudence.
Investment treaties and the use of arbitration

There have been tremendous increases in foreign investment since 1990, both within and outside the countries of central and eastern Europe and the Commonwealth of Independent States (CIS). In this period, annual global flows of direct foreign investment alone have grown from around US$ 200 billion to well over US$ 1 trillion. This growth of foreign investment flows has been accompanied by equally spectacular increases in the number of investment treaties. By the end of 1990, only approximately 400 bilateral investment treaties (BITs) had been concluded worldwide. Today there are roughly 2,000 BITs. About 170 countries have signed one or more of these treaties. Central and eastern Europe and the CIS alone account for approximately 650 of these treaties. Over the past decade, several regional multilateral treaties dealing with investment have also been concluded. These notably include the North American Free Trade Agreement (NAFTA) and the Energy Charter Treaty (ECT).

The provisions of the bilateral treaties, and the investment provisions of the above-mentioned multilateral treaties, are for the most part similar in form and content. Under some of the BITs and the NAFTA, each state grants certain rights of entry to investments from the other state or states involved. Most of the treaties, however, are principally concerned only with the treatment of investments following their admission. These provisions have been referred to as “full protection and security” in the host state.

More particular matters dealt with by the BITs and multilateral treaties include expropriation. The provisions on this topic normally address both outright and indirect or “creeping” expropriation. A typical treaty provision on the subject provides that covered investments “shall not be expropriated or nationalised either directly or indirectly through measures tantamount to expropriation or nationalisation ... except for a public purpose; in a non-discriminatory manner; upon payment of prompt, adequate and effective compensation; and in accordance with due process of law.” Currency transfers are another matter usually dealt with by the treaties. In this respect, most of the treaties provide that each state shall guarantee investors of the other state or states the “free transfer” of their investments and returns. The ECT and many BITs also have provisions on the observance by the state of undertakings related to covered investments. In these provisions, each state confirms that it will “observe any obligation” that it may have entered into with respect to such investments.

Almost all of the investment treaties furthermore provide for the arbitral settlement of disputes that might arise between a state party to the treaty and an investor from the other, or another, state party. In the overwhelming majority of the treaties, the provisions set forth the consent of each state to the submission of such disputes to one or more forms of arbitration specified in the treaty. In the event of a dispute with the state, the investor concerned may resort to the appropriate form of arbitration on the basis of the state’s consent in the treaty. In most of the treaties, including the NAFTA and ECT, there are consents to one or both of the forms of arbitration administered by the ICSID. These are arbitration under the 1965 ICSID Convention and arbitration under the 1978 ICSID Additional Facility Rules.

ICSIID’s growing caseload

The creation of this vast network of treaties with such consents has had a dramatic impact on the caseload of ICSID, particularly in the last few years. Since 1998, ICSID has been registering arbitration cases at the rate of one new case a month. Three-quarters of the new cases have been brought to the Centre by investors relying for the consent of the host state on the investor-to-state dispute-settlement provisions of one or more of its investment treaties. Altogether, 41 cases have been submitted to arbitration under the ICSID Convention or the ICSID Additional Facility Rules on this basis. In one of these cases, the investor invoked the dispute-settlement provisions of both a BIT and the ECT. The other cases involved only one of the treaties. In eight of them, the treaty concerned was the NAFTA, and in 32 it was a BIT.

1 This article is based on a presentation made by the author at the International Federation of Commercial Arbitration Institutions 6th Biennial Dispute Resolution Conference in Prague, 22 June 2001.
2 ICSID was established pursuant to the Convention on the Settlement of Investment Disputes between States and Nationals of Other States of 18 December 1965. On 14 October 1966, 30 days after the deposit with the International Bank for Reconstruction and Development of the twelfth instrument of ratification, the Convention entered into force.
7 The texts of bilateral investment treaties are published or forthcoming in ICSID, Investment Promotion and Protection Treaties (looseleaf, 1983).
8 Many BITs, as well as NAFTA and ECT, also refer to arbitration under the UNCTRAL Arbitration Rules. See NAFTA, supra note 3, Article 1120(1)(c) and ECT, Article 26(4)(b). The ECT refers, in addition, to arbitration under the Rules of the Arbitration Institute of the Stockholm Chamber of Commerce. See ECT, supra note 3, Article 26(4)(c). Some BITs also, or instead, mention arbitration under the ICC Arbitration Rules. See, for example, Agreement on Promotion and Protection of Investments, Algea – Spain, Article 11(2) (23 December 1994).
States in major regions of the world have been parties to these ICSID proceedings initiated under investment treaties. The activity has, however, been higher in some regions than in others. Two-fifths of the investment treaty cases have had Latin American countries as respondents. The next largest group of states parties to the cases have been countries in central and eastern Europe or the CIS. Of the 32 BIT disputes, seven involved a country from central and eastern Europe or the CIS. It might be noted that, while it was not a BIT case, in Tradex Hellas S. A. v. Albania, the EBRD hosted the hearing on the merits in the first ICSID arbitration proceeding to involve one of the EBRD’s countries of operations. In late 1998, the EBRD provided the facilities for the hearing at its premises in London. Although it was not itself in any way connected with the dispute or its formal resolution, the EBRD indicated at the time that it wished to support ICSID in this way in order to signal to the EBRD’s recipient countries its encouragement of international arbitration as an appropriate method of resolving cross-border disputes.

In the majority of the cases, the home states of the investors (that is, the other parties to the treaties concerned) have been members of the Organisation for Economic Cooperation and Development. Reflecting the great number and reciprocal nature of the investment treaties, however, the claimant investors have also included nationals of developing and transition countries, and the respondent states have also included industrial countries.

The investments underlying the cases brought to ICSID under the investment treaties have included equity contributions, concession agreements and various other contractual forms of investment in virtually all economic sectors. In many of the cases, the investments have been in newly privatised utilities. The disputes often have related to measures of sub-national entities, such as provinces, for which the investor seeks to hold the state responsible. In some of the cases, the disputes have been precipitated by ostensibly environmental or other regulatory measures. The complaints of the investors in three of the cases, including two of the NAFTA cases, have been directed at decisions of courts in the host state. Two of the other cases have concerned losses occasioned by civil strife in the host state.

In all of the cases submitted to ICSID pursuant to the investor-to-state dispute-settlement provisions of investment treaties, the investors have alleged violations by their host states of the substantive provisions of the treaties, even though most of the treaties also allow claims to be made on other grounds. The investors have in each case invoked one or more of the general treatment provisions of the treaties – the provisions calling for “full protection and security” and treatment that is “fair and equitable” and “no less favourable” than that granted to investors of other nationalities. The protection of the treaties against measures tantamount to expropriation have also been relied upon by the claimant investors in most of the cases. In some of the cases, the investors have, in addition, cited in support of their claims the provisions of the treaties on the “observance of undertakings”. The amounts in dispute in the cases have totalled some US$ 4 billion.

**ICSID’s evolving jurisprudence**

Of the 41 arbitration proceedings that have so far been initiated under the ICSID Convention or Additional Facility Rules on the basis of consents in investment treaties, nine have been concluded with settlements agreed by the parties. In two further cases, the tribunals rendered awards declining jurisdiction over the disputes. There were awards on the merits in an additional eight of the cases. One of these awards has, however, been partially set aside and annulment proceedings under the ICSID Convention are pending in respect of two more of the awards on the merits. The claims of the investors were completely dismissed by one of the five remaining awards on the merits. The four others granted the claimants compensation averaging 10 per cent of the amounts claimed.

The five above-mentioned remaining awards on the merits have all been published. Although none of these awards pertains to countries in central and eastern Europe or the CIS, they have helped to elucidate some of the substantive standards of treatment contained in the investment treaties, including those concluded by central and eastern European and CIS countries. The first of these awards was rendered in June 1990, in Asian Agricultural Products Limited v. Sri Lanka. This was the first case brought to ICSID under a BIT. The award dealt with the standard of “full protection and security” set forth in the BIT. This was equated by the award with the standard of “due diligence” of customary international law. The award rejected the argument of the claimant that the “full protection and security” provision of the treaty instead imposed on the host state strict or absolute liability for harm suffered by covered investments. In addition, the tribunal in the Asian Agricultural Products case declined to grant compensation in respect of future profits of the investment enterprise as it had never been an ongoing concern “enjoying a proven future profitability”.

The second of the five above-mentioned awards on the merits was made in February 1997 in American Manufacturing & Trading, Inc. v. Democratic Republic of the Congo, an arbitration also initiated under a BIT. The BIT in that particular case provided for “protection and security ... not less than that recognised by international law”. In its award, the tribunal reaffirmed that the relevant standard of international law was one of “vigilance and care” on the part of the host state. The third award was rendered in March 1998 in Fedex N.V. v. Venezuela, which was another BIT case. In an apparent reference to the “observance of undertakings” provisions that the BIT contained, the award remarked that the state had, under the BIT, “to honour the specific payments established in the promissory notes” concerned. The fourth award was the November 1999 award in Robert Azizian and Others v. Mexico. This was the first award on the merits made in a NAFTA investor-to-state arbitration. It rejected an expropriation claim based on the invalidation of a contract by an administrative act upheld by competent local courts in circumstances not involving a denial of justice or bad faith. The fifth award was made in November 2000, in another BIT case, Emilio Augustín Maffezini v. Spain. The award in that case held that the “fair and equitable” treatment standard of the BIT had been violated by a lack of transparency in the imposition of certain charges on the investor.

Proceedings are pending in 22 further cases submitted to ICSID under investment treaties. Six of these further cases have been initiated under the NAFTA and 16 under BITs (with the ECT also being relied upon in one of the latter cases). In due course, therefore, there should be a considerably larger ICSID jurisprudence on the substantive provisions of the investment treaties.
Conclusion

Several prominent non-governmental organisations have questioned the wisdom of the investor-to-state dispute-settlement provisions of the investment treaties. They have expressed the concern that the provisions may be too readily deployed to undermine measures taken for such purposes as protecting the environment and public health. But it may be too soon to draw such conclusions. As indicated above, only a few of the cases have been definitively disposed of, and most of them are still pending.

