trade and commerce. However, it was generally considered that establishing a unified régime was a complex problem which warranted more attention than could be given at that stage of the deliberations in respect of the draft Convention. Furthermore, liquidated damages and penalty clauses were also important in many types of contracts which were outside the scope of the draft Convention. For all these reasons, it was suggested that it would be preferable to deal with liquidated damages and penalty clauses in a separate instrument which could be applied to a wider range of international contracts and not be restricted to contracts for the international sale of goods.[c]

Desirability of unification

3. Clauses or stipulations providing for the payment of damages or of a penalty on default are in wide use in commercial contracts. Their purpose is to determine in advance the amount of damages in the event of a breach of contract or, by imposing a penalty for such breach, to encourage performance of the obligations under the contract. Frequently such clauses or stipulations are intended to serve both purposes.

4. Such clauses are attractive to merchants and their lawyers. If the sum stipulated in the clause is high enough, it increases the likelihood that the other party will perform his obligations at the time and in the manner agreed. If the other party does not perform in conformity with the contract, the clause gives an easy, rapid and clear calculation of the compensation for that breach. This is true whether the clause was intended to make an accurate estimate of the actual damages, to encourage performance by stipulating by way of penalty a sum higher than the estimated damages, or to limit damages by stipulating a sum less than the estimated damages. As a result, the likelihood of controversy between the two parties is reduced, along with the costs directly involved in settling any dispute and the danger of rupturing the business relationship between the parties.

5. These advantages of the clauses would seem to be even more significant in a contract between parties from two different countries. The possibilities for delay or failure of performance are greater, the informal pressures which can be exerted to encourage performance by the other party are less effective, and access to a foreign legal system—which would be necessary for at least one of the parties in case of litigation—is more difficult and expensive than when the contract is between two parties from the same country.

6. Nevertheless, various restrictions are placed by different legal systems on the use of such clauses. In some jurisdictions, a court will not enforce a clause in a contract unless it is construed as providing for liquidated damages rather than as providing for a penalty. In some other jurisdictions, a court may revise a clause which sets the compensation either substantially higher or substantially lower than the estimated damages. This result may reflect the view that the dominant purpose of such clauses is a pre-estimate of future damages in cases of breach or may reflect the view that the clause might have been imposed by the economically stronger party. As a result most legal systems appear to authorize the courts either to disregard such a clause or to lower the amount stipulated in it if the amount stipulated appears to be excessively high, and, in some legal systems, to raise the amount stipulated in the clause if that amount appears to be excessively low.

7. Even within legal systems which have the same underlying philosophy towards the use of these clauses there are often important differences in the law in respect of such questions as to whether damages may be awarded in addition to the stipulated sum, whether the sum may be stipulated in terms other than money, and whether a party who is not liable for damages for failure to perform his obligations because that failure was due to an impediment beyond his control is also by that impediment absolved from liability to pay the sum stipulated.

8. Since some legal systems restrict the freedom of the parties to contract in respect of liquidated damages and penalty clauses, the merchant community cannot overcome the diversity of legal régime by agreement amongst themselves. It is therefore submitted that, if unification is to be achieved, it must be by international legislation.

[c] A/32/17, annex I, paras. 510-512.

Feasibility of unification

9. Although there are important differences in public policy which lie behind the rules in respect of liquidated damages and penalty clauses in the various countries, it would appear that these differences can either be minimized or avoided. This is particularly true in respect of the rules which have developed in some countries to protect consumers from the abusive use of such clauses. The elimination of all consumer transactions from the eventual unified régime should reduce the difficulties of introducing rules which may be different from those which have been developed in the national legal systems to govern consumer as well as non-consumer contracts.

10. In addition, less opposition is to be expected to a change in the law where the clause is stipulated in a contract between parties from different States. In such a case, and in the absence of uniform legislation, rules of private international law come into operation to determine whether and to what extent a liquidated damages or penalty clause will be enforced by the foreign court that is seized of the suit. It is thus possible that, in a case before a foreign court, a party will have a penalty clause enforced against him though under the domestic law of that party's State such a clause would have been held invalid or would have been modified by reducing the damages stipulated. Conversely, a party may not be able to obtain enforcement of such a clause even though in the court of his own State adjudication would have led to a recognition of the rights stipulated in that clause.

