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Draft provisions on electronic transferable records

Note by the Secretariat

Addendum

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II. Draft provisions on electronic transferable records (continued)

C. Use of electronic transferable records (continued)

“Draft article 16. Possession

“Where the law requires the possession of a paper-based transferable document or instrument or provides consequences for the absence of possession, that requirement is met through the control of an electronic transferable record in accordance with the procedure set out in draft article 17.”

Remarks

1. Draft article 16 reflects the understanding of the Working Group that the functional equivalence of possession with respect to the use of electronic transferable records is achieved through the notion of “control” (A/CN.9/761, paras. 24-25 and A/CN.9/768, paras. 45, 77 and 85). While the Rotterdam Rules use the phrase “exclusive control” of an electronic transport record, the word “control” has been used in draft article 16 and throughout the draft provisions as the concept in itself implies exclusivity. The Working Group may wish to confirm this understanding.
2. It should also be noted that the concepts of “right of control” and “controlling party” used in the Rotterdam Rules should be distinguished from the term “control”, as those terms relate to the substantive rights of the holder of an electronic transport record (A/CN.9/768, para. 83, and A/CN.9/WG.IV/WP.122, para. 30).

“Draft article 17. Control

“1. A person has control of an electronic transferable record if a method employed for the [use] [management] of electronic transferable records reliably establishes that person as [the person which, directly or indirectly, has the de facto power over the electronic transferable record] [the person to which the electronic transferable record was issued or transferred].

“2. A method satisfies paragraph 1, and a person is deemed to have control of an electronic transferable record, if the electronic transferable record is issued and transferred in such a manner that:

[(a) the uniqueness and integrity of the electronic transferable record are preserved in accordance with draft articles 11 and 12;

(b) the electronic transferable record identifies the person asserting control as: (i) the person to which the record was issued or (ii) the person to which record was most recently transferred; and

(c) the electronic transferable record is maintained by the person asserting control].”

Remarks

3. Draft article 17 is based on the discussion of the Working Group on the notion of “control” (A/CN.9/768, paras. 77-85).
4. To illustrate the notion of control, paragraph 1 of draft article 17 states that: (a) a method employed for the use or management of electronic transferable records should be set up, which would, among others, evidence the transfer of interests as a legal consequence of the issuance or transfer of the electronic transferable record; and (b) the method should establish the person which, directly or indirectly, has the de facto power over the electronic transferable record (A/CN.9/768, para. 81). De facto power is understood to mean, among others, the power to deal with or factually dispose of the electronic transferable record but should not be understood as being the technical ability of a third-party service provider to manage the information contained in an electronic transferable record (A/CN.9/768, para. 77).
5. Whether the person with control is a rightful holder and the substantive rights conferred to that person would be determined by substantive law (A/CN.9/768, para. 77). Therefore, a person in control of an electronic transferable record might be able to dispose of the electronic transferable record, even if it might not be the rightful holder (A/CN.9/768, para. 78). In this context, the Working Group may wish to consider the treatment of persons who were not authorized to assert control.
6. As the notion of de facto power might not necessarily be clear, another way of drafting the latter part of paragraph 1 would be to state that the person with control is “the person to which the electronic transferable record was issued or transferred”. While the validity of issuance and transfer of an electronic transferable record would be determined by substantive law, such drafting would cover the two instances where a person will be able to establish control over an electronic transferable record (A/CN.9/768, para 79). However, under such an approach, an unauthorized person (for example, one who had stolen the password required to access the electronic transferable record) would not be considered as having control of the electronic transferable record as it was never issued or transferred to that person. Nonetheless, that person, just like someone who had stolen a paper-based cheque, would be in a position to deal with or dispose of the electronic transferable record. In any case, if the Working Group wishes to formulate the paragraph in this manner, it may also wish to reconsider the definition of “holder” in draft article 3, as it would result in a circular definition.
7. Identifying a person asserting control as mentioned in paragraph 2, subparagraph (b), would not necessarily mean disclosing the identity (name) of that person, as an electronic transferable record may be issued or transferred to bearer and the method employed may provide for anonymity.
8. Mindful of the principle of technological neutrality, paragraph 2 aims at providing some guidance on when and how a method would meet the reliability standard in paragraph 1. The Working Group noted that the level of reliability would vary depending on the system or types of records and that it was for the parties to choose the level of reliability adequate for their transactions (A/CN.9/768, para. 82).
9. The Working Group may wish to combine draft articles 16 and 17 (A/CN.9/768, para. 84) upon considering the content of draft article 17.

