



UNITED NATIONS
GENERAL
ASSEMBLY



Distr.:
GENERAL

28302

A/CN.9/247
28 February 1984

ORIGINAL: ENGLISH

UNITED NATIONS COMMISSION
ON INTERNATIONAL TRADE LAW
Seventeenth Session
New York, 25 June-13 July 1984

REPORT OF THE WORKING GROUP ON THE NEW INTERNATIONAL
ECONOMIC ORDER ON THE WORK OF ITS FIFTH SESSION
(New York, 23 January - 3 February 1984)

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INTRODUCTION

1. At its eleventh session the United Nations Commission on International Trade Law decided to include in its work programme a topic entitled "The legal implications of the new international economic order" and established a Working Group to deal with this subject. 1/ At its twelfth session the Commission designated member States of the Working Group. 2/ At its thirteenth session the Commission decided that the Working Group should be composed of all States members of the Commission. 3/ The Working Group consists of the following 36 States: Algeria, Australia, Austria, Brazil, Central African Republic, China, Cuba, Cyprus, Czechoslovakia, Egypt, France, German Democratic Republic, Germany, Federal Republic of, Guatemala, Hungary, India, Iraq, Italy, Japan, Kenya, Mexico, Nigeria, Peru, Philippines, Senegal, Sierra Leone, Singapore, Spain, Sweden, Trinidad and Tobago, Uganda, Union of Soviet Socialist Republics, United Kingdom of Great Britain and Northern Ireland, United Republic of Tanzania, United States of America and Yugoslavia.

2. At its first session the Working Group recommended to the Commission for possible inclusion in its programme, inter alia, the harmonization, unification and review of contractual provisions commonly occurring in international contracts in the field of industrial development. 4/ The Commission at its thirteenth session agreed to accord priority to work related to these contracts and requested the Secretary-General to undertake a study concerning contracts on supply and construction of large industrial works. 3/

1/ Report of the United Nations Commission on International Trade Law on the work of its eleventh session, Official Records of the General Assembly, Thirty-third Session, Supplement No. 17 (A/33/17), para. 71.

2/ Report of the United Nations Commission on International Trade Law on the work of its twelfth session, Official Records of the General Assembly, Thirty-fourth Session, Supplement No. 17 (A/34/17), para. 100.

3/ Report of the United Nations Commission on International Trade Law on the work of its thirteenth session, Official Records of the General Assembly, Thirty-fifth Session, Supplement No. 17 (A/35/17), para. 143.

4/ A/CN.9/176, para. 31.

3. The studies 5/ prepared by the Secretariat were examined by the Working Group at its second and third sessions. 6/ At its third session the Working Group requested the Secretariat, pursuant to a decision of the Commission at its fourteenth session, 7/ to commence the drafting of a legal guide on contractual provisions relating to contracts for the supply and construction of large industrial works. 8/ The legal guide is to identify the legal issues involved in such contracts and to suggest possible solutions to assist parties, in particular from developing countries, in their negotiations. 7/

4. At its fourth session the Working Group examined a draft outline of the structure of the legal guide and some sample draft chapters prepared by the Secretariat 9/ and requested the Secretariat to proceed expeditiously with the preparation of the legal guide. 10/

5. The Working Group held its fifth session in New York from 23 January to 3 February 1984. All the members of the Working Group were represented with the exception of the Central African Republic, Peru, Senegal and the United Republic of Tanzania.

6. The session was attended by observers of the following States: Argentina, Benin, Canada, Chile, Colombia, Democratic People's Republic of Korea, Finland, Honduras, Indonesia, Liberia, Netherlands, Nicaragua, Republic of Korea, Suriname, Switzerland, Thailand, Turkey and Venezuela.

7. The session was also attended by observers from the following international organizations:

(a) United Nations organs: United Nations Centre for Transnational Corporations, United Nations Industrial Development Organization and United Nations Institute for Training and Research;

(b) Specialized Agency: World Bank;

5/ A/CN.9/WG.V/WP.4 and Add.1-8, and A/CN.9/WG.V/WP.7 and Add.1-6.

6/ A/CN.9/198, paras. 11-80, and A/CN.9/217, paras. 13-129.

7/ Report of the United Nations Commission on International Trade Law on the work of its fourteenth session, Official Records of the General Assembly, Thirty-sixth Session, Supplement No. 17 (A/36/17), para. 84.

8/ A/CN.9/217, para. 130.

9/ A/CN.9/WG.V/WP.9 and Add.1-4.

10/ A/CN.9/134, paras. 51-52.

(c) Other inter-governmental organizations: Asian-African Legal Consultative Committee, European Economic Community;

(d) Non-governmental organizations: International Bar Association, International Federation of Consultative Engineers, International Chamber of Commerce.

8. The Working Group elected the following officers:

Chairman: Mr. Leif SEVON (Finland)*

Rapporteur: Mr. Peter Kihara MATHANJUKI (Kenya).

9. The Working Group had before it draft chapters of the legal guide on drawing up international contracts for construction of industrial works, on "Termination" (A/CN.9/WG.V/WP.9/Add.5), and on "Inspection and tests", "Failure to perform", "Damages", "Liquidated damages and penalty clauses", "Variation clauses", "Assignment" and "Suspension of construction" (A/CN.9/WG.V/WP.11 and Add.1-8), together with a document discussing some aspects of the format of the guide (A/CN.9/WG.V/WP.11/Add.9).

10. The Working Group adopted the following agenda:

1. Election of officers.
2. Adoption of the agenda.
3. Consideration of draft chapters of the legal guide for drawing up international contracts for the construction of industrial works.
4. Other business.
5. Adoption of the report.

11. The Working Group reaffirmed the importance of this project in the context of the new international economic order and agreed that the draft chapters should be examined keeping in view its objectives.

* The Chairman was elected in his personal capacity.

