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No. 2/2023
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REVIJA KOPAONIČKE ŠKOLE PRIRODNOG PRAVA

ČASOPIS ZA PRAVNU TEORIJU I PRAKSU

Naučni časopis Kopaoničke škole prirodnog prava *Revija Kopaoničke škole prirodnog prava* izlazi od 2019. godine. Časopis objavljuje naučne članke, teorijska istraživanja i studije iz srpskog i uporednog prava, analize izabranih sudskih i arbitražnih odluka, komentare zakonskih rešenja, prikaze knjiga i druge naučne priloge istaknutih domaćih i inostranih autora. Tematska sadržina priloga prilagođena je Heksagonu Kopaoničke škole prirodnog prava: *Pravo na život, Pravo na slobodu, Pravo na imovinu, Pravo na intelektualnu tvorevinu, Pravo na pravdu i Pravo na pravnu državu,* a objavljeni radovi raspoređuju se prema odgovarajućim katedrama Kopaoničke škole. Kao glasilo Kopaoničke škole prirodnog prava – Slobodan Perović, časopis prati naučni rad i aktivnosti Škole i o njima obaveštava čitaoce.

KOPAONIČKA ŠKOLA PRIRODNOG PRAVA
– SLOBODAN PEROVIĆ

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REČ UREDNIKA

Izlaskom ovog izdanja iz štampe *Revija Kopaoničke škole prirodnog prava* zaokružuje četiri godine života u svetu juristička pisane reči, gradeći biblioteku koja broji više hiljada stranica. Tokom prethodnog perioda, *Revija* je postala poznata pravničkoj javnosti i stekla naklonost i poverenje u akademskim krugovima. Danas, na nama je odgovornost da istrajemo na putu daljeg razvoja i stalnog usavršavanja našeg naučnog časopisa.

* * *

Ovo izdanje *Revije Kopaoničke škole prirodnog prava* okuplja šest naučnih radova posvećenih sudskom postupku, arbitraži i međunarodnoj prodaji robe. Sa aspekta sistematike Heksagona prirodnog prava, radovi po svojoj tematskoj sadržini ulaze u oblast katedara *Pravo na imovinu* i *Pravo na pravdu* Kopaoničke škole prirodnog prava – Slobodan Perović.

Prva sekcija sadrži članak *Litigation Risks in the Financial Sector and Climate Change* (*Rizici sudskih sporova u finansijskom sektoru i klimatske promene*) autora *prof. dr Pilar Perales Viscasillas*. U članku su analizirane različite vrste sporova u finansijskom sektoru u kontekstu klimatskih promena i podvučen rastući značaj ovog pitanja, u cilju korigovanja korporativnog ponašanja.

Druga sekcija sadrži radove iz oblasti arbitraže.

Prof. dr Alfredo Ferrante napisao je rad *Breach of the Arbitration Agreement, Defaulting Defendant in Litigation and New York Convention's Model Fluctuations: the Italian and Brazilian Examples* (*Povreda arbitražnog sporazuma, izostanak tuženog sa ročišta i fluktuacija modela Njujorške konvencije: italijanski i brazilski model*). U fokusu pažnje nalazi se pitanje procene efikasnosti arbitražnog sporazuma onda kad tužilac ne pokrene arbitražni postupak, već tradicionalni sudski spor, pre svega u slučaju kontumacije i nepodnošenja odgovora na tužbu od strane tuženog. U kontekstu odgovora na ovo i druga povezana pitanja, autor analizira relevantna pravila Njujorške konvencije i UNCITRAL Model zakona o međunarodnoj trgovinskoj arbitraži, kao i odgovarajuća rešenja u italijanskom i brazilskom pravu.

Milan Lazić i *Srđan Dragićević* u radu *Cryptoassets and Arbitration in Serbia* (*Kripto-imovina i arbitraža u Srbiji*) istraživali su da li je Srbija pogodna jurisdikcija za sporove vezane za digitalnu imovinu kao sedište arbitraže, odnosno pogodna jurisdikcija za priznanje i izvršenje arbitražnih odluka. Na osnovu analize pomenutih pitanja, autori zaključuju da je Srbija pogodna jurisdikcija kako za sam arbitražni postupak, tako i za priznanje i izvršenje arbitražnih odluka, ali da specifičnosti srpskog pravnog sistema, a posebno pravosuđa i sudske prakse, stvaraju određene probleme.

David Wohlgemuth u radu *Selected Overview of Recent Swiss Case Law in International Arbitration* (*Pogled na odabrane slučajeve novije švajcarske sudske prakse u oblasti međunarodne arbitraže*) detaljno analizira četiri odabrana pitanja koja su bila predmet nedavnih odluka švajcarskog Saveznog suda u kontekstu međunarodne arbitraže sa sedištem u Švajcarskoj.

U ovom broju *Revije* objavljujemo i dva naučna rada u formi priloga.

Prvi prilog predstavlja rad *Conflicts of Interest between Sharia and International Sale of Goods: Does CISG Interest Fit with Islamic Law?* (*Sukob interesa između šerijatskog prava i međunarodne prodaje robe: jesu li interesi Bečke konvencije usklađeni sa islamskim zakonom?*), čije su autorke *dr Lisa Spagnolo* i *dr Maria Bhatti*. U radu je analizirano pitanje da li se pravila o kamati sadržana u Bečkoj konvenciji mogu uskladiti sa šerijatskim pravom, polazeći od zabrana *ribe* i *gharara.* U radu je detaljno razmotreno i tumačenje obaveze plaćanja kamate u okviru pravila same Bečke konvencije. Na osnovu učinjene analize, autorke zaključuju da bi Bečka konvencija i šerijatsko pravo bez sumnje postali kompatibilni ukoliko bi se u Mišljenje broj 14 Savetodavnog tela za tumačenje Bečke konvencije unele odgovarajuće manje izmene.

Rad *Application of the CISG to International Government Contracts for the Procurement of Goods* (*Primena Bečke konvencije o međunarodnoj prodaji robe na međunarodne vladine ugovore o javnim nabavkama*) čiji je autor *Cesar Pereira* objavljujemo kao drugi prilog u ovom broju. U radu je analiziran odnos između Bečke konvencije o međunarodnoj prodaji robe i propisa o javnim nabavkama u svetlu sudske prakse, prakse pojedinih vlada i međunarodnih agencija, kao i brojnih tumačenja Bečke konvencije i modela međunarodnih javnih nabavki. Autor analizira i prednosti usvajanja jedinstvene regulative ugovora na koje se primenjuje Bečka konvencija, kao i moguće teškoće u postupcima javnih nabavki u slučajevima primene Bečke konvencije zajedno sa domaćim zakonodavstvom o javnim nabavkama.

* * *

Redakcija izražava nadu da će i ovo, deveto po redu, izdanje *Revije Kopaoničke škole prirodnog prava* ispuniti očekivanja naših čitalaca i upućuje zahvalnost autorima koji su za nju pisali.

Prof. dr Jelena S. Perović Vujačić
Glavni i odgovorni urednik

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PILAR PERALES VISCASILLAS

LITIGATION RISKS IN THE FINANCIAL SECTOR AND CLIMATE CHANGE

Strategic Litigation is becoming an increasingly important tool in the fight against climate change thanks to the awareness of this global problem throughout the world and the increased knowledge about case law in this area. This article tries to elaborate on the kind of disputes in the financial sector related to climate change, and the increased importance of litigation in order to change corporate behavior.

Key words: *climate change, climate litigation, financial sector, sustainable finance*

INTRODUCTION

Judges and arbitrators in general do not decide whether a claim, or in particular a claim about climate change, is justiciable or arbitrable, or whether rights have been violated without considering potential remedies.[1] A full range of

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Prof. Dr. Pilar Perales Viscasillas, Commercial Law Professor, University Carlos III of Madrid, e-mail: *pperales@der-pr.uc3m.es.* This work is within the Grant TED2021-130293B-100, *Climate Change and Sustainable Finance*, funded by MCIN/AEI/10.13039/501100011033 and by the European Union NextGenerationEU/PRTR. Further: State Plan for Scientific and Technical Research and Innovation Projects 2017-2020. *Business and Markets: Digital (R)evolution, Integrity and Sustainability and its assimilation by Private, Regulatory and Competition Law*. Reference: PID2020-114549RB-I00. Part of this article corresponds to an essay written for the book in honor of Prof. Miguel Ángel Fernández Ballesteros.

[1] Kent Roach, "Judicial Remedies for Climate Change", *Journal of Law and Equality*, Vol. 17, No. 1, 2021, 105.

remedies and entry points, as well as redress options, alone or in combination,[2] are available which raises the issue of the litigation strategy to follow. Remedies are one of the fundamental pieces in the fight against climate change and the type of remedy to be sought will depend on a variety of factors, both procedural and substantive, namely the kind of method available for litigants, in isolation or in parallel (judicial , arbitration, administrative, etc.), which is also dependent upon the kind of relationship between the parties, the costs associated with the method of resolving disputes, the applicable laws and regulations to be applied, and indeed it will be very much interrelated with the objectives to be pursued by litigants. Contrary to what we might think at first sight, a variety of remedies are available in a climate change litigation and many times pecuniary remedies are left behind in order to seek for climate change justice, including a change in corporate or governmental behavior, creating, modifying or updating the corporate policies on human rights and climate change (as well as included them into supply chains and codes of ethics or conduct), or upgrading the national plans on climate change (strategic litigation). Notwithstanding this, some actions against governments have been rejected since no remedy was available to the Court.[3]

In this paper, I will focus on climate change litigation in the financial sector, since another essential element in the fight against climate change is finance,[4] which is key to drive a sustainable, net zero recovery and to achieve the goals established by the Paris Agreement towards 2050,[5] i.e., a carbon-free world where the limitation of global average temperature increases to well below 2°C, while trying to achieve the more ambitious 1.5°C limit (Article 2.1 a).[6]

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[2] *Ibidem,* 131. As considered by Roach, a single-track approach to remedies is not suitable: neither the traditional remedial goals of restitution nor Compensation alone will remedy climate change. Therefore, he defends "a "two-track" approach to remedies that borrows from the frequent distinction that supranational adjudicators make between specific measures that provide remedies (often damages) for individual litigants and more ambitious, dialogic, and interactive systemic remedies to prevent continuing or new violations".

[3] *Aji P.v. State of Washington*, 10 June 2021.The matter is highly debatable as shown by the dissenting view within the Court by the Chief Justice (González, CJ), *http://climatecasechart.com/wp-content/uploads/sites/16/case-documents/2021/20211006_docket-99564-8_order.pdf*, 01.10.2023.

[4] More so since as considered by Nicholas Stern, *The Economics of Climate Change: The Stern Review*, Cambridge University Press, 2007, viii: "Climate change is the greatest market failure the world has ever seen, and it interacts with other market imperfections".

[5] International Energy Agency (IEA), Net Zero by 2050. A Roadmap for the Global Energy Sector, October 2021, addressing Governments to implement energy policies to the 2050 climate objectives.

[6] Global Landscape of Climate Finance 2021, Climate Policy Initiative, December 2021, 8.

The so-called sustainable finance is key to promoting a sustainable economy and achieving the objectives established by the Paris Agreement towards the year 2050[7] (Article 2.1 a), the European Green Deal,[8] as well as in the EU Strategy on Sustainable Finance.[9] As indicated in Mark Carney's 2015 seminal speech[10] "climate change is a tragedy of the horizon": *sustainable finance can help fight against that tragedy that the horizon holds for us*. This speech is considered to have marked a turning point with a view to reinforcing the financial sector's commitment to climate change.[11]

Financing the transition, mitigation and adaptation[12] of both developing countries and corporations to a net zero economy requires the involvement and cooperation between the public and private sectors[13] in order to achieve the goals

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[7] International Energy Agency (IEA), Net Zero by 2050. A Roadmap for the Global Energy Sector, October 2021.

[8] Commission Communication, The European Green Deal, Brussels, 11.12.2019, COM(2019) 640 final. Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions. Investment Plan for a Sustainable Europe, Investment Plan of the European Green Pact. Brussels, 14.1.2020, COM (2020) 21 final.

[9] Action Plan: Financing Sustainable Development, 2018, 8 March 2018, COM(2018) 97 final. This is the first major instrument in this matter that has been followed by the New Strategy of July 6, 2018. Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions. Strategy to finance the transition to a sustainable economy, 6 July 2021, COM(2021) 390 final.

[10] *Breaking the tragedy of the horizon* - a speech given by former Bank of England Governor, Mark Carney, at Lloyd's of London on 29 September 2015, specifically at 5:13, *https://www.youtube.com/watch?v=V5c-eqNxeSQ*, 01.10.2023.

[11] Final report, Green finance in the UK and Spain: latest developments and main service providers, 1 July 2020, 4, also citing another relevant passage from the speech "when climate change becomes a determining factor for stability finance, it may be too late",*https://finresp.es/wp-content/uploads/2021/03/las-finanzas-verdes-en-reino-unido-y-espana.pdf*, 01.10.2023, 17.

[12] "Mitigation finance is needed across renewable energy, energy efficiency, transport and forestry, while adaptation finance is needed for activities related to water, agriculture, coastal protection and resilience". See: UNFCCC Synthesis Report: 'Nationally Determined Contributions Under the Paris Agreement: revised synthesis report by the secretariat' (UNFCCC, 25 October 2021), nº196. Particularly, the needs of financing for the adaptation period are considered key but several gaps and vulnerabilities have been identified in The Technical Summary IPCC WGII Sixth Assessment Report, TS-56-57 (hereinafter TS).

[13] International Energy Agency (IEA), Net Zero by 2050. A Roadmap for the Global Energy Sector, October 2021, imploring the governments to implement energy policies to the 2050 climate objectives, 154: "the private sector is central to finance higher investment needs. It requires enhanced collaboration between developers, investors, public financial institutions, and governments.

of the Paris Agreement,[14] in particular "to strengthen the global response to the threat of climate change, in the context of sustainable development and efforts to eradicate poverty" (Article 2.1 Paris Agreement); a process that has been rightly coined as "financing green", and that goes hand in hand with the other side of the coin "green finance", i.e., mainstream climate and environmental factors in financial decision making and market products globally.[15] An increase of at least 590% in annual climate finance is required to meet internationally agreed climate objectives by 2030 and to avoid the most dangerous impacts of climate change.[16] As considered by the IPCC Report 2022, the adaptation finance needs estimates to be higher than those presented in the previous report (AR5) and therefore, enhanced mobilization of and facilitating access to financial resources removing legal barriers are essential for implementation of adaptation and to reduce adaptation gaps.[17]

The consideration of climate risk must be seen from the triple perspective of materiality (the possible damages could be enormous), of its systemic consideration (a wide range of financial and non-financial entities may be affected), instability (both in terms of developments in climate science as in laws and regulations) and finally singularity (climate change is a unique and global type of risk).[18]

Collaboration will be especially important over the next five to ten years for the development of large infrastructure projects and for technologies in the demonstration or prototype phase today such as some hydrogen and CCUS applications. Companies and investors have declared strong interest to invest in clean energy technologies, but turning interest into actual investment at the levels required in the NZE also depends on public policies".

[14] An important effort was made in the last COP26. Megan Bowman, "Turning Promises into Action: 'Legal Readiness for Climate Finance' and Implementing the Paris Agreement", *Carbon & Climate Law Review*, Vol. 16, Issue 1, 2022, 42. According to Bowman, "the COP26 summit was deemed the 'Finance COP' for its explicit focus on discussions about the public and private sector finance needed to implement the Paris Agreement. Indeed, the resulting Glasgow Climate Pact interweaves non-state actors and private finance into the delivery of Paris objectives in terms that are explicit and unprecedented".

[15] M. Bowman, "Law and Regulation for Climate Finance: Presenting a Legal Analytical Framework", *Climate Change and Sustainable Finance: Law and Regulation* (Ed. R Smits), Edward Elgar, 2022, 12, referring to "blending finance".

[16] Global Landscape of Climate Finance 2021, Global Climate Policy, December 2021, 2.

[17] IPCC (Intergovernmental Panel on Climate Change), Climate Change 2022, Impacts, Adaptation and Vulnerability, Summary for Policymakers, Working Group II contribution to the Sixth Assessment Report of the Intergovernmental Panel on Climate Change, 30 (hereinafter: IPCC Report (AR 6)).

[18] Climate Related Litigation: Raising awareness about a growing source of risk, Network for Greening the Financial System, Technical document, November 2021, 9, *https://www.ngfs.net/sites/default/files/medias/documents/climate_related_litigation.pdf*, 01.10.2023.

Mitigation or adaptation actions that focus on short-term solutions will often lead to maladaptation of infrastructures and institutions resulting in inflexibility, exacerbating existing inequalities and increasing expenditures for adaptation needs.[19] Therefore, further economic losses and litigation are likely to increase during the transition period, either from failing to take a perspective based on the long-term impacts of adaptation and mitigation options, or from insufficient consideration of climate risks when designing a project.[20] In addition, as considered by Prof. Solana: "In light of the growing trend of climate change litigation, companies that ignore their potential exposure to climate change litigation could see their operations, value and profitability seriously affected."[21]

The financial sector, including also the world of insurance and reinsurance, has a fundamental role in this fight against climate change. It is evident that climate issues affect insurance companies in terms of double materiality, both in terms of the object of their business - underwriting activity - and their investment facet. Hence, many insurance companies have publicly stated that they will not secure contracts or invest in projects covering certain oil and gas activities. However, they will accompany those companies that have credible and verifiable plans on the path to decarbonization.[22]

EXAMPLES OF CLIMATE LITIGATION

There is no uniform definition of "climate change litigation" or "climate litigation", nor a uniform typology of it, be in general or in particular in the area of climate finance, and climate change cases are difficult to distinguish from the more

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[19] IPCC Report (AR 6), 29 and TS-58.

[20] International Energy Agency (IEA), Net Zero by 2050. A Roadmap for the Global Energy Sector, October 2021, 29: "there has been a rapid increase over the last year in the number of governments pledged to reduce greenhouse gas emissions to net zero. Net zero pledges to date cover around 70% of global GDP and CO2 emissions. However, fewer than a quarter of announced net zero pledges are fixed in domestic legislation, and few are yet underpinned by specific measures or policies to deliver them in full and on time". With these data, the risks of litigation for lack of ambition on climate change will certainly increase in the future.

[21] Javier Solana, "Climate Change Litigation as a Financial Risk", *Green Finance*, Vol. 2, Issue 4, 2020, 346.

[22] A reasonable position is adopted by financial institutions such as the World Bank Group (Climate Change Action Plan 2021-2025, 25, 27), considering that natural gas investments may be considered aligned in countries where there are urgent energy demands and no short-term renewable alternatives to reliably serve such demand, *https://openknowledge.worldbank.org/server/api/core/bitstreams/86de07e6-a8a2-5ae5-bc20-99a9ffee0b57/content, 01.10.2023*.

general category of environmental cases. This phenomenon is broad and mostly unknown for financial institutions and thus poses new challenges and risks due to the different causes of actions and remedies associated with climate change, and the different procedural and substantive rules. Since the definition adopted is directly linked to the type of disputes to be included in the scope of this paper, we will follow a broad approach and thus we will consider cases that has climate change as an issue of discussion including those with human rights associated to it. This includes lawsuits or complaints that can be brought before internal, investigative, administrative, judicial, or arbitral bodies (commercial and investment). Finally, we will also consider cases where climate change is at the core of the dispute, and to a lesser extent those where it is ancillary to others.[23] Climate litigation in the financial sector can cover different causes of action, whether contractual, non-contractual, corporate (breach of loyalty, diligence or fiduciary duties, information, or disclosure obligations, as in the case of *greenwashing*), administrative, commercial or civil. Examples are beginning to abound in the field of financial companies, except in insurance companies where the phenomenon is still very incipient.[24] Several real examples illustrate the potential litigation that we will see with increasing frequency in the future:

1. *ClientEarth v. European Investment Bank*: Judgment of the General Court, January 27, 2021[25]

The financing by the European Investment Bank (EIB) of a biomass power plant project in Galicia (Curtis Project) is the basis of the litigation that confronted

[23] Joana Setzer, Catherine Highman, "Global Trends in Climate Change Litigation: 2021 Snapshot", Grantham Research Institute on Climate Change and the Environment, 2021, 5, 12-13, considering a growing trend of cases where climate change is at the core of the dispute. For a recent discussion of the different concepts: Ana Vargek Stilinović, "The Rise of Climate Change Litigation: Is There a (Real) Legal Risk for EU Banking Sector?", EU and Comparative Law Issues and Challenges Series (ECLIC), Vol. 6, 2022, 239-242.

[24] Javier Solana, "Climate Litigation in Financial Markets: A Typology", *Transnational Environmental Law*, Vol. 9, Issue 1, 2019, 19-20, refers to the complaints received by the Financial Conduct Authority (FCA) by ClientEarth, against three insurance companies in the United Kingdom for not having sufficiently reported non-financial information related to climate change in line with the Non-Financial Information Directive as transposed in the UK. Other potential litigation for insurance companies may occur if polluting companies are insured. See: information on Lloyd's and coal mine insurance on the ClientEarth website, *https://www.clientearth.org/latest/latest-updates/news/lawyers-warn-lloyd-s-over-legal-risks -of-underwriting-contested-carmichael-coal-mine/*, 01.10.2023.

[25] ClientEarth v. European Investment Bank, *https://curia.europa.eu/juris/document/document.jsf?text=&docid=237047&pageIndex=0&doclang=EN&mode=req&dir=&occ=first&part=1&cid=2967749*, 01.10.2023.

the NGO activist, ClientEarth, with the EIB, supported by the European Commission as intervener, on account of the rejection by the EIB of the request for internal review made by the NGO of the agreement to grant the financing. The basis on which the EIB Board of Directors preliminarily granted financing to the Curtis project was based on the contribution of the project to the EU objective of mitigating the effects of climate change, counting on the prior favorable opinion of the Commission and of a non-objection opinion from the Kingdom of Spain.

The NGO, ClientEarth, requested before the EIB an internal review of the agreement in accordance with article 10 of Regulation (EC) No. 1367/2006 of the European Parliament and of the Council, of September 6, 2006, regarding the Aarhus Convention on access to information, public participation in decision-making and access to justice in environmental matters (Aarhus Regulation) and Decision 2008/50 (Decision of the Commission of December 13, 2007 establishing the provisions for the application of Regulation (EC) no. 1367/2006 of the European Parliament and of the Council regarding the Aarhus Convention with regard to requests for internal review of administrative acts).

In particular, ClientEarth criticized the Board of Directors of the EIB for having committed, in the contested agreement, a manifest error of assessment in considering that the Curtis project would make a significant contribution to Union policy by responding to three of the objectives pursued by it , namely: i) the Curtis project would not contribute to the achievement of Spanish and European objectives in terms of renewable energy production, energy security and environmental objectives; ii) the project would not contribute to preventing forest fires and to the sustainability of forestry activities in Galicia; and iii) the project was not in line with the EIB's priorities in terms of lending in favor of renewable energies and the fight against climate change, therefore, in their opinion, the Curtis project did not have a positive balance in terms of greenhouse gases.

The rejection of the request for internal review was based on legal criteria relating to the application and interpretation of the Aarhus Regulation. Leaving aside the legal vicissitudes and legal grounds that the interested reader can find in detail in the text of the Judgment itself, in particular regarding the interpretation of the concept of measure of individual scope adopted "according to environmental law", included in the article 2, paragraph 1, letter g) of the Aarhus Regulation, it is now worth noting that this is a historic ruling, which has found an NGO right against an institution as sophisticated and unlikely to be the target of legal actions such as the EIB, and has annulled the EIB's decision to declare inadmissible the NGO's request for an internal review of a financing decision taken by the EIB's

Board of Directors. The EIB's refusal to grant legitimacy to an NGO that demands a review of a decision for (supposedly) infringing environmental criteria is curious, given that the institution, if it does boast something precisely, is its "new and ambitious climate strategy and an energy loan policy", as announced on its website.[26] In any case, the tension that exists between the objectives (environmental sustainability) and the means to achieve them (independence and discretion in decision-making, without interference from third parties, NGOs or not) is revealed. In this sense, the ruling focuses its arguments on the admissibility of the application, and on the concept of "act adopted in accordance with environmental law" (which it interprets in a very broad sense) but does not go so far as to question the discretion of the EIB on the merits of the decision itself.

It is a case that also demonstrates how the involvement of third parties can contribute to the control function of sustainable financing and serve as a basis, where appropriate, for future litigation in this area. Transparency of information, the duty to motivate acts, even to review them, may be key to understanding the elements that have been taken into consideration to adopt sustainable financing decisions by public authorities or private institutions.