11. It is not possible within the scope of this report to analyse the kinds of contract for which a unified régime in respect of liquidated damages and penalty clauses might be adopted. Nevertheless, in view of the fact that the common law systems and the civil law systems are in agreement that such clauses can serve a useful function but that they can be utilized to take unfair advantage of the other party, it seems reasonable to conclude that agreement could be reached on rules in respect of liquidated damages and penalty clauses for use in a wide range of contracts used in international trade.

ANNEX II*

Note by the Secretariat: international barter or exchange

1. In the course of consultations with international organizations on the future programme of work of the Commission, attention was drawn to the growing importance of transactions by barter or exchange. Such transactions can be distinguished from sale transactions in that the goods sold are not to be paid for by money, but by other goods or some other valuable consideration.

2. Legal systems approach the contract of barter or exchange in different ways. In general, civil law systems provide expressly that the provisions on sale apply, by analogy, also to barter,[a] and specify that each of the parties to a contract of barter is considered the seller of the goods which he transfers and the buyer of the goods which he receives. A similar approach is found in the Uniform Commercial Code of the United States of America which, in section 2-304, provides that "the price can be made payable in money or otherwise. If it is payable in whole or in part in goods each party is a seller of the goods which he is to transfer."

3. The approach of common law countries that follow the English Sale of Goods Act, 1893 is different. Section 1 of that Act restricts the meaning of a contract of sale to a contract "whereby the seller transfers or agrees to transfer the property of goods for money consideration". Where the consideration for the transfer of goods is not money, there is a contract of exchange that is distinguished from a contract of sale, and the Sale of Goods Act has no direct application to such a contract.[b] Apparently, the common law principles applicable to sales of goods are ordinarily applicable to exchanges.[c]

* Originally issued as A/CN.9/149/Add.2 on 12 May 1978.

[a] E.g. Brazil, Codiglio Civil, art. 1164; Ethiopia, Civil Code, art. 2409; France, Code civil, art. 1707; Germany, Federal Republic of, BGB1. art. 515; Hungary, Civil Code, art. 386; Italy, Codice Civile, art. 1552-1555; Netherlands, Civil Code, art. 1582; Russian Soviet Federated Socialist Republic, Civil Code, art. 255; Switzerland, Code des obligations, art. 237. See also International Trade Code of Czechoslovakia, art 425.

[b] Benjamin; *Sale of Goods*, 1st ed. (1974), p. 29; Cheshire and

4. That the law relating to barter or exchange transactions is relatively undeveloped may be due to the fact that, on the domestic level, such transactions are apparently not very frequent. Where they do so occur, the provisions on sale will be made applicable by analogy in some countries or, in other countries, the comon law principles applicable to sales will apply. However, there is evidence that international barter or exchange transactions are now quite frequent and that their economic function and importance may be considerable. Thus, so-called "compensation" transactions, amounting to an exchange of goods, are often resorted to in order to ease foreign exchange difficulties.

5. It is submitted that the international barter or exchange transaction is of sufficient commercial importance to warrant further study. Such a study would probably show that a unified régime in respect of international barter transactions could not be satisfactorily established by merely widening the scope of application of the draft Convention on the International Sale of Goods so as to include such transactions. First, the provisions of that draft Convention do not, in every instance, meet the issues that are inherent in a barter transaction, and difficult problems of interpretation would arise because of the fact that goods or another consideration, not being money, are substituted for the purchase price in money. Second, the régime of remedies for non-performance would have to be adapted, in particular in connexion with the remedy which consists in a reduction of the price. Third, the sales provisions do not contain provisions relating to the supply of technical services and documentation in respect of the goods sold; under many international exchange contracts part of the consideration consists in the supply of such services and documentation.

6. It is suggested that the Commission retain provisionally the contract of international barter or exchange in its programme of work, pending a study by the Secretariat on the scope and contents of a possible uniform régime. Such a study could be submitted to the Commission at its twelfth session in 1979.