“Draft article 18. Delivery

“Where the law requires the delivery of a paper-based transferable document or instrument or provides consequences for the absence of delivery, that requirement is met with respect to the use of an electronic transferable record through the transfer of control of an electronic transferable record in accordance with draft article 21.”

“Draft article 19. Presentation

“Where the law requires the presentation of a paper-based transferable document or instrument or provides consequences for the absence of presentation, that requirement is met with respect to the use of an electronic transferable record by demonstrating that the person has control of the electronic transferable record in accordance with draft article 17.”

“Draft article 20. Endorsement

“Where the law requires the endorsement of a paper-based transferable document or instrument or provides consequences for the absence of endorsement, that requirement is met with respect to the use of an electronic transferable record when the requirements in draft articles 8 and 9 are met.”

Remarks

10. Draft article 18 reflects the understanding of the Working Group that delivery requirements are met through the transfer of control (A/CN.9/761, para. 50, and A/CN.9/768, para. 45).

11. It was pointed out that presentation including presentation for performance in an electronic environment introduced significant practical challenges due to remoteness and possible lack of familiarity between the parties (A/CN.9/761, paras. 70-71). The Working Group may wish to consider whether draft article 19 should be retained as a rule for achieving the functional equivalence of presentation, separate from those on possession and delivery, or simply be deleted as draft article 18 on delivery was sufficient (A/CN.9/768, para. 102 (c)).

12. It should be noted that draft article 19 on presentation was prepared to also cover requirements under substantive laws to “surrender” a paper-based transferable document or instrument for its performance (for example, article 47, para. 1, subpara. (a)(i), of the Rotterdam Rules). The Working Group may wish to confirm this understanding. The Working Group may also wish to note that draft articles 23 on replacement and 25 on division and consolidation respectively require “presentation” of the paper-based transferable document or the electronic transferable record.

13. Draft article 20 reflects the understanding of the Working Group that the functional equivalent of “endorsement” would be achieved when both requirements under draft article 8 (writing) and 9 (signature) are met (A/CN.9/768, para. 46). The Working Group may wish to consider whether to retain draft article 20 as a separate article or simply note this possibility.

14. Under the current approach, if both delivery and endorsement are required for the transfer of a paper-based transferable document or instrument, transfer of control of an electronic transferable record in accordance with draft article 21 without meeting the endorsement requirement would result in the transferee being in control of the record, despite not being the rightful holder. The Working Group may wish to consider whether this is the correct understanding or whether transfer of control should be understood as having met the endorsement requirement, if any.

15. With regard to the possibility of requiring or including a statement indicating transfer(s) in an electronic transferable record (A/CN.9/WG.IV/WP.122, draft article 19, para. 5), the Working Group noted that such a requirement or inclusion might introduce additional burden not present in substantive law and would frustrate the circulation of an electronic transferable record to bearer (A/CN.9/768, para. 91). In response, it was said that consideration should be given to how to record the chain of endorsements in electronic transferable records issued to a named person so as to enable the action of recourse. The Working Group may wish to consider whether draft article 20 is sufficient for this purpose.

“Draft article 21. Transfer of an electronic transferable record

“1. To transfer the electronic transferable record, the holder shall transfer the control of the record to the transferee.

“2. Subject to any rule of law governing the transfer of a paper-based transferable document or instrument, an electronic transferable record issued to bearer may be transferred to a named person and an electronic transferable record issued to a named person may be transferred to bearer.”

Remarks

16. The Working Group agreed that rules on the transfer of control should be prepared (A/CN.9/761, paras. 50-58). Paragraph 1 of draft article 21 should be understood as stating that transferring control of the electronic transferable record is necessary in order to transfer the electronic transferable record, and that further transfer requirements may exist under the substantive law (A/CN.9/768, para. 87).