This decision of the General Court confirms that the very decision to reject an application can be the subject of litigation and that the *enforcement* of sustainable climate policies can come from the (potential) litigation faced by relevant actors, such as corporations, but from which governments, or European institutions such as the EIB, do not escape it either. The growing judicial activism in ESG matters is particularly intense in relation to environmental criteria in general and climate change in particular, and it is here to stay.

In a similar vein, in the case *UK Export Finance (2022),*[27] a decision by UKEF (the UK's export credit agency) to back a liquefied natural gas project in Mozambique has been unsuccessfully challenged by Friends of the Earth in judicial review proceedings. The campaigners claimed that the decision was unlawful as it was not aligned with the UK and/or Mozambique's Paris Agreement commitments and failed to take into account relevant considerations, including the project's Scope 3 emissions. The Court found that the decision was lawful, concluding that the decision-making process of UKEF was multifaceted and involved balancing

[26] EIB Announcement, *https://www.eib.org/en/press/all/2019-313-eu-bank-launches-ambitious-new-climate-strategy-and-energy-lending-policy*, 01.10.2023.

[27] Friends Of the Earth Ltd, R. (On the Application Of) v The Secretary of State for International Trade Export Credits Guarantee Department (UK Export Finance) ("UKEF") & Anor [2022] EWHC 568 (Admin) (15 March 2022), *http://www.bailii.org/ew/cases/EWHC/Admin/2022/568.html,* 01.10.2023.

different policy considerations. These included not only climate change but other factors, such as the eradication of poverty in Mozambique.

2. *Abrahams v. Commonwealth Bank of Australia (2017)*[28] illustrates the risks of failure to report. In this case, shareholders of the Bank of Australia sued the bank, alleging a breach of the Companies Act 2001 in relation to the issuance of the 2016 annual corporate report, as financial risks related to climate change, in particular the possible investment in a controversial coal mine were not disclosed. Before the court issued its decision, the shareholders withdrew their lawsuit after the company published an annual report in 2017 that acknowledged the risk of climate change and committed to conducting a climate change scenario analysis to estimate the risks to the company business.

Connected to this case, is *Abrahams v. Commonwealth Bank of Australia* (2021),[29] in connection with the request for information regarding the bank's reported involvement in various projects, including a gas pipeline in the US, a gas project in Queensland, a gas field and an oil field, among other projects that potentially violate the bank's Environmental and Social Framework (E&S Framework) and Environmental and Social Policy (E&S Policy). In particular, the E&S Framework and the E&S Policy require the bank to carry out an assessment of the environmental, social and economic impacts of projects and whether the projects are in line with the objectives of the Paris Agreement.

Church of England Pensions Board and others v. Volkswagen AG (2022)[30] is also worth mentioning. Pension funds from England, Sweden and Denmark filed a lawsuit against Volkswagen AG, after it failed to provide information about its corporate lobbying activities. Through the lawsuit, the institutional investors seek to include in the agenda of the next general meeting a proposal to modify the by-laws by which the company must provide information on its "lobbying" activities to determine to what extent are aligned with the company's climate objectives.

3. *Ewan McGaughey et al v Universities Superannuation Scheme Limited* (October 29, 2021)[31] represents a clear example of potential claims for breach of fiduciary duties of the managers of financial institutions. On 26 October 2021, the claimants,

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[28] Abrahams v. Commonwealth Bank of Australia (2017), *http://climatecasechart.com/non-us-case/abrahams-v-commonwealth-bank-australia/,* 01.10.2023.

[29] Abrahams v. Commonwealth Bank of Australia (2021), *http://climatecasechart.com/non-us-case/abrahams-v-commonwealth-bank-of-australia-2021/,* 01.10.2023.

[30] Church of England Pensions Board and others v. Volkswagen AG, *http://climatecasechart.com/non-us-case/church-of-england-pensions-board-and-others-v-volkswagen-ag/,* 01.10.2023.

[31] McGaughey & Davies v. Universities Superannuation Scheme Limited, *http://climatecasechart.com/non-us-case/ewan-mcgaughey-et-al-v-universities-superannuation-scheme-limited/,* 01.10.2023.

who are university professors and researchers and contributors to the University's pension fund, commenced proceedings in the UK High Court of Justice against the managers of the private pension scheme (*University Superannuation scheme* (USS)), which is considered the largest private pension scheme in the UK, for breach of duty to act in the best interest of beneficiaries and breach of fiduciary duties.

Along with various other issues related to the administration of the scheme, the plaintiffs argue that fossil fuels have been the worst-performing asset class since 2017 and that the failure of current and former managers to create a credible plan for fuel divestment fossil fuels has hurt and will continue to hurt the Company's success. For the purposes of the claim, it is assumed that the plan's level of investment in fossil fuels exceeds £1 billion. On May 4, 2021, the USS announced its ambition to become "net zero" by 2050. However, according to the plaintiffs, the company does not have a credible plan to achieve this goal. Furthermore, no credible assessment of the financial risk posed to the company by climate change has been provided. On May 24, 2022,[32] the High Court denied permission to bring a derivative action against USSL on procedural grounds. In October 2022, it was reported that the Court of Appeal had granted permission to appeal, with the trial being set for June 13, 2023.

4. ING Bank exemplifies the concept of "indirect polluter" in the context of privately financed projects. In 2020, the OECD National Contact Point for the Netherlands accepted for processing a complaint filed by Friends of the Earth against ING Bank for human rights and environmental abuses in palm oil plantations run by funded companies. by the Bank. The case is particularly significant because it was one of the first to argue that a financial sector actor (in this case, ING Bank) should be considered to have "contributed to" (rather than the lower threshold of being "directly linked" to) abuses in oil palm plantations, for its financing of oil palm companies and for failing to carry out effective due diligence to prevent or mitigate the impacts.[33]

5. *ClientEarth v. Belgian National Bank (April 13, 2021)*[34]

The lawsuit is based on whether the Belgian National Bank's purchase of bonds from fossil fuel companies breached EU law, and has been dismissed on procedural grounds by the Court of First Instance although an appeal is pending before the Brussels Court of Appeal.

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[32] [2022] EWHC 1233 (Ch), *https://www.bailii.org/ew/cases/EWHC/Ch/2022/1233.html,* 01.10.2023.

[33] As pointed out in United Nations, *Remedy in Development Finance: Guidance and Practice*, 2022, 17, *https://www.ohchr.org/sites/default/files/2022-03/Remedy-in-Development.pdf,* 01.10.2023.

[34] ClientEarth v. Belgian National Bank, *http://climatecasechart.com/non-us-case/clientearth-v-belgian-national-bank/,* 01.10.2023.

6. *Kang et al. v. Ksure and Kexim (March 23, 2022)*[35] is a sample of the legal and financial risks that are at stake when financing a project related to fossil fuels. In this case, the claimants argued that the project has a significant financial risk since (i) the development of new fossil gas wells is incompatible with the climate objectives of the Paris Agreement, (ii) the demand for fossil gas is expected to fall 55% by 2050 based on the IEA projection of the Net Zero 2050 scenario, and (iii) CCS technologies are not mature enough to ensure reliable capture and storage of CO2 emissions, creating a serious risk of cost overruns.

7. The pre-complaint letters sent to *BNP Paribas* in October 2022 under the French Duty of Vigilance Act are a recent example and heralds the coming litigation movement in relation to supply chains, as it is the first financial institution that could be held responsible for illegal deforestation and serious human rights violations linked to the Brazilian beef industry.[36] In addition, when complaining about climate change, through this type of letters,[37] which are mandatory under French Law, companies can adopt different attitudes: ignore them, deny any type of responsibility or adopt a proactive attitude that avoids potential litigation.[38] Considering the answer by BNP Paribas as largely insufficient and non-satisfactory, the NGOs have decided to bring suit before the Judicial Court of Paris on February 2023.[39]

8. *Connect Human Rights v. BNDES and BNDESPAR* (2022)[40] suggest another important trend that could lead to the modification of corporate policies and

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[35] Kang et al. v. KSURE and KEXIM, *http://climatecasechart.com/non-us-case/kand-v-ksure-andkexim/,* 01.10.2023.

[36] Banktrack Article, 17.10.2022, *https://www.banktrack.org/article/bnp_paribas_receives_a_formal_notice_for_financing_major_brazilian_beef_producer_marfrig_implicated_in_illegal_deforestation_indigenous_land_rights_violations_and_slave_labor,* 01.10.2023.

[37] Those pre-litigation letters should be taken seriously by company executives. Letters are usually sent giving enough time for the company to act. An example: Milieudefensie et al. v. Royal Dutch Shell plc, C/09/571932 / HA ZA 19-379, Judgment of May 26, 2021, the Court refers in no. 2.6 to two letters (Notification of liability) in 2018 and 2019.

[38] For example, Casino case: Envol Vert et al. v. Casino (2021), *HTTP://CLIMATECASECHART.COM/NON-US-CASE/ENVOL-VERT-ET-AL-V-CASINO/,* 01.10.2023.

[39] Comissão Pastoral da Terra and Notre Affaire à Tous v. BNP Paribas, *http://climatecasechart.com/non-us-case/comissa%cc%83o-pastoral-da-terra-and-notre-affaire-a-tous-v-bnp-paribas/,* 01.10.2023 ; Notre Affaire à Tous Les Amis de la Terre, and Oxfam France v. BNP Paribas, *http://climatecasechart.com/non-us-case/notre-affaire-a-tous-les-amis-de-la-terre-and-oxfam-france-v-bnp-paribas/,* 01.10.2023.

[40] Conectas Direitos Humanos v. BNDES and BNDESPAR, *http://climatecasechart.com/non-us-case/conectas-direitos-humanos-v-bndes-and-bndespar/,* 01.10.2023.

that includes the participation of third parties that are related to the company. On June 21, 2022, Conectas Direitos Humanos filed a lawsuit against BNDES (Brazilian Development Bank) and BNDESPar, the bank's investment arm responsible for managing its stakes in various Brazilian companies held by the bank. According to Conectas, this is the world's first civil climate action against a national development bank. Although BNDESPar, which is publicly owned, follows an Environmental and Social Policy for Operating in Capital Markets, which bans support for companies with a track record of environmental crimes and modern-day slavery, this policy does not include climate criteria. The company also does not report the carbon emissions associated with its investment portfolio and still maintains equity positions in sectors that are among the most carbon-intensive in the Brazilian economy. The lack of rules or protocols for assessing the impacts of its investments on the climate crisis are in violation of the Brazil's commitments under the Paris Agreement and the country's own PNMC (National Policy on Climate Change), among other provisions.

Based on two technical opinions, Conectas asks the court to require BNDESPar and its controller, BNDES, to be given 90 days to adopt transparency measures and present a plan with rules and mechanisms to commit their investments and divestments to the reduction of greenhouse gas emissions by the companies they finance. In practice, these actions will affect the just transition and guarantee the country's readjustment in the world economy towards sustainable development, which would be the institutional mission of BNDES itself. The plan should align with commitments to reducing GHG emissions by 2030 in the sectors currently financed by the company, in accordance with the international commitments assumed by Brazil. In addition to presenting concrete goals, the plan should be prepared together with civil society, public bodies and academics, and it should provide for environmental and social compensation whenever the targets are not achieved. The case also calls for the creation by BNDESPar of a Climate Situation Room to assess compliance with the targets established in the plan to reduce greenhouse gas emissions, while publishing the progress or setbacks in the sectors that have investments from BNDESPar. One of the requests made in the case is for the Room to be accessed by representatives of civil society, traditional peoples and communities, the Public Prosecutor's Office, the Public Defender's Office, academics and members of the Judiciary.

9. Whether the financial disclosures required for an oil and gas company to list on the London Stock Exchange were lawful, despite not detailing in the prospectus certain climate-related risks is the core issue in *ClientEarth v. Financial Conduct Authority (Ithaca Energy plc listing on London Stock Exchange*)

(2023).[41] The case is also directed against the FCA for breach of the EU Regulation 2017/1129 on the prospectus to be published when securities are offered to the public or admitted to trading on a regulated market.

10. *Greenwashing.-* The example of greenwashing can be useful to see the complexities of the different litigation systems and remedies to be applied to the same issue. Greenwashing is gaining a lot of attention in general[42] and is likely to be a source of future litigation.[43] The reasons are the adoption of the EU taxonomy regulation of financial products and the investments associated to them,[44] as well as because the supervisory role of market regulators like market, banking, insurance or competition authorities,[45] legal texts such as Unfair Commercial Practices Directive,[46]

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[41] ClientEarth v. Financial Conduct Authority (Ithaca Energy plc listing on London Stock Exchange), *http://climatecasechart.com/non-us-case/clientearth-v-financial-conduct-authority-ithaca-energy-plc-listing-on-london-stock-exchange/,* 01.10.2023.

[42] See for example: "The Corporate Climate Responsibility Monitor" that evaluates the transparency and integrity of companies' climate pledges, particularly the 2022 Report where none of the 25 companies analyzed are in the financial sector, *https://newclimate.org/sites/default/files/2022/02/CorporateClimateResponsibilityMonitor2022.pdf,* 01.10.2023.

[43] On the 1 June 2023, The European Supervisory Authorities (EBA, EIOPA and ESMA – ESAs) published their Progress Reports on Greenwashing in the financial sector. See: EBA, EIOPA, and ESMA reports. In these reports, the ESAs put forward a common high-level understanding of greenwashing applicable to market participants across their respective remits – banking, insurance and pensions and financial markets.

[44] There are several cases where investors allege that public information of the financial products are fraudulent in relation to climate change risks or that there was a failure to take into account physical and transition risks that are material to the investments. See the cases in: Global Climate Litigation Report, 2020, Status Review, United Nations Environment Programme, Sabin Center for Climate Change Law, 26-27, *https://wedocs.unep.org/bitstream/handle/20.500.11822/34818/GCLR.pdf?sequence=1&isAllowed=y,* 01.10.2023. The regulation in this area is well-known. See: EU Taxonomy for Sustainable Activities, *https://finance.ec.europa.eu/sustainable-finance/tools-and-standards/eu-taxonomy-sustainable-activities_en,* 01.10.2023.

[45] Italian Competition Authority Ruling Eni's Diesel+ Advertising Campaign (2019), *http://climatecasechart.com/non-us-case/italian-competition-authority-ruling-enis-diesel-advertising-campaign/,* 01.10.2023; and Greenpeace Canada v. Shell Canada (2021), *http://climatecasechart.com/non-us-case/greenpeace-canada-v-shell-canada/*, 01.10.2023. Greenpeace Canada submitted a formal complaint to the Competition Bureau of Canada alleging that Shell's Drive Carbon Neutral products are making false and/or misleading representations to the public in contravention of the Federal Competition Act.

[46] Greenpeace France and Others v. TotalEnergies SE and TotalEnergies Electricity and Gaz France, March 2 2022, *http://climatecasechart.com/non-us-case/greenpeace-france-and-others-v-total-energies-se-and-totalenergies-electricite-et-gaz-france/,* 01.10.2023. This case was brought under the French national law implementing the European Union Unfair Commercial Practices Directive, and

unfair competition laws,[47] or misleading or false marketing advertising as by the specific laws[48] or general laws, such as consumer protection rules.[49] A new Directive proposal on greenwashing (Green Claims Directive) could be an important step forward in this area.[50] Other cases could affect the climate neutrality of the General Meetings of the companies.[51]

Greenwashing is by itself emerging as a specific subsector in climate change litigation[52] with its own peculiarities, which in certain cases involves specific

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according to the summary of the case this is the first case challenging an oil and gas major's net-zero claims for greenwashing in Europe. Most recently, on 28 April 2023, Total has counterattacked by filing a civil lawsuit against Greenpeace and the climate consulting group Factor-X alleging that the report issued by the organizations, which claimed that Total did not report its 2019 greenhouse gas (GHG) emissions, is knowingly false and misleading, *https://www.greenpeace.org/international/press-release/56491/greenpeace-finds-totalenergies-emissions-almost-4-times-higher-than-reported/,* 01.10.2023. Total is seeking a French court order to force Greenpeace to withdraw the report and remove all references to Total from its website and in communications. Total has also asked the court to impose a penalty of 2,000 euros on Greenpeace for each day that the complaints remain published and grant a symbolic compensation of 1 euro. Total Press Release, *https://totalenergies.com/media/news/press-releases/totalenergies-response-greenpeace-report,* 01.10.2023.

[47] Verbraucherzentrale Baden-Württemberg e.V. v. Commerz Real Fund Management S.à.rl., *http://climatecasechart.com/non-us-case/verbraucherzentrale-baden-wurttemberg-ev-v-commerz-real-fund-management-sarl/* , 01.10.2023. In January 2022, the Court (Landgericht Stuttgart) considered that the advertising of an investment with its positive effect on the 'personal carbon footprint' is a misleading commercial practice and violated Art. 5.1 of the Law against Unfair Competition.

[48] Vegetarian Society et al. of Denmark v Danish Crown (2021), *http://climatecasechart.com/non-us-case/vegetarian-society-et-al-of-denmark-v-danish-crown/,* 01.10.2023.

[49] Ad ex., the cases in relation to investor's fraud and consumer protection in the US, analyzed by: Mark B. Taylor, "Litigating Sustainability - Towards a Taxonomy of Counter Corporate Litigation", *University of Oslo Faculty of Law Legal Studies Research Paper Series No.2020-08*, 8-10.

[50] Proposal for a Directive of the European Parliament and of the Council on substantiation and communication of explicit environmental claims (Green Claims Directive), COM/2023/166 final, 22 March 2023, *https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=COM%3A2023%3A0166%3AFIN* 01.10.2023.

[51] In a similar vein, see: KlimaAllianz v. FIFA (2022); New Weather institute v. FIFA (2022), Notre Affaire à tous v. FIFA (2022), Carbon market Watch vs. FIFA (2022), in relation to the Celebration of the 2022 Soccer World Cup in Qatar and the publicity about being a carbon neutral event.

[52] Other subsectors are identified. For example, the specialized dispute resolution methods provided for by The World Intellectual Property Organization (WIPO) (Arbitration and Mediation Center) in relation to the disputes derived from the new technologies (patents, transfer of technology, licenses, etc) that can help to mitigate climate change and the transition to a green economy involving the area of intellectual property.

bodies for resolving disputes in the area of marketing and false advertising[53] that are easily accessible to consumers in general and with no litigation costs.[54] In terms of remedies, the most usual are the cessation or modification of the misleading marketing and advertising campaigns and the publicity of the decision.[55] However, the reputational effects of being sued for greenwashing also operate as a "remedy". The latest case of Deutsche Bank (DB) AG's asset management is an example after investigations made by the US and German regulators. One of the results so far has been the resignation of the CEO after the shares down more than 20% and the vote against the Board in the Shareholder's meeting by main investors.[56] Complaints were also made by consumer associations.[57]

Regulators and companies must take into account the risks associated with climate-related litigation against financial and non-financial corporations. This is

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[53] *Australasian Center for Corporate Responsibility v. Santos,* 25 August 2021, *http://climatecasechart.com/non-us-case/australasian-centre-for-corporate-responsibility-v-santos/,* 01.10.2023 (whether an oil and gas company's representations that natural gas is a clean fuel and that the company has a credible net zero emissions plan were misleading).

[54] See Complaint to *Ad Standards on HSBC's Great Barrier Reef ad*, 13 October 2021, *http://climatecasechart.com/non-us-case/complaint-to-ad-standards-on-hsbcs-great-barrier-reef-ad/*, 01.10.2023.; Id., *Advertising Standards Authority's Ruling on Shell UK Ltd.'s Shell Go+ Campaign* (2020), *http://climatecasechart.com/non-us-case/advertising-standards-authoritys-ruling-on-shell-uk-ltds-shell-go-campaign/*, 01.10.2023.; *ASA Ruling on Ryanair Ltd t/a Ryanair Ltd* (2019), *http://climatecasechart.com/non-us-case/asa-ruling-on-ryanair-ltd-t-a-ryanair-ltd/*, 01.10.2023; *Lawyers for Climate Action Complaint against Energy company Firstgas* (2021), *http://climatecasechart.com/non-us-case/lawyers-for-climate-action-complaint-to-the-advertising-standards-board/,* 01.10.2023.

[55] *Greenpeace France and Others v. TotalEnergies SE and TotalEnergies Electricity and Gaz France*, 2 March 2 2022, *http://climatecasechart.com/non-us-case/greenpeace-france-and-others-v-totalenergies-se-and-totalenergies-electricite-et-gaz-france/*, 01.10.2023. The claim was filed before the Judicial Court of Paris on the 2nd of March 2022, and the organizations claim for an injunction to stop the campaign, the publication of the decision, the compensation of the moral damages suffered by the organizations and the repayment of legal fees (see full text at: *http://climatecasechart.com/wp-content/uploads/sites/16/non-us-case-documents/2022/20220302_15967_petition.pdf*, 01.10.2023). Id., *Advertising Standards Authority's Ruling on Shell UK Ltd.'s Shell Go+ Campaign* (2020), *http://climatecasechart.com/non-us-case/advertising-standards-authoritys-ruling-on-shell-uk-ltds-shell-go-campaign/,* 01.10.2023. The ASA stipulated that the advertisement must appear in the "complained of" form and that Shell UK Ltd must clarify that carbon offsetting is contingent on membership of a loyalty scheme.

[56] Reuters, 9 June 2022, *https://www.reuters.com/markets/europe/union-investment-vote-against-dws-management-supervisory-board-agm-2022-06-09/,* 01.10.2023.

[57] *DWS Greenwashing* (2022), though ultimately shelved by DWS's cease and desist statement, *http://climatecasechart.com/non-us-case/dws-greenwashing/,* 01.10.2023.

particularly important since litigation is a legal and financial risk factor with special characteristics.[58] That includes "materiality" (potential damages could be enormous), systemic importance (financial and non-financial entities may be affected), uncertainty (both in terms of developments in climate science and laws and regulations), and finally uniqueness (climate change is a unique and global type of risk).[59] At the same time, however, these new litigation risks[60] create opportunities to improve accountability. Therefore, it is imperative to treat the various instruments aimed at protecting sustainability and climate change as complementary to each other rather than as alternatives.

Climate change litigation in the financial sector should be taken seriously by corporations and their managers because of the potential legal and financial risks,[61] as well as the disruption it could cause to the core business of financial and other companies in general. The initiation of complaints procedures that cannot offer direct remedies but can provide indirect relief is a possibility that can be used effectively in the fight against climate change. It provides a good example of reputational effects and how attitude change can be achieved indirectly.

LITIGATION RISK AS A LEGAL AND FINANCIAL RISK

Litigation risks due to climate change are a legal and financial risk and should be treated as such. From this perspective, it is necessary to avoid the financial and legal risks associated with climate change,[62] and thus align business investments, plans, corporate policies and the duties of administrators with the

[58] Network for Greening the Financial System, *Raising awareness about a growing source of risk,* 2021, 9.

[59] *Ibidem.*

[60] If weather-related litigation risk should be treated as a subcategory of physical and transition risks, Raising Awareness, op. cit., 5.

[61] *Milieudefensie et al. v. Royal Dutch Shell plc*, C/09/571932 / HA ZA 19-379, Judgment of May 26, 202, no. 2.3.6: "All parts of Europe will suffer the adverse effects of climate change. Individual citizens and businesses will be at substantial financial risk as a result of these impacts", *https://uitspraken.rechtspraak.nl/#!/details?id=ECLI:NL:RBDHA:2021:5339*, 01.10.2023.

[62] A description of the different climate risks faced by banks and insurance companies (physical, transition and legal) can be found in the Supervisory Statement | SS3/19, Enhancing banks' and insurers' approaches to managing the financial risks from climate change' of the Bank of England, Prudential Regulation Authority, *https://www.bankofengland.co.uk/-/media/boe/files/prudential-regulation/supervisory-statement/2019/ss319*, 01.10.2023.

objectives of the Paris Agreement. The actual scenario depends on many factors such as the corporate object or "purpose" of the company, whether the board complied with the duties of diligence, loyalty and care, the type and location of the investment and others, such as the need to support energy companies during the transitional period. As exemplified in the famous Shell case,[63] which can also extend to financial companies, non-credible, general, vague, intangible, non-binding or vague business plans or objectives or corporate policies are a source of litigation. As such, financial companies' corporate plans and policies should encompass reduction obligations that are in line with legal obligations.