The investor-to-state arbitral process has also been criticised for lacking transparency in that written and oral phases of proceedings take place away from the public eye, without the opportunity for concerned citizens to make submissions to the tribunals. Arbitration proceedings under the ICSID Convention and Additional Facility, however, receive publicity through the Centre’s case registers, newsletter and annual reports. The Centre publishes the awards as soon as it obtains the required consent of the parties for such publication.11 There appears, moreover, to be no instance of an investor-to-state arbitral tribunal holding that it cannot entertain “friends of the court” briefs. On the contrary, it appears that the tribunals may already have the authority to receive such briefs.12 A further opening of the process, to allow for example for public hearings, may be done with the consent of the parties. In one case recently administered by ICSID there were, with the consent of the parties, hearings open to the public and simultaneous postings on the ICSID web site of filings by the parties.13 General authorisations for such further openness might be incorporated into future investment treaties.

Countries have meanwhile continued to conclude numerous BITs containing the usual investor-to-state dispute-settlement provisions. According to the United Nations Conference on Trade and Development, 130 BITs were concluded in 1999 alone.14 ICSID’s caseload has also continued to grow rapidly. In view of the still expanding network of investment treaties throughout the world, including in central and eastern Europe and the CIS, this trend in the caseload is likely to be with us for some time.

9 See United Mexican States v. Metalclad Corporation, Supreme Court of British Columbia, Reasons for Judgment, 2 May 2001, 2001 British Columbia Supreme Court Reporter, p. 664, partially setting aside the award of the Arbitral Tribunal in Metalclad Corporation v. United Mexican States (Case No. ARB(AF)/97/1). The award in that case, a NAFTA Chapter 11 proceeding, was rendered under the ICSID Additional Facility Rules. Awards rendered in ICSID Convention proceedings are not subject to any appeal or to any other remedy except those provided for in the Convention itself. In contrast, awards rendered in ICSID Additional Facility proceedings may be set aside by competent national courts at the designated place of arbitration. See also ICSID Cases, supra note 6, for information on the ICSID Convention annulment proceedings referred to in the text and initiated in Wena Hotels Limited v. Arab Republic of Egypt (Case No. ARB/98/4) and in Compañía de Aguas del Aconcagua S.A. and Viendi Universal v. Argentine Republic (Case No. ARB/97/3).

10 References for these and other published awards in ICSID cases are provided on ICSID’s web site http://www.worldbank.org/icsid. See ICSID Cases, supra note 6. The texts of most of these awards are available on-line on the web site of the Centre or have been published or are forthcoming in the ICSID Review - Foreign Investment Law Journal.

11 Article 48(5) of the ICSID Convention provides that the Centre shall not publish awards made pursuant to the Convention without the consent of the parties concerned.

12 See Methanex Corporation v. United States of America, Decision of the Tribunal on Petitions from Third Persons to Intervene as “Amici Curiae”, 15 January 2001, at http://www.methanex-claim.com. The Tribunal in this NAFTA Investment Chapter proceeding, conducted under the UNCITRAL Arbitration Rules, held that it had “the power to accept amicus written submissions from the Petitioners”. This decision was rendered in regard to petitions for amicus curiae status in this arbitration submitted by four NGOs.

13 The reference is to the Southern Bluefin Tuna Case (Australia and New Zealand v. Japan). In that case, an arbitration instituted under Annex VII of the United Nations Convention on the Law of the Sea, the parties and the arbitral tribunal agreed to entrust the administration of the proceeding to ICSID, and to open the proceeding to the public in the ways mentioned in the text. The case showed that ICSID has the administrative capabilities to handle proceedings open to the public if parties decide to do this in investor-to-State cases (even though the Southern Bluefin Tuna Case was a State-to-State proceeding). For further details on the Southern Bluefin Tuna Case, see the full record of the proceeding at http://www.worldbank.org/icsid.


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Lender beware: an overview of contractual defences

A party attempting to enforce the terms of a written document in complex commercial transactions may be prevented from relying on what it considers to be the literal meaning of the words of the contract. Denying the validity of the contract, seeking a non-literal interpretation, implying unwritten terms, relying on the conduct of the opposing party, or the existence of an extraneous event, are all potentially valid reasons to prevent enforcement. This article briefly canvasses the relevant considerations to each of these defences under English law.
Parties who seek to enforce the strict terms of written contracts will often be faced with a bewildering array of defences and manoeuvres under English law. The very existence of a binding contract may be denied. The plain words of the contract may be construed against their apparent meaning. Terms may be implied into the contract. Unplanned events may disrupt the bargain. The behaviour of the parties may change the terms of the deal. This article will examine a number of legal principles which may arise in the context of attempts to enforce commercial contracts under English law.

The incentives to avoid the written words of a contract may be more acute in the international context. Each of the contracting parties may bring a unique language, legal and economic background to the bargain. In matters such as project finance, the arrangements will be reduced to a series of interrelated, complex and creative contracts. These documents often reflect the English language, law and economic system. The diverse backgrounds of the contracting parties may cause them to interpret the same documents differently. Those involved in creating international financial contracts, performing the bargains contemplated by them, and ultimately attempting to enforce those bargains under English law, risk being subject to constraints which are not apparent from a simple reading of the contractual documents.

In the context of commercial contracts, including financing contracts, the relationship between the parties is consensual. Parties allocate economic risk and attempt to embody that risk allocation in a written contract. If the relationship breaks down, courts or arbitrators must first determine what bargain existed between the parties. Having determined the extent of the original bargain, it is necessary to determine whether any behaviour subsequent to the formation of the contract alters the parties’ rights. Only then is a court in a position to assess the remedies which are available to address the effects of the breakdown.

At each stage of this analysis, English law allows the court to move beyond the literal meaning of the words of the contract. Those words will be interpreted against the background of the contract. Words may not be given their ordinary meaning. Terms may be implied into the contract to give effect to what the court finds was the true bargain. Events may occur after the formation of the contract which affect the bargain. These events may involve the conduct of the parties or completely extraneous events.

Despite the existence of these mechanisms to move beyond the literal words of the contract, the process is one of determining the real bargain between the parties. Courts will respect consensual commercial arrangements when applying English law. Parties will be held to what is found to be their contractual undertakings.

The contract is not binding

One of the common tactics for avoiding the enforcement of a contract is to suggest that the contract was not validly executed. Unsophisticated parties may argue that they were unaware of the nature of the document when it was entered into. The English law doctrine governing such defences is “non est factum”.

The defence of non est factum requires a contracting party to argue that it has executed the written document under a fundamental misapprehension as to the nature of the document. In such circumstances, the party pleads that the mistakenly executed document is “not its deed”, and is therefore void.

A party relying on non est factum must satisfy a two-stage test: first, it must be demonstrated that the party took reasonable care to find out at least the general effect of the document before signing; and, secondly, the party must further prove that there is a radical difference between what was signed and what the party thought was signed.

In the leading English authority in this particular area, each member of the House of Lords contributed certain key principles governing when the defence of non est factum is and is not available. Thus, it is clear that there must be a radical or fundamental difference between what was signed, and what was believed to have been signed (per Lord Reid); the difference must go to the substance of the whole consideration or to the root of the matter (per Lord Hodson); the difference must be such that the document signed is entirely or fundamentally different from that which it was thought to be, so that it was never the signatory’s intention to execute the document (per Viscount Dilhorne); and the transaction must be essentially different in substance or in kind from the transaction intended (per Lord Wilberforce).
Given the broad discretion of the courts to import commercial reasonableness into the interpretation of contracts, it should be anticipated that defaulting parties may attempt to avoid liability by suggesting that the words of the contract should not be given their literal meaning. Instead, creative interpretations based on the “matrix of fact” against which the bargain was struck may be put forward.

The House went on to state that the plea cannot be available to anyone who was content to sign without attempting to determine (at least) the general effect of the document. Nor is it available to a person whose mistake was really a mistake as to the legal effect of the document, whether that was his or her mistake or that of his or her adviser. In all cases, the burden of proof rests on the signing party who now seeks to escape the consequences of the contract.

Generally, in commercial financing transactions, all of the parties will be well aware of the nature of the contractual documents which they are executing, and will be informed of their effect by professional advisers. In the context of international project finance, the bargain will be made up of a series of individual but related contracts between a foreign sponsor, a domestic entity and a lender or lenders (often including an international financial institution). If one of these parties, in the event of a dispute, is able to convince the adjudicator under English law that, despite taking care, it did not comprehend one of the documents which it signed, there is a risk that this entire document may be unenforceable against that party. The danger will be heightened if the party seeking to enforce the document was aware, prior to the signing of the documentation, that the other party was uncertain as to the nature of the document.

In international transactions this concern is particularly relevant and should be addressed when dealing with counterparties who lack experience in Western financing practices, or where parties are asked to sign, in English, documents which they have only been able to review through inadequate translations and/or without the assistance of experienced legal counsel (who in turn can review the agreements in English). In such cases, it is prudent to ensure all parties’ proper understanding of the contractual terms, legal representation by experienced legal counsel, as well as the accuracy of translations presented. In addition, competent independent legal advice and plain language expression in documentation may be supplemented by correspondence from each party explaining in brief terms the nature and effect of each of the contractual documents. While such correspondence may not be used to interpret the contract, it will be very useful in avoiding a later plea of non est factum.

### Determining the bargain from the words of the contract

Under English law, if a dispute arises over the performance of a contract, the initial task is to determine whether the contract expressly deals with the issue. Modern courts have dispensed with much of the formalism involved in contractual interpretation. It has been noted that “[a]lmost all the intellecutal baggage of ‘legal’ interpretation has been discarded”, with the result that the way in which contractual documents are interpreted by judges has been assimilated “to the common sense principles by which any serious utterance would be interpreted in ordinary life”.

The House of Lords has set out five principles to be utilised in the construction of a contract. These principles may be summarised as follows:

1. **Interpretation is the ascertainment of the meaning which the document would convey to a reasonable person having all the background knowledge which would reasonably have been available to the parties in the situation in which they were at the time of the contract.**

2. **The matrix of fact which the court will look to in interpreting the contract includes absolutely anything which would have affected the way in which the language of the document would have been understood by a reasonable person subject to the following exception.**

3. **The law excludes from the admissible background the previous negotiations of the parties and their declarations of subjective intent.**

4. **The meaning which a document would convey to a reasonable person is not the same thing as the meaning of its words.** The meaning of words is a matter of dictionaries and grammars; the meaning of the document is what the parties using those words against the relevant background would reasonably have been understood to mean. The background may not merely enable the reasonable person to choose between the possible meanings of words which are ambiguous but even to conclude that something must have gone wrong with the language, the law does not require judges to attribute to the parties an intention which they plainly could not have. If detailed somatic and syntactical analysis of words in a commercial contract is going to lead to a conclusion that flouts business common sense, it must be made to yield to business common sense.