FORMAT OF THE LEGAL GUIDE

12. The Working Group discussed various issues concerning the format of the legal guide (A/CN.9/WG.V/WP.11/Add.9).

13. A view of general nature was expressed that the Guide should more clearly bring out that it only contained recommendations to the parties, and that it should avoid stating that the parties "must" or be "obliged to" include certain provisions in their contract. However, the use of such words may be necessary in the illustrative provisions of the Guide.

14. According to one view, chapter summaries were disadvantageous in that it would be difficult in such summaries to reflect the balance achieved in the text of the chapter, and in that a summary of complex legal issues and discussions could produce misleading results. The prevailing view, however, was that chapter summaries would be of great help to businessmen, contract administrators and others who had to be aware of the principal issues covered by a particular type of contract clause, but who did not require the detailed information contained in the text of the chapter.

15. It was suggested that the general approach adopted in the present set of draft chapters for summaries should be followed. In this regard, it was suggested that it would be useful for the chapter summaries to contain references to paragraphs of the text of the chapter where particular issues referred to in the summaries were used, as well as cross-references to other relevant chapters.

Index

16. It was generally agreed that the legal guide should contain a detailed alphabetical index with references to the text of the guide.

Check-lists and table of contents

17. It was suggested that a check-list for each chapter might be useful, if it were detailed enough to make the reader aware of the points discussed in the chapter. According to another view, however, a detailed table of contents could serve the same purpose. It was generally agreed that the Secretariat should consider whether it would be possible to structure a table of contents in such a way as to enable it to serve as a check-list as well, taking into account that the legal guide will also have a detailed index.

Illustrative provisions

18. With respect to illustrative provisions, the view was expressed that such provisions should not normally be included if they merely repeated what was contained in the text. Nevertheless, it was recognized that it might be desirable to include illustrative provisions on some issues even if the provisions in substance set forth what was contained in the text, because of the importance of such issues. It was suggested that in principle, illustrative provisions should be included only for the purpose of illustrating the drafting needed to cover a complex issue, or making an issue in the text easier to understand.

19. It was also suggested that the relationship among the various illustrative provisions contained in a chapter be clarified, to enable the reader to know whether two or more illustrative provisions were intended to be or could be used together.

20. The view was expressed that illustrative provisions expressed in clear language could be useful in that they could make it easier for businessmen, contract draftsmen and administrators, particularly from developing countries, to formulate contractual provisions.

21. The suggestion was made that the legal guide should make it clear that the illustrative provisions should not necessarily be regarded as models for inclusion in particular contracts. There was a general view that the Guide should present alternative illustrative provisions when it was appropriate and useful to do so.

22. It was suggested that illustrative provisions should be placed in footnotes at locations in the chapter containing the issues which are illustrated.

23. It was proposed that the Guide should contain instructions for its use.

VARIATION CLAUSES

24. The Working Group considered the draft chapter on variation clauses (A/CN.9/WG.V/WP.11/Add.6). A suggestion was made that the chapter would gain in clarity if the kinds of variations to which it related were specified at the beginning of the chapter.

25. The Working Group discussed whether variations of the work to be performed under the contract should be possible only with the consent of both parties, or whether the purchaser should be able to order variations unilaterally. The Secretariat was requested to consider whether the result should depend upon the type of works contract involved.

26. It was recognized that an appropriate balance should be struck between the principle of pacta sunt servanda and the desirability of permitting variations of the contract when they were necessary or desirable due to the complex and long-term character of works contracts. Some support was expressed for the approach taken in the draft chapter, according to which the purchaser should be able to vary the contract unilaterally, subject to certain conditions designed to protect the interests of the contractor. In this regard, it was noted that purchasers from developing countries have a particular interest in being able to order variations because, due to their lack of experience of works contracts, they are often not able to foresee at the time of concluding a contract all circumstances which may arise during construction. According to another view, the consent of both parties should be required for all variations.

27. Certain intermediate approaches were suggested. According to one, the legal guide would make no recommendation as to whether the purchaser should be able to order variations unilaterally, or whether all variations should require the consent of both parties. The guide would recommend, however, that if the parties chose to permit unilateral variations, the contract should contain provisions dealing with such issues as the effect of the variation on the contract price, time for performance and other contract terms, the scope of variations which may be ordered, the right of the contractor to object to variations, and procedures to be followed with respect to ordering and objecting to variations.

28. According to another intermediate approach, the consent of both parties would normally be required for a variation, but it would be recognized that in some situations the parties might wish to permit the purchaser unilaterally to order variations. If so, the contract should contain provisions dealing with the issues mentioned in the previous paragraph.

29. It was suggested that the scope of variations which may be ordered unilaterally by the purchaser should be restricted. Various suggestions were made for achieving this, such as permitting unilateral variations only if they have no impact on the contract price, or only up to a specified percentage of the contract price, or providing quantitative limits to certain types of variations (e.g., permitting variations of the production capacity of the works only up to a certain limit), or specifying in the contract which contractual provisions may be varied. Other suggestions included permitting unilateral variations only as to the construction of the works, and not as to the supply of equipment or materials to be incorporated in the works, or limiting the period during which unilateral variations may be made. It was noted that the limitation of unilateral variations to those "within the overall scope of the works" would become clearer when considered in relation to chapter IX of the legal guide ("Scope and quality of works").

30. With respect to the grounds on which the contractor should be able to object to a unilateral variation by the purchaser, various formulations were proposed as alternatives to the ground of "substantial prejudice" referred to in the draft chapter. Those included "unreasonably more work", "unreasonably additional cost", "undue burden" and "undue inconvenience".

31. A suggestion was made that the contract should set forth specific circumstances which would entitle the contractor to object, rather than setting forth general standards. A further suggestion was that the legal guide might propose alternative formulations of the grounds entitling the contractor to object to a unilateral variation by the purchaser.

32. A view was expressed that if the variation clause contained a list of specific circumstances which would entitle the contractor to object, the list should be only illustrative, since contractors would not agree to have their ability to object restricted to circumstances contained in an exhaustive list.