ANNEX III*

Note by the Secretariat: some legal aspects of international electronic funds transfer

INTRODUCTION

Background

1. At the Commission's fifth session (1972), in connexion with the consideration of the item "International payments", attention was drawn to the significant changes in international banking practices brought about by recent developments in electronic payment methods and procedures and the hope was expressed that the Commission's work in the field of international payments would take account of such developments.[a] At its third session, in connexion with its assessment of the desirability of preparing uniform rules applicable to international cheques, the Commission's Working Group on International Negotiable Instruments requested the Secretariat "to obtain information regarding the impact, in the near future, of the increased use of telegraphic transfers and of the development of telecommunication systems between banks on the use of cheques for settling international payments".[b]

2. The present note, prepared in the context of the Commission's impending consideration of its future programme of work, seeks to outline those legal issues in international electronic funds transfer with respect to which the Secretariat's inquiries among banking and commercial circles have revealed a need or a desire for action on the international level. It may be noted in this connexion that this subject was considered at some length at the last session of the UNCITRAL Study Group on International Negotiable Instruments (19-22 September 1977), a summary of which deliberations is included in this note (see paras. 36-48 below).[c]

The existing system

3. Electronic funds transfer (EFT) is a general term by which is comprehended all those developments in the field of payments which have as their objective, or effect, the total or partial elimination of the ordinary paper-transmitted order and the substitution therefor of machine-processible electronic impulses.

4. A numerous variety of electronic funds transfer systems (EFTS) have been developed or may be contemplated, many of which are currently in use in various countries, though largely for domestic rather than international transfers. These range from a simple system in which paper-born data is encoded by the first bank on to a magnetic tape for automatic processing by itself and subsequent banks to which the tape is delivered to such fully automatic and computerized system as the so-called point-of-sale transfer system; in the latter, the system's computer link-ups enable an authorized user, by inserting a plastic card into a terminal located at a payee-merchant's premises and punching the requisite entry in the keys, to cause funds to be transferred from his account at a bank to the merchant's account at the same or other participating bank almost instantaneously (i.e. in "real time", as it is referred to).

5. In the context of international payments, however, the two most common "electronic" means of transfer at present are still transfer by cable or by telex. These two modes of transfer may be illustrated by the following simple example. A buyer, B, wishing to transmit funds to a seller, S, in another country approaches bank X where he maintains an account and requests it to transmit for his account a specified amount to S. Bank X, having debited B's account for the amount in question or being otherwise put in funds, sends an order by cable or by telex to bank Y, its correspondent bank in the place where payment is to be made, requesting it to pay S the specified amount and debit bank X's account. Bank Y carries out the order by paying the amount personally to S, by forwarding a bank cheque to him or by depositing the amount in his bank account in bank Z, where this is known.

6. It may be observed with respect to these modes of transfer that they are at best only quasi-electronic, particularly as regards the cable transfer, in that the end-product contemplated is a piece of paper in which the payment order to bank Y is embodied and which is not directly susceptible of electronic processing by bank Y.

Future trend

7. The future trend is towards further reduction, if not eventual elimination, of the mediating role of paper in such transactions. This would not only speed up the process considerably but would lower costs by facilitating retrieval of information and by eliminating tedious manual checking of documents as well as opportunities for clerical error. A fully electronic transfer system would, in the example given above, envisage a link between the computers of banks X and Y and possibly Z either directly or, where such operates, indirectly, via a message-switching network embracing a large number of other banks. The payment order could then be executed almost instantaneously by means of credit and debit actions by the computers involved in response to electronic messages originating from the X bank computer.

8. A further requisite of a fully automatic and integrated EFTS is an arrangement for clearing of the transactions between originating and receiving banks such as is exemplified by the "automatic clearing houses" (ACH) which operate in the United States of America. These are regional associations of banks and other financial institutions each of which maintains facilities through which are channelled

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Fifoot, *Law of Contract*, third Australian edition, by J. G. Starke and P. F. P. Higgins, p. 211.

[c] Halsbury, *Laws of England*, vol. 29, 3rd ed. (1960), p. 387.

* Originally issued as A/CN.9/149/Add.3 on 1 May 1978.

[a] UNCITRAL, report on the fifth session (A/8717), para. 57 (Yearbook . . . 1972, part one, II, A).

[b] Report of the Working Group on International Negotiable Instruments on the work of its third session (1975), (A/CN.9/99), para. 136 (Yearbook . . . 1975, part two, II, 1).

[c] Attention may also be drawn to the fact that at least one State (United States of America) has formally proposed the inclusion of the item on electronic funds transfer in the Commission's future programme of work. See chap. IV, para. 17, of the present report.