Given the broad discretion of the courts to import commercial reasonableness into the interpretation of contracts, it should be anticipated that defaulting parties may attempt to avoid liability by suggesting that the words of the contract should not be given their literal meaning. Instead, creative interpretations based on the “matrix of fact” against which the bargain was struck may be put forward. This factual background will be more complex in the case of contracts involving parties from diverse political, social and legal backgrounds. In this context the factual assumptions of one party may be unexpressed or misunderstood. This kind of misunderstanding may occur in the context of financial covenant compliance. In that context, parties may have different understandings with respect to the applicability of customary terms which may be undefined, particularly where the referenced accounting principles are not specified. Another instance where this may typically occur is where the scope of a project is loosely defined, leaving room for differing interpretations.

To assist in the interpretation of the contract, care must be taken to use the simplest and most direct language possible, especially when setting out the conduct expected of each party. If the background analysis and assumptions which underlie the bargain have been appended to the documents as schedules, then it is an easier task to prove to an adjudicator the commercial realities which the parties faced when entering into the contract. These analytical documents remove the ability of defaulting parties to insist that they were unaware of, or had a different understanding of, the “matrix of fact” which lay behind the words of the contract.

Once the court has completed the task of interpreting the contract, it will make a factual determination of the obligations of each of the parties. In most cases, the obligations found will be exactly those set out in the literal words of
the contract. In all cases, the court will hold parties to the commercial bargains they have entered into.

**Implying terms into the written contract**

English law recognises that the entire bargain between the parties cannot be embodied in the formal written contract between them. If the parties do not expressly provide for a matter within the contract, the court may imply a term.

Implied terms fall into two categories: terms which are implied by law; and terms which may be implied by the wording of the contract in the surrounding circumstances in an attempt to reflect the intention of the parties.

Courts have recognised that, when the words of a contract are insufficient to provide business efficacy, it is necessary either to imply a term or interpret the existing terms on a commercially reasonable basis. On these grounds, English courts may imply a term to reflect the intention of the parties: (a) where a term is necessary to give business efficacy to the contract; and (b) where a term represents the obvious (but unexpressed) intention of the parties.

In one leading case, the court described the appropriate approach in the following manner:

“The tools available to a Court in this exercise of reluctance to accept that the parties have contracted to do the impossible are those of construction of the express terms used by the parties and of implying a term which qualifies, but does not contradict, the express terms. In many, and perhaps most, cases it may be debatable whether the Court is giving the words a ‘commercial construction’ or whether it is implying a qualifying term and I cannot think that it matters. What does matter is that in its struggle to make common sense prevail, the Court cannot say that the parties agreed upon something, however sensible, when their chosen words show clearly that they agreed the exact opposite.”

Despite the broad statements of the circumstances in which English courts will imply terms into a contract to provide business efficacy or where the omission is obvious, it is not enough that a term simply be reasonable, unless it is one which would be agreed to by both parties.

Accordingly the courts have been reluctant to imply terms, holding that the general presumption is that the parties have expressed every material term which they intended should govern their agreement.

Therefore, at a minimum, implied terms must be capable of being formulated with clarity and precision.

Commercial contracts which are to be performed in emerging economic markets may be subject to a series of risks which are not dealt with in more conventional contracts. When such instruments are expressed as subject to English law, it is important that all foreseeable risks be dealt with explicitly. This avoids the danger that a court will imply terms on the basis of traditional concepts of business efficacy or obvious inference. The danger is that a term which gives business efficacy in a fully developed economy may not be applicable in a region facing a developing political environment. Similarly, terms which may be obvious in a settled economy may make less commercial sense in a region undergoing economic change. If parties seek to avoid the performance of their obligations on the basis of implying terms into contracts, it may be necessary to develop a complete factual record to avoid the inference that such terms are warranted in the circumstances.

English law will not countenance the rewriting of contracts to reflect parties’ desire to alter the bargain in light of changed circumstances. The important factual context is that which existed at the outset. True obligations will not be varied by the implication of terms. These will only be clarified.

**Conduct of the parties altering the bargain**

A party who has successfully negotiated for certain protective rights, and who has ensured that such rights are expressly enshrined in the contract itself, must be conscious of the danger that certain forms of subsequent conduct may undermine the value and efficacy of these carefully drafted provisions.

More particularly, it must always be borne in mind that certain forms of action or inaction by one contracting party may be viewed as a concession or acknowledgement that that party does not...
indicate that the beneficiary of a contractual right does not intend to strictly enforce it. Although it is often stated that this promise, representation or conduct must be “precise”, “clear” and “unequivocal”, this does not mean that the promise needs to be express. Indeed, although the cases speak of “promises”, “promisors”, and “promisees”, it is important to bear in mind that the message in question — i.e., the message that the “promisor” will not insist on strict enforcement of his rights against the “promisee” — can be conveyed by words, or by silence (at least in situations where a duty to speak exists), or even by a course of conduct. Similarly, depending on the context, it may be that a combination of express words and meaningful silences (even in the absence of a duty to speak) may create a sufficiently clear representation that it can form the basis of a waiver or promissory estoppel.

In this context, the doctrine of “acquiescence” provides an example of waiver through silence or inaction. Acquiescence — which may, arguably, be characterised as either a sub-category of waiver or as a separate but parallel estoppel doctrine — applies where a party, having a legal right, stands by without objection and watches another party deal with property in a manner inconsistent with that right. In such circumstances, the failure to object in a timely manner precludes the first party from afterwards complaining about the violation of its rights.

Third, the party who has received the “promise” must have acted upon it in some manner, generally by altering its position in reliance on the promise. There is no requirement that this reliance must have been prejudicial to the promisee, although the demonstration of such “detrimental reliance” will significantly strengthen the promisee’s argument that the promisor should be bound by his representation or conduct. The key question addressed by a court assessing the legal impact of the promisor’s conduct is whether it would be “in equitable” or “unfair” in all of the circumstances to permit the promisor to strictly enforce its legal rights against the promisee. Obviously, an assessment of what is or is not “in equitable” is a highly facts-specific question. It has been suggested that a key consideration in deciding whether or not the promisor should be bound by his representation is the ease (or difficulty) attending efforts by the promisee to return to its pre-representation position.

The legal effect of a waiver or estoppel is similarly influenced by the facts of a specific case. As a general rule, the triggering of these doctrines has the effect of suspending or holding in abeyance the relevant contractual rights or obligations, rather than cancelling them entirely. Only in extreme situations — where the conduct or words of one party makes it inequitable for that party to ever again insist on the strict application of its legal rights — will the protective provisions of the contract be permanently lost to the promisor. More commonly, the party whose representations or conduct has led the other party to believe that the contractual terms will not be strictly enforced will be permitted, upon reasonable notice to the promisee, to retract the original representation and reassert the requirement that the promisee fulfill all obligations and face all penalties under the original contract. As a general rule, the giving of adequate notice that the promisor now insists on strict adherence to the terms of the contract will satisfy the requirement that such insistence not be inequitable to the promisee.

Issues of waiver and estoppel are particularly relevant to international financial institutions having a broader range of objectives than those of purely commercial lenders. Faced with an adverse development in respect of a project, international financial institutions may exercise greater restraint in enforcing or otherwise exercising their remedies. It is, however, particularly important that such action (or inaction) be pursued with extreme caution. The presence of a general non-waiver language in the agreements will not provide a complete answer if a clear inducement has been granted to a party and it has relied on this inducement to its detriment.

If the response to changed circumstances is to forebear in the performance of contractual obligations, then the conditions on which the forbearance is granted must be made explicit. The exact contractual obligations which are being excused should be clearly identified and the length of time of the waiver set out. If the duration of the exemption is not known, a mechanism for giving notice that performance will be required should be specified and agreed to in writing.

English law seeks to promote certainty in commercial dealings. The parties obtain the benefit of this certainty by reducing their contracts to writing. The court will attempt, as far as possible, to ensure that the expectations of the parties are also met when a circumstance arises which calls for forbearance. The value of predictability in commercial dealings is not diminished when an inducement is granted.

Of equal importance is the need to monitor and reassess the waiver or forbearance granted. Where a time-limited waiver of certain governmental registrations or regulatory approvals has been granted, it is critical to ensure that the absence of such registration or regulatory approval is not prejudicial to the waiving party’s rights. Similarly, where an extension is granted regarding compliance with a contractual term (e.g., achievement of project completion), and no step has been taken by the
extending party for some time after expiry of such extension period, the waiver which was initially intended to be time-limited may be construed as an indefinite one.

Dealing with events which prevent performance of the contract

The enforceability of contractual terms can be affected, not only by the conduct of the parties themselves, but also by intervening events beyond the control of either party. The principle of English law relevant in such circumstances is the doctrine of “frustration”.

This principle recognises that certain changes in circumstance may “frustrate” a contract by making it impossible, or fundamentally impracticable, for the parties to fulfil their original bargain. The Court of Appeal has recently enumerated five principles which explicate the fundamental character of the doctrine:26

1. The doctrine of frustration was evolved to mitigate the rigour of the common law’s insistence on literal performance of absolute promises. The object of the doctrine was to give effect to the demands of justice, to achieve a just and reasonable result, to do what is reasonable and fair, as an expedient to escape from injustice where such would result from enforcement of a contract in its literal terms after a significant change in circumstances.

2. Since the effect of frustration is to kill the contract and discharge the parties from further liability under it, the doctrine is not to be lightly invoked, must be kept within very narrow limits and ought not to be extended.

3. Frustration brings the contract to an end forthwith, without more and automatically.

4. The essence of frustration is that it should not be due to the act or election of the party seeking to rely on it. A frustrating event must be some outside event or extraneous change of situation.