33. With respect to the time within which the contractor should be required to notify the purchaser of his objection, the view was expressed that a single time period was unrealistic. One view suggested that the contract should provide for two time periods, one within which the contractor must notify his objection, and a further period within which the contractor would be obligated to calculate and notify the purchaser of the effect of the variation on the price and time for performance, and provide the purchaser with information pertinent thereto. According to another view, the time for notification should depend upon the nature of the variation, and this period should be agreed to by the parties after the variation had been proposed.

34. With respect to the consequences of a failure by the contractor to give a timely notification, the view was expressed that a loss of the right to object and to obtain adjustments in the contract price and time for performance was too harsh. It was suggested that the legal guide should propose alternatives to these consequences. One alternative might be to obligate the contractor to pay damages to the purchaser to compensate for any loss caused by the failure to give a timely notification. Another alternative might be to obligate the contractor to perform the variation, but to allow him to obtain appropriate adjustments in the price and time for performance.

35. A suggestion was made that if the contractor objected to a unilateral variation by the purchaser, the contract should require the parties to attempt to resolve the issue themselves through negotiations. It was suggested that if the parties failed to resolve the issue, the contract should provide for it to be resolved quickly by an independent third party available on site, who possessed the knowledge and experience necessary to resolve such issues. The view was expressed that the identity of the independent third party should be specified in the contract itself. A further view was expressed that a dispute concerning the effect of the variation on the price and time for performance should be resolved separately from a dispute over whether the variation should be performed.

36. With respect to the question of whether the contractor should be obligated to perform a variation pending the settlement of a dispute concerning the variation, one view suggested that it was too burdensome to require the contractor to perform the variation pending the settlement of the dispute. Another view suggested that the independent third party who is to settle the dispute should be empowered to require the contractor to perform if he makes a prima facie finding that the purchaser is entitled to order the variation unilaterally. According to another view, however, this could be

unduly burdensome for the contractor if it is ultimately determined that the purchaser is not entitled to order the variation unilaterally. Suggestions were made that the independent third party should be empowered to condition the contractor's performance of the variation pending settlement of the dispute upon the purchaser's providing a security for the payment of the increased price which may be occasioned by the variation.

37. The view was expressed that the issue of variations proposed by the contractor was inadequately dealt with in the chapter. A reference was made to a situation which sometimes occurs in practice, in which a contractor makes an unreasonably low bid, and then during construction demands variations which he claim to be necessary for the proper functioning of the works and which result in a substantially higher contract price. It was suggested that the solution to such problems may lie in the negotiation of proper and reasonable contracts by the purchaser, assisted by the legal guide.

38. Two alternative approaches were suggested with respect to the role of a consulting engineer. Under one approach, a consulting engineer would be empowered to settle disputes concerning variations, whether or not he had been engaged by or was an agent of one of the parties. It was suggested that this approach is sometimes followed in practice. Under the other approach, even if there were a consulting engineer involved in the project, such disputes should be resolved by an independent third party.

39. With respect to guidelines for determining the effect of a variation on the contract price, it was suggested that such guidelines should be more concrete and should be expressed in quantitative terms.

40. The Working Group discussed the illustrative provisions contained in the draft chapter. It agreed that the illustrative provisions would be redrafted so as to correspond with changes to be made in the text of the chapter.

41. With respect to paragraph (4) of the illustrative provision in footnote 1, it was suggested that an alternative provision be added requiring the written agreement of both parties for any variation which would produce an increase or decrease in the contract price in excess of a specified percentage.

42. It was suggested that it be made clear that the list of circumstances in the illustrative provision in footnote 2 was open-ended and not exhaustive. It was also suggested that it be made clear that the list of circumstances need not be adopted as a whole in a particular contract. The view was also expressed that terminology other than "substantially prejudice" should be used in paragraph (a) of this illustrative provision. With respect to paragraph (c), it was suggested that an alternative provision be added whereby the contractor would be obligated to perform a variation involving the doing of work which he does not normally do only if a sub-contractor which he has already employed can perform the variation. It was suggested that the illustrative provision in footnote 4 make no recommendation as to the exact number of days within which the contractor must dispatch his notification of objection and claims to the purchaser.

ASSIGNMENT

43. The Working Group discussed the draft chapter on assignment (A/CN.9/WG.V/WP.11/Add.7). It was generally agreed that rather than using the term "assignment" an attempt should be made to use a neutral term, such as "transfer", which does not carry with it special legal meanings under particular legal systems. A suggestion was made that the chapter should state that it deals only with assignments by act of a party, and not by operation of law.

44. It was suggested that the chapter should advise the parties to consider the positions of third parties in relation to assignments. In this regard, a suggestion was made that the chapter should advise an assigning party to consider whether, under applicable law, the consent of his guarantor was needed for an assignment since under some legal systems an assignment without such consent discharged the guarantor.

45. A view was expressed that the chapter should distinguish between assignments of the contract as a whole, assignments of specific rights and assignments of specific obligations.

46. It was generally agreed that an assignment of the contract as a whole should not be permitted without the consent of the other party. It was also generally agreed that an assignment of most specific rights and obligations should also not be permitted without the consent of the other party, although, in accordance with contracting practice, an assignment by the contractor of his right to receive payments, in order to obtain financing, should be permitted without the consent of the purchaser. A view was expressed that assignments without the consent of the other party should be permitted in other cases as well, such as an assignment of the completed works by the purchaser. According to one view consent should be required in these cases as well.

47. It was suggested that the chapter should mention issues concerning succession, merger and reorganization and should call to the attention of the parties that the issues in connection with such events would be settled under the applicable law. In this regard, the Secretariat noted that some of these issues might be explored when the legal issues associated with joint ventures and consortia in the context of industrial contracts was later considered by the Working Group.

48. With respect to assignment of a contract by one State organ or enterprise to another, it was suggested that the chapter should point out that when a Government was a party to the contract, the Government might decide which organ or enterprise was to administer the contract and that this should be reflected in the contract. It was also suggested that the chapter should point out that in some cases under the applicable law an assignment might be subject to the approval of a State authority and should advise the parties to examine the applicable law in this regard.