The remedies sought in such strategic litigation may be less or more intrusive to the essence of the business and the duties of managers. For example, following some of the cases mentioned in the previous section in *Kang et al., v. Ksure and Kexim*, the plaintiffs sought an injunction[64] prohibiting financial and insurance institutions from providing financial support in connection with an investment in a gas project.[65] In *Ewan McGaughey et al v Universities Superannuation Scheme Limited*, the plaintiffs requested that the members of board be removed.

As evidenced, in the financial sector we find not only an increase in litigation, but also a growing shift towards increased liability of financial institutions due to climate change, particularly in relation to investment projects being financed or insured and therefore a change of perspective is evident: from an absence or at most an indirect responsibility to a possible direct responsibility.

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[63] *Milieudefensie et al. v. Royal Dutch Shell plc*, C/09/571932/HA ZA 19-379, Judgment of 26 May 2021, *https://uitspraken.rechtspraak.nl/#!/details?id=ECLI:NL:RBDHA:2021:5339,* 01.10.2023. Further: PCWP and others v. Glencore (2022), a legal complaint was lodged on behalf of The Plains Clan of the Wonnarua People (PCWP) and Lock the Gate Alliance, with the Australian Competition and Consumer Commission (ACCC) and Australian Securities and Investments Commission (ASIC) regarding Glencore's misleading claims about climate impact and its behaviour towards Traditional Owners, *http://climatecasechart.com/non-us-case/pcwp-and-others-v-glencore/*, 01.10.2023.

[64] Roach, op. cit., 120-122, refers to the advantages of requesting precautionary measures prior to litigation, since it helps to give visibility to the problem of climate change, the standard to be applied from the point of view of the procedural satisfaction is less demanding than if it were the merits of the case.

[65] See: O'Donnell case, which is the first case to focus on sovereign bonds and government liability: *O'Donnell v Commonwealth* (2020) VID482/2020: 'O'Donnell v. Commonwealth', *http://climatecasechart.com/non-us-case/odonnell-v-commonwealth/*, 01.10.2023. See M. Bowman (Turning Promises*),* op. cit., footnote 75.

There is a growing tendency to shape climate change litigation with arguments related to human rights,[66] and in what interests us now combined with: i) financial law;[67] ii) corporate law, duties of the board and long-term interests of the company;[68] and iii) civil liability law.[69]

Likewise, there is evidence of growing judicial activism on the part of shareholders and other interested parties against companies and their boards of directors,[70] including those from the financial sector, for not contributing enough to combat climate change,[71] due to deceit or lack of information about climate change,

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[66] J. Solana (2019), op. cit., 6-10; J. Setzer, C. Highman, op. cit., 6.

[67] *Kang et al. v. Ksure and Kexim*, invoking Art.100 of the South Korean Finance Law.

[68] Ewan McGaughey et al v. Universities Superannuation Scheme Limited (2021) as derived from sections 171-172 of the UK Companies Act 2006: see claim 4. Breach of the company's long-term duty to act interests: fossil fuels, nº101 and ss of the Petition.

[69] See outside the financial sector: *Neubauer v. Germany* (Constitutional Court of Germany, 24 March 2021, *http://climatecasechart.com/wp-content/uploads/sites/16/non-us-case-documents/2021/20210324_11817_order-1.pdf,* 01.10.2023; *Steinmetz , et al. v. Germany*, 24 January 2022, *http://climatecasechart.com/non-us-case/steinmetz-et-al-v-germany,* 01.10.2023; *Deutsche Umwelthilfe (DUH) v. Mercedes-Benz AG*, 20 September 2021, *http://climatecasechart.com/non-us-case/deutsche-umwelthilfe-duh-v-mercedes-benz-ag/*, 01.10.2023; *Kaiser, et al. v. Volkswagen AG*, 8 November 2021, *http://climatecasechart.com/non- us-case/kaiser-et-al-v-volkswagen-ag/,* 01.10.2023; *Asmania et al. vs. Holcim* (2022), four inhabitants of the Indonesian island of Pari, supported by 3 NGO´s, have sued Swiss-based major buildings materials company Holcim. They request compensation and reduction of GHG´s emissions, *http://climatecasechart.com/non-us-case/four-islanders-of-pari-v-holcim/,* 01.10.2023.

[70] A current observation, see among others: Global Climate Report (2020), 5, 13. See *ClientEarth v. Board of Directors of Shell*. On 12 May 2023, the UK High Court dismissed the lawsuit brought by ClientEarth against Shell's board of directors, finding that ClientEarth failed to establish a *prima facie* case against the board for its management of climate risks. The claim was based on the fact that the directors breached their duties under the Companies Act, which creates a duty to promote the success of the company and to act with reasonable care, skill and diligence. ClientEarth stated that, among other things, Shell was obliged to adopt and implement an energy transition strategy consistent with the Paris Agreement in meeting these obligations and that it is not because it excludes short- and medium-term objectives to reduce Scope 3 emissions when such emissions represent 90% of the company's total emissions and it is estimated that they will be reduced by only 5% by 2030. The High Court did not agree with the NGO and considered that the allegations were insufficient to declare a violation of the Companies Law, appealing to the judgment of discretion enjoyed by administrators in decision-making since the plaintiff failed to establish the unreasonableness of the decision; it added that the weather-related duties asserted in the lawsuit were "vague" and could not establish "enforceable personal legal duties".

[71] McVeigh case which is the first disclosure and due diligence case brought by a beneficiary against his public pension fund: *McVeigh v. Retail employees Superannuation Pty Ltd, http://*

either in relation to the projects to be financed or modifications to the corporate structure,[72] by not complying with the obligation to carry out environmental or climate due diligence on a project or a corporation in general or in particular as a condition for granting financing, by investing in projects that are not green, ad ex, on fossil fuels.

Focusing on all interested parties (*stakeholders*) is precisely a trend that is observed at all levels, including the corporate one, where not only shareholders but also third parties are receiving attention, as evidenced by the expansion of legal doctrines in this matter,[73] and that the neglect of those interests can be a source of litigation.[74]

Finally, several interesting phenomena cannot be ignored, some of which have already been mentioned: i) the taking of a shareholding position by climate activists to exercise the rights that may correspond to them as shareholders; ii) coordination between the different organizations of climate activists; iii) in the legal sector, different trends are observed: an increase in teams specialized in matters of sustainability and climate change in law firms,[75] which also includes lawyers who support NGOs;[76] an increase in class action lawsuits; an increased use of litigation financing through crowdfunding and the use of companies specialized in this type of financing; a high degree of legal creativity on the part of lawyers and judges; a greater judicial role of NGOs through the figure of *amicus curiae*, and a certain

climatecasechart.com/non-us-case/mcveigh-v-retail-employees-superannuation-trust/, 01.10.2023. See: M. Bowman (Turning Promises), op. cit., 74; J. Solana (2019), op. cit., 27; J. Setzer, C. Highman, op. cit., 29: "In November 2020 the fund recognized that "climate change is a material, direct and current financial risk to the retirement fund across many risk categories, including investment, market, reputational, strategic, government and third-party risks".

[72] *AGL Limited,* 12 May 2022, *http://climatecasechart.com/non-us-case/in-the-matter-of-agl-limited/,* 01.10.2023.

[73] Pilar Perales Viscasillas, "Climate Change and Corporate Governance in Spain", *Ex/Ante Special Issue 2023, Zeitschrift der juristischen Nachwuchsforschung*, 2023, 52-64.

[74] *Kang et al. v. Ksure and Kexim,* where among the causes invoked is that the companies have not completed the required consultation process with the indigenous communities. Also: *Connect Human Rights v. BNDES and BNDESPAR* (2022).

[75] Burkhard Hess, "Strategic Litigation: A New Phenomenon in Dispute Resolution", *MPILux Research Paper Series*, N°2022 (3), 3.

[76] The publication of handbooks and toolkits for undertaking climate litigation against corporate actors. See: R. COX-M. REIJ, *Defending the Danger Line*, 2022, which offers a manual for lawyers and interested institutions, prepared by the lawyers of the Mileudefensie case that describes the legal basis and the approach taken in the lawsuit of the famous Shell case.

judicial permissiveness in the face of the violent actions of some climate activists[77] with the creation of the "state of climate necessity".[78]

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RIZICI SUDSKIH SPOROVA U FINANSIJSKOM SEKTORU I KLIMATSKE PROMENE

Rezime

Strateška parnica postaje sve važnije sredstvo u borbi protiv klimatskih promena zahvaljujući povećanoj svesti o ovom globalnom problemu ali i poznavanju sudske prakse u ovoj oblasti. U ovom članku, autor nastoji da predstavi ne samo različite vrste sporova u finansijskom sektoru u vezi sa klimatskim promenama, već i rastući značaj ovakvih sporova u cilju korigovanja korporativnog ponašanja.

Ključne reči: klimatske promene, klimatski sporovi, finansijski sektor, održive finansije

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[77] Example: R v. Brewer and others (Just Stop Oil protest, Esso terminal, Birmingham), 2022.

[78] J. Setzer, C. Highman, op. cit., 13. Décrochons Macron (2019) rejecting the "state of necessity", *http://climatecasechart.com/non-us-case/decrochons-macron/,* 01.10.2023.

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ORIGINAL SCIENTIFIC PAPER

DRUGA SEKCIJA

ARBITRAŽA

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ALFREDO FERRANTE

BREACH OF THE ARBITRATION AGREEMENT, DEFAULTING DEFENDANT IN LITIGATION AND NEW YORK CONVENTION'S MODEL FLUCTUATIONS: THE ITALIAN AND BRAZILIAN EXAMPLES

The aim of this Article is to assess what is the effectiveness of an arbitration agreement in the face of a plaintiff's will to activate the procedure not before the Arbitral Tribunal, but using legal proceedings before the ordinary courts, in the particular case of the other party failing to enter an appearance and file its response in litigation. The hypothesis of this paper, therefore, refer to situations where the contumacy of the party before the Court (i.e., defaulting defendant in litigation) - in certain cases - is not protected by law, and whether this legislative gap should be filled. The problem relates to the defaulting of defendant in litigation, despite an existing arbitration agreement whose validity is not questioned by the plaintiff. This solution varies depending on the system and does not apply where the legislative gap has been eliminated by national regulation. In order to solve that question will be analysed Article II.3 NY Convention, Art. 8(1) UNCITRAL Model on International Commercial Arbitration and the Italian and Brazilian Legal Systems.

Key words: *arbitration agreement, NY Convention, lack of jurisdiction, italian law, brazilian law, contumacy*

INTRODUCTION AND APPROACH

On the one hand, the role of freedom of contract and autonomy are key factors in both contract negotiation and arbitration. On the other hand, it is crucial that,

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in the case of pathological problems, the dispute develops in accordance with proper canons of justice in which adversarial and due process principles are established.

The objective of this paper is to assess how far the freedom of contract and party's autonomy of will and the protection of adversarial process can move within the scheme of international commercial arbitration. The decision to submit to dispute resolution is free and its manifestation is precisely that which is formalised through the arbitration agreement. It is precisely the contractual nature of the arbitration agreement that makes the party decide to go to an arbitral tribunal and not to judicial system. In this context, it is necessary to assess the limits of being able to restructure this volitional act, especially in the possible regressive exercise of the manifestation of the will, i.e., in the appropriate assessment of a possible repentance or waiver of the manifestation of the will. Is it therefore possible to bring the ordinary court action despite the existence of an arbitration agreement?

Can we always go to (ordinary) Court if the parties change their minds? If they do, does this will have to be expressed, or can it be inferred from silence or conclusive conduct? Can a unilateral willingness to go to Court in the face of the other party's inaction and subsequent silence be considered a breach of arbitration agreement?

In concrete terms, the aim is to assess what is the effectiveness of an arbitration agreement in the face of a will to take action not before the Arbitral Tribunal but before the ordinary Court, in the particular in case of defaulting defendant in litigation.

The hypothesis of this paper is whether the hypothesis of contumacy of the party before the Court (defaulting defendant in litigation) - in certain cases - is not protected by an appropriate rule, and this legislative gap should be filled. The problem analysed here focuses on the hypothesis of defaulting defendant in litigation, despite an existing arbitration agreement whose validity is not questioned by the plaintiff. This solution varies depending on the system and does not apply where the legislative gap has been eliminated by national regulation.

Specifically, the aim here is not to analyse when one of the parties fails to appear before the Arbitral Tribunal, but when, in the presence of an arbitration agreement, one of the two parties decides to go before the ordinary courts and the other party fails to appear: i.e., it is a case of contumacy. What is an arbitration agreement worth in case of defaulting defendant in litigation?

The starting point for the analysis is Art. II.3[1] of the 1958 New York Convention.[2] This provision established that in the presence of an arbitration agreement

[1] In relation to Art. II.3, see UNCITRAL Secretariat, *Guide on the Convention on the Recognition and Enforcement of Foreign Arbitral Awards*, 2016, No. 58, 57 ff.

[2] Convention on the Recognition and Enforcement of Foreign Arbitral Awards, commonly known as the New York Convention, New York, 10 June 1958 (forward NY Convention).

the Court of a Contracting State shall refer the parties to arbitration only at the request of one of the parties and never *ex officio.*[3]

This provision is a starting point for several reasons. On the one hand, because this provision would already seem to give a clear answer to the question. On the other hand, because it is precisely this provision that has influenced and recurred in Art. 8 Model Law on International Commercial Arbitration and it has also influenced the drafting of various national laws.[4] Essentially, in civil law systems the solution is to decline jurisdiction, meanwhile in common law it is staying judicial proceedings.[5]

A further reason for the analysis of Art. II.3 NY Convention is that - on the day the NY Convention was approved, i.e., on 10 June 1958 - it was passed unanimously. In fact, if Art. II.3 as a whole provision was generally voted in favour even if some States voted against,[6] the decision to exclude the possibility of the judge to determine *ex officio* the referral to the arbitral tribunal was unanimous.[7]

Thus, *prima facie* this provision appears to be clear and to clarify the issue that this paper wishes to analyse. Nevertheless, a closer reading of what happened leaves room for more careful reasoning regarding the working hypothesis we wish to analyse here.

Therefore, on the one hand, some reflections will be made on the purposes that led to the drafting of the Art. II.3 NY Convention. On the other hand, we will take two antithetical national models, the Italian and the Brazilian, to see how they responded to the question under examination. These two cases are chosen, one because a jurisprudential solution is given to the legislative gap in the legal system, and because in the other case the legislator envisages through a reform of the law to expressly regulate the situation.

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[3] Art. II.3 NY Convention: "The court of a Contracting State, when seized of an action in a matter in respect of which the parties have made an agreement within the meaning of this article, shall, at the request of one of the parties, refer the parties to arbitration, unless it finds that the said agreement is null and void, inoperative or incapable of being performed."

[4] With particular importance in France and Switzerland (Art. 1448 French Civil Procedure Code; Art. 7 Switzerland's Federal Code on Private International Law).

[5] Cfr. *V.gr.* Uk Arbitration Act 1996, sec. 9-11. For jurisprudential references, including common law ones see UNCITRAL Secretariat, *Guide on the Convention on the Recognition and Enforcement of Foreign Arbitral Awards*, No. 60 ff, 59 ff.

[6] United Nations Conference on International Commercial Arbitration, Summary of record of the 24th Meeting, [E/CONF.26/SR.24 - Adoption and signature of the Final Act and Convention (E/CONF.26/8 and 9, E/CONF.26/L.63), Report of the Credentials Committee (E/CONF.26/10)], 10 June 1958, 10:15am, 9 (hereinafter: United Nations Conference, 24th Meeting).

[7] 29 votes favourable to 2, with 4 abstentions: United Nations Conference, 24th Meeting, 10.

LE *COUP DE MAIN* of Art. II.3 NY CONVENTION

Notwithstanding what was stated in the epigraph above, the truth about Art. II.3 NY Convention is another one: it was the provision that most animated the last two meetings of the working group, the 23rd[8] and 24th,[9] held respectively the day before - 9 June 1958 - and the morning before - 10 June 1958 - the final approval of the final text of the NY Convention.

That is to say, until the day before the approval, the last two texts of the NY Convention, those of 6th[10] and 9th[11] June, provided for the opposite hypothesis from the one finally approved. They provided that in the presence of an arbitration agreement[12] the Court of a Contracting State shall refer the parties to arbitration not only at the request of one of the parties but also *ex officio*. This was due to the presence in the text also of the words "of its own motion". In fact, these texts provide that the Court of Contracting States shall, of its own motion or at the request of one of the parties refer the parties to arbitration.

The presence of a provision drafted in this way would solve the problem of defaulting defendant in litigation in the presence of a previous arbitration agreement.

However, the words 'of its own motion' was unanimously[13] removed on the morning of 10 June at Israel's request.[14] The day before, the same request had been made by Turkey[15] - supported by Japan[16] - and had provoked the reopening of the debate despite the Chairman had recalled "that the Conference has already settled

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[8] United Nation Conference on International Commercial Arbitration, Summary of record of the 23rd Meeting, E/CONF.26/SR.23 - E/CONF.26/L.60; Adoption and signature of the Final Act and Convention (E/CONF.26/8, 9, E/CONF.26/L.28, L.49, L.58, L.61)] 19 June 1958, 3:30pm.

[9] United Nation Conference, United Nations Conference, 24th Meeting.

[10] United Nation Conference on International Commercial Arbitration, Text of Articles Adopted by the Conference: 4-6 June 1958, E/CONF.26/L.59 - Text of new article to be included in the Convention, adopted by the Conference at its 21st meeting.

[11] United Nation Conference on International Commercial Arbitration, Text of the Convention on the Recognition and Enforcement of Foreign Arbitral Awards as Provisionally Approved by Drafting Committee 6-9 June 1958, E/CONF.26/8 - Text of the Convention as provisionally approved by the Drafting Committee on 9 June 1958.

[12] The "agreement" of Art. III.2 NY Convention.

[13] United Nations Conference, 24th Meeting, 10.

[14] Mr. Cohn (Israel), United Nations Conference, 24th Meeting, 8

[15] Mr. Koral (Turkey), United Nations Conference, 23rd Meeting, 13.

[16] Mr. Urabe (Japan), United Nations Conference, 23rd Meeting, 13.

the matter".[17] So, it came to a new vote - on the afternoon of 9 June - which reiterated that the "of its own motion" was maintained. In fact, during the 23rd meeting, the proposal to remove this clause was rejected by 10 votes to 9, with 8 abstentions.[18] Nevertheless, the next day everything changed, and the approval of the final text was unanimous. Apart from reasoning about the methodology of the re-vote and the agenda, it must be understood the legal reasons behind this change: apparently unexpected and sudden. We will return to these aspects later (*infra*).

THE VALIDATION/CONSOLIDATION OF THE PROVISION IN ART. 8 (1) OF UNCITRAL MODEL LAW ON INTERNATIONAL COMMERCIAL ARBITRATION

Apart from the above discussion, what is certain is that a provision similar to Art. II.3 NY Convention has been reproduced in the field of international arbitration and specifically by Art. 8(1) UNCITRAL, Model Law on International Commercial Arbitration (1985). The fact that this provision was not amended in 2006 consolidates its position.[19]

Being inserted in a text on the specific issues of International Commercial Arbitration also strengthens the content of its provision: before - being inserted in a text on the Recognition and Enforcement of Foreign Arbitral Awards - it might have been out of place, as was the whole of Art. II NY Convention. In fact, following this line of logic, Guatemala voted against Art. II "because it contained a provision on the validity of arbitrary agreements going beyond the powers of Conference".[20]

Furthermore, Art. 8(2) UNCITRAL Model Law gives the important possibility that "arbitral proceedings may nevertheless be commenced or continued, and an award may be made, while the issue is pending before the court".

In connection with the working group on Art. 8(1), it should be noted that specifically - *mutatis mutandis* - the analysed question of Art. II.3 NY Convention was not dealt with in depth.

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[17] President, Mr. Schurmann (Netherlands), United Nations Conference, 23rd Meeting, 13.

[18] United Nations Conference, 23rd Meeting, 13.

[19] See UNCITRAL *Digest of Case Law on the Model Law on International Commercial Arbitration*, 2012, 33 ff.

[20] Guatemala also abstained from voting on the Convention as a Whole Mr. Kestler Farnes (Guatemala), United Nations Conference, 24th Meeting, 12.

However, at the 312th meeting, an important aspect was noted: in the face of the silence of the article "the court should have a third possibility, i.e., that of referring the parties to arbitration while keeping its own proceedings open until a later stage".[21]

Thus, it can be seen that the question partly remained open despite the stipulation that the provision should not be changed. In fact, highlighting this possibility is elevated as a requirement for approving this text.[22]

IT IS A PROBLEM OF LOCAL PROCEDURAL LAW

It should be noted that although the working Group retains the text that excludes *ex officio* review by the Court, NY Convention and UNCITRAL Model Law note problems with it. In particular, with regard to both Art. II.3 NY Convention and Art. 8(1) UNCITRAL Model Law, there is a problem of local procedural law. Thus, the Italian delegation initially justified the double possibility of referring the parties to arbitration - of its own motion or at the request of one of the parties - noting that the "paragraph 3 merely stated two possibilities: that the Court could act either of its own motion or at the request of one of the parties. In a State whose domestic law did not recognise the first possibility, the Courts would obviously have only the second open to them".[23]

The Chairman and the delegate of the United Kingdom also pointed out in the work of Art. 8(1)[24] that the problem is to be coordinated with local procedural law.[25]

DEFAULTING DEFENDANT IN LITIGATION IN THE COURT AND ARBITRATION: BRAZIL AND ITALY AS ANTITHETICAL MODELS?

Having established, therefore, that local procedural law also plays an important role in international arbitration, the Italian and Brazilian cases will be

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[21] Chairman Mr. Loeve (Austria), in United Nation Conference on International Commercial Arbitration, Summary of record 312th Meeting, (A/CN.9/246, Annex A/CN.9/263 add. I-2, A/CN.9/264) 6 June 1985, 2pm, *Yearbook of United Nation Commission on International Trade Law*, Vol. XVI, 1985, 426.

[22] In fact, in the records the Chairman established that "the text should be left unaltered by the report for the present session should state that the course of the judicial proceedings was not described there, so that it was quite possible for a decision to be taken to refer the parties to arbitration, while the case remained open pending a further possible application. If there was no objection, he would tale it that the Commission agreed to that course".

[23] Mr. Matteucci (Italy), United Nations Conference, 23rd Meeting, 13.

[24] Mr. Mustill (United Kingdom), and chairman Mr. Loewe (Austria), Summary of record 312th Meeting, 426.

[25] *Ibidem*.

analysed below. The choice of these two jurisdictions is threefold. On the one hand, because in both cases we are faced with a monist system of arbitration,[26] on the other hand, because they arrive at the identical solution in the presence of an arbitration agreement in the case of a defaulting defendant in litigation. The peculiarity lies, and this is the third reason justifying the comparison, that the legal paths followed are totally different.

THE POWER OF THE JUDGE: THE ITALIAN MODEL

As far as the Italian legal system is concerned, the points of reference for arbitration are to be found in Arts. 806 ff Code of Civil Procedure (CPC) and also in some normative references in the Italian Private International Act (Law No. 218/1995),[27] particularly useful will be, as we shall see, Art. 11 of Law 218/1995 for which "the lack of jurisdiction can be detected, at any stage and level of the trial, only by the constituted defendant who has not expressly or tacitly accepted Italian jurisdiction. It is revealed by the judge *ex officio*, always at any stage and level of the trial, if the defendant is in default, if the hypothesis referred to in Article 5 occurs, or if Italian jurisdiction is excluded as a result of an international law".[28]

Another reference provision must be Art. 819 *ter* CPC according to which it is stated that "the objection of the judge's incompetence pursuant to the arbitration agreement must be raised, under penalty of forfeiture, in the response.

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[26] Indeed, the transition from the monist to the dualist system tends to occur with the 2006 reform. See Luca Radicati di Brozolo, "Requiem per il regime dualista dell'arbitrato: riflessioni sull'ultima riforma", *Rivista di Diritto Processuale*, Vol. 65, No. 6, 2010, 1267 ff. The monist thesis is also maintained with the 2015 arbitration reform although not free from criticism: Leandro Tripodi, "Arbitragem doméstica e internacional: o que significam monismo e dualismo no terreno da arbitragem?", *Arbitragem. Estudos sobre a Ley n. 13.129, de 26-5-2015* (Eds. Francisco José Cahali, Thiago Rodavalho, Alexandre Freire), Saraiva, *São Paulo*, 329 ff.

See also *v.gr.* Andrea Bonomi, "Monisme et dualisme", *Arbitrage interne et international - Actes du colloque de Lausanne du 2 octobre 2009* (Eds. Andrea Bonomi, David Bochatay), Librairie Droz, Genève, 2010, 167 ff.; Aline Dias Henriques, "Os Sistemas Monista e Dualista na Arbitragem Comercial", *Revista Brasileira de Arbitragem*, Vol. 13, No. 50, 2016, 92 ff.