5. A frustrating event must take place without blame or fault on either side of the party seeking to rely on it.

Traditional examples of frustrating events have included: (i) the physical destruction of the subject matter of the contract;27 (ii) the eradication of the commercial basis for the undertaking28 (although not the mere fact that the venture turns out to be a commercial disaster for one party);29 and (iii) the occurrence of a radical change in the nature of (but not merely the expense or onerousness of) one party’s obligation under the agreement.30

In an important decision, the House of Lords has set out specific guidelines to be followed by a court asked to find that the doctrine of frustration should release one party from its obligations under the contract.31 First, the court should seek to delineate the precise nature of the parties’ obligations, as they existed when the contract was negotiated and executed. This is an exercise in contractual interpretation, involving a review of the nature and substance of the parties’ bargain, read in light of the context in which the contract was created. Secondly, the court should look to the allegedly frustrating event, in order to determine how this supervening change in circumstances has altered the original obligations agreed to by the parties. Finally, the court is required to compare the obligations faced by the objecting party, both before and after the occurrence of the allegedly frustrating event. This will permit the court – utilising an objective eye – to determine whether there has been a fundamental or radical alteration in the obligations agreed to and undertaken by the parties ab initio. Only if the answer is affirmative will the doctrine of frustration apply.

The applicability of the doctrine will generally be precluded if the intervening event was itself the subject of an express provision in the contract. In such circumstances, it is self-evident that the allegedly “frustrating” event cannot be characterised as something “radically different” from the circumstances contemplated by the parties at the time of contracting. It is thus possible for the parties to contractually exclude (or limit) the availability of the common law doctrine of frustration by expressly identifying potential supervening developments, and addressing the parties’ ongoing obligations should such events occur.32

In the same way that the contracting parties can expressly provide that the agreement will continue unmodified despite the occurrence of certain future events (thus ousting the common law doctrine of frustration), it is also possible for the parties to make explicit provision for those supervening changes of circumstances which will permit one or both parties to avoid or modify their obligations under the contract. Such provisions are generally described as “force majeure clauses”.33

In contrast to certain civilian systems, there is no common law force majeure doctrine in English law. The applicability or non-applicability of force majeure principles is therefore a matter for the parties to decide between themselves at the time of the agreement. If the agreement contains no force majeure clause, the principle will have no relevance and the common law doctrine of frustration will instead be applicable. In addition to determining whether to include a clause of this sort, the parties also enjoy
considerable discretion in tailoring the contents of such a provision to their unique requirements – i.e., it is open to the parties to determine which supervening events will and will not trigger the force majeure clause, and also to decide what precise effect the occurrence of such events will have on the ongoing agreement. The onus of demonstrating that the necessary occurrences have arisen lies on the party seeking to rely on the force majeure clause to excuse its continued performance.34

Both types of clause described above – i.e., those seeking to oust the doctrine of frustration and those defining the application of force majeure – have a similar goal. Both categories of provision seek to exclude or modify the application of the doctrine of frustration should certain, specified circumstances arise in the future. As a general rule, the courts will strictly construe any contractual provision (whether a force majeure clause or otherwise) which seeks to oust the availability of the doctrine of frustration.35

In emerging markets, circumstances giving rise to frustration are more likely to occur. Therefore, in order to avoid a defence of frustration it is prudent to expressly address in the contract those potential causes of frustration which will relieve or, conversely, will not relieve, a party from its obligations. In the context of a financing transaction, it is more often the borrower’s concern to include a specific force majeure clause identifying those circumstances which relieve the borrower from its obligations. In the absence of such explicit force majeure clauses, a borrower, or another obligor, may nonetheless argue the doctrine of frustration as a basis for non-performance. This is an instance where international financial institutions are protected as a result of their preferred creditor status (for instance, payment moratoriums, absence of hard currency reserves, etc.). In a purely commercial context, however, where a lender or another party wishes to protect itself from the frustration defence being brought forth by a counterparty, those circumstances should be expressly addressed in the contract.

Conclusion

Creating, performing, and ultimately enforcing, complex commercial financing contracts in the context of emerging economies presents unique challenges. Against a volatile background, bargains are reduced to static written documents. The challenge is to ensure that these documents anticipate and reflect the dynamic nature of the relationship. English law prides itself on its ability to provide a high degree of certainty that, once commercial bargains are struck, they can be relied upon. If a party fails to perform legally binding obligations, English courts will provide a remedy for any breach. English law has also developed a number of principles which recognise that the literal words of contractual documents may not reflect the full bargain between the parties. These principles will only be invoked in an attempt to give effect to the true intentions of the parties. The potential application of these legal doctrines is a matter of which parties should be cognisant, both while negotiating the contract itself and during the life of the resulting agreement. At all stages of the contractual relationship, it is open to a party to alter its behaviour so as to ensure that the agreement is enforced on its original terms, while minimising the likelihood that these legal defences will be successfully raised.
Contract enforcement in Lithuania

If a counterparty defaults on a contract in Lithuania, there are some interim steps to be taken before the foreign investor can obtain the desired performance under the contract. With little possibility to undertake legally coercive measures, the investor must turn to the competent forum or arbitral panel to obtain a decision on the matter, which afterwards must be executed. Making these steps successful is a primary concern, even at the early stages of negotiations between the parties.
The Lithuanian Supreme Court has, for the first time, introduced doctrines characteristic of the Anglo-Saxon tradition, such as the forum non conveniens. There is no practice in applying this doctrine and only the future will indicate whether its introduction into the Lithuanian legal system, which is based on the civil law tradition, was justified and will be efficient.

An increasing number of people and enterprises from different countries face the necessity to enforce contracts in Lithuania. This increase is due to two main factors. After regaining its independence in 1990, the formerly closed Lithuanian economy changed dramatically and opened up to the rest of the world. Most significantly, Lithuania became a participant in the international global economy.

If the defaulting party to a contract is a resident of Lithuania, or has assets there, then whatever dispute resolution mechanism the plaintiff chooses, he or she might face enforcement in Lithuania. This should be borne in mind when drafting the contract, the dispute resolution and governing law clauses.

Lithuanian conflict of law rules in respect of contract enforcement, which should guide the foreign party in its decisions, are scarce and have been substantially supplemented by the courts. On 21 December 2000, the Senate of the Lithuanian Supreme Court approved the Digest of the Court Practice in Applying Conflict of Law Rules and the Resolution No. 28 On the Court Practice in Applying Conflict of Law Rules to be followed by the lower courts. This has made Lithuanian conflict of law rules more transparent, consistent and easier to follow.

From a contract enforcement perspective, there are generally three scenarios in Lithuania. The foreign plaintiff may lodge:
- a civil suit in a Lithuanian court;
- a civil suit in a foreign court;
- an application for arbitration.

Self-help remedies in enforcing private contracts are currently prohibited by Lithuanian law, except in very limited instances. These remedies are not a viable solution for the foreign party seeking contract enforcement in Lithuania. The new Civil Code of the Republic of Lithuania provides for self-help remedies, such as the possibility on the part of the non-defaulting party to suspend the performance of its obligations under the contract or retain the defaulting party’s assets in its possession until the defaulting party performs its obligations.

These three scenarios are examined below, with particular attention given to the practical issues of special interest for the foreign parties to the contract.

**Contract enforcement in Lithuanian courts**

Despite such obvious drawbacks for foreign parties as the need to engage local counsel and to pay translation costs and travel expenses, this dispute resolution mechanism might be attractive because there is no need for separate recognition proceedings. In some cases this might be the only way of contract enforcement available for the plaintiff. This is the case, for instance, for contracts regarding real estate situated in Lithuania.

Lithuanian law provides for the exclusive jurisdiction of Lithuanian courts of law in disputes regarding ownership rights or the use of real estate situated in Lithuania.

Since almost all jurisdictions have a similar conflict of law rule, there is a high likelihood that a foreign court would decline jurisdiction and the plaintiff’s only option would be to apply to Lithuanian courts.

**Jurisdiction**

A court shall accept the claim only if it has jurisdiction over the particular dispute. According to the Code of Civil Procedure, jurisdictional rules of international treaties or conventions prevail over those of national law. However, so far Lithuania is not a party to the Brussels or the Lugano Conventions.

Therefore, the only international sources of jurisdictional rules are multilateral conventions on the unification of some conflict of law rules, and Bilateral Treaties on Mutual Legal Assistance in Civil and Family Cases.

When a relevant bilateral treaty has been concluded, its provisions prevail over the national ones. When a multilateral convention stipulates conflict of law rules, those rules are to be applied, except if the convention provides for the opposite. If there are no rules provided for in the convention or bilateral treaty, general national conflict of law rules apply. To sum up these rules, Lithuanian courts shall accept jurisdiction over a civil suit arising out of a contractual relationship if:
- the defendant has his or her place of residence or its seat in Lithuania;
- the defendant is a foreign legal person but has a branch in Lithuania and the dispute is related to the activities of the branch;
- the place of contract performance is in Lithuania;
- the object of the dispute is real estate situated in Lithuania.

The parties to the contract may also choose the jurisdiction. However, their autonomy is not absolute. In order to be accepted and enforced by Lithuanian courts, jurisdiction clauses cannot infringe on the exclusive jurisdiction of the courts of Lithuania. The clause must be definite to be capable of enforcement and the forum chosen must have a connection to the case (it might be the place of residence of one of the parties, the place where the object of dispute or all evidence is situated, etc.). Lithuanian courts shall also agree to hear a case if the defendant does not object to the jurisdiction, and if such a hearing does not infringe upon the exclusive jurisdiction of the courts of any of the parties’ state.

In addition to the aforementioned general conflict of law rules, the Supreme Court has suggested to the lower courts to take into consideration the following factors before assuming jurisdiction:
- Whether the decision in the particular case shall have to be recognised and enforced in the foreign state. If it shall, and Lithuania has no Bilateral Treaty on Mutual Legal Assistance in Civil and Family Cases with the state of prospective recognition and enforcement, the court is directed to find out whether the courts of the state of the defendant’s residence or seat have jurisdiction over the dispute, and to decline jurisdiction if the result of such inquiry is positive (except for the cases of exclusive jurisdiction).
- Whether the court of the state where the decision will have to be recognised and enforced has an exclusive jurisdiction over the dispute. If it does, the Lithuanian court should decline jurisdiction as well, because the decision of a Lithuanian court would not be recognised and enforced in the foreign state.
- The place of residence or seat of the parties and the place of the evidence. If the plaintiff and most of the evidence are in a state which has no Bilateral Treaty on Mutual Legal Assistance in Civil and Family Cases, the court is suggested to decline jurisdiction as well, because the decision of a Lithuanian court would not be recognised and enforced in the foreign state.
Assistance in Civil and Family Cases with Lithuania, the courts are instructed to decline jurisdiction and to suggest to the plaintiff to sue in the court of the place of residence or seat of the defendant and the place of the evidence.