17. The effectiveness or validity of the transfer of an electronic transferable record would depend on whether the transfer meets the requirements under the substantive law. In that context, draft article 21 does not aim to list all the requirements for an effective transfer nor to deal with consequences of the lack thereof (A/CN.9/768, para. 89).

18. Paragraph 2 reflects the Working Group’s discussion that transfer of control should allow for change in the manner of transmission of an electronic transferable record to the bearer if the record had been issued to a named person and vice versa (A/CN.9/761, para. 55, and A/CN.9/768, para. 88).

19. The Working Group may wish to further consider whether transfer of control would be achieved through the amendment of an electronic transferable record (A/CN.9/761, para. 49) and, if not, whether draft article 21 should include rules on the procedure for transfer of control distinct from that for amendment.

20. The Working Group may wish to further discuss the need to include provisions on the transfer of partial rights in the electronic transferable record.

“Draft article 22. Amendment of an electronic transferable record

“1. [Subject to any rule of law governing a [corresponding] paper-based transferable document or instrument], a reliable procedure for amendment of information in an electronic transferable record shall be provided whereby the amended information is reflected in the electronic transferable record and is readily identifiable as such.

“2. Upon amendment, a statement to the effect that an amendment has taken place shall be included in the electronic transferable record.”

Remarks

21. The Working Group agreed that the draft provisions should acknowledge the need to address amendments and their effectiveness, while issues of establishing which party could make such amendments and under what circumstances should be left to substantive law (A/CN.9/761, para. 49).

22. The term “amendment” could be understood in a broad sense to refer to any change or addition of information contained in an electronic transferable record, but for sake of clarity and to avoid unintended consequences, the meaning of that term would need to be qualified (A/CN.9/768, para. 96). This would also be closely related to whose consent is required for the amendment to be effective.

23. The following are issues to be considered by the Working Group. First, as mentioned above (see para. 19 above), the Working Group may wish to consider whether transfer of control would be achieved through an amendment of information about the holder (unless transferred to bearer). If not, a separate procedure should be provided in draft article 21 (A/CN.9/WG.IV/WP.122, paras. 32 and 36). Second, if the amendment relates to a change in the obligation specified in the electronic transferable record, the substantive law would generally require the consent of the obligor for such amendments. Third, there may be instances where the holder may amend the record unilaterally (for example, when an endorsement is made) (A/CN.9/761, para. 37, and A/CN.9/768, para. 96).

24. So as to achieve functional equivalence, paragraph 1 of draft article 22 states that when amendment of a paper-based transferable document or instrument is permitted under substantive law, a reliable procedure should be in place so that the amended information is reflected in the electronic transferable record and is readily identifiable as such (A/CN.9/768, para. 93). The Working Group may wish to consider whether the words in square brackets is appropriate and if not, whether the following words “where any rule of law governing a [corresponding] paper-based transferable document or instrument permits amendments” may be more appropriate.

25. With respect to paragraph 2 of draft article 22, the Working Group may wish to consider whether such a statement shall be included in the electronic transferable record or whether the fact that the amended information is readily identifiable as such in paragraph 1 is sufficient. The Working Group may wish to note that other information about the amendment (for example, the identity of the person requesting the amendment or time of request) might also need to be included in the electronic transferable record.

26. If the substantive law required that parties affected by the amendment should consent to or be notified with respect to the amendment of a paper-based document or instrument, the same requirement shall apply to the amendment of an electronic transferable record (A/CN.9/768, para. 95). The Working Group may wish to confirm its understanding that this need not be stated in the draft article.

“Draft article 23. Replacement

“1. If a paper-based transferable document or instrument has been issued and the holder and the [issuer/obligor] agree to replace that document or instrument with an electronic transferable record:

(a) The holder shall present [for replacement] the paper-based transferable document or instrument to the [issuer/obligor];

(b) The [issuer/obligor] shall issue to the holder, in place of the paper-based transferable document or instrument, an electronic transferable record in accordance with draft article 14 that includes all information contained in the paper-based transferable document or instrument and a statement to the effect that it replaced the paper-based transferable document or instrument; and

(c) Upon issuance of the electronic transferable record, the paper-based transferable document or instrument ceases to have any effect or validity.