49. It was suggested that the chapter should point out that the rights of an assignee would in some cases be governed by mandatory provisions of the applicable law and should advise the parties to ascertain the extent to which their ability in their contract to affect the rights of an assignee may be restricted.

50. For cases in which the contractor is able to assign his right to receive payments without the consent of the purchaser, it was suggested that the chapter propose two alternative means of protecting the interests of the purchaser. The first means would require the contractor to notify the purchaser of the assignment. The second means would, in addition to the notice requirement, entitle the purchaser to object to the assignment on reasonable and substantial grounds.

51. It was suggested that the chapter should mention that when a contract requires notice of an assignment to be given to the non-assigning party, the assignee might wish to ensure that such notice has been given. In this regard, however, the view was expressed that the contract could not deal with this issue. Rather, the assignee should explore his obligations and position under applicable law and take such actions as were necessary to protect his position.

52. It was noted that the consequence recommended in the draft chapter of an unauthorized assignment, e.g., that the non-assigning party should be entitled to disregard the assignment, may not be possible under applicable law. It was suggested that alternative consequences should be added, such as a right of the non-assigning party to damages, or termination. A view was expressed that the consequences of an improper assignment should be dealt with in connection with the discussion of means to protect the rights of the non-assigning party.

53. It was agreed that in the illustrative provision in footnote 3 of the draft chapter, the period of time therein specified should be deleted. It was also suggested that an illustrative provision should be added under which, if the contractor were permitted to assign his right to payments, this should be conditioned upon his undertaking to procure the assignee's consent to the right of the purchaser to set off sums owed to the purchaser by the contractor against payments to be made to the assignee.

54. It was generally agreed to delete the illustrative provision in footnote 8 of the draft chapter.

SUSPENSION OF CONSTRUCTION

55. The Working Group considered the draft chapter on suspension of construction (A/CN.9/WG.5/WP.11/Add.8). A question was raised whether the topic of suspension should not be dealt with in a separate chapter, but rather in other chapters where the topic was relevant, e.g., in the chapter on termination. It was agreed that it would be preferable to discuss the topic in a separate chapter.

56. It was suggested that the guide should propose that in respect of suspension for convenience by the purchaser, it should be required that the suspension should be effective only if exercised in good faith. The view was expressed, however, that the requirement of good faith was a general principle which might be equally applicable in other chapters and that it should be dealt with separately. Furthermore, it was noted that such a requirement might not be in accordance with the concept of suspension for convenience under which the purchaser was not obliged to indicate reasons for suspension. It was agreed, therefore, that it was unnecessary to make reference to good faith in this context.

57. In connection with the treatment in the contract of suspension by the purchaser on specific grounds, it was suggested that parties might wish to include in the contract either a complete list of grounds for suspension, or only examples of such grounds.

58. It was agreed that the view set forth in paragraph 13 was unnecessary. It was also agreed that the question of compensating the contractor for loss of profit in respect of the contract affected by the suspension should be dealt with in paragraph 12. It was suggested that compensation should be payable for such loss of profit.

59. It was suggested that the guide should not express the view set forth in paragraph 17 that the contractor should be entitled to suspend the construction in cases of failure to perform certain obligations by the purchaser. According to another view, such a provision in the contract was admissible. It was agreed to mention in the guide the possibility of specifying in the contract situations in which the contractor might suspend the contract due to the failure to perform certain obligations by the purchaser, e.g., in case the purchaser fails to fulfil his obligation to supply a design to be used for the construction by the contractor. It was suggested that such a right of the contractor should be limited to cases where the design was to be supplied by the purchaser during construction.

60. It was suggested that paragraph (7) in the illustrative clause set forth in footnote 2 should include a reference to the costs of demobilization and remobilization, including housing and transportation.

TERMINATION

61. The Working Group discussed the draft chapter on termination (A/CN.9/WG.V/WP.9/Add.5). The Secretariat informed the Working Group that this chapter would be redrafted in a style corresponding to the other draft chapters which were before the Working Group at the present session. In particular, the text would be shortened and would be presented in a less normative style, and illustrative provisions and a summary would be added.

62. A suggestion was made that the chapter should clearly state that it dealt only with the termination of a contract by a party and not with the validity of contracts under applicable law, since the latter issue was outside the scope of the legal guide. It was also suggested that the chapter should stress that, if events occur which may give rise to a right of termination, it would be desirable for the parties to attempt negotiation or conciliation before resorting to termination, which should be regarded as a remedy of last resort.

63. Partial termination was discussed and the difficulties with respect to the matter were considered. It was agreed that the parties in drafting contract provisions with respect to partial termination should consider it carefully. According to one view a discussion of partial termination would be inadvisable.

64. With respect to termination by the purchaser for a breach by the contractor, it was suggested that, rather than permitting termination if the contractor does not remedy the breach within a certain time after being notified by the purchaser to do so, the contractor should be able to avoid termination if he begins to remedy the breach within the period and progresses in accordance with a mutually agreed schedule. According to another view, both these possibilities should be presented in the chapter as alternatives.

65. A suggestion was made that the treatment of termination for abandonment of the contract by the contractor and for delay by the contractor should be placed in separate sections.

66. There was a difference of opinion as to whether the purchaser should be able to terminate for delay by the contractor only if the delay was serious. According to one view, the chapter should recommend to the parties to set forth the circumstances of delay which would justify termination, without regard to their seriousness. According to another view, the contract should be terminable only if the delay was serious.

67. It was suggested that the purchaser should be able to terminate if there was one long delay of a specified period, or an accumulation of shorter delays totalling a specified period, at the purchaser's option.

68. Since the validity and effects of an assignment of the contract as a whole by the contractor in violation of the contract vary among legal systems, a suggestion was made that the chapter should recommend to the parties that they determine the effects of such an assignment by reference to the law applicable to the contract. One view was expressed that if such an assignment was not valid under applicable law, it should not be possible to terminate the contract for such an assignment. According to another view, however, the contract should be terminable even if the purported assignment was not valid, since the purported assignment could indicate a lack of interest by the contractor in performing the contract. However, it was acknowledged that a provision that the contract might be terminable in such cases could be retained.