The aforementioned instructions are intended to achieve economy of process and aim to avoid situations where a case is heard and a decision is rendered in Lithuania, but it is not recognised and enforced in the foreign forum. With this decision, the Lithuanian Supreme Court has, for the first time, introduced doctrines characteristic of the Anglo-Saxon tradition, such as the forum non conveniens. There is no practice in applying this doctrine and only the future will indicate whether its introduction into the Lithuanian legal system, which is based on the civil law tradition, was justified and will be efficient.

Proceedings

Litigation in Lithuania is a time-consuming enterprise. The hearing in most of the cases is oral and held publicly in Lithuanian (foreign parties are entitled to participate through an interpreter). Both parties are summoned to participate in the hearing, and it is common to postpone the hearing if a party, witness or attorney is not present.

However, in 1998 the Parliament introduced a novel type of proceedings for cases regarding monetary claims arising out of the contractual obligations based on written evidence. The judge in such summary proceedings upon accepting the claim sends a written notice to the defendant. The defendant is given a 14 days’ grace period for the performance. If the defendant does not perform and does not raise objections, the judge issues a court order, which may be subject to forced execution. If the defendant raises objections to the claim, and such objections are reasonable and supported by the evidence, the judge returns the claim to the plaintiff directing him or her to sue under the general rules.

Summary proceedings are a time-saving type of litigation. However, the plaintiff who has not performed his or her own obligation may not resort to it. It also may not be used when the place of residence or seat of the defendant are not known. The other important restriction is to be found in Part 3 of Article 256-1 of the Code of Civil Procedure, which states that if the debtor is a foreign national, the norms regarding the issuance of the court order in the summary proceedings may be applied only on the basis of international treaty or convention or private contract.

Lithuanian law follows the civil law tradition to give preference to specific performance, and the court would usually grant damages (if any) in addition to and not instead of the specific performance. Only if the specific performance were not feasible or practical would the court grant only damages.

The decision of the lower court might be challenged in two ways:

- **Appeal.** Challenge is open if the lower court decision has not yet entered into force. This type of proceedings is a hearing de novo, although a rather limited one. The appellant is prohibited from raising new claims, new evidence is admitted only if it could not be submitted in the initial proceedings or the need to submit it arose later.

- **Cassation.** This type of review is limited to the issues of law construction and application and basically serves public interest of uniformity in the construction and application of law. Fact-finding conclusions of the lower courts are never reviewed. Only the Supreme Court of Lithuania has jurisdiction over this kind of case.

Recognition and enforcement of foreign judgements

Judgements are a national phenomenon – a manifestation of state power. In order to have effect outside national borders, the judgement has to be recognised by the foreign state. Therefore, the party wishing to enforce a foreign judgement in Lithuania must apply to the Appellate Court of the Republic of Lithuania and submit the following documents:

- application for the recognition;
- judgement or its copy with the certification (in practice it is usually a court certification) of the entry into force and executability;
The recognition cases are heard in public hearings. Since the debtor is entitled to participate and raise defences, he or she must be duly summoned. However, if a duly notified defendant does not participate in the proceedings, this does not prevent the hearing.

Recognition under international agreements

According to Article 481 of the Code of Civil Procedure, foreign judgements are recognised and enforced according to the rules set by international conventions or treaties and the laws of Lithuania. As Lithuania is not a party to the Brussels or Lugano Conventions, the grounds for non-recognition are provided for in the Bilateral Treaties on Mutual Legal Assistance in the Civil and Family Cases. In general, these bilateral treaties concluded by Lithuania usually provide for the following grounds for non-recognition:

- the defendant or the applicant in the recognition proceedings was not duly notified about the hearing of the case or the due process of law has been infringed;
- if there is a judgement of the national court rendered in the same dispute between the same parties and it has entered into force;
- if there is a suit commenced in the court of Lithuania in the same dispute between the same parties;
- according to international treaty or convention, or Lithuanian laws, if there are no relevant international legal norms, Lithuanian courts have an exclusive jurisdiction over the particular dispute.

Some international treaties provide for specific grounds of non-recognition. For example, Article 54 item 5 of the Bilateral Treaty concluded with Poland provides for such grounds as the existence of the recognised or executed decision of the competent institution of the third state in the same dispute.

The court examines the existence of the said grounds ex officio, i.e., on its own initiative, even if no party relies on them. As the short presentation of the grounds for the non-recognition shows, the court dealing with the recognition case does not review the substance of the foreign judgement. However, there are some exceptions to this rule. For example, Article 54 item 6 of the Bilateral Treaty with Poland provides for such grounds of non-recognition as infringement of the conflict of law rules provided for in the Treaty.

Recognition of a foreign judgement if there is no international convention or treaty

As mentioned above, international treaties on legal assistance are not numerous. There is no special legislation on the recognition and enforcement of foreign judgements. This gap has been filled by court practice. In November 2000,15 the case of the recognition of a Dutch judgement was brought before the Lithuanian Appellate Court. The court held that, although Lithuania has no Bilateral Treaty on the Mutual Legal Assistance with the Netherlands, the judgement should be recognised, taking into consideration foreign practice, the purpose of conflict of law rules and the principles of international cooperation. Private parties are not to blame for the inability of their states to conclude international conventions or treaties. Denial of recognition solely on these grounds would deprive the parties of justice and would provoke retaliatory non-recognition of Lithuanian judgements in foreign states. This position was approved by the Supreme Court, to be followed later by the lower courts.16

The grounds for the non-recognition were found by analogy in the international practice and existing international conventions and treaties. The court may deny recognition of the judgement rendered in the state that has no relevant international treaty with Lithuania if:

- the recognition and enforcement would be contrary to the public order;
- exclusive jurisdiction of the Lithuanian courts has been infringed;
- the defendant has not been duly notified of the place and time of the hearing;
- a judgement of the Lithuanian court has been rendered regarding the identical claim;
- Lithuanian conflict of law rules requiring application of Lithuanian instead of foreign law have been infringed;
- the foreign judgement is not final and has not entered into force yet;
- the courts of the state where the judgement to be recognised has been rendered refuse recognition of the judgements of Lithuanian courts of law.

The same grounds must be applied when an international treaty17 provides for the recognition and enforcement of foreign judgements and is silent on the issue of the grounds on which the recognition may be denied.

Recognition and enforcement of foreign arbitral awards

Until very recently, Lithuanian attorneys firmly recommended to foreign investors to choose arbitration as the best dispute resolution mechanism, and to include an arbitration clause in their contracts with Lithuanian counterparties. Although the above-mentioned court practice has clarified the issues of recognition and enforcement of foreign judgements, a foreign creditor, who has an arbitration award to be enforced in Lithuania, may feel much more comfortable. The main reason for that is the fact that since 17 January 1995, Lithuania is a party to the 1958 New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards. In addition to this convention, the recognition of foreign arbitral awards is also subject to the Code of Civil Procedure and of the Law on Commercial Arbitration.18

Before the New York Convention is applied in the recognition proceedings, the court ascertains:

- whether it is an arbitral award that is sought to be recognised. It should be noted that the term “arbitration” may have different meanings. In the Soviet tradition the term used to denote a specialised court of law. Following this tradition, some post soviet states19 still have a type of courts of law called “courts of arbitration”. Despite their name, the New York Convention does not apply to the recognition and enforcement of their decisions.
whether it is a foreign arbitral award. The definition of a foreign arbitral award is to be found in Part 1 of Article 1 of the New York Convention. According to the Convention, only an award rendered outside Lithuania is a foreign arbitral award. It should be also noted that Lithuania applies the Convention in respect of arbitral awards rendered in non-member states solely on the basis of reciprocity. It should be noted that there have been instances\(^\text{15}\) when Lithuanian courts have applied the New York Convention and have recognised an arbitral award rendered in the proceedings under the ICC Rules of Arbitration, despite the fact that the place of arbitration was Vilnius, Lithuania.

The applicant wishing to recognise and enforce a foreign arbitral award in Lithuania has to submit to the Appellate Court the following documents:

- an application for the recognition;
- original or copy of the award translated into Lithuanian;
- original or copy of the arbitration agreement translated into Lithuanian.

The proceedings are identical to the recognition of the foreign judgement. The debtor is summoned to the public hearing of the case. However, his or her absence does not prevent the hearing (if the evidence of due notification is present).

The debtor may object to the recognition by presenting evidence to prove the grounds of the non-recognition provided for in Article 5 of the New York Convention. The provisions of Article 5, as well as of the whole Convention, should be construed uniformly by the courts of different members, in order to achieve its uniform application throughout the world. Therefore, the Supreme Court has specifically directed Lithuanian courts to take due regard of the practice of foreign courts and legal doctrine.

It should be noted that the incapacity\(^\text{21}\) of the Lithuanian counterparty to the arbitration agreement is ascertained under the rules of Lithuanian law, including Article 11 of the Law on Commercial Arbitration. This Article provides that the state and municipal enterprises and organisations have no capacity to agree on arbitration without prior consent of their incorporator. This provision should be borne in mind by the foreign investor intending to have an arbitration clause included in the contract concluded with the Lithuanian state enterprise. If the prior consent were not obtained, the arbitral award would not be recognised and enforced in Lithuania.

Non-arbitrability of the dispute\(^\text{22}\) is defined in the same Article 11 of the Law on Commercial Arbitration. Disputes related to competition, patents, trademarks, insolvency and consumer contracts are not arbitrable. Therefore, foreign arbitral awards rendered in such disputes cannot be recognised or enforced.

The Supreme Court has directed the courts towards a more liberal approach in establishing the existence of the grounds for non-recognition. For example, even if the debtor proves the circumstances provided for in Part 1 of Article 6 of the New York Convention, the court should not automatically refuse recognition. It must be established that the violation of the standards of due process has been substantial enough. Moreover, the public order\(^\text{23}\) is not to be construed broadly as every imperative national norm. This term should denote only the imperative standards accepted internationally.

\(^{15}\) 20 November 2000 decision in the civil case No. 27/96/2000.
\(^{16}\) Article 7.1.4 of the 21 December 2000 Digest of the Court Practice in Applying the Private International Law adopted by the Senate of the Supreme Court of the Republic of Lithuania.
\(^{17}\) For example, CMR or COTIF Convention.
\(^{18}\) No. 1274, dated 2 April 1996.
\(^{19}\) For example, Russia.
\(^{20}\) 16 December 1999 Ruling of the Court of Appeals in the civil case No. 2A-139/1999.
\(^{21}\) Article 5.1.a. of the 1958 New York Convention.
\(^{22}\) Article 5.2.a. of the 1958 New York Convention.
\(^{23}\) Article 5.2.b. of the 1958 New York Convention.