“2. If an electronic transferable record has been issued and the holder and the [issuer/obligor] agree to replace that electronic transferable record with a paper-based document or instrument:

(a) The holder shall present [for replacement] the electronic transferable record to the [issuer/obligor];

(b) The [issuer/obligor] shall issue to the holder, in place of the electronic transferable record, a paper-based document or instrument that includes all information contained in the electronic transferable record and a statement to the effect that it replaced the electronic transferable record; and

(c) Upon issuance of the paper-based document or instrument, the electronic transferable record ceases to have any effect or validity.

“3. The consent of the parties required in paragraphs 1 and 2 may be given at any time prior to the replacement.”

Remarks

27. Draft article 23 was prepared based on article 10 of the Rotterdam Rules on replacement (A/CN.9/761, paras. 72-77). As defined in draft article 3, “replacement” refers only to the change in the medium with the legal status and information contained in the document, instrument or record unchanged. As noted (see A/CN.9/WG.IV/WP.124, para. 23), the Working Group may wish to consider whether this limited definition is appropriate for the draft provisions or if it should be broadened to include instances where an electronic transferable record was issued to substitute another electronic transferable record (for example, when the electronic transferable record was damaged or when the holder lost the password to

the electronic transferable record). The draft provisions currently do not contain draft provisions dealing with such circumstances.

28. The Working Group might further discuss which parties should need to consent to or otherwise be involved in the replacement in addition to the holder as it is very unlikely that the substantive law would have any provision regarding the change of medium (A/CN.9/761, para. 76). While a replacement would generally require the consent of the obligor(s), the obligor would, in such a case, be able to request a replacement when the document, instrument or record for performance is presented (A/CN.9/768, para. 101). Thus, requiring the obligor's consent for replacement occurring prior to presentation might not be necessary.

29. As mentioned above (see A/CN.9/WG.IV/WP.124, para. 49), when a paper-based transferable document or instrument issued in multiple originals is to be replaced with an electronic transferable record, all of the originals should be presented for replacement (A/CN.9/768, para. 73).

30. The Working Group may also wish to consider whether paragraph 2, subparagraph (b), touches upon a matter of substantive law as it deals with the issuance of a paper-based transferable document or instrument.

31. Paragraph 3 of draft article 23 states the possibility of prior consent by the parties to replacement (for example, upon issuance).

“Draft article 24. Reissuance in the original medium

“1. A reliable procedure for the reissuance of a paper-based transferable document or instrument or of an electronic transferable record in the original medium prior to its replacement in accordance with draft article 23 shall be provided.”

Remarks

32. Draft article 24 addresses circumstances where the replaced document or record would need to be restored, for example, when the new substitute document, instrument or record had not been effectively issued or had been lost (A/CN.9/761, para. 76). The Working Group may wish to consider whether the draft article should remain separate (A/CN.9/768, para. 101) or be combined with draft article 23 on replacement.

“Draft article 25. Division and consolidation of an electronic transferable record

“1. [Subject to any rule of law governing a [corresponding] paper-based transferable document or instrument], a reliable procedure to provide for the division or consolidation of electronic transferable records shall be provided.”

[“1. If an electronic transferable record has been issued and the holder and the [issuer/obligor] agree to divide the electronic transferable record into two or more electronic transferable records:

(a) The holder shall present [for division] the electronic transferable record to the [issuer/obligor];

(b) Two or more new electronic transferable records shall be issued in accordance with draft article 14 and include: (i) a statement to the effect that division has taken place; (ii) date of division; and (iii) information to identify the pre-existing electronic transferable record and the new electronic transferable records; and

(c) Upon division, the pre-existing electronic transferable record ceases to have any effect or validity and shall include: (i) a statement to the effect that division has taken place; (ii) date of division; and (iii) information to identify the resulting new electronic transferable records.

“2. If the holder of two or more electronic transferable records, the [issuer/obligor] of which is the same, agrees with the [issuer/obligor] to consolidate the electronic transferable records into a single electronic transferable record:

(a) The holder shall present [for consolidation] the electronic transferable records to the [issuer/obligor];

(b) The consolidated electronic transferable record shall be issued in accordance with draft article 14 and include: (i) a statement to the effect that consolidation has taken place; (ii) date of consolidation; and (iii) information to identify the pre-existing electronic transferable records;

(c) Upon consolidation, the pre-existing electronic transferable records cease to have any effect or validity and shall include: (i) a statement to the effect that consolidation has taken place; (ii) date of consolidation; and (iii) information to identify the consolidated electronic transferable record.”]