[27] Legge No. 218/1995, de 31 of May, Riforma del sistema italiano di diritto internazionale privato, *Gazzetta Ufficiale,* No.128 del 03-06-1995 - Suppl. Ordinario n. 68.

[28] Art. 11 Law No. 218/1995, op. cit. "*Il difetto di giurisdizione può essere rilevato, in qualunque stato e grado del processo, soltanto dal convenuto costituito che non abbia espressamente o tacitamente accettato la giurisdizione italiana. È rilevato dal giudice d'ufficio, sempre in qualunque stato e grado del processo, se il convenuto è contumace, se ricorre l'ipotesi di cui all'articolo 5, ovvero se la giurisdizione italiana è esclusa per effetto di una norma internazionale*".

Failure to raise the objection excludes arbitral jurisdiction limited to the dispute decided in that judgment".[29]

To better understand the application of these rules in the arbitration field, take as a starting point an important leading case recently resolved by the Italian Supreme Court.[30]

AN ITALIAN LEADING CASE

In order to be able to show that the problem presented here is not just a theoretical hypothesis, we will present a concrete case and take it as our starting point an interesting ruling by the Italian Supreme Court[31] that will help us along this path.

The case starts from an international sale - between an Italian seller and an Algerian buyer - of a durum wheat grinding machinery with its assembly and installation and also the training of the technicians in charge.

As the UN Convention on Contracts for the International Sale of Goods (CISG) does not apply to this case since Algeria has not ratified it, the parties entered into an arbitration agreement[32] stating that the arbitration will be regulated by the rules of ICC and that the applicable law will be the Algerian Law.

A performance bond issued by an Italian bank[33] in the interest of the seller in case of faults of the good and corresponding to 10% of the price is associated with the contract.

The buyer reported the presence of some faults and the seller - despite stating that they were attributable to faulty maintenance - had sent some spare parts. Since the only repair would have been to return the goods to Italy, faced with the persistence of these faults, the buyer enforced the performance bond.

Since the performance bond is paid, the seller decides to take the ordinary course of action in the Italian courts[34] with the dual purpose of ascertaining the proper functioning of the goods and to ascertain the unlawful enforcement of the warranty.

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[29] Art. 819 *ter* CPC (omissis): "*L'eccezione di incompetenza del giudice in ragione della convenzione di arbitrato deve essere proposta, a pena di decadenza, nella comparsa di risposta. La mancata proposizione dell'eccezione esclude la competenza arbitrale limitatamente alla controversia decisa in quel giudizio*".

[30] Italian Supreme Court, Joint Civil Chambers No. 17244/2022, dated 27.5.2022.

[31] *Ibidem*.

[32] This is clause No. 25 of the sales contract.

[33] If performance bond was issued by an Algerian bank but is guaranteed by an Italian bank.

[34] By virtue of the joint interpretation of the Art. 6 Brussels Convention, Art. 3 Law No. 218/1995.

As can be observed, despite the fact that the contract provides an arbitration agreement for the resolution of disputes relating thereto, one of the parties unilaterally - and without prior agreement - decides directly to go to ordinary legal proceedings. This concrete case serves as a pretext to realise certain considerations and assess what the consequences are. Since there was no agreement of the parties on one party's decision, the different possibilities in relation to the possible behaviour of the other party have to be evaluated: A) the other party gives itself up and agrees to continue the legal proceedings; B) the other party does not want the ordinary court proceedings. The second hypothesis is divided into two sub-possibilities 1) it activates itself at Court and raises an issue of the lack of jurisdiction; 2) it remains inert: here the value of silence and absence must be identified. How should or can the Court operate in these cases?

Hypothesis A) is not particularly problematic and is therefore excluded from this discussion. If the defendant enters an appearance and manifests an express wish to object to the judge's lack of jurisdiction (hypothesis B.1), it is also not problematic. In this case the express intention is manifested in accordance with the procedural rules laid down by the law.

In the Italian case, this express will is manifested by filing an ordinary civil action and asking for a lack of jurisdiction of the Court[35] and demanding that the dispute be settled before the arbitral tribunal, expressly activating the application of Art. 819 *ter* CPC. This mode is less problematic and follows the normal evidentiary process that will result in the acceptance or rejection of the request regardless of the case.

The most problematic case is hypothesis B.2), i.e. where there is no joint agreement to go before the (ordinary) Court and where therefore one of the parties remains inert by not entering an appearance. Here it must be established whether or not this silence/inaction corresponds to the party's willingness to resolve the problem through the arbitral tribunal. In this regard, the role of the express or tacit manifestation of its will must be assessed.

Thus, if the defendant does not enter an appearance[36] in the proceedings, the Court may, while safeguarding certain rules of cross-examination in advance, declare the "*contumacia*"[37] of the party, i.e., "the situation of the party summoned who does not enter an appearance". It is true that the non-participation of one of the parties in the proceedings - the documents of which have been served on it - is an "anomaly";[38]

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[35] See Arts. 163 ff CPC.

[36] Cfr. Arts. 166 and 171 CPC.

[37] Cfr. Arts. 171.3, 187, 290 ff CPC.

[38] See Salvatore La Rosa, *Il contumace nel giudizio civile*, Filippo, Catania 1887; Arturo Rispoli, *Il processo civile contumaciale*, Società Editrice Libraria, Milano 1911.

despite this the party is free not to participate in the proceedings. In this sense, the declaration of "contumacy" operates under the rules of the civil trial. However, how does this state of 'contumacy' operate in civil proceedings in the (co-)presence of an arbitration agreement according to which the parties wanted to bring the case not before the judge but before the arbitral tribunal?

Here one perceives that the evaluation of these aspects is problematic in order to understand whether or not this behaviour of the other party also evidences a (tacit) manifestation of the other party's desire or unwillingness to initiate civil proceedings.

Faced with the absence of a precise and express rule in this regard (subject to the considerations that will be made) it must be considered whether there is a precise obligation or duty on the part of the Court, in such silence/absence, to pronounce *ex officio* on the matter. In this sense, two antithetical positions open up: a) a position in favour of the possibility for the judge to pronounce *ex officio* on the possible competence or otherwise of the matter of the judgement and, if he does not consider himself competent, to refer the dispute to the arbitral tribunal; b) a position antithetical to the one just proposed, in which case the questions of competence/incompetence should only be proposed by those who have a legitimate interest, otherwise the trial would have to follow the canons undertaken - i.e. those of legal proceedings - despite the fact that there is an arbitration agreement executed by the parties and ("violated") by one of the parties.

THE JUDGE MAY DECLARE *EX OFFICIO* ITS LACK OF JURISDITION IN PRESENCE OF AN ARBITRATION AGREEMENT (FIRST INSTANCE AND COURT OF APPEAL)

As can be seen, this is not a matter of arbitration with one of the parties being absent, but rather one of assessing what the value of the arbitration agreement is in the face of a change of course by one of the parties. The arbitration agreement is still in force, one party turns to the normal Court and the other, knowing this, deliberately decides not to appear before the Court and not to oppose the (new) proceedings established.

Is the arbitration agreement still in force and in this case the judge could confirm it *ex officio* and declare himself incompetent? This latter position is the one adopted by the first[39] and second instance[40] in the case just outlined (see *supra*).

[39] Tribunale di Modena dated 22.2.2011, unpublished.

[40] Corte di Appello di Bologna dated 13.6.2017, unpublished.

The legal reasoning underlying this position is the application of Art. 11 of the Italian Private International Law Act. This provision is expressly devoted to "lack of jurisdiction" stating that this may be requested by the party and not by a third party. The provision also provides for the possibility that the judge refers the parties to arbitration *ex officio* in certain instances: those of Art. 5 Italian Private International Act[41] or if Italian jurisdiction is excluded by an international rule, aspects that do not apply to the case analysed.

The Court of first instance and the Court of appeal interpret the rule expansively in terms of its factual content and they decide to apply it *ex officio* to the arbitration context in case of a defaulting party. They do not, however, allow the plea of lack of jurisdiction to be filed by the bank, i.e., a third party. Since the bank is a third party, it is not entitled to plead the lack of jurisdiction of the Italian court by virtue of the arbitration agreement in the contract of sale. The bank as a third party is not party to the arbitration agreement and therefore lacks standing to raise it.

The consequence of this position is that the arbitration procedure prevails, and the legal proceeding is blocked. Thus, for this position, the judge, faced with the valid arbitration agreement, decides that the matter must continue before the arbitral tribunal, despite the fact that the other party is absent in the proceedings and has not raised the objection.

THE JUDGE CANNOT DECLARE EX OFFICIO ITS LACK OF JURISDITION IN PRESENCE OF AN ARBITRATION AGREEMENT (ITALIAN SUPREME COURT)

A position contrary to the one previously analysed is to consider that the Court cannot of its own motion declare the lack of jurisdiction if it has not been requested by the party. This was the approach that the Italian Supreme Court adopted (changing the direction of the first and second instances) thus distancing itself from the possible application of the Art. 11 of Law No. 218/1995 but reinforcing the value of the autonomy of the parties and its interaction not only when drafting the arbitration agreement but also during the subsequent phase.

In this case the approach based on the application of the Art.11 of Law 218/1995 is considered wrong, since Art. II(3) NY Convention must be assumed to be relevant to provide that "The Court of a Contracting State, when seized of

[41] This disposition refers to actions in rem relating to immovable property located abroad ("azioni reali aventi ad oggetto beni immobili situati all'estero").

an action in a matter in respect of which the parties have made an agreement within the meaning of this article, shall, at the request of one of the parties, refer the parties to arbitration, unless it finds that the said agreement is null and void, inoperative or incapable of being performed".

The Italian Supreme Court considers that this disposition would also apply in this case since the Convention refers to both domestic and foreign arbitrations.[42]

To reinforce this aspect, it incorporates the reasoning of a previous case[43] in which, although it referred to a domestic arbitration,[44] it excluded the possibility for the ordinary judge to find *ex officio* that he lacked jurisdiction.

Moreover, it elevates the will of the parties as a fundamental character of any arbitration and therefore it is the parties alone who must choose whether to submit to arbitration and not to the judge. In this sense, it is stated that "it is the will of the parties that constitutes the sole basis of the jurisdiction of the arbitrators, it must necessarily be recognised that the parties, just as they may choose to submit the dispute to the arbitrators rather than to the ordinary judge, may also opt for a decision by the latter, not only expressly, by means of an agreement equal to and contrary to that reached in the compromise, but also tacitly, through the adoption of procedural conduct converging towards the exclusion of the arbitral jurisdiction, and in particular through the introduction of the ordinary procedure, which is counterbalanced by the failure to raise the objection of arbitration".[45]

For this the defendant can only object the lack of jurisdiction and the Law cannot decide the procedure to be carried out. In this sense, the Court fully embraces the importance of Art. 806 CPC, according to which "the parties may have disputes between them that do not concern non-disposable rights decided by arbitration, unless expressly prohibited by law", which takes on the character of a general principle, constitutionally guaranteed, of the whole legal system.[46]

In this sense, the Italian Supreme Court's solution, *mutatis mutandis*, would arrive at the same basic conclusion as Art. II.3 NY Convention: in both cases the judge cannot decide *ex officio*, but only at the request of one of the parties.

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[42] On the basis of Art. I NY Convention.

[43] Italian Supreme Court, sec. VI, No.22748/2015, dated 6.11.2015.

[44] The same sentence takes care to state that this aspect is not a limitation since the aspects relating to the voluntariness of the arbitration are independent of the characteristics of nationality but must be found in the post-institutional principles (Arts. 102 and 24 of the Italian Constitution).

[45] Italian Supreme Court, Joint Civil Chambers No. 17244/2022.

[46] Confirmed by Italian Supreme Court, sec. II, No. 32720/2022, dated 7.11.2022.

SOME REFLECTIONS

By virtue of what has been analyzed we can highlight some points including: 1) Indispensable voluntary nature of arbitration; 2) (Non) applicability of Arbitration Agreement in case of defaulting defendant in litigation; 3) Interesting comparison between Art. 5, 11 Law 218/1995 vs. Art. II.3 NY Convention.

The Italian Supreme Court's ruling confirms the first two points and gives priority to the position enshrined in the New York Convention. What are the repercussions of these aspects? Undeniable is the role that party autonomy plays in arbitration, yet in the analysed case this factor takes on a peculiar role. Indeed, it is necessary to clarify which reference point to take into consideration at the moment of the volitional act: should one take into consideration the will to be judged by arbitration proceedings (and the refusal to conduct civil proceedings) or the refusal to arbitration proceedings (and the will to conduct legal proceedings)?

Although these two factors are intimately related, some legal nuances in this regard are interesting.

Effectively, at the time of the arbitration agreement, both parties' will coincided and thus there is no major problem: both expressed the will to resolve the potential dispute through arbitration.

In the case at hand, however, these wills diverge and if the plaintiff's will is clear (will to go to civil trial and not to arbitration), the dilemma remains as to what the defendant's will is in case of defaulting defendant in litigation.

Here, it is important to elucidate whether the negative behaviour (defaulting defendant) leads to a positive (will to choose the arbitration or will to choose the legal proceeding) or negative (refusal of the arbitral tribunal or refusal of the legal proceedings) manifestation of the will.

The problem arises because this manifestation of will relates in a different context from the context in which it would manifest itself. Let us attribute Letter A to the (ordinary) legal proceeding at the Court and let us attribute Letter B to the arbitration proceeding: the Italian Supreme Court's solution would lead to say that the fact of not appearing in A, means to choose A (and therefore to reject B): which, if this were the case, might be partly paradoxical in the terms we will see below.

The Supreme Court holds that the fact of being contumacious entails a tacit will to submit to arbitration (otherwise one would have had to appear at the Court and submit the exception of jurisdictional competence). The Court therefore attaches a precise value to the party's silence, a silence due to non-representation in the Court.

In order to understand this, therefore, two factors come into play: a) Attendance at the Court (absent in this case) b) silence with respect to the manifestation of will (absence of a formal complaint at the hearing manifesting voluntariness about something).

Now let us see how these factors operate - and whether there are differences - depending on which manifestation of will comes into play and whether the party wishes to express a positive or negative will. We have these four hypotheses:

Hypothesis No. 1. Positive manifestation: will to carry out the arbitration proceedings

Hypothesis No. 2. Positive manifestation: will to carry out the ordinary legal proceedings

Hypothesis No. 3. Negative manifestation: will not to carry out the ordinary legal proceedings

Hypothesis No. 4. Negative manifestation: will not to carry out the arbitration proceedings.

As can be seen, some positive manifestations of will coincide with negative ones: positive hypothesis No. 1 coincides with negative hypothesis No. 3, and positive hypothesis No. 2 coincides with negative hypothesis No. 4. Although there are equal effects, it must be understood, however, which is the correct starting point in this case. Given that there is already a valid arbitration agreement, and that this remains valid during the silence of the parties, one must start from the assumption that the change of will must be antithetical to the pre-existing situation, on the contrary in the case of silence, the manifestation should coincide with the initial one.

In this sense, if the reasoning carried out is consistent, it means that silence *per se* validates (and does not exclude) hypotheses No. 1 and No. 3: the party's silence already presupposes them.

Notwithstanding this, the Italian Supreme Court arrives at the opposite solution, namely that silence does not validate hypotheses No. 1 and No. 3, but validates hypotheses No. 2 and No. 4.

This would lead to a kind of paradox of freedom of choice and will. In fact, it has been said that there are two factors at play, a) Attendance at the Court (absent in this case) b) silence with respect to the manifestation of will.

In this sense, the Court's reasoning leads to the fact that the (negative) decision not to become a party presupposes the tacit and implicit will to manifest the will of hypotheses No. 2 and No. 4. But note again a double complication.

First complication: according to this view, such a vision/imposition would be paradoxical. In fact, in this context, hypotheses No. 2 and No. 4, which seemed

to have (outside the process) identical values and effects, do not have it here. In fact, the manifestation of the will to carry out the ordinary legal proceedings should be manifested by attendance at Court and not by conduct to the contrary. If this is certain, one must arrive at the consequence that the non-appearance (not attendance) therefore implies the effect of hypotheses No. 2 and No. 4, and thus the party's choice not to attendance itself signifies the opposite intention (that of hypotheses No. 1 and No. 3): that of wanting to assume that the arbitration agreement is still valid.

On the other hand, if one were to follow the reasoning (which is the one adopted by the Italian Supreme Court) whereby one requires the party to attend and enter an appearance at the Court (and then make an objection of jurisdiction) it would mean associating non-participation in the court with the will to attend the Court (and then make the objection). If this were the case, following such abstract reasoning would mean that regardless of the presentation/non-presentation/constitution at the Court of the party, hypothesis No. 2 (will to carry out the ordinary legal proceedings) would be fulfilled when this is not necessarily the case. The inconsistency is due to the procedural requirement that defendant present the lack of jurisdiction motion. But it must be remembered that the starting point is the existence of a valid arbitration agreement, and it is hard to see why a burden should be placed on the party that is resisting the other party's unilateral decision to change the rules at play and bring the case before the ordinary court *sua sponte* when he was obliged to carry out an arbitration proceeding. Validating this position therefore means annihilating the true will of the parties and the choice freely made by the parties (and still valid) to carry out the arbitration proceedings. If one were to follow this approach, one would be employing reasoning that leads to antithetical solutions to the same volitional act: the will to carry out the ordinary legal proceedings would occur either through positive conduct (by attendance at Court) or negative conduct (no attendance at Court and no presentation of the lack of jurisdiction motion). This interpretation would never permit a negative volitional act manifesting a negative intention. It would always presuppose the concept of silent as consent: something that from the point of view of general contract theory is not accepted especially if one wants to elevate the will of the parties to a key factor in arbitration. Such a will must be express and clear: indeed, if one thinks about the arbitration agreement, it is required in writing (requirement of the NY Convention), i.e., through positive conduct. And if one thinks of tacit consent, it is substantially validated by positive, not negative, conclusive conduct. That is, although it is true that precise values and procedural burdens come into play here, one cannot lose sight of the high value of the party's will and thus the role of such a manifestation: an express manifestation of will, formulated in writing and giving rise to the validity of the arbitration agreement, cannot be swept away by the silence of the

party itself, a silence induced by the unilateral volitional change of the counterparty that wished to insert precise procedural obligations, which deviate from the content of the arbitration agreement and arbitration, by the (unilateral) activation of the ordinary legal proceedings. Admitting this would be tantamount to admitting the priority of a unilateral volitional choice over one that arose from the common agreement of both parties.

Second complication: the Italian Supreme Court's solution presupposes that the defense by arbitration has therefore been tacitly waived. Here another perspective opens up from the perspective of contract theory. It is recalled that the starting point of the dispute is the presence of a valid arbitration agreement and thus a right/duty to submit to arbitration proceedings. If one were to validate the reasoning that one cannot declare *ex officio* the lack of arbitral jurisdiction in the case of defaulting party, one would be validating a tacit waiver of a right. A tacit waiver of a right is also possible, but how would it operate in the concrete case?

In this case it must be remembered that the recent Cartabia[47] reform (not present at the time of the facts) validates the impossibility of reproducing for the future a solution like that of the Supreme Court. In fact, the Cartabia reform modifies the *translatio iudiciis* by Art. 819 *quarter* CPC, i.e., the possibility of resuming the arbitration proceedings - or civil proceedings - where the jurisdiction of the authority seized (i.e., of the judge or the arbitration tribunal, respectively) is denied, without the procedural activity carried out in the meantime by the parties being rendered useless.

In the presence of the new provision of the Art. 819 *quater* CPC, allowing a tacit waiver in case of non-attendance at Court and no presentation of an exception of jurisdiction could perhaps mean that the possibility of activating the Art. 819 *quater* would be subsequently barred?

Effectively, the activation of the *translatio iudiciis* requires that one of the parties (in this case, it would be the one who would have tacitly renounced) proceed pursuant to Art. 810 CPC within three months of the judgment denying jurisdiction becoming final. Would the current presence of this provision mean that the tacit waiver could also imply another tacit waiver not to use Art. 819 *quater* CPC? As can be seen, this is puzzling.

In the end, the Italian Supreme Court's effort to counter a glaring legal gap that does not provide for an *ad hoc* hypothesis in the case of contumacy in the legal proceedings in case of a valid arbitration agreement is commendable. The Court seeks to solve the problem by means of a jurisprudential integration of an implicit

[47] See *v. gr.* Maria Carla Giorgetti, "Commento alle novità in materia di arbitrato introdotte dal decreto legislativo 10 ottobre 2022, No. 149", *Judicium*, 2022, 1 ff.

or "unexpressed" rule[48] that establishes how the will of the party in the face of its silence is to be interpreted. In this sense, the Court's conclusion is to assume that such silence implies an implicit waiver of the arbitration process. This jurisprudential construction leads to an implied rule that is used for the purpose of determining the meaning of the parties' express silence as to whether or not to proceed to arbitration in the face of an arbitration agreement whose validity has not been questioned by either party. The court's conclusion is that silence is tantamount to acceptance of the procedure before the judge, but the problem goes deeper, especially in a system where from the point of view of manifestation of will, silence does not mean assent. In the end, we are witnessing a merely theoretical reconstruction by the Supreme Court that allows it to integrate the system of Art. 11 Law No. 218/1995 and momentarily eliminate the legal gap.

However, this initiative does not operate by virtue of a coherent concept of the manifestation of the will and the role of silence according to the canons of the Italian legal system (see *infra*).

THE POWER OF THE LEGISLATOR: THE BRAZILIAN MODEL

In Brazil, the arbitration legislation, which is regulated in the Brazilian Arbitration Act of 1996,[49] takes as reference also the rules of the Civil Procedure Code. Both texts were reformed in 2015 through a reform on arbitration and a broader reform relating to the Civil Procedural Code.[50]

Since 2015, the Brazilian legislator expressly regulates the problem relating to the absence of the defaulting litigant party in the presence of an arbitration agreement by reforming the ancient Art. 301 CPC of 1973 and replacing it with the current Art. 337 CPC.[51]

Before focusing on the reform, it must be highlighted that already for the previous provision (former Art. 301 CPC) there was a specific burden of proving the "*convenção de arbitragem*" on the part of the defendant. Thus, it was established that it is the defendant's responsibility, in the phase of defense and objection

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[48] See the theory of "norma implicita" or "inespressa" by Riccardo Guastini, *Interpretare ed argomentare*, Giuffrè Milano, 2011, 155 ff. More extensively, Riccardo Guastini, "Produzione di norme a mezzo norme", *Informatica e diritto*, Vol. 11, No. 1, 1985, 7 ff.

[49] Brazilian Arbitration Act No. 9307/1996 dated 23.9.1996.

[50] This occurred respectively with the Brazilian Law No. 13129/2015, dated 26.5.2015, and the Reform of Civil Procedural Code by Brazilian Law No. 13105/2015 dated 16.3.2015.

[51] By Brazilian Law No. 13105/2015 dated 16.3.2015.

(*Contestação*) and before discussing the merits (*antes de discutir o mérito*) to allege the "*convenção de arbitragem*"[52].

Furthermore Art. 310 §4 of the former CPC expressly stated that the judge could not decide *ex officio* in matters of "*compromisso arbitral*".[53]

As can be observed, this drafting essentially shaped in its contents those of Art. II.3 NY Convention. Thus, the influence on national law of international instruments being transplanted also for national arbitrations is clear here.

In this sense, it is perceived that if the "*convenção de arbitragem*" (and thus the arbitration proceeding) is to be invoked, active conduct on the part of the defendant in a certain part of legal proceedings is required. The Brazilian rule clarified this point in detail, being in this sense clearer than Art. II.3 NY Convention or Art. 8(1) Model Law.

Despite this, the nuances between the "*convenção de arbitragem*" and "*compromisso arbitral*" had left some interpretive doubts. In fact, although both figures are qualified and considered as "Convenção de Arbitragem" in Chapter II of the Brazilian Arbitration Act of 1996,[54] they are essentially categorised into two different volitional moments.[55] Thus, the "*convenção de arbitragem*" *is "a convenção através da qual as partes em um contrato comprometem-se a submeter à arbitragem os litígios que possam vir a surgir, relativamente a tal contrato*",[56] while the "*compromisso arbitral*" is "*a convenção através da qual as partes submetem um litígio à arbitragem de uma ou mais pessoas, podendo ser judicial ou extrajudicial*",[57] having to the latter "*celebrar-se-á por termo nos autos, perante o juízo ou tribunal, onde tem curso a demanda*"[58] and holding some formal requirements.[59] This led the doctrine to be able in some cases to doubt whether the judge could not intervene *ex officio* in the case of "*convenção de arbitragem*".[60]

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[52] Art. 301 CPC 1973 "Compete-lhe, porém, antes de discutir o mérito, alegar (…) IX: convenção de arbitragem".