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Legal transition developments

**Albania**

**Legal developments**

**Secured transactions**

In February 2001 the electronic registry for the registration of charges, provided for by the Law on Securing Charges of 1999, became operative. Under this law, transactions creating a "securing charge" that were effected before the registry entered into force on 26 January 2001 had to be registered within 90 days after this date in order to be treated as completed securing charges for priority purposes. There have already been a considerable number of registrations and the office of the Chief Registrar appears to make every effort to ensure the efficient operation of the registry. However, it is difficult to evaluate its functioning at this early stage.

**Azerbaijan**

**Legal developments**

**Tax code**

On 1 January 2001 the new Tax Code came into force. It is the first attempt at codification of tax legislation and introduces significant changes into the tax system. The Code lays out new principles of taxation and modifies methods of calculating and paying specific taxes. The Tax Code defines three types of taxes: state taxes, taxes of the autonomous republic, and local (municipal) taxes. State taxes include: (i) personal income tax, (ii) corporate (profits) tax, (iii) value added tax, (iv) excise tax, (v) assets tax on legal entities, (vi) land tax on legal entities, (vii) transit tax, (viii) mineral resources tax, and (ix) simplified tax. The foregoing taxes, except for the transit tax, are also considered to be taxes of the autonomous republic of Nakhchevan. Municipal taxes include: (i) corporate (profits) tax on enterprises owned by municipalities, (ii) assets tax on individuals, (iii) land tax on individuals, and (iv) mineral resources tax on construction materials of local importance. The Tax Code prohibits the imposition of any taxes other than those specified in the Code.

**Armenia**

**Legal developments**

**Energy law**

In March 2001 the Armenian President signed the Law On Energy, which was passed by the National Assembly earlier that month. The Law regulates the energy sector, which is defined as including electric and thermal power generation, transportation and distribution, as well as natural gas transportation and distribution. The Law governs the relationships between the state, the enterprises involved in the energy sector and consumers. It provides for the creation of the Energy Regulatory Commission, a state authority charged with the regulation of the energy sector. The Commission is authorised to set tariffs for electrical, thermal energy and natural gas, to issue licences to the operators of the energy sector, and to define the rules encouraging the creation of the infrastructure for the energy market. The Law On Energy is a further step towards the successful implementation of the privatisation of the national grid, which has been postponed twice due to the lack of bids.

**Bulgaria**

**Legal developments**

**Electronic signatures law**

On 22 March 2001 the Bulgarian Parliament passed a new Law on Electronic Documents and Electronic Signatures. After the Czech Republic, Bulgaria is the second country in central and eastern Europe to regulate electronic document signatures. The law defines an electronic signature as any piece of information, coordinated between the author and the addressee, which discloses the identity of the author, confirms his or her consent to the electronic statement and protects the content of the statement from later changes. It further defines the terms “improved” and “universal” electronic signatures. The universal electronic signature has the legal effect of a manual signature. The Law authorises the Council of Ministers to specify the state bodies that are under an obligation to accept documents signed by means of a universal electronic signature. Under the Law, an electronic signature will not be valid for certain documents of legal significance, such as securities, consignment notes, or for documents or transactions requiring a qualified written form. The Law will come into effect six months after its promulgation in the Official Gazette, and is expected to boost electronic commerce in the country.

**Croatia**

**Legal developments**

**Foreign exchange law**

On 10 April 2001 amendments to the Law on Foreign Exchange System, Foreign Exchange Operations and Gold Transactions entered into force. The amendments partially liberalise the foreign exchange market in Croatia. These modifications allow domestic persons to acquire foreign exchange devices by: (i) purchasing on the foreign exchange market in order to effect the payment of goods and services abroad and other capital transactions permissible by law, as well as in order to deposit on foreign currency accounts; (ii) legal operations with foreign persons which relate to the export of goods and services or other legal operations;
(iii) other legal operations in Croatia specifically determined by law; and (iv) inheritance. The amendments also refer to the approval procedures of foreign currency loans in Croatia, the settlement procedures of the obligees through cessation and the assignment of set-offs.

Czech Republic

Legal developments

Corporate governance code

In early 2001 the Czech Securities Commission finalised a Code of Corporate Governance. According to the Commission, the Code is modelled on the OECD Principles of Corporate Governance. The Code emphasises transparency and responsibility, and aims to introduce best governance practice to companies in the Czech Republic.

Commercial code

On 1 January 2001 various amendments to the Commercial Code entered into force. The changes significantly improve the protection of minority shareholders’ rights by strengthening the rules concerning mandatory offers and notification requirements when shareholders reach prescribed thresholds. The amendments also introduce other provisions designed to protect shareholders’ rights.

Execution code

On 1 May 2001 a new Law on Court Executors and Execution Activities (Execution Code) entered into force. However, key provisions relating to the execution of decisions and to the executors’ activities will not enter into force until 1 September 2001. Each newly appointed executor will be different from existing court executors, who act under the Civil Procedure Code and are court employees. The new executors are appointed by the Minister of Justice and, under the new Law, will be less time consuming than those performed under the Civil Procedure Code. Consequently, it is expected that future executions performed by newly appointed executors will be less time consuming than traditional Civil Procedure executions.

Federal Republic of Yugoslavia

Legal developments

Privatisation law

On 27 June 2001 the Serbian Parliament adopted a new Privatisation Law. The 1997 Law on Ownership, which was based on an insider privatisation model where up to 60 per cent of the capital of a company was transferred to workers and pensioners in the form of shares, was frozen while the new law was developed. With the assistance of the EBRD, the Serbian Ministry of Economy and Privatisation prepared the new Privatisation Law which creates three methods for privatising companies, which are: (1) competitive tendering process; (2) auction; and (3) out-of-court restructuring processes. The EBRD and the World Bank are now assisting the Ministry to develop key implementing regulations so that the new Law can become effective as quickly as possible.

Estonia

Legal developments

Financial markets legislation

On 9 June 2001 the Estonian Parliament passed legislation that merges the supervisory bodies for securities, banking and insurance into a single entity, the Financial Supervisory Authority (FSA). It is likely that the FSA will be constituted in the second half of the year so that it is fully functional by 1 January 2002. The FSA attempts to unify three related areas under one authority. Banking, insurance and securities, were previously monitored by various departments under the Ministry of Finance and the Central Bank. The new FSA will be independent of both state entities, while its managing board will consist of the Minister of Finance (as Chairman) and other members from the Ministry of Finance and the Central Bank.

The FSA will supervise all financial markets and efficiency will be gained through the grouping of similar operations under one authority. Although there is no explicit EU legislation setting out the standard of such authorities, it is thought the FSA addresses any concerns the EU might have had in this area, and ideally will result in compliance should the EU mandate such authorities. The FSA will also oversee all listings of public companies, as well as the Central Registry of Securities, in which all shares (including both private and public companies) will need to be registered within the next two years. The Central Registry of Securities was recently created and will eventually assist in the strengthening of pledges of shares.

Georgia

Legal developments

Enterprise law

In June 2001 the Georgian Parliament approved the second reading of the new draft Enterprise Law. This law limits the number of tax inspections of companies that can take place in any one year, and thus constrains the potential for corruption. Under Articles 2 and 5 of the draft Law, only the Tax Inspectorate is allowed to carry out tax audits at companies once a year. All other organisations, such as Interior Ministry departments, will be required to obtain a court warrant before making any kind of tax-related inspection. The proposals form part of an anti-corruption drive that was launched last year by the President of Georgia, after the International Monetary Fund warned Georgia that future lending would depend on the country’s efforts to stamp out corruption. Most of the draft Enterprise Law’s articles, which include further anti-corruption measures, have been approved by parliament. At the time this issue went to print, parliament was expected to hold the final reading of Articles 2 and 5 of the draft Enterprise Law in the near future.

Hungary

Legal developments

Banking law

On 19 June 2001 the Hungarian Parliament passed a new law on the National Bank of Hungary (MNB). The law defines the maintenance of price stability as the primary goal of the MNB. The new law dissolves the Central Bank’s supervisory board and transfers the control function to the State Accounting Office. According to the new Law, the Monetary Council takes over the tasks of the Central Bank Council from July 2001. The Monetary Council is composed of seven to nine experts, in addition to the President and Deputy Presidents of the National Bank.
Take-over legislation

In June 2001 the parliament passed amendments to the existing Securities Law relating to take-over rules aiming to enhance protections of minority shareholders. The amendments set stricter rules on reporting requirements, public offers, and the way public offer prices are determined. They also impose stricter penalties for violations of the reporting rules.

Telecommunications law

In June 2001, Hungary passed a new Telecommunications Law, which will take effect from 23 December 2001. The new law regulates three main areas. First, it provides for asymmetric local loop unbundling. From January 2002 the national operator, Magyar, will be obliged to unbundle the local loop to smaller players, but will itself be barred from expanding in concession areas of other local telecommunications operators. Secondly, it brings the mobile portion of calls from fixed to mobile networks under regulatory control. Thirdly, the new Law stipulates that telecommunications providers must share revenues from dial-up internet calls with Internet Service Providers, although the details of these regulations have yet to be worked out.

Bankruptcy law

Recently the Hungarian Parliament approved amendments to the Bankruptcy Law that will come into effect on 1 September 2001. The amendments aim to improve a secured lender’s position in liquidation proceedings in Hungary. Under the current law, secured claims are paid pro rata only after liquidation expenses, including the liquidator’s fees, have been paid. Any remaining proceeds are then distributed pro rata to the unsecured creditors. The new amendments will improve the position of secured lenders in the order of settlement. If a secured lender’s claim was created at least one year prior to the commencement of the liquidation proceeding, then half of the proceeds of the sale of the property subject to the claim will be reserved for the satisfaction thereof. Only then will the other half of the proceeds be shared according to the statutory order of payment. Another significant change will be the elimination of the so-called “six month” rule, pursuant to which mortgages registered with the Land Registry less than six months prior to the commencement of liquidation proceedings are treated as unsecured in the statutory order of payment.

