



# General Assembly

Distr.: General  
18 March 2008

Original: English

## United Nations Commission on International Trade Law

Forty-first session

New York, 16 June-3 July 2008

### Indicators of Commercial Fraud (A/CN.9/624, A/CN.9/624/Add.1, and A/CN.9/624/Add.2)

#### Compilation of comments by Governments and international organizations

Note by the Secretariat

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## I. Introduction

1. At its fortieth session (Vienna, 25 June to 12 July 2007, resumed 10 to 14 December 2007) the Commission commended the Secretariat, the experts and the other interested organizations that had collaborated on the preparation of the indicators of commercial fraud (A/CN.9/624, A/CN.9/624/Add.1 and A/CN.9/624/2) for their work on the difficult task of identifying the issues and in drafting materials that could be of great educational and preventive benefit. At that session, the Commission requested the Secretariat to circulate the materials on indicators of commercial fraud prior to the forty-first session of the Commission for comment.<sup>1</sup>
2. By a note verbale dated 8 August 2007 and a letter dated 20 September 2007, the draft text of the indicators of commercial fraud was transmitted to States and to intergovernmental and international non-governmental organizations that are invited to attend the meetings of the Commission and its working groups as observers.
3. The present document reproduces comments received by the Secretariat on the draft indicators of commercial fraud. Comments received by the Secretariat after the issuance of the present document will be published as addenda thereto in the order in which they are received.
4. Following its consideration of the comments of Governments and international organizations as set out below and in addenda to this document, the Commission may wish to consider how to proceed with respect to the indicators of commercial fraud. Given the technical nature of the comments received, the Secretariat could, for example, be requested to make such changes as are advisable following the consideration of the materials by the Commission, and to publish the materials as a Secretariat informational note for educational purposes and fraud prevention. The materials could be incorporated by the Secretariat as a component of its broader technical assistance work, which could include dissemination and explanation to Governments and international organizations intended to enhance the educational and preventive advantages of the materials. Further, Governments and international organizations could be encouraged in turn to publicize the materials and make use of them in whatever manner is appropriate, including tailoring them to meet the needs of particular audiences or industries.

## II. Comments received from Governments and international organizations

### A. States

#### 1. Latvia

[Original: English]  
[12 February 2008]

5. At the beginning of the draft “Indicators of Commercial Fraud” it could be useful to include explanations of terms used in the document, i.e., due diligence, loss of value, etc.

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<sup>1</sup> *Official Records of the General Assembly, Sixty-second Session, Supplement No. 17 (A/62/17)*, paragraph 200.

6. Latvia suggests to include also recommendations to State institutions.
7. There are several general recommendations, which do not refer to a concrete indicator. In order to avoid repeating the recommendations under each indicator such recommendations should be described separately from the indicators.
8. Some indicators are overlapping, that is why it could be useful to combine them:
  - “Undue Secrecy”, “Overly Complex or Overly Simplistic Transactions” and “Questionable or Unknown Source of Repayment” because the element of secrecy and source of repayment are already included in the indicator “Overly Complex or Overly Simplistic Transactions”.
  - “Inconsistencies in the Transaction” and “Irrational or Illogical Aspects or Explanations” because the inconsistency in the transaction is already included in the indicator “Irrational or Illogical Aspects or Explanations”.
  - “Fraud By or Involving Employees” and “Corrupted Incentives”.
9. It would be helpful to list all the indicators in two parts:
  - “Schemes of Fraud in particular spheres” (i.e., “Pyramid and Multi-Level Marketing Schemes”, “Fraud Based on Abuse of Personal Affinity or Relationships”, “Frauds Involving Goods and Services”, “Securities Fraud and Market Abuse”, “Misuse of Insolvency Proceedings”).
  - “Elements of Fraud” where other indicators could be included. This part could be split in subparagraphs, for example, indicators respecting corruption (“Corrupted Incentives”, “Fraud By or Involving Employees” etc.).
10. It is advisable to specify under each indicator who are possible victims of fraud, i.e., individuals, legal entities, State institutions.

## 2. Lebanon

[Original: Arabic]  
[7 January 2008]

11. We are concerned to make it clear that the Indicators of Commercial Fraud are practical indicators that make it possible to give those working in the public and private sectors an idea of the methods commercial fraudsters may use, with the aim of averting that risk. The indicators are based on general principles, laws and practical experience and are not incompatible with the provisions of Lebanese law but, on the contrary, provide examples that enable it to be applied in various fields.

## 3. Turkey

[Original: English]  
[15 February 2008]

12. It is observed in the draft that commercial fraud practices targeted at rendering trade policy measures as ineffective are not comprehensively reflected upon and clearly defined. A note prepared in this regard by the Turkish Undersecretariat for Foreign Trade is enclosed herewith (see below, paras. 14 to 26).

13. Furthermore, the Turkish Government wishes to suggest the inclusion of “abuse of a right under the guise of legal entity” in the draft as a separate indicator of commercial fraud.