[53] Art. 301 §4 CPC 1973: "Com exceção do compromisso arbitral, o juiz conhecerá de ofício da matéria enumerada neste artigo".

[54] Arts. 3-12 Brazilian Arbitration Act.

[55] See *v.gr.* Luis Fernando Guerreiro, *Convenção de arbitragem e processo arbitral*, 4th Edition, Almedina, São Paulo, 2022, 5 ff; Carlos Alberto Carmona Alberto, *Arbitragem e processo: um comentario à Lei No.9307*, 3rd Edition, Atlas, São Paulo, 2009, 16 ff.

[56] Art. 4 Brazilian Arbitration Act.

[57] Art. 9 Brazilian Arbitration Act.

[58] Art. 9 §1º Brazilian Arbitration Act.

[59] Art. 9. §2º Brazilian Arbitration Act: "O compromisso arbitral extrajudicial será celebrado por escrito particular, assinado por duas testemunhas, ou por instrumento público".

[60] See *v.gr.* André Luís Quintas Monteiro, *Princípio da competência-competência na arbitragem comercial: visão a partir do Brasil*, Tese (Doutorado em Direito) – Pontifícia Universidade

This situation is clarified by the legislator who reformed the rule by introducing the current Art. 337 CPC. On the one hand, the obligation to allege the defendant's "*convenção de arbitragem*"[61] is maintained, while on the other hand, it unequivocally eliminates[62] any interpretative doubt that arose under the previous legislation.

In this sense it expressly states that it is "*convenção de arbitragem*" and no longer the "*compromisso arbitral*" that cannot be decided *ex officio.*[63]

Moreover, the legislator expressly states the effects of the absence of an allegation of the "*convenção de arbitragem*": the absence of an allegation of the existence of an arbitration agreement "implies acceptance of state jurisdiction and waiver of arbitration".[64]

The legislator tautologically ratifies the effect due to the no allegation of the arbitration agreement by stating that 1) implies acceptance of state jurisdiction ("implica aceitação da jurisdição estatal") and 2) waiver of arbitration ("renúncia ao juízo arbitral").

The Brazilian solution therefore a) imposes, indirectly, a precise obligation to attendance at Court:[65] in fact, there is a precise burden of annexing the arbitration agreement; b) takes an express solution with respect to negative behaviour and silence: these generate waiver of the arbitral proceeding and imply the will to continue the legal proceeding.

CONSISTENCY BETWEEN THE ITALIAN AND BRAZILIAN SOLUTIONS? THE VALUE OF SILENCE AND WAIVER IN THE ARBITRATION PROCESS

Both the Italian and Brazilian solutions lead to the waiver of the arbitration process. Are they consistent with the appropriate expression of will issued by the parties? To this end we need to understand the value of silence in the relevant legal system.

Católica, São Paulo, 2017, 271 ff; Giovanna Filippi Del Nero, *Arbitragem e litispendência*, Dissertação de Mestrado, Universidade de São Paulo, Faculdade de Direito, São Paulo, 2019, 54 ff.

[61] Art. 337 CPC Incumbe ao réu, antes de discutir o mérito, alegar (…) (…) X: convenção de arbitragem".

[62] Art. 310 §4o §4 was replaced by Art. 337 §5 and §6 CPC.

[63] Art. 337 CPC §5º establishes that: "Excetuadas a convenção de arbitragem e a incompetência relativa, o juiz conhecerá de ofício das matérias enumeradas neste artigo".

[64] Art. 337 CPC §6º.

[65] On the analysis of a failure to appear during the arbitration proceedings, see Flávia Benzatti Tremura Polli Rodrigues *"Contumácia* e revelia na *arbitragem*", *Revista brasileira de arbitragem*, Vol. 11, No. 42, 2014, 15 ff.

From the point of view of Brazilian regulatory evolution, the model seems to be coherent in itself. In fact, a peculiarity of the Brazilian legal system is that according to Art. 111 Brazilian Civil Code "silence means consent, when circumstances or usage authorize it, and a declaration of express will is not necessary".[66]

This precise rule guarantees a silence that implies consent in certain cases and especially when there is a precise authorisation that, in this specific case, is expressly given by Art. 337 of the CPC. In this sense Art. 337 §6 CPC takes the form of an express authorisation by the legislature to treat silence as acceptance. This factor together with the burden of alleging the arbitration agreement of the same provision gives perfect coherence to the system, since in the event of negative behaviour or silence of the defendant the legal solution, by the combination of Art. 337 CPC and Art. 111 Brazilian Civil Code clearly leads to a manifestation of will consistent with the system, which is that of the will to proceed with the ordinary legal proceeding and not the arbitral one.

In this sense, the procedural solution is fully consistent with the private law perspective of the manifestation of the will according to the model adopted, a model that, among other things, is present in other jurisdictions with similar modalities. Thus, as expressly stated in the Brazilian legal system, the silence of the parties is valid as a declaration of will, when this value is attributed to it by law, usage or convention.[67]

The possible inconsistency in the Italian case has already been pointed out (see *supra*); this is reinforced by the fact that for the Italian legal system silence as a general rule is not equivalent to consent. In the Italian case, referring to the value of silence, the solution remains inconsistent since there is no such rule as in Brazil. In fact, the manifestation of the will must be occurred by positive conduct. It is true that the so-called *silenzio circostanziato* also exists in the Italian system, but unlike the Brazilian system, there is no rule that legitimises or authorises such silence to be valid as waiver of arbitration proceedings. In fact, there is an onus to allege the validity of the arbitral agreement, but only in the arbitral proceedings - i.e. before

[66] Art. 111 Brazilian Civil Code: "O silêncio importa anuência, quando as circunstâncias ou os usos o autorizarem, e não for necessária a declaração de vontade expressa". See Eduardo Ribeiro De Oliveira, *Comentários ao novo Código Civil*, Vol. II, 2nd Edition, Forense, Rio de Janeiro, 2012, 236 ff; Miguel Maria de Serpa Lopes, *O silêncio como manifestação de vontade*, Cohelho Branco Fiho, Rio de Janeiro, 1935; Maurício Andere Von Bruck Lacerda, *O silêncio no exercício da autonomçia privada no ambiente contractual privado brasileiro*, Tese de Doutorado, Facultade de Direito da Universiade de São Paulo, 2020.

[67] Artigo 218 Brazilian Civil Code (O silêncio como meio declarativo): "O silêncio vale como declaração negocial, quando esse valor lhe seja atribuído por lei, uso ou convenção".

the arbitrators - pursuant to Art. 817 Italian CPC but not before the ordinary Court (as is the case in Brazil pursuant to Art. 337 Brazilian CPC).

In the Italian legal system, the old debate that had characterised the antithetic positions of Pacchioni[68] and Bonfante[69] in the matter of the conclusion of contracts in the derogated Civil Code of 1865 seems to have come to an end, arriving at the fact that essentially silence corresponds in general terms to an absence of manifestation of the will.[70] Already the first commentators of the Italian civil code of 1942 considered that the canonical principle *qui tacet consente videtur*[71] (who is silent seems to agree) should not be accepted.[72]

It is also true that the maxim *qui tacet consentire videtur* (who is silent seems to agree) must be complemented with "*si loqui debuisset ac potuisset*" (if he should have spoken and could have)". In this case it could be argued that since Art. 819 *ter* CPC provides that the objection of the judge's incompetence pursuant to the arbitration agreement must be raised, under penalty of forfeiture, in the response, in this case there is a kind of duty for the party to allege the Court's lack of jurisdiction. Although it should be noted that this rule is not an ad hoc rule for arbitration but is a general rule. Thus, there is not a specific rule in Italy for which proof of the arbitration agreement must be attached. Nor would it appear that the (voluntary) attendance at Court or the possibility of alleging the lack of jurisdiction under Art. 819 *ter* CPC are precise and substantive obligations in the specific case we are taking into consideration since we are already in the presence of a valid agreement: a valid arbitration agreement in the presence of the default of a party. The case would be different if one of the two parties (in this case the plaintiff had) questioned its validity and it would be the party that should allege its invalidity. Although in the Roman process Paul's maxim existed and stated that

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[68] Giovanni Pacchioni, "Il silenzio nella conclusione dei contratti. Commento a Corte Cassazione di Torino 25 agosto 1905", *Rivista Diritto Commerciale*, No. 4, II, 1906, 23 ff.

[69] Pietro Bonfante, "Il silenzio nella conclusione dei contratti. Commento a Corte d'appello di torino 10 luglio 1905", *Rivista Diritto Commerciale*, No. 4, II, 1906, 233 ff.

[70] Silvio Perozzi, "Il silenzio nella conclusione dei contratti", *Rivista di Diritto Commerciale*, No. 6, I, 1906, 509. Please refer to Perozzi for a systematization of the antithetical positions relating to the silence of Pacchioni and Bonfante. On the evolution from the Italian civil code of 1865 to that of 1942, see Giovanni Battista Ferri, "Il silenzio e le parole nella cultura del civilista", *Il silenzio e le parole nella cultura del civilista*, Giuffrè Francis Lefebvre, 2021, 480 ff.

[71] The problem of silence has always also affected the French and German legal system in relation to this principle see: G. B. Ferri, op. cit., 474. Also see: Alfred Rieg, *Le role dans l'acte juridique en droit civil français et allemand*, Librairie générale de droit et de jurisprudence, Paris, 1961.

[72] Emilio Betti, *Teoria generale del negozio giuridico*, Utet, Torino, 1943, 93; Giuseppe Stolfi, *Teoria del Negozio Giuridico*, Cedam, Padova, 1962, 167 ss.

"*qui tacet non utique fatetur, sed tantum verum est eum non negare*",[73] the allegation of Art. 819 *ter* CPC is not an obligation as in the Brazilian case but an eventuality. The case of "*non negare*" does not mean admitting the will to participate in the legal proceedings.[74] It is certain that *silenzio circonstaziato* must be assessed according to the circumstances,[75] but the maxim that who is silent seems to agree must be refused by default as a general rule. In the Italian case, however, it will certainly not have the same value in the event that - in case of a valid arbitration agreement - the party has entered an appearance (and decides not to raise the objection) or decides to remain contumacious.

In this sense the Italian jurisprudential reconstruction[76] moves on a certain level of inconsistency with the view of Italian private law *a fortiori* when it evokes the importance of the autonomy of the will and its manifestation.

NEW YORK CONVENTION MODEL: THE JUSTIFICATION ABOUT THE EXCLUSION OF WORDS "OF ITS OWN MOTION" PRESUPPOSED THE PRESENCE OF THE BOTH PARTIES AT THE COURT

What is to be demonstrated below is that the exclusion of words "of its own motion" in the NY Convention working group's reasoning presupposed the presence of the parties before the Court. Consequently, the possibility or consequences that might occur - from the point of view of the manifestation of will - if the party does not decide not to enter an appearance before the Court, i.e., in case of defaulting defendant in litigation where the validity of the arbitration agreement by the plaintiff is not called into question, was not foreseen.

Three arguments will be given: A) The legal reasoning that led to the exclusion "of its own motion" during the 23rd and 24th meetings of the NY Convention

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[73] "He who is silent certainly does not admit it, but it is only true that he does not deny it": See Maria Sara Goretti, *Il problema giuridico del silenzio*, Milano, Giuffrè, 1982; 158 ff. Per uno studio delle fonti romani vid anche Guido Donatuti, "Il silenzio come manifestazione di volontà", *Studi in onore di Pietro Bonfante*, Vol. 4 Treves, Milano 1930, 459 ff.

[74] In support, remember the reasoning why "*Se il non contradicere fosse una manifestazione di volontá, fosse un consenso, sarebbe oziosa la domanda iniziale e non si comprenderebbe la necessità di un rescritto*". G. Donatuti, op. cit., 471.

[75] On silence and its legal value in detail see M. S. Goretti, op. cit; Fabio Addis, *Lettera di conferma e silenzio*, Giuffrè, Milano, 1999, 256 ff; Cesare Massimo Bianca, *Il Contratto*, 3rd Edition, Giuffrè, Milano, 2019, 188 ff. In relazione al codice civile de 1865 see Pietro Bonfante, "I rapporti continuativi ed il silenzio Commento a Corte di Cassazione Torino 28 novembre 191", *Rivista di Diritto Commerciale*, Vol. XIII, II, 1915, 677 ff.

[76] Supreme Court, Joint Civil Chambers No. 17244/2022.

and its application; B) Jurisprudential application of Art. II.3 NY Convention; C) Some reasoning concerning Art. 8 (1) Model Law

A) The main reason why it was decided to eliminate words "of its own motion" was the possibility that the judge would go against the common will of the parties to no longer want to go before the arbitral tribunal and instead carry out proceedings before the Court. For this reason, it was stated that "a Court should not have the power to impose arbitral procedure when the parties to the arbitration agreement both wished to submit the dispute to the ordinary courts".[77] If they had retained that power for the judge, "the Court would have no discretion whatsoever and would have to refer the parties to arbitration even if they both wished to litigate. Arbitration agreements would thus be indissoluble, regardless of the wish of the parties".[78] It is understood in this case that the prerequisite is that the two parties have a mutual agreement ("both wished"), an aspect which can manifest itself either in the same form in which the arbitration agreement was celebrated (i.e., in writing) or through the attendance in the legal proceedings.

The mutual presence of the parties is thus assumed in stating that "the words 'of its own motion' should therefore be deleted, as parties wishing to rescind an arbitration agreement by mutual consent should be allowed to do so",[79] so "the words under discussion struck at the very roots of contractual freedom. The paramount consideration in arbitration was the will of the two parties, and if they both decided in favour of judicial solution the court should be under an absolute obligation to proceed".[80] All these justifications fail in the case of defaulting party, given that the party is neither constituted nor able to express his desire simultaneously with the other.

B) Part of the jurisprudence shows how the manifestation of the desire to waive the right to arbitrate is manifested with the constitution, i.e., with positive behaviour. Thus, it was established that parties waive their right to arbitrate when they "substantially" participate in litigation, or when they seek to invalidate the arbitration agreement before the courts of another country.[81]

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[77] Mr. Koral (Turkey), United Nations Conference, 23rd Meeting, 13.

[78] Mr. Cohn (Israel), United Nations Conference, 24th Meeting, 8.

[79] Mr. Urabe (Japan), United Nations Conference, 24th Meeting, 8.

[80] Mr. Urquia (El Salvador), United Nations Conference, 24th Meeting, 9.

[81] *Anna Dockeray v. Carnival Corporation*, District Court, Southern District of Florida, Miami Division, United States of America, 11 May 2010, 10-20799; *Apple & Eve LLC v. Yantai North Andre Juice Co. Ltd*, District Court, Eastern District of New York, United States of America, 27 April 2009, 07-CV-745 (JFB)(WDW).

C) The Digest of Case Law on the Model Law on International Commercial Arbitration clarifies that Art. 8 "only mentions cases where referral to arbitration is requested by a party to the action. It does not explicitly state whether a court can refer an action to arbitration on its own motion". [82] Then it goes on to state that "however, it is clear from the *travaux préparatoires* that Art. 8 implicitly prevents a court from doing so, and courts have confirmed that they may only refer an action to arbitration if a request to that effect has been made by a party".[83] Therefore, despite what the Digest states, there is no express prohibition for the judge to refer the parties to arbitration 'of its own motion'. Remember also that during the 312th meeting, it was established that "the court should have a third possibility, i.e., that of referring the parties to arbitration while keeping its own proceedings open until a later stage". [84]

What has been stated allows us to observe how the hypothesis of defaulting defendant in litigation in case of arbitration agreement whose validity is not questioned by the plaintiff was not expressly contemplated in detail, partly generating a gap within the legislation.

CONCLUSIONS: FOUR MODELS AND PRESENT AND FUTURE CHALLENGES

The problem analysed here focuses on the hypothesis of defaulting defendant in litigation in case of arbitration agreement whose validity is not questioned by the plaintiff.

Since in this case the plaintiff does not contest the validity of the arbitration agreement, it means that he is breaking the principle of *pacta sunt servanda* by deciding to initiate - unilaterally - proceedings before the ordinary judge.

Four models could be observed: 1) Art. II.3 NY Convention; 2) Art. 8 Model Law; 3) Italian model; 4) Brazilian model.

The first model clearly influences the others, notwithstanding this, it seems that only the last model has a clear position with respect to the case analysed, expressly providing an obligation to attach the arbitration agreement and constituting a procedural rule - consistent with the private concept of silence contained in the Brazilian Civil Code - for which expressly inert behaviour or silence means both acceptance of the proceedings before the judge as waiver of the arbitration proceedings.

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[82] See UNCITRAL *Digest of Case Law on the Model Law*, 36.

[83] *Ibidem*.

[84] Chairman Mr. Loeve (Austria), Summary of record 312th Meeting, 426.

In the other three cases, there is a kind of legal gap, since there is no *ad hoc* rule. The Italian model provides for the possibility of declaring *ex officio* the lack of jurisdiction in certain cases (Art. 5 Ley No. 218/1995) but the arbitration agreement is not included among them. Faced with this, the Italian jurisprudential reconstruction arrives at the same conclusions as the Brazilian system, but through reasoning that is not consistent with the private concept of silence and manifestation of will in the Italian system. Although the jurisprudential solution of the Italian Supreme Court is commendable for its effort, it has a certain legal inconsistency.

Art. II.3 NY Convention - and also Art. 8 Model Law - decide to exclude that the judge refer the parties to arbitration *ex officio* on the ground that the Court could not subvert the will of the parties when they want to change their minds and no longer conduct the arbitration proceeding by mutual agreement. But this approach is based on the assumptions on which the two parties are attending the legal proceeding at the Court (see above). Similarly, they do not think in the event that the arbitration agreement is valid (and its validity is not putted into question) that such unilateral conduct of one of the parties is essentially prejudicing the party relying on the validity of the arbitration agreement.

Art. 8(2) Model Law partly improves the system by providing that arbitral proceedings may nevertheless be commenced or continued, and an award may be made, while the issue is pending before the court. The reform of the Italian Code of Civil Procedure essentially aligns itself with this possibility with similar, but not equal, features with the introduction of Art. 819 *quater* CPC giving the possibility to have the proceedings begun before the court continued before the arbitrators under certain conditions.[85]

On closer inspection, there is an argument that justifies that the Court cannot refer the parties to arbitration *ex officio*. This is what would protect the party that unilaterally decides to attend the Court when it had previously instituted the arbitral proceedings and the other party has not joined nor paid the costs (and so the party does not wish to assume them in their entirety in the arbitral proceedings). In this case, the arbitration proceedings could be considered as withdrawn and the only viable and remaining option (without resubmitting a new arbitration proceeding that would reach the same conclusions) would be to rely on the Court system. In this case, permitting the Court to refer the parties to arbitration

[85] Art. 819 *quater* CPC "*una delle parti deve procedere a norma dell'articolo 810 entro tre mesi dal passaggio in giudicato della sentenza con cui e' negata la competenza in ragione di una convenzione di arbitrato o dell'ordinanza di regolamento*".

ex officio - even though the arbitration agreement was still valid - would go against the interest of the real party who wants to resolve the dispute and who had initially - unsuccessfully - gone to the arbitral tribunal.

Certainly, to avoid some of these problems, an out-of-court solution that works as a preventive measure is to have a penalty clause in the event of a breach of the arbitration agreement where party decides to take legal proceedings without questioning the validity of the arbitration agreement. Indeed, the arbitration agreement is associated *mutatis mutandis* with a contract and the principle of *pacta sunt servanda*. For this reason, the party that unilaterally - in the event of a valid arbitration agreement - decides to break the agreement and take the case to court may be subject to a penalty clause; this would discourage such a possibility.

Ultimately, all of the models analysed are consistent in the event that the other party goes to court. On the other hand, they take on problematic aspects (except for the Brazilian model) in the event of the other party's default because they are assuming by default that both parties attend the legal proceedings. On the other hand, they do not consider the freedom not to enter an appearance and to legitimately rely on a valid arbitration agreement and the role of silence as absence of consent where the plaintiff has commenced the proceedings without questioning the validity of the arbitration agreement.

The Brazilian model cannot be transplanted to systems where the concept of the manifestation of the implicit will takes on different connotations; therefore, certain important aspects must be re-planned if arbitration is to develop into the full development of a theory of the manifestation of the coherent will where it plays a principal role.

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POVREDA ARBITRAŽNOG SPORAZUMA, IZOSTANAK TUŽENOG SA ROČIŠTA I FLUKTUACIJA MODELA NJUJORŠKE KONVENCIJE: ITALIJANSKI I BRAZILSKI PRIMERI

Rezime

Cilj rada je procena efikasnosti arbitražnog sporazuma onda kad tužilac ne pokrene arbitražni postupak, već tradicionalni sudski spor, pre svega u slučaju kontumacije i nepodnošenja odgovora na tužbu. Hipoteza rada se odnosi na slučajeve u kojima izostanak sa ročišta tuženog nije regulisan, pri čemu se postavlja pitanje da li je ovu pravnu prazninu potrebno popuniti. Pomenuti problem se

odnosi na izostajanje tuženog u parnici, uprkos postojećem arbitražnom sporazumu čiju valjanost tužilac ne dovodi u pitanje. Rešenje varira u zavisnosti od pravnog sistema i ne primenjuje se tamo gde je pravna praznina popunjena postojećom nacionalnom regulativom. U pokušaju odgovora na ova pitanja u radu su analizirani član II.3 Njujorške konvencije, član 8(1) UNCITRAL Model zakona o međunarodnoj trgovinskoj arbitraži, kao i italijanski i brazilski pravni sistem.

Ključne reči: arbitražni sporazum, Njujorška konvencija, nedostatak nadležnosti, italijansko pravo, brazilsko pravo, kontumacija

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CRYPTOASSETS AND ARBITRATION IN SERBIA

Blockchain and digital assets are the new frenzy. What seemed like just another fad is now here to stay. Usage of blockchain and digital assets on a global scale and in greater volume necessitates a deeper scrutiny of the technology and its impact on the world and the legal and economic landscape beyond the initial analysis of its applicability and regulation. This paper focuses on the intersection of blockchain, digital assets and arbitration in Serbia. It analyses whether Serbia is suitable for digital asset disputes as a seat of arbitration and jurisdiction for recognition and enforcement of arbitral awards. The paper aims to answer very specific questions on crypto assets in the arbitration procedure and potential issues with these arbitration cases in Serbia. The conclusion it reaches is that Serbia is indeed a suitable jurisdiction for both the arbitration procedure itself and the recognition and enforcement of arbitral awards, but that idiosyncrasies of the Serbian legal system, and particularly judiciary, give rise to certain issues.

Key words: *arbitration, blockchain, cryptocurrencies, smart contracts, digital assets*

INTRODUCTION

This paper focuses on the intersection of blockchain, digital assets and arbitration in Serbia, in particular crypto assets as a predominant type of digital

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assets.[1] It analyses whether Serbia is a suitable jurisdiction for digital asset disputes as a seat of arbitration and for recognition and enforcement of arbitral awards. It does so in the following manner: the paper gives an overview of the topic and a brief description of the Serbian legal landscape regarding digital assets (section 2); it analyses the arbitrability of digital asset disputes (section 3) and validity of arbitration clauses in digital asset agreements (section 4); further, it inspects the possibility of recognition and enforcement of arbitral awards which deal with digital assets (section 5); the paper analyses which substantive law would be applicable for digital asset agreements (section 6); finally, the paper examines the possibility of securing interim measures over digital assets (section 7).

OVERVIEW OF THE TOPIC AND THE SERBIAN LEGAL LAND–SCAPE

"Crypto craze", the phenomenon of explosive growth and popularity of cryptocurrencies is still ongoing, with top officials and industry experts claiming that crypto is here to stay.[2] The initial veil of doubt about reputation and usability of cryptocurrencies seems to have been lifted, with more and more countries adopting sets of regulations dealing with digital assets.

As digital assets (and cryptocurrencies in particular) gain popularity and their usage becomes more common, it is inevitable that other aspects of their utilization come into focus. This was particularly the case during the so-called "crypto winter", an early 2022 drop in value of crypto currencies by a whopping US$2 trillion.[3] This fluctuation had a domino effect on the entire crypto sector, with several big players on the market going bankrupt.[4]

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[1] The terms "digital assets" and "crypto assets" are related but not necessarily interchangeable, as they can have different connotations depending on context. In this paper, the authors sometimes use them interchangeably, especially because the majority of all court cases actually deal with cryptocurrencies as the most popular type of digital assets.