Remarks

33. Whether division or consolidation could take place is a matter of substantive law and the draft articles on division and consolidation would operate only when permitted under substantive law (A/CN.9/768, para. 100). The Working Group may wish to consider whether the words in square brackets are appropriate and if not, whether the following words “where any rule of law governing a [corresponding] paper-based transferable document or instrument permits division or consolidation” may be more appropriate.

34. The Working Group, however, also noted that the electronic environment made it easier to divide and consolidate electronic transferable records (A/CN.9/768, para. 100). Moreover, while the substantive law may have provisions on whether division or consolidation may take place in a paper-based environment, it would be unlikely that the substantive law would also provide procedures for division or consolidation in an electronic environment. Therefore, it may be necessary to set forth a specific procedure. Draft article 25 in square brackets has been prepared on the basis of article 10 of the Rotterdam Rules and draft article 23 on replacement for the Working Group’s consideration.

“Draft article 26. Termination of an electronic transferable record

“1. A reliable method shall be provided to prevent further circulation of the electronic transferable record [upon its termination] [when an electronic transferable record ceases to have effect or validity].

“2. Where the law requires that a statement to indicate the termination of a paper-based transferable document or instrument be included in the document or instrument, that requirement is met by including a statement in the electronic transferable record to the effect that it has been terminated.”

Remarks

35. In general, when an electronic transferable record ceases to have effect or validity is a matter of substantive law (A/CN.9/768, para. 104). The termination of the underlying performance obligation is also a matter of substantive law (A/CN.9/761, para. 78).

36. The Working Group may wish to confirm the understanding that the draft provisions need to deal with termination of an electronic transferable record only when a replacement, division or consolidation takes place in accordance with draft articles 23 and 25 as the procedure set out therein foresees the termination of replaced or pre-existing documents, instruments or records as the case might be.

37. Paragraph 1 aims at achieving the operation of the rules on termination in the substantive law in an electronic environment and states that a method that would achieve the functional equivalence of “destruction” of a paper-based transferable document or instrument should be provided in an electronic environment.

38. Paragraph 2 replicates the requirement to include annotations indicating termination in a paper-based documents or instrument. The Working Group may wish to consider whether paragraph 1 is sufficient and there is no need to retain paragraph 2.

39. The Working Group may also wish to consider whether a definition of the term “termination” should be included in draft article 3.

“Draft article 27. The use of an electronic transferable record for security right purposes

“1. [Subject to any rule of law governing a paper-based transferable document or instrument], a reliable procedure to allow the use of electronic transferable records for security right purposes shall be provided.”

Remarks

40. Draft article 27 provides a general statement that a reliable procedure should be provided so that an electronic transferable record may be used for security right purposes with the understanding that the substantive law may already provide relevant rules, which would govern the procedure for creating a security right in that document or instrument (A/CN.9/768, para. 105).

41. The UNCITRAL Legislative Guide on Secured Transactions (2007) defines a security right as a property right in a movable asset that is created by agreement and secures payment or other performance of an obligation, regardless of whether the parties have denominated it as a security right.

“Draft article 28. Retention of [information in] an electronic transferable record

“1. Where the law requires that a paper-based transferable document or instrument [or information therein] be retained, that requirement is met by retaining an electronic transferable record [or information therein] provided that the following conditions are satisfied:

(a) The information contained therein is accessible so as to be usable for subsequent reference;

(b) The integrity of the electronic transferable record is assured in accordance with draft article 12; and

(c) Information, if any, enabling the identification of the issuer and holder of the electronic transferable record and the date and time when it was issued and transferred as well as when it ceases to have any effect or validity is made available.”