Currency regulations

On 16 June 2001 new currency regulations entered into force. These regulations lift most restrictions on current and capital operations in Hungarian forint or foreign currency, and allow for the forint to become fully convertible. According to the regulations, resident businesses may hold forint accounts abroad and initiate foreign currency purchases from such accounts. Resident businesses or private individuals are no longer obliged to transfer any of their foreign currency earnings or income from abroad to Hungary. Non-residents are free to hold forint accounts and transfer money from their domestic forint accounts abroad without the obligation to report to the authorities.

Legal reform projects

Assistance with drafting a new securities law

At the request of the Ministry of Finance, the EBRD is undertaking a project to assist Hungary in reforming its securities market legislation by adopting a new comprehensive Securities and Investment Services Law. This project aims to bring the principal parts of the Hungarian securities market legislation into line with international standards and sound practices of other markets, while meeting the EU accession requirements.

Kazakhstan

Legal developments

Law on transfer pricing

On 5 January 2001 a new Law On Government Control Over the Use of Transfer Pricing was approved. The new Law establishes an authorised governmental body that will monitor international transactions and related domestic transactions. The Law aims to prevent tax evasion through the use of transfer pricing.

Currency legislation

On 30 January 2001 amendments to the Law on Currency Regulation were adopted. The amendments include the introduction of a 120 day maximum time period, by which foreign currency must be received in payment for the export of goods and services. If a resident exporter does not receive such currency from the non-resident within 120 days, it must obtain a special licence from the National Bank of Kazakhstan.

Language law enforcement

On 7 February 2001 a new State Programme on the Operation and Development of Languages for 2001-2010 was passed by Presidential Decree. This programme evidences a trend towards increased enforcement of the Law on Languages of 7 July 1997, requiring, among other things, mandatory use of the Kazakh language in corporate agreements and related correspondence.

Legal reform projects

Telecommunications reform project

On 30 June 2001 the EBRD completed the first two phases of its telecommunications regulatory reform project. Working with the Ministry of Transport and Communications and Kazakhtelecom, the EBRD and its consultants prepared draft laws on the telecommunications sector and on the creation of a universal service fund, and provided pricing models to establish the real cost of telecommunications services.

Kyrgyzstan

Legal developments

Land reform

In January 2001 a new Law on the Management of Farmland came into effect, lifting the restrictions on the disposal of plots of farmland by farmers. The new Law covers the rights of the landowner to lease, exchange, buy, sell, mortgage and inherit land. The absence of such a law, and of general mechanisms regulating legal relations in the field of management of farmland, had a detrimental effect on internal migration, on the efficient use of farmland and on the development of the agricultural sector and economy of Kyrgyzstan as a whole.

Law on judicial activities

In March 2001 a law on the status of the judges was adopted. The new law sets out principles of supervision for the judges. In addition, it provides for financial support, as well as state and social protection for judges and for members of their families.

Latvia

Legal developments

Commercial law

Recently, the Latvian Parliament approved the Law on Commerce. This comprehensive law sets in place a cohesive revamped body of jurisprudence, applicable to the rights and relations of persons engaged in all aspects of commerce and trade. The new Law replaces a series of laws currently governing different forms of business (for example, joint Stock Companies Law, Limited Liability Companies Law, etc.). The new Law specifies general provisions applicable to all forms of business activity and sets out specific provisions that are unique to each form of business. It is anticipated that, pending the adoption of further legislation, there will be some tensions between the new Law and the existing insolvency regime. At the time this issue went
to press, the parliament was still debating whether to delay the effective date of the new commercial law until January 2002.

**Taxation legislation**

On 20 April 2001 amendments to the Law on Fiscal Year Reviews became effective. Under the new provisions, a company’s annual report must be reviewed by a sworn auditor or auditing company if the company’s indicators exceed two of the criteria set forth in the new law: a total balance exceeding LVL 100,000; a net turnover of LVL 200,000; and an average of at least 25 employees over the course of one fiscal year.

**Regional**

**Legal developments**

**World Bank’s global insolvency principles**

On 10 April 2001 the Executive Directors of the World Bank approved the “Principles and Guidelines for Effective Insolvency and Creditor Rights Systems”, and authorised its use for a series of pilot country assessments over the coming year. The World Bank developed the principles with the assistance of international financial institutions, including the EBRD, leading insolvency organisations and international insolvency experts. The Principles paper emphasises contextual, integrated solutions, and the policy choices involved in developing those solutions. The Principles rely on a fundamental premise: sustainable market development requires access to affordable credit and capital investment that can occur only in an environment that enables parties to manage the insolvency risk associated with credit relationships. There are 35 core principles identified and addressed in the Principles. These core principles distil international best practice in the design of insolvency and creditor rights mechanisms, and will be used to benchmark the strengths and weaknesses of existing systems. Notably, the Principles allow flexibility for domestic policy choices and the manner of application takes into account the comparative domestic laws and institutions.

**Legal reform projects**

**CIS model securities law**

Since 1997, the EBRD has been involved in a series of projects aimed at the harmonisation of the laws of the Commonwealth of Independent States (CIS) member states, co-sponsored by the Dutch and German governments. The EBRD has provided in-house expertise on the development of CIS model Mortgage and Company laws. The Bank is now sponsoring a technical assistance project to develop model CIS securities legislation. The Drafting Group has now combined its drafts “On Securities Circulation” and “On Capital Markets” into one draft model law. Comments and suggestions on this draft model law were received from various CIS countries and western experts, and the model law was discussed at open hearings of the CIS Inter-Parliamentary Assembly on 20–21 June in St Petersburg where issuers, investors and professional market participants from CIS countries and IFI representatives provided their views. The draft model law is expected to be considered and approved at the November session of the CIS Inter-Parliamentary Assembly.

**Russia**

**Legal developments**

**Banking law**

On 17 March 2001 the Russian Parliament approved three bills to amend Russia’s banking legislation. The amendments aim to establish a sound banking system in Russia by preventing the flow of capital out of banks on the verge of bankruptcy, and by protecting investors’ and depositors’ rights at the early stages when financial troubles of such financial institutions are recognised. The amendments are expected to significantly simplify the procedures for liquidating or revoking the licences of troubled banks.

**Currency regulations**

On 4 June 2001 the Russian President signed a law amending the Law “On Currency Regulation and Currency Controls”. The new amendments permit the carrying out of a range of operations that in the past were not possible in principle. The law expands the range of operations that do not require a special permit from the Central Bank. For instance, any payments made by residents outside Russia for construction, insurance and reinsurance can be made without Central Bank permission. In addition, Russian citizens are now allowed to freely transfer abroad foreign currency worth up to US$ 75,000 for the purchase of securities.

**Corporate governance ratings**

**Corporate governance code**

The EBRD sponsors a project that aims to assist the Russian Federal Commission on the Securities Market (FCSM) to develop a Corporate Governance Code, to be accompanied by an explanatory commentary that would be used as a central reference for issuers of securities. The proposed Code will be based on the OECD Principles of Corporate Governance and will provide guidance for improved corporate bylaws and operating procedures. The Code will be developed and approved by the FCSM and its application is expected to be discretionary. However, the FCSM will require Russian companies to disclose the degree of compliance with the Code’s provisions, and justify any lack of compliance. It is hoped that the Code, broadly publicised and accessible (through the assistance of other organisations), will ultimately serve as an important tool for the assessment of Russian companies’ compliance with best international practices of governance.

The EBRD project was started on 21–22 May 2001 with the first meeting of the Working Group. The international law firm of Coudert Brothers and a consortium of other advisors have been selected to assist the FCSM.

**Slovak Republic**

**Legal developments**

**Commercial code**

The Slovak Government has completed a significant amount of work on various amendments to the Commercial Code. The draft amendments are designed to significantly improve minority shareholders’ protection, incorporate the OECD principles of Corporate Governance, and further approximate Slovak commercial law with the laws of the European Union. At the time this issue went to print, the third reading and approval of the latest proposed amendments in the parliament were expected during the course of summer 2001.
Constitutional law

On 23 February 2001 the parliament adopted significant amendments to the Slovak Constitution. The amendments provide for the reform of public administration and the passage of legislation on regional elections. Amendments address parliamentary immunity, allowing for the prosecution of deputees after the expiry of their term and, in cases where parliament does not lift their immunity in criminal charges, the amendments allow for civil action by private parties against them. The amendments increase the number of Constitutional Court justices from 10 to 13, and also increase their term from 7 to 12 years. In addition, they establish the Judicial Council as a body with authority to propose nominations and removal of judges, and propose candidates for the chair and vice chair of the Supreme Court (who are, in turn, nominated by the President). The Judicial Council is composed of 18 members and is chaired by the head of the Supreme Court; eight members will be justices elected by judges, three members will be elected by parliament, three members will be nominated by the president, and three by the government. Articles regulating the competence of the Supreme Auditing Office were also substantially amended, and its powers over budgetary spending were strengthened and more clearly defined.

Money laundering legislation

On 1 January 2001 a new Law on Protection against Legalising Income from Criminal Activities entered into force. The Law is designed to help control and prevent money laundering. Among other measures, it requires so called “liable entities” (for example, banks, post offices, auditors, tax advisors, insurance companies, etc.) to notify the financial police of any transactions that might involve money laundering. The Law also bans anonymous deposits. On 7 May 2001, the Slovak Republic ratified the Council of Europe Convention on Money Laundering, which will take effect on 1 September 2001. The Convention complements the recently adopted money laundering legislation.

Uzbekistan

Legal developments

Energy sector reforms

Uzbekistan is set to launch more energy sector reforms that will privatise and liberalise the domestic electricity industry. The reforms will involve the abolition of the Energy Industry and Electrification Ministry, and the privatisation of a number of state-owned companies. The intention is to replace the Ministry by an open joint-stock company, Uzbekenergo. An electricity regulator, the State Agency for Supervision in the Electricity Industry, would also be set up. The proposed reforms should encourage investment in the electricity sector.

Law on mutual investment funds

On 24 April 2001 a new Law “On Institutions of Mutual Investments” entered into force. The new Law establishes comprehensive rules for setting up, operating and liquidating mutual investment funds and asset management companies in Ukraine. Under the Law, investment funds are designed to pool investors’ monetary funds for the purposes of deriving profits from investing in securities, corporate rights and real estate.