[2] Ankur Grover, "The future of payments: Why cryptocurrencies are here to stay", The Economic Times, 2023, available at: *https://economictimes.indiatimes.com/markets/cryptocurrency/the-future-of-payments-why-cryptocurrencies-are-here-to-stay/articleshow/102274620.cms?from=mdr*, 13. 10. 2023; Rosemarie Miller, "Crypto Is Here To Stay, Says Billionaire Hedge Fund Manager Ackman", *Forbes*, 2022, available at: *https://www.forbes.com/sites/rosemariemiller/2022/11/21/crypto-is-here-to-stay-says-billionaire-hedge-fund-manager-ackman/?sh=a49f2d91db8d*, 13. 10. 2023.

[3] Edward Taylor, Helen Wang, "Crypto winter disputes: Navigating the intersection of crypto, arbitration and insolvency", *International Bar Association*, 2022, available at: *https://www.ibanet.org/crypto-winter-disputes,* 13. 10. 2023.

[4] *Ibidem.*

Times of crisis usually lead to increase of disputes, and the situation is no different when it comes to digital assets. With increased use of digital assets, paired with an array of new questions and possibilities that this relatively new technology brings, it was only a matter of time when dispute resolution aspect of crypto assets would come into the spotlight. Together with the recent "crypto winter" and uncertainty it brought it appears that the time is now.

The typical disputes that arise in the world of digital assets include:

– disputes that are not a direct consequence of trading with digital assets on trading platforms but are related to and arise out of transactions with digital assets, such as, for instance, contractual disputes that have cryptocurrencies as means of payment. These would be an example of typical "off-chain disputes", i.e. disputes that did not arise on blockchain platform but only touch upon or arise out of the blockchain transactions;
– disputes involving the issues of nullity of smart contracts or performance of obligations from or arising out of smart contracts;[5]
– breach of contract claims by investors against platforms arising from lack of access to the trading platform, and by platforms against investors arising from failure to make payment;
– misrepresentation claims by investors against platforms concerning the represented risks of investment (the latter two being the so called "on-chain disputes").[6]

Arbitration could be a preferred method of dispute resolution for claims involving digital assets for a number of reasons: international character of transactions requiring departure from national courts to international forums, confidentiality and efficiency requirements, highly technical and specialized character of disputes that require specific choice of arbitrators and rules of procedure.[7] However, there are also a number of matters that bring into question suitability of arbitration as an effective dispute resolution mechanism, as this technology itself brings forth an abundance of problems – unknown identity of the parties, unknown seat

[5] Smart contract is essentially an agreement written in a computer code that automatically executes or enforces all or parts of an agreement. See section 4 for more details.

[6] Andrea Utasy Clark, "Cryptocurrency disputes increasingly referred to arbitration, with unique issues arising", *Pinsent Masons*, 2022, available at: *https://www.pinsentmasons.com/out-law/analysis/cryptocurrency-disputes-increasingly-referred-to-arbitration-with-unique-issues-arising*, 10. 10. 2023.

[7] Edward Taylor, Jennifer Wu, Zach Li, "Crypto Arbitration: A Survival Guide", *Kluwer Arbitration Blog*, 2022, available at: *https://arbitrationblog.kluwerarbitration.com/2022/09/29/crypto-arbitration-a-survival-guide/*, 13. 10. 2023.

of the parties, unknown legal regime applying to them, unknown legal capacity of the parties, to name a few. This paper deals with country specific issues of digital asset arbitration – it does not aim to cover all of the potential issues with arbitration of digital asset arbitration (be it on- or off-chain), but to present a selection of most important issues and questions on a local market.

Cryptocurrencies and other forms of digital assets in Serbia are regulated by the Law on Digital Assets ("LDA").[8] With this law, Serbia joined the group of countries that legalize the usage of digital assets as opposed to countries that ban all cryptocurrency-related transactions (due to national security or social reasons). By establishing a regulatory mechanism and government oversight and control, Serbia was one of the first countries in Europe to adopt a regulatory framework dealing with digital assets.[9]

ARBITRABILITY

While Serbia falls into a category of countries where crypto assets are legalized, some jurisdictions have banned crypto assets or heavily regulated their use.[10] If an arbitration is seated in such a jurisdiction, or recognition and enforcement of an award is sought there, national courts may rule that crypto disputes are not arbitrable or deny recognition and enforcement of awards on public policy grounds.[11] This chapter aims to analyse whether disputes concerning digital assets are arbitrable according to Serbian legislation.

The Serbian Arbitration Act, modelled after the UNCITRAL Model Law, delineates arbitrability in Article 5(1) by permitting parties to engage in arbitration for resolving pecuniary disputes involving freely disposable rights, except those falling under the exclusive jurisdiction of courts.

None of the applicable laws in Serbia provide for exclusive jurisdiction of courts in disputes concerning digital asset. This means that the only question that remains is whether digital assets and transactions involving digital assets are in fact rights that the parties can freely dispose with.

It is the position of authors that these types of disputes do indeed concern rights that the parties can freely dispose with. Following a strictly common sense

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[8] Law on Digital Assets, *Official Gazette of the Republic of Serbia no. 153/2020.*

[9] Marko Mudrinić, "Dve godine Zakona o digitalnoj imovini: Dok se web3 razvija, regulativa u Srbiji stagnira", *Netokracija*, 2022, available at: *https://www.netokracija.rs/zakon-o-digitalnoj-imovini-izmene-i-dopune-203689*, 11. 10. 2023.

[10] E. Taylor, J. Wu, Z. Li, op. cit.

[11] *Ibidem.*

– since users freely and frequently trade with digital assets, it only makes sense that any rights relating to or arising out of relationships involving digital assets can be freely disposed with. Authors cannot seem to find any argument to the contrary. Serbian court practice is scarce, but case law of the Permanent Arbitration of the Serbian Chamber of Commerce offers a different angle on the matter, which nonetheless leads to the same conclusion: "The fact that the parties had to act in accordance with the regulations when concluding the agreement does not entail that they were not free to dispose with certain rights. Freedom of disposition is always limited with public order and imperative regulations."[12]

Therefore, even though movement of digital assets is regulated, it should not be concluded that parties are prevented from freely disposing with rights arising out of the digital assets. Since digital assets (and their regulation) is relatively novel, one should expect more case law to appear which would cement this position.

Courts in Europe also confirmed that crypto assets are property and that disputes involving them are arbitrable.[13] UK Jurisdiction Taskforce has recently published its Digital Dispute Resolution Rules – a new set of arbitration rules for dispute resolution in on-chain digital relationships and smart contracts.[14]

Having in mind the typical type of disputes listed above, there is very little room for argument of non-arbitrability. Even though one cannot exclude that certain types of digital asset disputes will not be suitable for arbitration, it should be concluded that arbitrability of this type of disputes is the norm, whereas the opposite is an exception. Same holds true for arbitrability of these disputes in Serbia.

VALIDITY OF AN ARBITRATION AGREEMENT RELATED TO ARBITRATION OF DIGITAL ASSETS

In this specific section of the paper, two provisions from Section II of the Serbian Arbitration Act are vital: Article 9 allows parties to submit future disputes or existing disputes within a defined legal relationship to an arbitral tribunal through an arbitration

[12] Permanent Arbitration of the Serbian Chamber of Commerce, case T-7/09, *Collection of the Arbitration Awards of the Foreign Trade Court of Arbitration at the Chamber of Commerce and Industry of Serbia 1997 – 2016*.

[13] The High Court of Justice, Business & Property Courts Of England and Wales, Commercial Court (Qbd) in private, AA v Persons Unknown & Ors, Re Bitcoin (December 2019), *https://www.bailii.org/ew/cases/EWHC/Comm/2019/3556.html*.

[14] Douglas Robinson, Basil Woodd-Walker, David Bridge, "A new forum for digital disputes: the digital dispute resolution rules", *Simmons Simmons*, 2021, available at: *https://www.simmons-simmons.com/en/publications/cksu381ia1jpj0a72kyuktebq/digital-dispute-resolution-rules*, 11. 10. 2023.

agreement, which can be included in a contract clause or a separate contract, and Article 12 specifies the requirements for a written arbitration agreement, including signed documents, written exchanges of messages, references in written contracts, or the initiation of written arbitral proceedings and acceptance by the respondent without challenging the agreement or jurisdiction prior to participating in the dispute.

We have previously concluded that disputes regarding digital assets are arbitrable as a rule. Against that backdrop, if we are considering a traditional, natural language agreement on the sale of digital assets and as long as there are no reasons for nullity of an arbitration agreement, there should be no issues with respect to the validity of arbitration clauses which in their essence contain a resolution of crypto disputes.

On the other hand, new type of contracts which often regulate digital asset transactions require more thought. This new type of contract is dubbed "smart contract". Smart contract is essentially a computer code that automatically executes or enforces all or parts of an agreement.[15] For blockchain-based smart contracts, the terms of an agreement are embedded in a computer code on a blockchain-based platform (such as Ethereum).[16] Smart contracts are currently considered best suited to automatically execute payments even in regular commercial transaction that do not deal with blockchain, for instance by executing payments of penalties if certain objective criteria are met.[17]

Seeing that the entire agreement is recorded in the form of a code, the question arises whether such agreement would also contain a valid arbitration agreement. To be more precise, if the agreement is only concluded in digital form (as a part of a smart contract) without referring to a natural language agreement, this raises the question of whether the signatures of the parties can be validated and recognised by the legal framework if they are in the form of a code.[18] Going back to

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[15] Stuart D. Levi, Alex B. Lipton, "An Introduction to Smart Contracts and Their Potential and Inherent Limitations", *Harvard Law School Forum on Corporate Governance*, 2018, available at: *https://corpgov.law.harvard.edu/2018/05/26/an-introduction-to-smart-contracts-and-their-potential-and-inherent-limitations/*, 4. 10. 2023

[16] Dirk Wiegandt, "Blockchain, Smart Contracts and the Role of Arbitration", *Journal of International Arbitration* (Ed. Maxi Scherer), No. 5, Vol. 39, 676. "Examples for the use of smart contracts include simple consumer transactions (e.g., 'pay out purchase price X to seller once the customer received the parcel'), compensation claims in the event of cancelled or delayed trains or flights (e.g., 'pay out a penalty X to the customer in case the flight is delayed by more than 2 hours'), transactions involving cryptocurrencies or NFTs, as well as insurance and logistics."

[17] D. Wiegandt, op. cit., 676.

[18] Sara Hourani, "Chapter 12: The Resolution of B2B Disputes in Blockchain- Based Arbitration: A Solution for Improving the Parties' Right of Access to Justice in the Digital Age?", *Access to Justice in Arbitration: Concept, Context and Practice* (Ed. Leonardo V. P. de Oliveira, Sara Hourani), 2020, 267.

Article 12 of the Serbian Arbitration Act, the arbitration agreement is considered as being in writing if the agreement was concluded by an exchange of messages through means of communication which provide a written record of the parties' agreement, regardless of whether the messages were signed by the parties or not. Agreeing to a code containing the terms of an agreement is certainly closer to what the law refers to as exchange of messages through means of communication providing a written record of the parties' will, but this still remains controversial.

Seeing that smart contracts and arbitration agreements concluded within them are quite novel occurrences, Serbian courts are yet to have the question of validity of arbitration agreements concluded in smart contracts posed before them. This issue is recognized by other authors who note that this situation may be a problem in all countries which are signatories of the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards and/or whose arbitration rules are verbatim adoptions of UNCITRAL Model Law, i.e. in any jurisdiction where the mandatory form of arbitration agreement is prescribed as written.[19]

Authors of this paper are of the stance that this requirement should be interpreted flexibly. International arbitration (and courts dealing with recognition and enforcement of arbitral awards and legislators as well) should also adapt to the new technologies such as blockchain and smart contracts, as arbitration and jurisdictions with a more flexible position will benefit from it in this process.[20]

Both of the relevant acts – the New York Convention and the UNCITRAL Model Law – appear to promote this flexible interpretation. The New York Convention Article II(2)'s scope of application became more extensive in application as a result of the adoption of the UNCITRAL Recommendation for Article II(2) of the New York Convention in 2006. According to this recommendation, consideration must be given to the wide use of electronic commerce, which legitimizes the wider interpretation of the *in writing* requirement.[21] Similarly, it would appear that UNCITRAL Model Law (in Option I of its Article 7) gives room for this more liberal interpretation. Serbian Arbitration Act adopted an amended version of option I in its Article 12. However, limitations to this interpretation exist under the national laws – Articles II(3), V(1)(a) and IV(1)(b) of the New York Convention all refer the courts back to the applicable national law, which means that if the national law

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[19] Françoise Lefèvre, Nicolas Delwaide, "Resolving Smart Contracts Disputes Through Arbitration: Thoughts And Perspectives", *Liber Amicorum CEPANI (1969-2019): 50 Years of Solutions* (Ed. Dirk De Meulemeester, Maxime Berlingin *et al.*), 235.

[20] *Ibidem.*

[21] S. Hourani, op. cit., 267.

in question does not recognise a wide understanding of the 'in writing' requirement of the New York Convention, then the agreement in code might not be recognised under the Convention.[22] Serbian legislation and case law for the time being remain unclear and scarce on this matter.

The wide array of legal challenges caused by blockchain and lack of clear legal framework and case law imply that for the time being, parties should conclude separate, natural language arbitration agreements. While this solution would somewhat reduce the confidentiality and efficiency benefits of smart contracts, it would preserve the parties' choice of dispute resolution method and at the same time provide a more robust and safer contractual framework.

RECOGNITION AND ENFORCEMENT

The Serbian Arbitration Act, in Article 66, addresses the question of recognition and enforcement of foreign arbitral awards, allowing refusal upon the request of the party against whom it is invoked, provided that the party can demonstrate (i) the invalidity of the arbitration agreement, (ii) improper notice to one of the parties, (iii) that the dispute was beyond the arbitration agreement's scope, (iv) irregularities with respect to the tribunal or the procedure itself, (v) non-binding status, or court-set aside or suspension of the award; furthermore, under Article 66(2) recognition and enforcement can also be denied if the subject matter of the dispute is non-arbitrable under the Republic of Serbia's law or if the award's effects contravene the Republic's public policy.

A close examination of the initial five grounds for refusal to recognize and enforce outlined in Article 66(1) of the Serbian Arbitration Act reveals that each of them necessitates a case-specific assessment. This implies that a universal conclusion applicable to all disputes related to digital assets is unattainable based on Article 66(1). Consequently, the only two pertinent reasons for consideration within the scope of this topic are those stipulated in Article 66(2). However, having in mind that the issue of arbitrability was covered in the previous sections, the authors will only analyse whether the effects of an award concerning (or containing a reference to) digital assets are contrary to the public policy of the Republic of Serbia (although this should also be assessed on case-by-case basis, as any other reason for refusal to recognize and enforce).

The standpoint of Serbian courts is that public policy argument in the procedure for recognition and enforcement should be interpreted narrowly and

[22] *Ibidem.*

restrictively in the sense that it should only regard the fundamental principles of justice which the legal system is based on.[23] Seeing that Serbia already recognized and legalized digital assets, it is only reasonable to conclude that an arbitral award related to digital assets does not contravene public policy. As of the date of publication of this paper, the authors are not aware of any judgement of a Serbian court which recognized a foreign judgement or arbitral award related to digital assets. However, certain situations arose in different jurisdictions which should be taken into account.

For instance, Greek courts ruled that the recognition of a US-seated arbitral award granting damages in Bitcoin would run contrary to Greek public policy. The reasoning of the Greek courts was that because Greek law classified cryptocurrency as a digital asset, distinct from traditional currency as defined by the European Central Bank (ECB), the ECB did not extend any rights or guarantees for using cryptocurrency, specifically Bitcoin, as means of payment. Given this context, the court concluded that cryptocurrency transactions posed a threat and were detrimental to Greece's interests due to the absence of regulatory oversight and the tax-free nature of cryptocurrency. Consequently, the Court of Appeal in Western Central Greece ruled that recognizing an award based on Bitcoin, a decentralized digital currency, and mandating the repayment of a debt in Bitcoin, went against Greek public policy. Therefore, they declined to enforce the award on these grounds, as well as considering the potential disruption to established norms in Greece regarding the utilization of cryptocurrency in payment agreements.[24]

It is questionable whether Serbian courts would follow this rather conservative approach. While the use of cryptocurrencies is allowed in Serbia, they are not envisaged as means of payment in Serbia, nor do they have the status of money or currency.[25] Furthermore, unlike Greece at the time, Serbian authorities tax cryptocurrencies under a capital gains regime, meaning that the owner of a cryptocurrency must pay taxes on any profits gained through the sale of the cryptocurrency. While Serbia was one of the first European countries to regulate digital assets, it was rather sluggish in keeping the legislation up to date. This fact, paired with a rather conservative

[23] Decision of the Commercial Appellate Court Pvž. 215/2011 dated 16 March 2011, Judicial Practice of Commercial Courts - Bulletin No. 1/2011.

[24] Ergin Mizrahi, "Bitcoin And Public Policy In International Arbitration Enforcement", *Market Screener*, 2022, available at: *https://www.marketscreener.com/quote/stock/PUBLIC-POLICY-HOLDING-COM-130670778/news/Bitcoin-And-Public-Policy-In-International-Arbitration-Enforcement-40711447/*, 11. 10. 2023; A. Utasy Clark, op. cit.

[25] Law on Digital Assets, *Official Gazette of the Republic of Serbia no. 153/2020*, Art. 2, Para. 1, It. 2.

judiciary, means that one can only hypothesize how a court would rule when presented with the recognition and enforcement of an arbitral award that mandates a debtor to fulfil a payment obligation in cryptocurrency. It remains to be seen to what extent the courts would restrict their interpretation of public policy under Serbian law, but one should thread carefully when drafting its request for relief.

GOVERNING LAW

Whether the agreements on the transfer or other disposal with digital assets is in the form of a natural agreement or a smart contract, the novelty of this technology inherently means that legislation in most countries is lagging behind. Another example of this is the issue of governing law. While this poses a big problem with smart contracts (having in mind the above-mentioned issues with unknown identity of the parties and other problems that follow suit), even natural language agreements dealing with digital assets present a challenge in ascertaining the right applicable law to the agreement.

Applying existing conflict of law rules to disputes relating to crypto assets and smart contracts is potentially difficult.[26] For instance, Serbian Private International Law dates back to 1986, with latest amendments being in 2006; even these latest amendments predating the idea of blockchain.[27] Failure of legislation to keep up with relevant trends is recognized as a problem:

> "They [cryptoassets] are intangible assets that exist as records on decentralised networks with touchpoints in multiple jurisdictions. The market in many cryptoassets is a global one and counterparties to transactions may be unknown or untraceable to a particular jurisdiction. The large public blockchains (such as Bitcoin and Ethereum) are open to all, with no terms or conditions. Where a dispute arises, this market structure (or lack thereof), can create practical problems for claimants in understanding where they can bring claims, and for defendants that find themselves being sued in jurisdictions with which they have no real connection or which they never anticipated being in."[28]

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[26] Sam Brown, "Arbitration of cryptoasset and smart contract disputes: arbitration unchained?", *Practical Law Thomson Reuters*, 2023.

[27] Law on Resolving Conflict of Laws With Regulations of Other Countries, *Offical Gazzete SFRY no. 43/82 and 72/82 – ammend., Offical Gazzete SRY no. 46/96 and Offical Gazzete RS no. 46/2006 – other law.*

[28] S. Brown, op. cit.

In analysing the question which law applies to the transaction involving digital assets, we should search for the answer in two prongs: can the parties choose the applicable law, and if they do not or cannot, which law applies to these transactions?

With respect to the first question, Article 19 of the Serbian PIL clearly stipulates party autonomy with respect to contractual relationships, save for a different provision of the PIL or other international law. Leading private international law practitioners note that there are very few prohibitions of party autonomy in the Serbian PIL – these are mostly related to real estate, status matters, transport issues or third-party agreements.[29] Other notable restrictions are if the foreign applicable law is contrary to basic social organization of the state, or if the choice of law is agreed in order to avoid applicability of Serbian law.

In this respect, leading authors note that accepting a choice of law which the parties made is the easy and simple solution.[30] The question of digital assets seems to align perfectly with this statement. A conclusion can also be derived from the viewpoint of the courts that choice of law is allowed as long as there is a foreign element in the business transaction, and as long as the choice of law is not contrary to Serbian law.[31] Authors of this paper also take a pro-choice stand – choice of law with respect to transactions involving digital assets is free as long as it is in accordance with the PIL.

However, if there is no choice of law clause, Serbian law (much like many other jurisdictions) does not provide a clear answer as to which law is applicable for the transactions dealing with digital assets. Serbian Private International Law contains a number of default provisions for applicable law in specific legal relationships in Article 20(1), if the parties do not choose an applicable law (e.g. sale, loan, shipping etc.). Another potential solution can be found in Article 20(1), item 20, which states that applicable law for "other contracts" shall be the law of the place where the offeror's seat was at the time the offer was received by the offeree. In a specific transaction of crypto assets trading, the seat of the offeror would typically be the one of the seller of crypto asset while the seat of the offeree would be the seat of the buyer, or vice versa. Again, applying this provision to specific cases is not that simple especially given the involvement of third-party intermediaries

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[29] Tibor Varadi, Bernadet Bordaš, Gašo Knežević, Vladimir Pavić, *Međunarodno privatno pravo*, University of Belgrade Faculty of Law, 2020, 373.

[30] *Ibidem*.

[31] Judgment of the Commercial Appellate Court, Pž. 4900/2012 dated 6 August 2012, Judicial Practice of Commercial Courts – Bulletin No. 4/2012.

(i.e. trading platforms) and since the location of the parties in these types of transactions is usually unknown. Hence, using any default provision of Article 20 requires a careful consideration as to the real nature of the contractual relationship and the real nature of the digital asset itself.

One example of such analysis is a (controversial) decision in *Tulip Trading v Bitcoin* whereby the English courts identified the *lex situs* of an intangible asset and then decided that it is the place of the owner's residence.[32] This solution, as criticized as it is, shows how different courts may apply different regimes over digital assets. This is one of the reasons why UNIDROIT is currently working on Principles on Digital Assets and Private Law.[33] The Principles became publicly available, containing a number of provisions for better regulation of digital assets. These Principles recognise that the usual connecting factors for choice-of-law rules (e.g., the location of persons, offices, activity, or assets) have no useful role to play in the context of the law applicable to proprietary issues relating to digital assets.[34] Instead, the approach of this Principle is to provide an incentive for those who create new digital assets or govern existing systems for digital assets to specify the applicable law in or in association with the digital asset itself or the relevant system or platform. This approach would accommodate the special characteristics of digital assets and the proprietary questions concerning digital assets that may arise.[35] So far, it appears that the idea is to have the applicable law of the state which is expressly specified in the digital asset/system/platform as the law applicable to such issues, or alternatively the law of the forum state.[36]

Until these Principles are widely adopted, the position of Serbian courts would most likely rely on the location of the digital asset (as case law has shown insofar, which will be explained later), or the application of the Article 20 of the PIL regarding a specific legal relationship (sale, loan, copyright etc.). With this in mind, the parties are advised to clearly stipulate their desired applicable law in order to avoid any undesirable consequences.

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[32] Tulip Trading Ltd v Bitcoin Association for BSV, *https://uk.practicallaw.thomsonreuters.com/Document/I84727720AE7A11ECA3D199746B99F390/View/FullText.html?transitionType=Default&contextData=(sc.Default)*, 11. 10. 2023.

[33] Digital Assets and Private Law – Public Consultation, available at: *https://www.unidroit.org/work-in-progress/digital-assets-and-private-law/digital-assets-and-private-law-public-consultation/*, 11. 10. 2023.

[34] UNIDROIT, *Principles on digital assets and private law*, C.D. (102) 6, 10 May 2023.

[35] *Ibidem*.

[36] *Ibidem*, Principle 2.

SECURING INTERIM MEASURES OVER CRYPTO ASSETS

At the first glance, it appears that enforcement and security of assets (before or during the arbitration procedure) is a well-regulated and clear procedure. This section will put this notion to a test and answer the following questions: (i) can authorities in Serbia assist arbitral tribunals with respect to interim measures over digital assets and (ii) does the current state of legislation and court practice in Serbia allow a quick and efficient freezing of digital assets.