Remarks

42. Draft article 28 deals with the storage of information in electronic transferable records and was prepared based on article 10 of the UNCITRAL Model Law on Electronic Commerce (A/CN.9/761, para. 81, and A/CN.9/768, para. 106). Subparagraph (b) focuses on the integrity of the record (A/CN.9/768, para. 106), yet the Working Group may wish to consider whether subparagraphs (b) and (c) deal with the same matter. The Working Group may also wish to consider whether subparagraph (c) should state that all the information in the electronic transferable record should be made available rather than listing certain types of information.

43. The Working Group may wish to consider whether a separate rule should be prepared for the retention of a paper-based transferable document or instrument or an electronic transferable record when replacement has taken place in accordance with draft article 23. It may wish to further consider whether this draft article should be expanded to cover the possibility of archiving and storing paper-based transferable documents or instruments in an electronic manner (without necessarily replacing it with an electronic transferable record).

D. Third-party service providers

44. Based on articles 9 and 10 of the UNCITRAL Model Law on Electronic Signatures, the following draft articles dealing with third-party service providers have been revised in light of the considerations by the Working Group, being particularly mindful of the principle of technological neutrality (A/CN.9/768, paras. 107-110). They are provided for guidance purposes only, encompassing all third-party service providers (A/CN.9/761, para. 27). The placement of these articles would depend on the final form of the draft provisions.

“Draft article 29. Conduct of a third-party service provider

“1. Where a third-party service provider supports the use of an electronic transferable record, that third-party service provider shall:

- (a) Act in accordance with statements made by it with respect to its policies and practices;
- (b) Exercise reasonable care to ensure the accuracy of all statements made by it;
- (c) Provide reasonably accessible means that enable a relying party to ascertain from an electronic transferable record information about it;
- (d) Provide reasonably accessible means that enable a relying party to ascertain, where relevant, from an electronic transferable record:
 - (i) The method used to identify the [issuer/obligor] and the holder;
 - (ii) That the electronic transferable record retained its integrity and has not been compromised;
 - (iii) Any limitation on the scope or extent of liability stipulated by the third-party service provider;
- (e) Use trustworthy systems, procedures and human resources in performing its services.”

“Draft article 30. Trustworthiness

“For the purposes of article 29, paragraph 1 (e) in determining whether, or to what extent, any systems, procedures and human resources utilized by a third-party service provider are trustworthy, regard may be had to the following factors:

- (a) Financial and human resources, including existence of assets;
- (b) Quality of hardware and software systems;
- (c) Procedures for processing of electronic transferable record;
- (d) Availability of information to related parties;
- (e) Regularity and extent of audit by an independent body;
- (f) The existence of a declaration by the State, an accreditation body or the third-party service provider regarding compliance with or existence of the foregoing; and
- (g) Any other relevant factor.”

E. Cross-border recognition of electronic transferable records

“Draft article 31. Non-discrimination of foreign electronic transferable records

“1. Nothing in this Law affects the application of the conflict of laws rules governing a paper-based transferable document or instrument.

“2. [An electronic transferable record shall not be denied legal effect, validity or enforceability on the sole ground that it was issued or used in a foreign State.] [In determining whether, or to what extent, an electronic transferable record is legally effective, valid or enforceable, no regard shall be had to the location where the electronic transferable record is issued or used.]”

Remarks

45. At the forty-fifth session of the Commission, in 2012, the need for an international regime to facilitate the cross-border use of electronic transferable records was emphasized.¹ The Working Group also reiterated the importance of cross-border aspects of legal recognition of electronic transferable records (A/CN.9/761, paras. 87-89).

46. Paragraph 1 reflects the Working Group’s understanding that the draft provisions should not displace existing private international law rules applicable to paper-based transferable documents or instruments (A/CN.9/768, para. 111). The Working Group may wish to consider whether to retain paragraph 1 for greater certainty or whether draft article 1, paragraph 2, is sufficient.

47. It was noted, however, that the possibility of discriminating against a foreign electronic transferable record by virtue of its origin only (or of a technology used in the electronic transferable record, for example a foreign electronic signature), should be discouraged and may deserve additional consideration. Paragraph 2 aims at addressing such concerns. Yet, it should be noted that the draft provisions do not include any reference to the “location where electronic transferable record is issued or used” other than in draft article 31.

¹ *Official Records of the General Assembly, Sixty-seventh Session, Supplement No. 17 (A/67/17)*, para. 83.