69. In addition to permitting the purchaser to terminate if the contractor improperly purported to assign the contract as a whole, it was suggested that the purchaser should also be able to terminate if the contractor improperly purported to assign specific rights and obligations under the contract.

70. In addition to permitting the purchaser to terminate if the contractor violated a provision of the contract or applicable law prohibiting subcontracting without the purchaser's consent, it was suggested that the purchaser should be able to terminate if the contractor violated other restrictions on the ability to subcontract. In this connection, it was suggested that the chapter should mention that restrictions on the ability of the contractor to subcontract might be imposed by applicable law, in addition to restrictions set forth in the contract itself.

71. A suggestion was made that even if the contract did not permit termination for trivial breaches, it should be made clear that the purchaser's other remedies in respect of such breaches were not prejudiced. It was also suggested that a failure to exercise the right of termination in one instance should not prejudice a party's right to terminate in other instances.

72. With respect to termination due to the bankruptcy of a party, it was suggested that the chapter mention that in some legal systems a contract could not be terminated when a party was bankrupt, and the parties should be advised to explore carefully the applicable law in this regard. It was suggested that, if permitted by applicable law, the contract should be terminable if a party entered receivership.

73. A suggestion was made that termination in the event of bankruptcy or similar proceedings should be permitted only after allowing a period of time which would allow the party affected to take steps to have the proceedings dismissed or stayed.

74. According to one view, the treatment of termination for convenience should be deleted from the chapter, since termination should be resorted to only as a last resort. According to another view, however, this treatment should be retained because, due to the high cost to the purchaser of terminating for convenience, it would in fact be used only as a last resort. In addition, according to this view, a provision permitting termination for convenience benefited both parties by providing an orderly and certain procedure for such a termination in the limited areas when it became necessary, without having to rely on applicable law.

75. It was suggested that the chapter should make it clear that the consequence of termination for convenience, particularly with respect to the costs of such termination to the purchasers, would be different from the consequences of termination by the purchaser on grounds of a breach by the contractor or circumstances not within the responsibility of either party.

76. With respect to termination by the contractor for interference by the purchaser with the contractor's work, it was suggested that the contract specify types of interference which would give rise to a right of termination.

77. It was agreed that the treatment in the chapter of termination when performance was prevented by the actions of a State should be deleted and that the chapter should merely state that the validity of the exercise of jurisdiction by a State and its consequences under national law were beyond the scope of the legal guide.

78. It was suggested that the chapter should mention the possibility of enabling the non-terminating party to ask the party entitled to terminate whether he would do so, thus reducing the uncertainty as to the continuance of the contract. However, it was noted that such a provision may not be suited to all situations in which the right of termination existed under a works contract, since, for example, in cases of delay by the contractor, the purchaser might wish to postpone the decision of whether to terminate in order to see whether the work would resume. Furthermore, if the purchaser renounced his right to terminate, and thought the contractor failed to perform or cure defects, the purchaser may be left without a remedy.

79. A suggestion was made that the legal guide should deal in general with issues related to the giving of notice in works contracts. It was suggested that the chapter should advise the parties to consider the possibility of notice being given to a representative of a party on site.

80. With respect to the hiring of a new contractor to replace a terminated contractor, it was suggested that the chapter refer to the fact that the surety under a performance bond sometimes provided a new contractor, and that a cross-reference be made to the chapter dealing with performance bonds.

81. A suggestion was made that in addition to being obligated to deliver existing drawings and descriptive documents to the purchaser, a contractor, upon termination of the contract, should be obligated to create and deliver such necessary drawings or descriptive documents that have not yet been created.

82. It was suggested that in connection with the treatment of payments to be made to a contractor when the contract is terminated, reference should be made to any obligation on the part of the contractor to mitigate his losses. A suggestion was made that when the contract is terminated due to circumstances within the responsibility of the purchaser, or for convenience, the purchaser should reimburse the contractor for his costs incidental to the termination only to the extent that they are not already included in the contract price.

83. With regard to the losses in respect of which a purchaser would be entitled to be compensated in the event of termination, it was suggested that reference be made to the possibility of limiting such damages to a liquidated sum.

84. With respect to the treatment in the chapter of the question whether the contractor should be entitled to be compensated for his lost profit on the terminated portion of the contract when the contract was terminated for convenience by the purchaser, differing views were expressed. According to one view, the contractor should be compensated for his lost profit on the contract in question, since the contractor may have foregone other contracting

opportunities in anticipation of completing the contract in its entirety. Another view suggested that the contractor should be compensated for some of his lost profit through the payment of a premium or penalty by the purchaser. On the other hand, it was suggested that if the purchaser had to compensate the contractor for his lost profit, termination for convenience would be deprived of its purpose. A further view suggested that rather than making any recommendation on the question, the chapter should merely advise the parties to consider whether and to what extent the contractor should be entitled to his lost profit, and how this profit should be calculated. It was also suggested that the chapter should note that in international practice, while under some works contracts the contractor was not entitled to his lost profits, under other contracts he was so entitled. A suggestion was made that the practice in this regard should be investigated further by the Secretariat.

85. It was suggested that the chapter should deal with the question whether the contractor should be able to terminate even after the purchaser made a delayed payment, and whether the purchaser should be able to terminate even after the contractor had completed performance after delay.

INSPECTION AND TESTS

86. The Working Group considered the draft chapter on inspection and tests (A/CN.9/WG.V/WP.11/Add.1). There was agreement that certain parts of the chapter should be redrafted with a greater emphasis on suggestions as to what parties might include in their contract. Suggestions were also made for improving the terminology used in the draft chapter.

87. It was pointed out that the phrase "inspection and tests" was uniformly used throughout the chapter. It was noted, however, that in respect of some situations to which the phrase was applied, only the term "inspection" was relevant, while in respect of others only the term "tests" should be used. It was also observed that the guide should indicate that the kinds of inspection and tests might differ in various situations and might also differ depending on the type of contract concluded by the parties.