Judicial reforms

In June 2001 the parliament approved an initial package of judicial reforms, which were expected to be signed into law by the president during July 2001. The Constitution required an overall reform of the judicial branch by 28 June 2001. Passage of this initial package will play an important part in the reform process, which is expected to include a new civil procedure, criminal procedure and administrative procedure codes. Under this initial package of reforms, an additional level of courts will be introduced, and all arbitration (commercial) courts are to be liquidated. In lieu of the commercial courts, courts of appeal and specialised courts are to be created.

Civil code

In June 2001 the parliament approved the first three volumes of the draft Civil Code - “General Concepts”, “Personal Property Rights of Natural Persons”, and “Right of Ownership and Other Rights”. The draft Civil Code is expected to include eight volumes, specifying personal property rights of natural persons and regulating property law, contracts, family law and inheritance law. A separate chapter will deal with copyright law, industrial ownership law and trademarks. It is unlikely that the full Code will be adopted before the end of 2001.

Competition law

On 11 January 2001 the parliament enacted a new Law on Protection of Economic Competition. The Law defines and sets forth the principal features of anti-competitive concerted actions of business entities, abuse of monopoly position on the market, and restrictive and discriminatory activity by business entities and their associations.

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Meetings of IOSCO’s Committee on the Implementation of “Objectives and Principles of Securities Regulations”, London and Stockholm

The International Organization for Securities Commissions’ (IOSCO) Committee on the Implementation of “Objectives and Principles of Securities Regulations” held meetings in London on 5 March and in Stockholm on 23 June 2001 respectively. The meetings were organised to discuss, among other topics, whether and how IOSCO’s “Objectives and Principles of Securities Regulations” need to be updated. The meetings also considered issues relating to the Committee’s collaboration with international financial institutions (IFIs), in particular with regard to the financial sector assessment work conducted by IFIs in various countries.

Concessions Roundtable, EBRD Annual Meeting, London

On 22 April 2001 the EBRD sponsored a legal roundtable on Building the Legal Environment for Public Private Partnerships at its Annual Meeting. The roundtable was moderated by the General Counsel of the EBRD, Participants included Emmanuel Maurice, Dr. Jernej Sekolec, the Secretary of the United Nations Commission on International Trade Law, Blanka Primec, State Under-Secretary for the Public Procurement Department of Slovenia, Christopher Clement-Davies, partner at Vinsons & Elkins in London, and Walid Labadi, Senior Counsel at the EBRD. Discussions at the roundtable focused on international and institutional efforts to build a legal environment conducive to public private partnerships, and on the issues of concern for financiers and developers in concession-based projects. Dr. Sekolec outlined efforts undertaken by UNCITRAL to increase awareness of issues relating to the development of public private partnerships, and in particular the development of the UNCITRAL Legislative Guide on Privately Financed Infrastructure Projects. Ms Primec discussed legal issues related to the development of public private partnerships in Slovenia. Mr. Labadi focused on issues of concern to lenders in assessing the bankability of concession agreements, while Mr. Clement-Davies outlined ten key issues that arise in the context of negotiating concession agreements.

Annual Conference of the Yugoslav Association of Commercial Lawyers, Vrnjačka Banja

On 23-25 May 2001 the Annual Conference of the Yugoslav Association of Commercial Lawyers took place in Vrnjačka Banja, FR Yugoslavia. The general theme of the Conference was the harmonisation of Yugoslav law with European Union law. Frederique Dahan, Counsel at the EBRD, made a presentation to the general session of the Conference, which focused on: (i) the importance of secured transactions and the EBRD’s “core principles”, (ii) the progress throughout the region since 1992, (iii) the steps needed for further legal reform, including a focus on implementation and judicial enforcement, and (iv) legal reform in FR Yugoslavia itself.

OECD Second Eurasia Corporate Governance Roundtable, Tbilisi

On 7-8 June 2001 the OECD organised the second Eurasia corporate governance roundtable in Tbilisi, Georgia. The roundtable was a well-attended event that brought together representatives of businesses, international financial institutions and academics throughout the region. The roundtable focused on transparency and disclosure issues. Participants discussed some of the key disclosure issues that affect their business and shared their experience on the ways to improve corporate governance practices in their respective sectors and countries. EBRD Counsel Alexei Zverev made a presentation describing the EBRD’s efforts to improve corporate governance through its investment operation and technical assistance. Materials from the roundtable can be found on the OECD web site (http://www.oecd.org/).

OECD, Fourth Russian Corporate Governance Roundtable, Moscow

On 20-22 June 2001 the OECD, the Russian Federal Securities Commission and the Supreme Arbitrazh Court co-hosted a corporate governance roundtable focusing on the responsibilities of the board of directors and the role of stakeholders. Participants discussed the role and responsibility of boards in OECD countries, the situation in Russia (including a presentation by Boris Fedorov, member of the Boards of Gazprom OAO, RAO UES and Sberbank) and possibilities for improving the training and qualifications of board members. During the second day, discussion centred on the role of stakeholder relations between companies and such groups as employees and creditors. The roundtable was supported by USAID and the Global Corporate Governance Forum. On 22 June the roundtable core participants group met to discuss the most recent version of the White Paper on Corporate Governance in Russia. Debate centred on the chapter on transparency and disclosure. The White Paper is expected to be finalised during the first quarter of 2002, and will serve as a blueprint for corporate governance improvements in Russia, with recommendations for action by both the Russian Government and the private sector.

UNCITRAL 34th Session, Vienna

Between 23 June and 13 July 2001, UNCITRAL held its 34th session. In response to requests at the 33rd session held last year, this year’s session considered, among other things, the possibility for UNCITRAL to resume its earlier work on the area of security interests law. The main themes discussed at the session were the reasons for using secured lending, the relationship between insolvency law and the law
on security rights, the issues pertaining to the
development of model legislative solutions on
security rights in general and the drafting of asset-
specific model legislation. The session also
discussed more specifically issues relating to
model legislation.

UNCITRAL Workshop on Privately
Financed Infrastructure Projects, Vienna

On 2-4 July 2001, UNCITRAL held a workshop
to follow-up on the successful launch of the
PFI Legislative Guide. The workshop gathered a
group of practitioners and officials from various
countries to discuss the use of the PFI Guidelines
in assisting countries to implement concession-
type arrangements. A separate session was
devoted to bringing together international financial
institutions and countries where the PFI framework
has not yet been developed to discuss the
possibilities for assistance to reform such
frameworks. EBRD Counsel Alexei Zverev
shared the EBRD’s experience as a lender
to concessionaires and as a legal technical
assistance provider to its countries of operations
to improve their concession frameworks.

World Bank Second Global
Conference on Law and Justice:
“Empowerment, Security and
Opportunity through Law and Justice”
St. Petersburg

On 8-11 July 2001 the World Bank and the
Russian Government hosted the second Global
Conference on Law and Justice. The Conference
was designed to explore a variety of legal reform
areas including: (i) building political will to support
legal and judicial reform; (ii) elements of an
effective judiciary; (iii) using law to advance
the poor; and (iv) legal reform and post-conflict
countries. The Conference was addressed by
Dmitri Kozak, Deputy Chief, President’s
Adminstration who read a statement of welcome
from President Vladimir Putin, World Bank
President James Wolfensohn and Hernando
de Soto, President, Institute for Liberty and
Democracy, Peru. Presentations were made by
judges and justices representing the Supreme or
Constitutional Courts of Bolivia, Brazil, Colombia,
East Caribbean, England and Wales, Germany,
People’s Republic of China, Russia, Sierra Leone,
South Africa, and the United States. EBRD Chief
counsel David Bernstein discussed the evaluation
of the EBRD Legal Transition Programme as part
of the panel looking at mechanisms for evaluating
legal and judicial reform assistance. The
Conference concluded with a special session
among IFIs and other legal reform donors on
improving the coordination of legal technical
assistance. Additional seminars focusing on
Europe and Central Asia, legal aid and judges took
place on 12 July 2001.

UNCITRAL Insolvency Law Working
Group Meeting, New York

UNCITRAL hosted a working group meeting
bringing together experts on international
insolvency law from IFIs, international
organisations, academia and the private sector
in New York from 23 July to 3 August 2001.
During the meeting the experts considered the
development of a detailed and comprehensive
Legislative Guide on Insolvency Law. The purpose
of the Guide will be to assist in the development
of efficient and effective legal frameworks for
insolvency. Currently, UNCITRAL has identified 14
areas on which to focus its efforts and resources.
To help the contributors, UNCITRAL prepared a
“model format” that responses should follow,
building towards “model outlines” for each of the
14 targeted areas. The Guide is intended to have
a more pragmatic and practical focus than the
recently completed and approved “matrix” of
principles produced by the World Bank.

EBRD Roundtable on South East Europe, Bucharest

In May 2002 the EBRD will host a legal roundtable during the Bank’s Annual
Meeting in Bucharest. The roundtable will consider critical legal issues
affecting south-eastern Europe, a subject which will also be the focus section
of the Spring 2002 issue of Law in transition. Participants will be announced
closer to the time on the Bank’s web site at www.ebrd.com. However, it is
expected that they will be drawn from the EBRD, government officials from
the region responsible for developing and implementing legislation, and
representatives from the local and international legal community and legal
international organisations.
The European Bank for Reconstruction and Development (EBRD) is an international institution whose members comprise 60 countries, the European Community and the European Investment Bank. The EBRD operates in the countries of central and eastern Europe and the Commonwealth of Independent States committed to multiparty democracy, pluralism, and market economies.

The EBRD’s countries of operations are: Albania, Armenia, Azerbaijan, Belarus, Bosnia and Herzegovina, Bulgaria, Croatia, Czech Republic, Estonia, FR Yugoslavia, FYR Macedonia, Georgia, Hungary, Kazakhstan, Kyrgyzstan, Latvia, Lithuania, Moldova, Poland, Romania, Russian Federation, Slovak Republic, Slovenia, Tajikistan, Turkmenistan, Ukraine and Uzbekistan.

The EBRD works through the Legal Transition Programme, which is administered by the Office of the General Counsel, to improve the legal environment of the countries in which the EBRD operates. The purpose of the Legal Transition Programme is to foster interest in, and help to define, legal reform throughout the region. The EBRD supports this goal by providing or mobilising technical assistance for specific legal assistance projects which are requested or supported by governments of the region. Legal reform activities focus on the development of the legal rules, institutions and culture on which a vibrant market-oriented economy depends.

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