Serbian courts have a duty to assist the parties with interim measures before or during the course of arbitration procedure, irrespective of the seat of the arbitration.[37],[38] Arbitral tribunals are equally authorized to so.[39] In practice, courts and enforcement agents comply with these provisions and assist the parties and the arbitral tribunals, although not consistently or with optimal results.

Moving particularly to the matter of interim measures over digital assets, one can observe that it operates in a relatively straightforward framework. Article 14 of the LDA provides that provisions of the law governing enforcement and security shall apply to the enforced collection of digital asset claims by enforcement creditors. Moreover, a company operating in the Republic and having the status of an enforcement debtor as defined by the law governing enforcement and security shall cooperate with the competent authorities in the enforcement procedure in accordance with that law, and shall provide all notices and data needed for the settlement of claims against digital assets, including the instruments for accessing digital assets (e.g. cryptographic keys). This applies accordingly to other legal persons and entrepreneurs operating in the Republic.[40] Therefore, the LDA recognizes that enforcement and interim measures over digital assets is in fact a possibility.

If we go to the essence of the matter, i.e. to conditions for adoption of an interim measure, one can detect several practical issues.

The conditions for granting interim measures, applicable to both monetary and non-monetary claims, involve demonstrating, in addition to the likelihood of the claim's existence, that without such measures, the enforcement debtor would engage in actions like asset disposal or concealment that could obstruct the claim's collection (applicable to monetary claims) or that the claim's satisfaction might be

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[37] Serbian Arbitration Act, *Official Gazzete of the Republic of Serbia no. 46/06*, Art. 15.

[38] Commercial Appellate Court judgement, Pž 7679/2012 dated 23 August 2012.

[39] Serbian Arbitration Act, *Official Gazzete of the Republic of Serbia no. 46/06*, Art. 31.

[40] Law on Digital Assets, Art. 14.

hindered, involve the use of force, or result in irreparable damages (pertinent to non-monetary claims).[41]

In both instances, the creditor would need to prove the probability of its claim and danger for the collection of a claim. The Law on Enforcement and Security, in Article 450, further provides that there is an assumption that danger exists if the claim needs to be fulfilled abroad, even if domestic court is competent.[42] Typical measures that the court could order include prohibiting the enforcement debtor to dispose with, or encumber movable assets in his ownership, and, when needed, seizing such movable assets from the enforcement debtor and entrusting them to the enforcement creditor or another person or court deposit for safekeeping, instructing the Central Securities Depository to make an annotation of the prohibition of disposal and encumbrance of shares of the enforcement debtor or seizing of cash or securities from the enforcement debtor, among other.[43]

Even though the Law on Enforcement and Security does not explicitly mention digital assets, there should be no doubt that it should apply to digital assets as well. However, on a more practical level, court practice has shown that this is far more problematic than anticipated.

Specifically, it is a traditional position of the courts that Serbian courts only have jurisdiction over property that is located in Serbia, and that they cannot issue an interim measure over assets abroad. A recent decision upholding a first instance decision which rejected an interim measure request against a Serbian resident stated, among other things: "The assets – cryptocurrency, whose prohibition of disposal is requested with the interim measure request, and which can be found on the Binance platform, is not property located in Serbia, but the servers are located abroad, in many locations in the world."[44]

The authors of this paper disagree strongly with this reasoning. First, the interim measure can be directed towards the debtor, thus prohibiting the debtor from disposing with or encumbering the cryptocurrencies under a threat of court penalties, irrespective of where the debtor or the asset is located. Second, the decision goes completely contrary to the necessity of modern-day commerce and business and contrary to practice of courts from other jurisdictions which already granted interim measures over digital assets.[45] Third, there is nothing in the Law on

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[41] Law on Enforcement and Security, Art. 449.

[42] Law on Enforcement and Security, Art. 450.

[43] Law on Enforcement and Security, Art. 459.

[44] Decision of the Higher court in Belgrade, Gži no. 1203/23, *private archive*.

[45] *Yan Yu Ying v Leung Wing Hei* [2022] HKCFI 1660, available at: *https://hsfnotes.com/asiadisputes/2022/07/05/hong-kong-court-summarises-features-of-bitcoin-digital-keys-and-hot-and-cold-wallets/*,

Enforcement and Security prohibiting a Serbian court from rendering a decision against the assets located abroad. Fourth, Article 14 of the LDA would be rendered senseless as it would mean that Serbian Law on Enforcement and Security could not be applied to any digital asset whose location is not in Serbia.

So, despite the existing regulatory framework allowing the tribunals and courts to render interim reliefs, practice showed that interim measure requests in Serbia may be rejected due to lack of jurisdiction of a Serbian court. While this reasoning goes hand in hand with the Serbian courts' conservative perception, we should wait and see if any future amendments to the laws would perhaps change this position.

CONCLUSIONS

In navigating the intricate world of crypto-arbitration, Serbia finds itself at a unique crossroad. The Serbian Law on Digital Assets clearly acknowledges the importance and relevance of digital assets in today's economy whereas overall legal framework makes Serbia a suitable seat for arbitration and recognition and enforcement of arbitral awards. Within this legal framework, it was determined in this paper that arbitrability of on-chain or off-chain disputes is not problematic as well as that crypto disputes generally should not be subject to public policy concerns. Caution is advised when incorporating arbitral clauses in smart contracts and usage of natural language agreements is advised for the time being. When it comes to the issue governing law, it is advisable that the parties themselves chose the substantive law in their contracts, because the laws still do not provide clear solutions in that respect. Yet, when it comes to the issue of interim measures over digital assets, notably the Serbian courts are reluctant to award interim measures over crypto assets as they are perceived as located outside of Serbia. This becomes even more pronounced when we juxtapose Serbian court practices with global trends. In places like Hong Kong and Singapore, courts have taken progressive strides in handling crypto disputes, making the gap in Serbian practices more evident. The recurring challenge in Serbia is balancing tradition with the necessities of modern commerce. If Serbia wants to keep up in the global crypto landscape, a pivot is essential. This would mean re-evaluating and potentially redefining the approach of courts towards digital assets, ensuring they are aligned with the realities of the digital age.

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11. 10. 2023; *CLM v CLN and others* [2022] SGHC 46, *https://www.elitigation.sg/gd/s/2022_SGHC_46*, 11. 10. 2023; Nico Constantijn Antonius *Samara v Stive Jean Paul Dan* [2022] HKCFI 1254, *https://hsfnotes.com/asiadisputes/2022/06/23/unravelling-the-cryptic-hong-kong-court-helps-victim-recover-crypto-assets-against-pilfering-agent/*, 11. 10. 2023; AA v Persons Unknown [2019] EWHC 3556 (Comm), *https://www.bailii.org/ew/cases/EWHC/Comm/2019/3556.html*, 11. 10. 2023.

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KRIPTO-IMOVINA I ARBITRAŽA U SRBIJI

Rezime

Blokčejn i digitalna imovina su deo nove realnosti – ono što je delovalo kao još jedan prolazni trend postalo je deo svakodnevnog poslovanja, a izvesno je da će tako ostati i u budućnosti. Masovna globalna upotreba blokčejna i digitalne imovine zahteva dalekosežnu analizu tehnologije i njenog uticaja na svet i ceo pravni i ekonomski sistem, a ne samo analizu primenjivosti ove tehnologije i osnovnih propisa. Ovaj rad se fokusira na blokčejn, digitalnu imovinu i arbitražu u Srbiji, te analizira da li je Srbija pogodna jurisdikcija za sporove vezane za digitalnu imovinu kao sedište arbitraže, odnosno pogodna jurisdikcija za priznanje i izvršenje arbitražnih odluka. Rad ima za cilj da odgovori na vrlo specifična pitanja o kripto-imovini u arbitražnom postupku i potencijalnim problemima sa ovim sporovima u Srbiji. Zaključak je da je Srbija pogodna jurisdikcija kako za sam arbitražni postupak, tako i za priznanje i izvršenje arbitražnih odluka, ali da specifičnosti srpskog pravnog sistema, a posebno pravosuđa i sudske prakse, stvaraju određene probleme.

Ključne reči: arbitraža, blokčejn, kriptovalute, pametni ugovori, digitalna imovina

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REVIEW PAPER

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SELECTED OVERVIEW OF RECENT SWISS CASE LAW IN INTERNATIONAL ARBITRATION

This article discusses four selected issues that were subject of recent decisions of the Swiss Federal Tribunal in the context of international arbitration seated in Switzerland. The first case examines the scope of the parties' duty of curiosity when it comes to challenging an arbitrator's independence and impartiality, specifically in the context of online resources. The case further touches upon the possibility for a review of an award if such grounds for challenge of an arbitrator were discovered after the 30-day time limit for setting aside the final award. The second case concerns a successful challenge to a partial award, in which the Swiss Federal Tribunal confirmed that an arbitration agreement cannot be extended to a non-signatory subcontractor based on its interference in the execution of the main contract. In the third case, the Swiss Federal Tribunal clarifies that a blanket dismissal of overly broad and vague document production requests as fishing expedition does not violate a party's right to be heard. Finally, in the fourth case, the Swiss Federal Tribunal dealt with the interpretation of a waiver clause in the arbitration agreement that excludes all appeals against arbitral awards.

Key words: *arbitration, duty of curiosity, extension of arbitration agreements, fishing expeditions, waiver of all appeals*

THE SCOPE OF PARTIES' DUTY OF CURIOSITY IN THE CONTEXT OF ONLINE SOURCES AND PARTICULARLY SOCIAL MEDIA

BGer 4A_318/2020 of 22 December 2020[1]

On 28 February 2020, the Court of Arbitration for Sport (hereinafter: "CAS") Panel chaired by Mr. Franco Frattini decided in its Award that the Chinese swimmer

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[1] Later published under BGE 147 III 65.

and multiple Olympic Medallist, Mr. Sun Yang, was guilty of violating Art. 2.5 of the Fédération Internationale de Natation[2] Doping Control Rules and thus banned Mr. Yang from swimming for the next eight years from the date of the Award, i.e., 28 February 2020. On 15 June 2020, Mr. Yang submitted a request for review of the arbitral award before the Swiss Federal Tribunal.[3] The request was based on the fact that Mr. Yang on 15 May 2020 became aware through an online article published on a website that the chair of the CAS Panel had repeatedly posted unacceptable comments about Chinese nationals on his Twitter account in the years 2018 and 2019, i.e., also during the proceedings.[4] These comments were, in Mr. Yang's view, giving rise to legitimate doubts as to the impartiality of the said arbitrator. The Swiss Federal Tribunal ultimately accepted the request for review, annulled the CAS Award, and accepted the challenge against the chair of the CAS Panel.[5]

In its reasoning, the Swiss Federal Tribunal assessed, whether the ground for a challenge of the arbitrator could be accepted after the expiry of the 30 days' time limit for setting aside the award.[6] Thus, the Swiss Federal Tribunal examined whether Mr. Yang could have discovered these comments during the arbitration proceedings by exercising required due diligence relating to the specific circumstances.[7] In this context, the Swiss Federal Tribunal referred to its existing case law that parties generally do have a duty of curiosity regarding possible grounds for a challenge of an arbitrator and may not solely rely on the statement of independence and impartiality of the arbitrator.[8] Rather, a party, in line with its duty of curiosity,

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[2] International Swimming Federation, available at: *https://gaisf.sport/members/international-swimming-federation/,* 24.09.2023.

[3] A party may request for review of an award based on the Art. 190a Federal Act on Private International Law (PILA). According to Art. 190a para. 1 lit. c PILA, a review of an award is *inter alia* possible if a ground for a challenge under Art. 180 para. 1 lit. c PILA, i.e., if circumstances that give rise to legitimate doubt as to the independence and impartiality of an arbitrator, only came to light after conclusion of the arbitration proceedings despite exercising due diligence and no other legal remedy is available. The request for review based on Art. 190a para. 1 lit. c PILA must be filed within 90 days of the grounds for review coming to light and may not be requested more than ten years after the award becomes legally binding (Art. 190a para. 2 PILA).

[4] BGer 4A_318/2020 of 22 December 2020, Facts A to D. as well as consid. 5.

[5] BGer 4A_318/2020 of 22 December 2020, consid. 7.9.

[6] A party's action to set aside an award must be filed within 30 days from the award being communicated and may solely be based on the grounds set out in art. 190 para. 2 lit. a-e PILA. Thereafter, only a review of an award may be possible as per art. 190a PILA.

[7] BGer 4A_318/2020 of 22 December 2020, consid. 6.

[8] BGer 4A_318/2020 of 22 December 2020, consid. 6.5 referring to the existing case law, e.g. BGE 136 III 605 of 29 October 2010, consid.3.4.2; BGer 4A_110/2020 of 2 March 2020, consid. 2.2.2; BGer 4A_763/2011 of 30 April 2012, consid. 3.3.2; BGer 4A_234/2008 of 14 August 2008, consid. 2.2.2.

has to assure that the arbitrator is indeed independent and impartial, and may not ignore certain publicly available information, e.g., information published on the website of the CAS.[9]

While the Tribunal acknowledged that it is difficult to draw exact lines of duty of curiosity, it also held that such duty cannot be limitless. It is generally expected that parties consult the most important computer search engines, as well as the websites of the principal arbitral institutions, the parties, their counsel and the law firms in which they practice. Yet, it is not expected that a party systematically and thoroughly goes through all sources relating to an arbitrator. Depending on the circumstances a party may need certain indications that draw the attention to a possible conflict of interest to be required to investigate further. Hence, the mere fact that an information is publicly available on the internet may not, *ipso facto*, mean that the party violated its duty of curiosity if, despite its research, has not discovered such information.[10]

In the present case, it had not been proven that the use of the search terms "Franco Frattini" would lead to a display of the disputed tweets in the Google results. Thus, Mr. Yang could not be blamed for also not having searched for the word "China", as this would amount to him being aware from the outset of a possible lack of impartiality of the chair solely on the basis of his Chinese nationality. The Swiss Federal Tribunal then addressed the question whether Mr. Yang should have consulted the "main social media networks" of the arbitrator. In this regard, it held that while it should not *prima facie* be excluded that a party may under certain circumstances be required to go through the social media of an arbitrator – given the number of different social media networks and their frequent use – the requirements should not be set too high, as otherwise the duty of curiosity would be unlimited.[11]

The Swiss Federal Tribunal held that Mr. Yang did not violate his duty of curiosity by not discovering tweets of the arbitrator that were posted on a very active twitter account ten months before the arbitrator's appointment on 1 May 2019 also keeping in mind Mr .Yang had only seven days to challenge the arbitrator as per R34 Procedural Rules of the CAS. Likewise, it established that a party cannot be expected to investigate an arbitrator online and on his social media accounts during the course of the proceedings.[12]

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[9] BGer 4A_318/2020 of 22 December 2020, consid. 6.5 referring to BGer 4A_234/2008 of 14 August 2008, consid. .2.2.2.; BGer 4A_506/2007 of 20 March 2008, consid. 3.2.

[10] BGer 4A_318/2020 of 22 December 2020, consid. 6.5.

[11] BGer 4A_318/2020 of 22 December 2020, consid. 6.5.

[12] BGer 4A_318/2020 of 22 December 2020, consid. 6.5.

Regarding the question whether the tweets of the arbitrator were likely to give rise to doubts about his impartiality, the Swiss Federal Tribunal reasoned that although an arbitrator may state its views freely in public, this does not mean that one may state everything one thinks in extreme offensive terms without entering into the risk of creating doubts to one's impartiality. In the present case, the Swiss Federal Tribunal held that while the cause advocated by the arbitrator was not *per se* problematic (i.e., criticizing animal abuse), the extremely offensive terms[13] the arbitrator had used, which had absolutely nothing to do with the animal abuse itself, were. In consideration thereof, the Tribunal concluded that the tweets objectively gave rise to legitimate doubts as to the arbitrator's impartiality. Consequently it accepted the challenge against the chair of the CAS Panel and annulled the award.[14]

Commentary

This case of the Swiss Federal Tribunal is important as it gives clearer guidelines relating to the scope of the duty of curiosity of the parties and discusses the interplay of one's freedom of speech and the appearance of an arbitrator's impartiality and independence.

Regarding the first issue, the approach adopted by the Swiss Federal Tribunal appears generally reasonable as it does not require parties to systematically and thoroughly go through each and every online source including each and every post, comment or alike of the arbitrator on social media to flag a potential bias of the arbitrator. This particularly, if there were no previous indications that the arbitrator has such potential bias, and the comments could not have been easily found without assuming a potential bias. Otherwise, the threshold of the duty of curiosity is set too high and a review of an award based on Art. 190a lit. c PILA would be rendered nearly impossible.

Nonetheless, practitioners are well advised to conduct reasonable investigations, including the most common social media networks (such as e.g., Facebook,

[13] Among other "*This yellow face chinese monster smiling while torturing a small dog, deservers the worst of the hell*", BGer 4A_318/2020 of 22 December 2020, consid. 7.9.

[14] BGer 4A_318/2020 of 22 December 2020, consid. 7.9. Note by the author: While the first CAS award was effectively set aside by 28 February 2020, the subsequent CAS Award dated 22 June 2021 rendered by a newly formed CAS Panel, banned Mr. Yang again from swimming for four years and three months from 28 February 2020. A subsequent complaint by Mr. Yang was dismissed by the Swiss Federal Tribunal in BGer 4A_406/2021 of 14 February 2022, cf. Swiss Federal Tribunal, Press Release of 4 March 2022, available at: *www.bger.ch/files/live/sites/bger/files/pdf/en/4a_0406_2021_2022_03_04_T_e_12_07_26.pdf, 2*4.09.2023.

Twitter, Instagram, Linkedin, or similar) to find out whether there is an appearance of an arbitrator's lack of impartiality and independence and not to forfeit their right to challenge an arbitrator. This all the more, as the threshold on the duty of curiosity heavily depends on the specific facts of the case. Particularly, the level of diligence might be elevated under certain circumstances. For instance, if the case is to be adjudicated by a sole arbitrator,[15] or if there is a longer deadline to challenge an arbitrator compared to the seven-day limit in the current case,[16] or in situation the party was already aware of certain affiliations to a party.[17]

As to the content of the tweets, the Swiss Federal Tribunal carefully and rightly distinguished between being critical to a certain cause, which should not be problematic for challenging the impartiality of an arbitrator *per se*, and the use of offensive language or of an ethnic slur, which had nothing to do with the cause. The Swiss Federal rightly concluded that the challenge of the arbitrator, even if he had no actual bias against the party, was objectively justified to give doubts as to his impartiality.

THIRD-PARTY EXTENSION OF AN ARBITRATION AGREEMENT TO A SUBCONTRACTOR DENIED

BGer 4A_124/2020 of 13 November 2020[18]

On 15 July 2010, A.B. Co., Ltd (hereinafter: "Supplier" and "Claimant") concluded with C. Pte Ltd. (hereinafter: "Principal") and E.E. Company Ltd. (hereinafter: "Guarantor") a supply agreement over the planning, procurement, manufacturing and delivery of a diesel power plant in V. (hereinafter: "V. Agreement"). Thereafter, the Supplier entered into three further supply agreements with further parties (jointly with the Principal and Guarantor referred as "Respondents"). All four supply agreements contained the same arbitration clause and the same choice of law in favour of Swiss law. The diesel engines for the power plant were to be supplied by A.A., a subcontractor of the Supplier (hereinafter: "Subcontractor" or "A.A."), for which the Supplier and the Subcontractor entered into a separate supply contract (hereinafter: "Supply Contract").[19]

[15] BGer 4A_234/2008 of 14 August 2008, consid. 2.2.2.

[16] BGer 4A_318/2020 of 22 December 2020, consid. 6.5 *e contrario*.

[17] BGer 4A_100/2022 of 24 August 2022, consid. 3.3.1 and 3.3.2.

[18] Published as BGE 147 III 107 of 13 November 2020.

[19] BGer 4A_124/2020 of 13 November 2020, Facts A.

After delivery and installation of the diesel engines, the Guarantor raised complaints about technical issues and alleged defects in relation to the installed diesel engines, which ultimately could not be settled between the parties. The Respondents then denied payment under the four supply agreements, which is why the Supplier initiated arbitration proceedings. Thereupon, the Respondents submitted that the Subcontractor should be included as an additional party in the arbitration proceedings, since they wanted to submit counterclaims for alleged damages against both, the Supplier and the Subcontractor. Following the Subcontractor's plea of lack of jurisdiction, the arbitral tribunal declared itself competent to assess the claims brought by the Respondents under the V. Agreement in its partial final award on jurisdiction. The Subcontractor thereafter requested the Swiss Federal Tribunal to set aside the said partial award based on the ground that the arbitral tribunal wrongfully accepting jurisdiction (Art. 190 para. 2 lit. c PILA).[20]

At the core of the dispute was the arbitral tribunal's consideration that an extension of the arbitration agreement was justified, as the Subcontractor had allegedly interfered in such a manner in the conclusion and execution of the V. Agreement that in good faith it could be interpreted as implied consent to the arbitration agreement contained in the V. Agreement.[21]

The Swiss Federal Tribunal first explained that it is long established practice that an arbitration agreement may bind parties, which did not sign and are not mentioned in the contract containing the arbitration agreement, e.g., through assignment, assumption of debt or the contract itself. Moreover, third parties, which interfere in the execution of a contract, may also agree to the arbitration agreement by implied consent.[22]

In the present case, the Swiss Federal Tribunal pointed out that the fact that A. A. was a subcontractor of the Supplier, needs to be considered. This all the more as it was explicitly listed in Annex I of the V. Agreement (hereinafter: "Vendor List") as a supplier of a part of the works, i.e., the diesel engines. In light of this role, it is not surprising that certain terms, e.g. guarantee values, performance test procedures or payment terms, contained in the V. Agreement corresponded or originated from the Supply Contract. The view of the Swiss Federal Tribunal was that these facts do not amount to an interference in the conclusion of a contract. Likewise,

[20] BGer 4A_124/2020 of 13 November 2020, Facts B, C.

[21] BGer 4A_124/2020 of 13 November 2020, consid. 3.2, 3.3.1 et seq.

[22] BGer 4A_124/2020 of 13 November 2020, consid. 3.3.1 with references to BGE 145 III 199 of 17. April 2019, consid. 2.4; BGE 134 III 565 of 19 August 2008, consid. 3.2; BGE 129 III 727 of 16 October 2003, consid. 5.3.1 f.

the mere fact that the Subcontractor was present at the first meeting, where a certain type of engine was discussed, is insufficient to construe interference.[23]

As the V. Agreement was signed only between the Supplier, the Principal and the Guarantor, the Respondents should have been aware that A. A. was only a subcontractor of the Supplier.[24]

In its role as a subcontractor and supplier of a significant part of the diesel power plant, A. A. was involved in the execution of the V. Agreement. Likewise, there is nothing out of the ordinary, if representatives of A. A. are present during the test of the diesel motors after the performance of the V. Agreement, or if they replace certain components of the diesel engines at the diesel power plant in V. This as well cannot be interpreted as interference in the execution of the V. Agreement that would amount to an implied consent to the arbitration agreement therein. Rather the measures by the Subcontractor to rectify the issues with the diesel engine were undertaken in its role as subcontractor responsible for the diesel engines under Supply Contract.[25]

In light of the contractual distribution of roles within this project, the joint communication by the Supplier and the Subcontractor, where representatives of both companies promised to "*take care of this matter with [their] best attention*", could not be understood in good faith as a clear expression of the Subcontractor's intention to agree to the arbitration agreement in the V. Agreement and waive state jurisdiction vis-à-vis the Respondents.[26]

Thus, the Swiss Federal Tribunal concluded that the arbitral tribunal wrongfully declared jurisdiction over the Subcontractor based upon implied consent and referred the case back to the arbitral tribunal to rule on the other remaining open questions relating to the jurisdiction.[27]

Commentary

Under Swiss law, an extension to a non-signatory generally should not be accepted lightly and the evidence relied upon is subject to a restrictive interpretation. Such extension of the arbitration agreement based on third-party interference may be possible, if the third party has interfered in such a way in the conclusion or execution

[23] BGer 4A_124/2020 of 13 November 2020, consid. 3.2 and 3.3.2.

[24] BGer 4A_124/2020 of 13 November 2020, consid. 3.2 and 3.3.2.

[25] BGer 4A_124/2020 of 13 November 2020, consid. 3.2 and 3.3.2.

[26] BGer 4A_124/2020 of 13 November 2020, consid. 3.2 and 3.3.2.