88. The view was expressed that the section on "general remarks" did not sufficiently clarify the distinctions between inspections and tests during manufacture, building and erection, and those upon completion. It was suggested that the differing functions of these inspections and tests, and their different legal consequences, should be amplified.

89. It was observed that, while all testing requirements did not need to be expressly specified in the contract documents, it was nevertheless advisable that they should be specified in as much detail as was appropriate. Such a course would reduce possible disputes at a later stage.

90. There was general agreement that inspection by the purchaser's personnel during manufacture may give such personnel an opportunity to acquaint themselves with certain aspects of the plant. The view was expressed, however, that improper operation of equipment by the purchaser's personnel during such inspection might lead to defects in the equipment and might, therefore, diminish the contractor's responsibility for providing equipment free of defects.

91. The question of possible restrictions on the purchaser's access to sites of manufacture because of the need to protect confidential information was discussed. It was observed that, in addition to the factors which might restrict access noted in the chapter, the public law in the country of manufacture relating to secrecy might restrict access. However, the view was expressed that confidentiality should not be unduly overemphasized so as to unnecessarily limit participation by the purchaser in inspection and tests. It was also noted that the contracts under discussion always involved to a certain degree a transfer of technology, and concern was expressed that restrictions on access might hinder the transfer of technology. It was noted in that connection that the legal guide would contain a separate chapter on the transfer of technology and that that issue could be addressed therein.

92. In regard to tests additional to or different from those originally specified in the contract, it was suggested that the contract should provide that such tests should only be permitted with the consent of both parties, but that the contract should also provide that consent could not be unreasonably withheld. It was further suggested that what was to be regarded as standard practice should be clarified in the contract. The view was expressed that if a requirement by the purchaser of additional or modified tests caused delay and consequent loss to the contractor, he should be compensated for such loss. The view was expressed that the attention of the parties should be drawn to the fact that the practice as to the tests might change after the conclusion of the contract and that, therefore, the contract should deal therewith in one way or another.

93. Suggestions were made in regard to the section dealing with inspection of shipments relating to payments and passing of risks. Concern was expressed that, if such inspection were made by third parties, confidential information might be wrongfully divulged. It was stated, however, that this might be prevented by providing that the inspection was to be made by an agent of the party entitled to inspect. Furthermore, it was noted that inspections of the kind referred to would mainly be visual inspections to ascertain shortages or breakages, as in a normal sale of goods transaction, and would not involve the operation of machinery or inspection of technical documents. The view was also expressed that the relationship between inspection and the passing of risks should be clarified. The passing of risks occurred by operation of law and was unconnected with inspection. It was noted, however, that under certain contracts for the supply of machinery or equipment, the responsibility of the supplier for the condition and quality of the goods might end with the shipment, and that the contract might provide that the risk of loss of or damage to the goods passed to the purchaser after inspection. In that connection, it was pointed out by the Secretariat that the passing of risk and the transfer of property would be dealt with in detail in two separate chapters. It was also noted that inspection of the packing of goods was often important and should be mentioned.

94. The view was expressed that the chapter should provide more detailed suggestions as to certain procedural aspects of inspection and tests. Additional information should be supplied as to possible methods of collaboration between the parties in the keeping and production of records of the work done and in verifying and preserving the records of inspection and tests.

95. In regard to mechanical completion tests, it was observed that the chapter should mention the possibility of performing certain tests even before the date fixed for completion, as sometimes occurred in practice. In regard to performance tests, it was observed that, in exceptional cases, those were conducted by the purchaser, and that the chapter should deal with the issues which might arise in such cases.

96. There was general agreement that the Secretariat should add some illustrative provisions relating to situations dealt with in the chapter where the procedures envisaged were complex and needed to be clearly described.

97. A suggestion was made that the summary of this chapter should refer to the availability of international inspection services and standards.

FAILURE TO PERFORM

98. The Working Group considered the draft chapter on failure to perform (A/CN.9/WG.5/WP.11/Add.3). It was suggested that the chapter should be drafted in a style which would give more guidance to the parties and should present various options and examples where appropriate.

99. It was decided that, in the light of the issues covered by the chapter, an appropriate title to it would be "Delay, defects and other failures to perform". It was suggested that an introductory section of the chapter should clarify the system of remedies proposed and their interrelationship. Various suggestions were made for the elaboration of certain paragraphs to clarify the situations covered by them. The inclusion of more cross-references to other chapters was recommended.

100. Some suggestions were made in respect of the terminology to be used; for example, different terms should be used to describe equipment to be incorporated in the works and equipment of the contractor used for effecting the construction. It was suggested that some issues dealt with in the chapter might more appropriately be dealt with in other chapters. For example, the issues of the quality of the equipment and services to be supplied and the standards for performance and functioning of the works discussed in paragraphs 12 to 15 might be discussed in the chapter entitled "Scope and quality of works".

101. It was suggested that this chapter should deal only with the remedies available to the purchaser in case of a breach of a quality guarantee and that the nature and scope of the guarantee should be dealt with in another chapter, for example in the chapter entitled "Scope and quality of works" or the one entitled "Completion, take-over and acceptance". It was agreed that the Secretariat should find a more appropriate place in the legal guide for the treatment of the guarantee in the light of the discussion.

102. It was suggested that this chapter should include a consolidated description of the main categories of delay by either party and should have, if necessary, cross-references to other chapters. One view was that the issue of the delay of the purchaser to pay the price should be dealt with in the chapter entitled "Price".

103. A suggestion was made to exclude from the category of delay in construction by the contractor not only cases where the failure of the contractor to perform was due to the lack of co-operation of the purchaser, but also cases where such failure was due to the acts of other contractors employed by the purchaser.

104. A view was expressed that "delay" should not always be the essence of non-performance of contracts of this type. Obligations to perform contract and its breach would give rise to liability not only as provided under the contract but also as dictated by the applicable law.

105. It was suggested that the issue of liability of the contractor for failure in the training of the purchaser's personnel should not be discussed in paragraph 21 of this chapter, but should rather be discussed in the chapter entitled "Training".