### **Commercial Fraud Practices Targeted At Rendering Trade Policy Measures Ineffective**

#### **Introduction**

14. The note on Commercial Fraud<sup>2</sup> submitted by United Nations Commission on International Trade Law covers a wide range of indicators of commercial fraud, gives examples of these fraudulent practices and demonstrates the possible ways to escape from becoming victims of such kinds of practices.

15. In international trade, preventing commercial fraud is of vital importance, inter alia, for sustaining the effectiveness of trade policy measures. Trade policy measures such as anti-dumping, countervailing and safeguard measures and mechanisms like price undertakings have been applied to trade in goods within the context of GATT under the auspices of WTO. The main interested parties of these measures are domestic industry in the host country, the exporter country or the company whose export is causing injury in the domestic industry, and the Government, which conducts relevant trade policy measure investigations and takes measures. In this framework, the structure of trade policy measures are not directly linked with commercial fraud practices since causing injury on domestic industry, because of imported goods, is not a violation of law. Causing injury on domestic industry is one of the components that requires an appropriate measure. Even if this injury stems from dumped or subsidized imports, which can be a cause for an unfair competitive environment, it is not the subject of commercial fraud. However, after introducing a trade policy measure into force, some fraudulent practices to render these measures ineffective fall within the scope of commercial fraud.

16. Trade policy measures are applied to the origins of specifically described goods and these measures can bring about some price controls as well. Therefore, the accuracy of origin,<sup>3</sup> description<sup>4</sup> and the value<sup>5</sup> of the goods imported, are essential in effective implementation of trade policy measures. In this context, some fraudulent practices tainting the accuracy of the above-mentioned patterns (origin, description and value of the goods) of the trade may result in circumvention of trade policy measures.

17. In the note on Commercial Fraud submitted by United Nations Commission on International Trade Law, a classification of commercial fraud based on the victims attracts the attention. In fraudulent practices targeting at circumvention of trade policy measures the victims are the domestic industry affected by injurious imports

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<sup>2</sup> A/CN.9/624, 10 May 2007.

<sup>3</sup> In some cases, declaration of exporter companies are important as well, since some measures like company specific quotas and individual anti-dumping duties, vary within the same country among different companies.

<sup>4</sup> Mainly linked with the Harmonized System (HS) Code of the goods.

<sup>5</sup> The value declared to the customs authorities and supported by commercial invoice.

and the governments losing their revenue.<sup>6</sup> The parties that profit, on the other hand, are the importer and the exporter of the goods normally subject to trade policy measures.

18. The aim of the party who resorts to fraudulent practices is to avoid paying the trade policy measure or to avoid being subject to any other non-payable measures. In general, the importer or exporter of the goods subject to the measure resort to such practices. The importer and/or exporter try to change the origin, Harmonized System (HS) Code or the value of the goods so that customs authorities of the importing countries could not treat these goods as a subject to a measure.

### **The Elements of Fraudulent Practices Targeting at Trade Policy Measures**

19. In the note on Commercial Fraud submitted by the United Nations Commission on International Trade Law, key elements to the identification of commercial fraud have been cited. It is possible to evaluate these elements by considering trade policy measures.<sup>7</sup>

(1) There is an element of deceit or of providing inaccurate, incomplete or misleading information: In this case, inaccurate, incomplete or misleading information are declared to customs authorities. For example, suppose that Country X imposed a measure to some specific goods originating in Country Y. But, the goods are declared as originating in Country Z to not being subject to the measure.

(2) There is a serious economic dimension and scale to the fraud: This element is an important aspect of fraudulent practices aiming at circumvention. Because, as a result of subsequent rounds of trade negotiations (now under the WTO umbrella) there has been a severe reduction in tariffs. This development has increased the importance of trade policy measures to protect domestic industry against imported goods. Therefore, as the tariffs have gradually been reduced, trade policy measures applied by countries have widened in range and increased in numbers. This widespread character of the measures has created a huge profit margin for fraudsters.

(3) The fraud uses or misuses and compromises or distorts commercial systems and their legitimate instruments, potentially creating an international impact: The fraud on trade policy measures threatens the very centre of multilateral trading system. In particular, anti-dumping and countervailing duties aim at preventing unfair competition stemming from dumped or subsidized imports. By circumventing these measures via fraudulent practices, unfair practices in international trade can not be prevented.

(4) There is a resultant loss of value: As it is mentioned above, domestic industry and the government in the importing country lose a significant amount of value. The government is deprived of relevant revenue; and

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<sup>6</sup> Although the aim of the duties put into force as a result of a trade policy measure is not to provide the governments with more revenue, it is a loss to the government which could not collect the duties because of fraudulent practices.

<sup>7</sup> Normally these elements are cited by considering all forms of commercial fraud. Therefore, some of them do not meet the elements of a commercial fraud aiming at circumventing trade policy measures.

domestic industry, which met the cost<sup>8</sup> of application for a trade policy measure investigation, has not been able to utilize the result of the measure.