106. It was noted that in cases of partial take-over there may be several guarantee periods in respect of different parts of the works. It was agreed that it was not appropriate to indicate in the legal guide any specific guarantee period (even in the form of an example) and that parties should be advised to determine the length of such a period in the light of the relevant factors mentioned in the guide. According to one view, the legal guide should state that the parties should take into consideration usages in different industries.

107. With respect to a manufacturer's guarantee, the view was expressed that assignment of such a guarantee to the purchaser may not be permitted by the applicable law. A suggestion was made that one way of overcoming this difficulty might be for the contractor to act as the agent of the purchaser in procuring the equipment from the manufacturer.

108. The view was expressed that the legal guide should stress that the parties should take into account the rules of the applicable law in determining the remedies to be available in case of a failure to perform. It was noted that enforcing performance by the contractor was often not available or practicable as a legal remedy. However, it was desirable that in the case of a failure to perform by the contractor the purchaser should, in the first instance, request him to effect proper performance.

109. With respect to the suggested obligation of the contractor not to take from the site defective equipment at least partially paid for by the purchaser without his approval, it was pointed out that in some cases defective equipment had to be repaired in the contractor's country and removal should be possible if a financial guarantee was procured.

110. Under one view, the purchaser should bear certain consequences if he inspects equipment during manufacture and does not object to their quality. It was suggested that, for example, he should be considered to have accepted the quality if defects were discoverable by the inspection. Under another view, however, during manufacture the purchaser only participates in tests carried out by the contractor, and if the defects are discoverable they should be discovered and cured by the contractor. It was suggested that the legal guide should suggest that when the purchaser does not discover the defects, he should not lose any of his rights arising from such defects. If the purchaser discovers defects, he should be obliged to notify them to the contractor.

111. A suggestion was made that the distinction between defects which entitle the purchaser not to take over the works and other defects should be elaborated. It was suggested that some defects causing a reduction of the production capacity of the works to a specified percentage should not be considered as serious defects. It was generally agreed that the parties should be advised to specify as precisely as possible the situations where the purchaser was not obliged to take over the works.

112. It was suggested that in cases of non-performance for whatever reason, the parties should have opportunity through a process of constant interaction to agree on mutually acceptable alternatives before resorting to remedies such as cure of defects, price reduction or termination. Further, it was suggested that the Guide should provide for a clear analysis of remedies available in case of non-performance due to defects discovered during the manufacture or construction, during the guarantee period and during the post-guarantee period.

113. A view was expressed that price reduction may not be appropriate as a remedy as it might give rise to bargaining between the parties. Under another view, however, price reduction was frequently used in works contracts as a remedy and, in some situations, might be the only remedy which was practicable. The question was raised whether, instead of the term "value", another term might be used in connection with the calculation of the price reduction. It was also suggested that the relationship between price reduction and damages should be clarified.

114. It was suggested that the remedies available in respect of defects discovered and notified after the take-over but during the guarantee period might be more limited in comparison with the remedies available in respect of defects discovered at taking over, e.g., price reduction may be excluded.

115. It was suggested that the time within which the purchaser might exercise the remedies of cure of defects by employing a new contractor, price reduction and termination should be clarified. A reasonable opportunity should be given to the contractor to cure the defects, and if he fails to do so the purchaser should notify him of his choice of remedy. It was suggested that paragraph 63 should be redrafted to make clearer the situation when the purchaser was entitled to change a choice of the remedy.

116. A view was expressed that in some cases it was important to the purchaser for defects to be cured immediately. It was suggested that in such cases the purchaser should be able to hire a new contractor immediately to cure the defects, at the expense of the first contractor, rather than being required to notify the first contractor of the defects and to give him an opportunity to cure them. It was also suggested that the purchaser should be permitted in some cases to cure the defects himself.

117. A discussion was held concerning the remedy of permitting the purchaser to hire a new contractor to cure defects caused by the first contractor. It was suggested that the chapter should alert the purchaser to the fact that under some performance bonds the hiring of a new contractor was subject to the consent of the surety.

118. It was agreed that the costs of hiring a new contractor should be borne by the first contractor. However, different views were expressed concerning whether the efforts by the new contractor to cure the defects should be at the risk of the first contractor. According to one view, the first contractor should not bear this risk. Another view suggested that it might be appropriate for the first contractor to bear this risk in the case of a separate contract dealing with a part of the works (e.g., a contract for electrical or mechanical work), but it would not be appropriate in a contract for the construction of the entire works. A third view suggested that the first contractor should bear the risk of all defects in work performed by him unless he proved that the defect was caused by the new contractor. In such a case, the first contractor and the new contractor should each be responsible for his own defects. It was also suggested that the original contractor and the contractor engaged by the purchaser could be jointly liable as regards defects. According to another view this should only be the case where the defects could not be attributable to either of these contractors. A suggestion was made that the chapter should provide various alternatives with respect to this question, including the bearing of risk by the first contractor, but that in connection with the latter alternative reference should be made to contract forms or general conditions which contain that alternative.

119. Reference was made to the possibility mentioned in paragraph 72 that the liability of the contractor for the purchaser's lost profits might be limited to cases in which the contractor intentionally caused a delay, or performed with defects intentionally or with knowledge that defects would result. A view was expressed that such a limitation on the recovery of lost profits by the purchaser was excessive. A suggestion was made that the chapter present, as alternatives, this limitation together with the ability of the purchaser to recover his lost profits fully. Another suggestion was made that the section on damages for failure to perform be removed from the chapter and included in the chapter entitled "Damages".

120. With respect to the obligation of the purchaser to pay interest when he fails to make a payment on the due date, a view was expressed that the purchaser should be obligated to pay interest even when his failure to pay on time was due to an exempting impediment. A different view was also expressed in this regard. As to the interest rate to be applied, one view suggested

that the contract merely refer to applicable law, while another view suggested that the contract provide a specific rate or formula for determining the rate. A suggestion was made that the rate or formula should be one used in the particular industry involved. A further suggestion was that the interest rate should be related to the contractor's borrowing rate.

121. Reference was made to the obligations of the purchaser to notify the contractor of defects discovered during the guarantee period. Differing opinions were expressed as to the consequence of a failure by the purchaser to give such notice in time. According to one view, in the event of such a failure the purchaser should lose his rights with respect to the contractor's defective performance, while, according to another view, he should not lose his rights, but he should be obligated to compensate the contractor for losses caused by a failure to give timely notice. It was suggested that the chapter should present both these approaches as alternatives. It was also suggested, however, that the purchaser should lose his rights if he does not give notice within the guarantee period. With respect to whether the consequences of a failure to notify in time should arise if the purchaser does not dispatch a notice in time, or whether they should arise if the notice is not received by the contractor in time, it was suggested that both these approaches should be presented in the chapter as alternatives.

122. It was agreed that the summary of the chapter should be redrafted so as to correspond with changes in the text. A suggestion was made that the summary refer to two types of situations which might be considered delay, i.e. performance which occurred late, and performance which had not occurred at all.

123. It was agreed that the illustrative provisions should be redrafted so as to correspond with changes in the text. It was suggested that, in the illustrative provision in footnote 1, it should be made clear that the contractor's guarantee covered only equipment, materials and supplies which were incorporated in the works. A suggestion was made that the illustrative provision in footnote 2 make it clear that it was not intended to be an exhaustive list of exclusions from the guarantee, but merely illustrations, and that the parties could choose such of those exclusions mentioned which were useful or appropriate to their contract.

124. A suggestion was made for the addition to the illustrative provision in footnote 3 of an optional provision for a maximum guarantee period. A suggestion was also made for the addition of an optional provision under which the guarantee period would be suspended when the works were incapable of operation and resumed when they became capable of operation. It was also suggested that it be made clear that when a part of the works was repaired or replaced, a new guarantee period would cover only that part, and not the entire works.

125. Various suggestions were made concerning the desirability of including in the illustrative provision in footnote 10 specific figures as to the percentage of price reduction to which the purchaser would be entitled. One suggestion was that the figures should be omitted, as they might not be appropriate in some contracts and could mislead readers of the legal guide. Another suggestion was that the figures should be placed in square brackets.

It was agreed that the Secretariat should consider the best way to deal with this question, including the possibility of a text or verbal description of different methods of price reduction, such as a progressive, degressive or proportional reduction. It was suggested that the illustrative provision should note that this mechanism for determining a price reduction was useful only for turn-key contracts.

126. Various other suggestions were made for improving the drafting of the illustrative provisions.

DAMAGES

127. The Working Group held an exchange of general observations on the draft chapter on damages (A/CN.9/WG.5/WP.11/Add.4). The view was expressed that there was a need to emphasize the limitations on the contractor's liability which existed in practice in relation to works contracts. Thus the liabilities of the contractor under quality guarantees, his liabilities covered by various forms of insurance and his extra-contractual liabilities were all, in practice, subject to certain forms of limitation. Under another view, however, the chapter should stress that the purchaser was likely to suffer serious loss by failure of performance on the part of the contractor, and the legal guide should indicate that he should be compensated for such losses. It was observed that one approach to resolve that difference of views was to distinguish between direct losses (in respect of which liability should in principle be unlimited) and indirect losses (in respect of which the parties should be advised to provide in their contract for a proper limitation of liability). It was also suggested that the parties should consider an overall limitation of liability on part of both parties. Discussion continued and it was decided to revert to this issue at the next session of the Working Group.

128. There was general agreement that it would be advantageous to include in the chapter an introductory section which would mention methods other than damages of compensating the purchaser for loss (e.g., insurance, performance bonds and guarantees, liquidated damages) and would indicate the interrelationship between these various methods. Thereafter, the chapter could deal with various possible approaches to settling the question of recovery of damages and indicate the relative advantages and disadvantages of each approach, as well as the impact of the various approaches on other methods of obtaining compensation (e.g., a restricted liability for damages may necessitate the taking out of insurance with a wide coverage). The parties should also be advised to consider the applicable law relating to damages and the extent to which it might be desirable or possible to modify the impact of such law by agreement. The chapter would, therefore, indicate the risks the purchaser might bear under different contractual arrangements and the techniques which he might adopt to cover such risks.

129. The view was expressed that the terminology used in the chapter should be clarified and, in particular, that attention should be paid to the terms "liability" and "responsibility" and to the distinction between "compensation" and "damages". It was noted that the distinction between "compensation" and "damages" resulted in certain sections of the chapter (e.g., the section relating to mitigation of losses) not applying to cases where compensation and not damages was payable, and that this might not always be advisable.

130. A view was expressed that no suggestions should be made in the Guide that the parties should provide for a limitation of liability of the contractor to compensate any loss caused by him to the purchaser.

131. It was agreed that the Working Group should, at its next session, continue its deliberations on the basis of the draft chapter, which would then be examined in detail.

OTHER BUSINESS AND FUTURE WORK

132. There was general agreement in the Working Group that the work on the legal guide should proceed as quickly as possible and that two sessions of the Working Group should, whenever feasible, be held every year in order to expedite the work. The Secretary of the Commission informed the Working Group that, subject to approval by the Commission, the sixth session of the Working Group could be held at Vienna from 10 to 21 September 1984 and the seventh session in New York in February 1985.

133. The Working Group was informed that, due to the limited capacity of the Arabic Translation Service at Vienna, it had been impossible to provide the Arabic version of documents for the present session of the Working Group, but that all efforts would be made to provide Arabic Translation of documents starting from the next session. The Working Group welcomed this information and agreed that the availability of the Arabic version of documents would be highly desirable, particularly in the light of the objective sought in the preparation of the legal guide.

134. At the close of the session, the Working Group expressed its appreciation to its Chairman, Mr. Leif Sevón for his assistance and guidance. Appreciation was also expressed on behalf of the Group of 77 which recognized the value of the Chairman's services from the point of view of developing countries.