#### **Forms of Fraud and the Ways of Dealing with it**

20. Circumvention of trade policy measures does not always stem from a fraudulent practice. There is economic circumvention<sup>9</sup> in which the practice of circumvention does not fall into the scope of criminal law. In this regard, the difference is similar to that between tax avoidance and tax evasion. While economic circumvention is not an illegal act, fraudulent circumvention is. The investigating authorities for trade policy measures are responsible for economic circumvention; the customs enforcement authorities, on the other hand, stand as relevant agents to prevent these illegal practices.

21. People may resort to these illegal practices through different ways. In the note on Commercial Fraud these ways are cited as to alert international trade community to not being a victim of fraudulent commercial practices. In this regard, since the governments are the victims of commercial fraud on trade policy measure, they have to take necessary measures against these illegal acts.

22. Fraudulent practices on documents are the most common way to circumvent a trade policy measure. The commercial invoices, certificates of origin, bills of lading, export declarations and documents of payment may be changed or reissued. Therefore, inaccurate documents may be declared to the customs authorities. Inaccurate documents are easy to issue but to discover inaccuracies is not as easy as to issue them. In such a case, the customs authorities have to cross-check suspicious documents with other supplementary documents. Asking for the accuracy of the documents of the party who purportedly issues them may be another way to deal with the problem. For example, suppose an electronic product originating in country A, which is subject to a measure is declared as originating in Country B. The customs officer knows that Country B does not have a production capacity to produce this electronic product. In this situation, the customs authority should question the accuracy and the authenticity of the documents.

23. The other common commercial fraud practice is to change the origin of the goods just on documents. In most of the countries, the chambers of commerce and industry are authorized to issue certificates of origin. Because of the huge profit margin mentioned above, issuing false certificates of origin has become a common fraudulent practice affecting the international trade. To give the specific example, since the World Trade Organization was established in 1995, more than 500 anti-dumping duties have been imposed on the products originating in the People's Republic of China. After imposition of these anti-dumping duties, the imports for the same products originating in the neighbouring countries of PRC have been increased. Unfortunately, it has been determined as the result of anti-circumvention investigations that some part of this increase was caused by the inaccurate issuance of certificates of origin by neighbouring countries. To deal with this problem,

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<sup>8</sup> This cost is an opportunity cost. There is not a requirement to pay a fee for an application for an investigation.

<sup>9</sup> This kind of circumvention practice occurs mostly when the parts or components of a product, which is originally subject to the measure, have been imported to an importing country directly or through third countries.

governments should more strictly focus on these chambers. Suspending the authority to issue the certificate of origin of chambers, which is involved in these fraudulent practices, and taking measure against relevant officers accordingly is one of the first solutions to come to mind. However, when issuing a certificate of origin, cross checking with capacity and production reports belonging to that company may be another way.

24. As far as the description of the goods is concerned, the customs authorities should strictly focus on products similar to the goods subject to trade policy measure. The goods subject to the measure may be declared with a different name. The physical appearances of the goods may be similar as well. For chemicals and textile products whose identification requires laboratory research, such fraudulent practices may be applied. Laboratory tests are essential to find out such an abuse.

### **Conclusion**

25. In circumvention practices, it is not always easy to draw the distinguishing line between illegal fraudulent acts and economic practices aiming at circumventing the measures, much like tax avoidance. Anti-circumvention investigation, which still seeks its legal base within the multilateral trade negotiations, provides the widest tools to deal with fraudulent commercial practices targeting at rendering trade policy measures ineffective. The investigating departments, which conduct anti-dumping, anti-subsidy and other trade policy investigations, are the main bodies to prevent such unfair practices.<sup>10</sup>

26. The cooperation and dialogue between countries to prevent commercial fraud is of vital importance. United Nations Commission on International Trade Law plays a crucial role to organize such cooperation between countries and it may set up a wider platform than WTO does. In attempting to summarize its views on this matter as its field of work coincides, the Republic of Turkey Prime Ministry of Undersecretariat for Foreign Trade stands ready to further cooperate on this matter with United Nations Commission on International Trade Law.

## **B. International Organizations**

### **1. European Investment Bank (Office of the President)**

[Original: English]  
[22 November 2007]

27. The United Nations Commissions are to be commended on their extensive work which further seeks to raise awareness of fraudulent schemes. In particular, I have noted with pleasure that the indicators correspond closely to the indicators (or “red flags”) of fraud and corruption that have been identified by the EIB’s Fraud Investigation Unit and their colleagues in the investigation/ integrity functions of the Multilateral Development Banks (MDBs), in the course of their investigative work.

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<sup>10</sup> In Turkey, the Prime Ministry of Undersecretariat for Foreign Trade, Directorate General of Imports is the investigating department.

28. I am also pleased to inform you that the UNCITRAL document will be a useful addition to the materials available to EIB. In particular, I wish to inform you that the Fraud Investigation Unit of the Inspectorate General will integrate elements of this document in its training so that staff members can better identify and report suspicions of fraud and corruption, as part of the process of rolling out EIB's Anti-Fraud Policy. In addition, the UNCITRAL document will also be a useful tool that the Office of the Chief Compliance Officer could employ in raising awareness among EIB's borrowers, promoters, contractors, suppliers and consultants of such issues and take into account in its Integrity check-list.

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