[27] BGer 4A_124/2020 of 13 November 2020, consid. 3.3.3.

of the main contract that the party seeking the extension had reasonable grounds to believe that the third party intended to become a party to the arbitration agreement.[28]

In its case law, the Swiss Federal Tribunal, had assumed such interference to be sufficient to bind a non-signatory third party, where an third party was not contractually involved in the execution of the main contract, but influenced the management of the companies regarding the real-estate project, and repeatedly interfered in performance of the contract.[29] In another case, the non-signatory third party was assumed to be bound to the arbitration agreement, as it had fulfilled a distribution agreement instead of the signatory (which belonged to the same group) for years with the agreement of all parties involved.[30]

The present case thus, underscores that simply being a subcontractor of the main contractor, which is bound to the arbitration agreement and involvement in the execution of the main project, cannot be sufficient to bind that subcontractor to the arbitration agreement as long as this involvement was predicated by a contract with the subcontractor.[31] In conclusion, in arbitrations seated in Switzerland, a subcontractor has only a limited risk of being drawn into a pending arbitration proceeding between the parties of the main contract, even if it was actively involved in the performance of the contract.[32]

OVERLY BROAD DOCUMENT PRODUCTION REQUESTS MAY GENERALLY BE DISMISSED AS FISHIING EXPEDITION BY A TRIBUNAL

BGer 4A_438/2020 of 15 March 2021[33]

B. is professional football player (hereinafter: "Footballer B"), who concluded an employment contract with the professional football club A. (hereinafter: "FC A")

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[28] Bernhard Berger, Franz Kellerhals, *International and Domestic Arbitration in Switzerland*, Bern, 2021, paras. 565a ff.; Stephanie Pfisterer, *Ausdehnung von Schiedsvereinbarungen im Konzernverhältnis*, Zurich, 2011; para. 422 f.; Dieter Gränicher, „Commentary to Art. 178 PILA", *Basler Kommentar zum Internationalen Privatrecht* (Eds. Pascal Grolimund, Leander Loacker, Anton Schnyder), Basel, 2020, para. 79 with further references.

[29] BGE 129 III 727 of 16 October 2003, consid. 5.1.1.; 5.3.2.

[30] BGE 145 III 199 of 17 April 2019, Facts, consid. 2.4; see also Berger B., Kellerhals F., op. cit., para. 566 for further references.

[31] BGer 4A_124/2020 of 13 November 2020, consid.3.3.3.

[32] Cf. Stephanie Pfisterer, Balz Gross, «Urteilsbesprechung 4A_124/2020», *AJP 2021*, 515-523, 520.

[33] Published as BGE 147 III 107 of 15 March 2021.

on 1 June 2016 and expiring on 31 May 2018 (jointly reffered as "the Parties"). On 3 August 2016, Footballer B. unilaterally terminated the employment contract with immediate effect. Subsequently, Footballer B. had entered an employment agreement with football club C. (hereinafter: "FC C") and then with football club D (hereinafter: "FC D"). On 1 February 2019, the Dispute Resolution Chamber of FIFA partially approved the claim filed by Footballer B. against FC A and ordered the FC A to pay EUR 976.666, plus interest at 5% from 1 February 2019. Both Parties subsequently appealed to the CAS.[34]

During the CAS arbitration, FC A had requested the release of the following documents:

> "*In relation to [FC D]:*
> - *Employment contract(s) signed with [FC D] in January 2018 as well as any and all annexes to said contract and/or side-agreements;*
> - *Any and all emails exchanged between the Player, his agent and [FC D] leading up to the conclusion of the employment contract with [FC D];*
> - *Copy of any and all pre-contractual documents, offers, memorandum of understanding exchanged and/or signed with [FC D]*;
>
> In relation to [FC C]:
> - *Employment contract (s) signed with [FC C] in August 2018 as well as any and all annexes to said contract and/or side-agreements;*
> - *Any and all emails exchanged between the Player, his agent and [FC C] leading up to the conclusion of the employment contract in August 2016;*
> - *Copy of any and all pre-contractual documents, offers, memorandum of understanding exchanged and/or signed with [FC C] as of July to August 2016;*
>
> In relation to his Agent E.:
> - *Representation Agreement (s) signed with Mr. E. and any other third agent in relation to his agency activities with regards to him signing an employment contract with A. and/or in force during said time period."*[35]

On 6 January 2020, the CAS Panel partially granted the requests and ordered FIFA to hand over the complete dossiers, in particular the concluded contracts of Footballer B. with FC D and FC C. However, it had rejected all other document

[34] BGer 4A_438/2020 of 15 March 2021, Facts A, B.

[35] BGer 4A_438/2020 of 15 March 2021, consid. 4.2.

production requests. Upon further FC A's inquiry via email of 6 January 2020, the CAS Panel confirmed on 7 January 2020 that it had rejected all other document production requests.[36]

On 4 February 2020, FC A reserved all of its rights in relation to the decision of the CAS Panel of 6 January 2020 relating to the rejected document production requests. On 14 February 2020, the hearing took place, during which the President of the CAS Panel explained that the CAS Panel rejected these document production requests, as they constituted "*a kind of fishing expedition*". At the conclusion of the hearing, both parties affirmed that they had no objections to the CAS Panel's handling of the proceedings and that their right to be heard had been upheld throughout. With award of 2 July 2020, the CAS Panel dismissed the FC A's appeal, partially granted the appeal of Footballer B. and ordered the latter to pay EUR 2.939.131, plus interest at 5% from 3 August 2016.[37]

In the following, FC A requested the Swiss Federal Tribunal *inter alia* to set aside the Award of 2 July 2020 based on a violation of its right to be heard because the CAS Panel did not evaluate its document production requests.[38]

According to the case law of the Swiss Federal Tribunal the right to be heard entails in particular parties' right to comment on all material facts, to represent their legal point of view, to prove their material factual arguments with suitable means offered in due time and form, to participate in the proceedings and to inspect the case file.[39]

With regards to the case at hand, the Swiss Federal Tribunal reasoned that the correspondence of 7 January 2020 confirmed that the CAS Panel in no way omitted document production requests, but deliberately assessed and expressly rejected them. During the hearing, it had even provided the reasons for such rejection, namely, that the requests were "*a kind of fishing expedition*". The Swiss Federal Tribunal further held that in view of the vague and overly broad formulation "*any and all*" of the further requests for disclosure, without any further specification as to the existence of these material documents, no further explanation was required. After the hearing, FC A did also not insist on these requests and did not raise any reservations regarding a violation of the right to be heard.

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[36] BGer 4A_438/2020 of 15 March 2021, consid. 4.2.

[37] BGer 4A_438/2020 of 15 March 2021, consid. 4.2.

[38] BGer 4A_438/2020 of 15 March 2021, consid. 4.

[39] BGer 4a_438/2020 of 15 March 2021, consid. 4.2 with references to BGE 142 III 360 of 26 April 2016, consid. 4.1.1.; BGE 130 III 35 of 30 September 2003, consid. 5.; BGE 127 III 576 of 10 September 2001, consid. 2c.

Thus, the CAS Panel did not violate FC A right to be heard and the appeal to the Swiss Federal Tribunal was dismissed. [40]

Commentary

Generally, procedural orders issued by an arbitral tribunal regarding document production requests do not need to state the reasons for its decision in writing.[41] In the present case, too, the arbitral tribunal initially did not provide any reasons for the rejection of the requests in questions, but only informed the party that all other requests were rejected. Only one month later at the hearing it provided presumably an (oral) explanation that these requests were "*a kind of fishing expedition.*" The Swiss Federal Tribunal also did not see an infringement of the party's right to be heard by categorically rejecting vague and overly broad document production requests as "*a kind of fishing expedition*".[42] Nonetheless, summary explanations may be a good instrument for the arbitral tribunal to inform the parties, what it sees as relevant and material to the outcome of the case, and thus, may render the remainder of the dispute more efficient.[43] In the author's experience, this also appears to be common practice nowadays in international arbitration.

At last, the case at hand also highlights that uncarefully vague and broadly drafted document production requests by parties, e.g. by using catch-all expressions like "*any and all*" or broad descriptions of a category of documents or by requesting documents relating to a general contention[44] – regularly end up in the arbitral tribunal's bin. Even more so, if the arbitral tribunal and the parties have a civil law background, who are not used to extensive US-style discovery.[45] Hence, parties should ensure from the outset that their document production requests are as narrow and specific as possible and relate to facts that are in fact relevant to the case and material to its outcome.[46]

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[40] BGer 4a_438/2020 of 15 March 2021, consid. 4.2 et seq.

[41] Cf. Tobias Zuberbühler, Dieter Hofmann, Christian Oetiker, Thomas Rohner, *IBA Rules of Evidence*, *Commentary on the IBA Rules on the Taking of Evidence in International Arbitration,* Zurich, 2022, Art. 3 para. 185.

[42] BGer 4A_438/2020, consid. 4.2.

[43] Cf. T. Zuberbühler, D. Hofmann, Ch. Oetiker, Th. Rohner, op. cit., Art. 3 para. 185; Hilmar Raeschle-Kessler, „The Production of Documents in International Arbitration – A Commentary on Article 3 of the New IBA Rules of Evidence", *Arbitration International,* 2002, 411 ff., 423 et seq.

[44] Cf. T. Zuberbühler, D. Hofmann, Ch. Oetiker, Th. Rohner, op. cit., Art. 3, paras. 100 et seqq., 106.

[45] *Ibidem,* Art. 3, paras. 77.

[46] *Ibidem,* Art. 3, paras. 96 et seqq.

INTERPRETATION OF AN EXCLUSION OF "ALL APPEALS" AGAINST ARBITRAL AWARDS

BGer 4A_69/2022 of 23 September 2022[47]

In 1990, the Republic of Croatia (hereinafter: "Croatia") privatized INA-INDUSTRIJA NAFTE D.D.. (hereinafter: "INA"), a Croatian Oil and Gas Company founded in 1964 and became the main shareholder. In 2003, MOL Hungarian Oil and Gas PLC (hereinafter: "MOL"), acquired 25% of the share capital plus one share of INA. The same year Croatia and MOL entered into the Shareholders' Agreement (hereinafter: "SHA"). Subsequently in 2008, MOL obtained 47.15% of INA's shares and became the largest shareholder of INA. On 30 January 2009, Croatia and MOL entered into the GAS Master Agreement (hereinafter: "GMA") and the first amendment to the SHA (hereinafter: "FASHA"). These contracts were approved unanimously by the members of the government of Croatia and according to Croatia, led to the transfer of management control of INA to MOL.[48] They both contained an arbitration agreement with the seat of arbitration in Switzerland.

On 17 January 2014, Croatia initiated arbitration proceedings against MOL and claimed that the GMA and the FASHA were concluded thanks to a bribe of EUR 10 million offered by the CEO of MOL to the former Prime Minister, and thus, should be declared void. On 23 December 2016, the arbitral tribunal dismissed Croatia's claim.[49]

Croatia's subsequent request to set aside the award of 17 October 2017 was not considered by the Swiss Federal Tribunal, as it held that Croatia and MOL had validly waived their right to appeal (hereinafter: "First Judgement"). Both arbitration agreements in the SHA and the GMA contained a waiver clause, which unmistakably expressed the parties' joint intention to waive any right of recourse against any decision of the arbitral tribunal before any state court whatsoever.[50] The respective clauses stated:[51]

"*Awards rendered in any arbitration hereunder shall be final and conclusive and judgment thereon may be entered into any court having jurisdiction for enforcement thereof. There shall be no appeal to any court from awards rendered hereunder.*"

On 8 February 2022, Croatia filed a request for review of the final award rendered on 23 December 2016 seeking its annulment based the two grounds in

[47] Later published as BGE 148 III 436.

[48] BGer 4A_69/2022 of 23 September 2022, Facts A.; PCA n° 2014-15.

[49] BGer 4A_69/2022 of 23 September 2022, Facts B; PCA n° 2014-15.

[50] BGer 4A_69/2022 of 23 September 2022, Facts B.c.

[51] BGer 4A_69/2022 of 23 September 2022; also BGE 143 III 589 of 17 October 2017, consid. 2.2.

Art. 190a para. 1 lit. a[52] and b[53] PILA of Switzerland. In support thereof, Croatia submitted that the former Prime Minister was convicted by a final judgement of the Supreme Court of Croatia of 7 July 2021 for having accepted a bribe in connection with the GMA and FASHA and that the award was influenced by a felony or misdemeanour.[54]

With regard to the Art. 190a lit. a PILA, the Swiss Federal Tribunal denied such request *inter alia*, because Croatia did not comply with the 90-days' time limit to submit such request as it already became aware of all significant facts with the judgement of the lower instance at the end of 2019.[55]

Additionally, the Swiss Federal Tribunal reasoned that the Parties had validly excluded any right to appeal in accordance with Art. 192 PILA. The Swiss Federal Tribunal held that it is a matter of interpretation, whether the exclusion clause agreed upon by the parties also would encompass the legal remedy of review as per Art. 190a PILA. In this regard, the existing case law of the Swiss Federal Tribunal had already established that the word "appeal", in its broadest sense, is a generic term embracing the most diverse legal remedies.[56] With its First Judgement, the Swiss Federal Tribunal had concluded that the term "appeal", as used by the Parties, should be understood in this generic sense. Therefore, given the clear intention of the Parties to remove any dispute from the hands of the state courts, it has to be accepted that the Parties' waiver clause also entailed the right to review as per art. 190 Abs. 1 lit a. PILA.[57]

In any case, the Swiss Federal Tribunal held that Art. 190a para. 1 lit. a PILA would also not apply in the present case, as Croatia relied on facts within the judgement of 7 July 2021, and hence, on elements which were produced after the award.[58]

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[52] Art. 190a lit. a PILA states: "*A party may request a review of an award if: it has subsequently become aware of significant facts or uncovered decisive evidence which it could not have produced in the earlier proceedings despite exercising due diligence; the foregoing does not apply to facts or evidence that came into existence after the award was issued*."

[53] Art. 190a lit. b PILA states: "*A party may request a review of an award if: criminal proceedings have established that the arbitral award was influenced to the detriment of the party concerned by a felony or misdemeanour, even if no one is convicted by a criminal court; if criminal proceedings are not possible, proof may be provided in some other manner*."

[54] BGer 4A_69/2022 of 23 September 2022, Facts C.

[55] BGer 4A_69/2022 of 23 September 2022, consid. 4.2.2.

[56] BGer 4A_69/2022 of 23 September 2022, consid. 4.3.1, 4.3.2 f. with references to BGE 131 III 173, consid. 4.2.3.2.

[57] BGer 4A_69/2022 of 23 September 2022, consid. 4.3.3.

[58] BGer 4A_69/2022 of 23 September 2022, consid. 4.4.

With regard to the Art. 190a lit. b PILA, the Swiss Federal Tribunal concluded that the conviction in Croatia did not show that the award was influenced by a felony or misdemeanour.[59]

Commentary

Generally parties, which have neither their domicile, habitual residence or seat in Switzerland may, by a declaration in the arbitration agreement or by subsequent agreement wholly or partly exclude all appeals against arbitral awards, safe for the right to a review under Article 190a paragraph 1 letter b.[60] While it is not necessary to reference art. 190 (or 190a PILA)[61] in the waiver clause, the common intent of the parties to waive all appeals as per art. 192 PILA must be clear and unambiguous. According to the Swiss Federal Tribunal this is a matter of interpretation.[62]

In this respect, authors already have rightly pointed out that the use of ambiguous term such as "*appeal*", which depending on the jurisdiction may have different meanings, cannot constitute a clear and unambiguous intent of parties to waive all their legal remedies in Switzerland. Given the consequences of such waiver, the Swiss Federal Tribunal should adopt again a more restrictive approach for the interpretation of waiver clauses.[63]

Conclusively, foreign parties should be aware that the Swiss Federal Tribunal repeatedly held that if parties, like in the case at hand, would use expressions in their arbitration agreements, such as *"no appeal to any court*" or "*any rights of appeal*", that such terms would be considered as an unambiguous waiver of all possibilities to challenge or review an award.[64]

In any case, one may ask, if it is reasonable to waive all possibilities to challenge or review an award from the outset. It is generally known that the Swiss Federal Tribunal established a high threshold for setting aside an award with only seven

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[59] BGer 4A_69/2022 of 23 September 2022, consid. 5.

[60] Art. 192 para. 1 PILA.

[61] BGer 4A_69/2022 of 23 September 2022, consid. 4.3.3.

[62] BGer 4A_69/2022 of 23 September 2022, 4.3.3; BGE 143 III 589 of 17 October 2017, consid. 2.1.1.

[63] Mladen Stojiljkovic, Alisa Winter, „Der Vorausverzicht auf die Revision von Schiedsurteilen", *Der Vorausverzicht auf die Revision von Schiedsurteilen*, 2023, which both criticized the Swiss Federal Tribunal's approach used in the case at hand, paras. 17, 19 et seq., 25 et seq.

[64] *Ibidem,* paras. 14 et seqq.

percent of all applications succeeding.[65] Further, in comparison to Dutch, French and English Courts, the proceedings in front of the Swiss Federal Tribunal are rather fast and usually over within six months.[66] In Switzerland it is also not possible to review an award on a point of law, as may be possible in the United Kingdom or United States.[67] Rather, the substantive review is limited to the question on whether the award complies with Switzerland's *ordre public*.[68] Hence, in consideration of the above, it appears that the advantages of having a last resort remedy against an award in Switzerland as provided for in art. 190 and 190a PILA outweigh potential efficiency gains from an exclusion of such remedies.

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POGLED NA ODABRANE SLUČAJEVE NOVIJE ŠVAJCARSKE SUDSKE PRAKSE U OBLASTI MEĐUNARODNE ARBITRAŽ

Rezime

U radu su razmotrena četiri odabrana pitanja koja su bila predmet nedavnih odluka švajcarskog Saveznog suda u kontekstu međunarodne arbitraže sa sedištem u Švajcarskoj. Prvi slučaj ispituje obim dužnosti radoznalosti (tzv. „*duty of curiosity*“) kada je u pitanju nezavisnost i nepristrasnost arbitra u kontekstu onlajn izvora. Slučaj se dalje tiče mogućnosti osporavanja arbitražne odluke kada su takve okolnosti otkrivene nakon isteka roka od 30 dana za poništaj oduke. Drugi slučaj se odnosi na delimičnu odluku koja je uspešno osporena, u kojoj je švajcarski Savezni sud potvrdio da se arbitražna klauzula ne može proširiti na podizvođača koji nije potpisao glavni ugovor na osnovu njegovog učešća u izvršenju glavnog ugovora u ulozi podizvođača. U trećem slučaju, švajcarski Savezni sud pojašnjava da neobrazloženo odbacivanje zahteva za izvođenje pismenih dokaza koji su opšti i neprecizni ne predstavlja povredu prava stranke da bude saslušana ukoliko se takav zahtev smatra vidom „lovljenja informacija“ (tzv. *fishing expedition*). Konačno, u četvrtom slučaju, švajcarski Savezni sud se bavio interpretacijom klauzule o odricanju prava na žalbu koja je sadržana u arbitražnom sporazumu.

Ključne reči: *arbitraža, dužnost radoznalosti, proširenje arbitražne klauzule, „lovljenje informacija“, odricanje od pravnih lekova*

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[65] Felix Dasser, „Judging, Fast and Slow“, ASA Bulletin, Vol. 41, No. 2, 2023, 254.

[66] Ibidem., 254; see for further statistical data, Felix Dasser, Piotr Wójtowicz, „Swiss International Arbitral Awards Before the Federal Supreme Court – Statistical Data 1989-2019“, ASA Bulletin, Vol. 39, No. 1, 2021, 7-41.

[67] Art. 69 Arbitration Act 1996; Gary Born, *International Commercial Arbitration*, Kluwer Law International, 2020, § 25.05 [A], [a] and [b].

[68] Art. 190 para. 2 PILA.

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REVIEW PAPER

PRILOZI

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CONFLICTS OF INTEREST BETWEEN SHARIA AND INTERNATIONAL SALE OF GOODS: DOES CISG INTEREST FIT WITH ISLAMIC LAW?

Obligations to pay interest are widely accepted in commerce. However, in Muslim-majority countries subject to sharia law, they are normally forbidden. The United Nations Convention on Contracts for the International Sale of Goods ('CISG') Article 78 imposes an interest obligation. Consequently, many have been reluctant to accede to the Convention. The CISG Advisory Council has partially addressed how the CISG interest obligation is affected by prohibitions on interest. What remains unresolved is whether this renders the CISG compatible with sharia law. To date, perceptions of their compatibility have relied on generalised views of both the Islamic prohibitions and CISG interest. This article seeks to truly determine whether sharia and the CISG are reconcilable on the question of interest. It examines the basis for Islamic prohibitions on riba and gharar, but importantly, considers differing approaches across individual Muslim-majority states. Likewise, interpretation of the CISG interest obligation is considered in detail. Given this richer contextual landscape, we analyse whether sharia 'fits' with the CISG. We conclude that the CISG and sharia are compatible if slight modifications to Opinion No. 14 are adopted.

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This may encourage greater accession to the CISG by Muslim countries as part of their push to adopt laws that attract more international trade.

Key words: *interest, CISG, sharia law, compatibility, international trade*

I INTRODUCTION

The question of interest being payable within the uniform law pertaining to international sales is notoriously fraught. Interest obligations are widely accepted in much of the commercial world and thus are included within many transnational commercial laws. Awards of compound interest are becoming more frequent. However, in Muslim-majority countries subject to *sharia* law, obligations to pay interest are normally forbidden as *riba*.

The United Nations Convention on Contracts for the International Sale of Goods ('CISG') Article ('Art.') 78 imposes an obligation to pay interest.[1] Arguably, this is why many Muslim-majority states have not acceded to the Convention. The CISG Advisory Council's Opinion on Interest under Article 78 CISG ('Opinion No. 14') CISG Advisory Council Opinion No. 14 has attempted to address the position under *sharia* within its interpretation of CISG Article 78.[2] However, it does not fully resolve the issue.

This article provides the context necessary to truly determine whether *sharia* and the CISG can be reconciled on the question of interest. It examines Islamic prohibitions on *riba* and *gharar*, but importantly, considers the vast range of practical approaches to *riba* that exist across Muslim-majority states. The Article interrogates the comprehensive range of interpretations open within both laws, delving into the implications of those interpretations upon enforceability of awards. This comprehensive contextual landscape enables the authors to resolve the extent to which views on interest within *sharia* 'fit' with the CISG, to define the contours of pragmatic compatibility between these two laws, and importantly, to enable the reader to distinguish perceived conflicts from those which are real.

Perceptions of conflicts between *sharia* and the CISG are also discussed in relation to interest.[3] The authors argue that adoption of a more textured, pragmatic

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[1] United Nations Convention on Contracts for the International Sale of Goods, opened for signature 11 April 1980, 1489 UNTS 3 (entered into force 1 January 1988), Art. 78 ('CISG').

[2] See Yeşim M. Atamer, Rapporteur, CISG Advisory Council Opinion No. 14, Interest under Article 78 CISG ('Opinion No. 14'), *https://cisgac.com/wp-content/uploads/2023/02/CISG_Advisory_Council_Opinion_*No.*_14.pdf*, 20. 10. 2023.

[3] Other scholars have raised further potential conflicts between *sharia* and the *CISG* beyond interest obligations. Given limitations of space, and the likelihood that interest obligations are the

approach to interpretation of both laws can reduce perceived conflicts, which may in turn encourage greater accession to the CISG by Muslim countries.

In Part. II, we briefly review CISG accession amongst Muslim-majority states. Part. III gives a brief legislative history of the CISG interest obligation and examines the function of interest and its calculation in other international instruments; Part. IV compares this with how the interest obligation is interpreted within the CISG context: whether it is an internal or external gap, its function and calculation, and the CISG Advisory Council view; Part. V introduces the Islamic prohibitions on *riba* and *gharar* and permitted charges of '*gharamah*' and '*ta'widh*'. The basis for each is explained; moreover, reasons for relevant variations on the interpretation of each are highlighted. Most importantly, we then undertake a survey of approaches to *riba* and *ta'widh* in practice within a selection of Muslim-majority states. Part. VI reviews scholarly views about compatibility or otherwise of *sharia* and the CISG and the comments of the Advisory Council relevant to jurisdictions which forbid interest, identifies gaps in the Advisory Council comments relevant to compatibility, and suggests slight adaptations to the latter's approach which render the two compatible. Part. VII works through hypothetical scenarios to test how the Advisory Council approach, modified by the suggestions, would operate in practice. Part. VIII then contemplates effects on accession amongst Muslim-majority jurisdictions, while Part. IX concludes.

II CISG ACCESSION AMONGST MUSLIM-MAJORITY COUNTRIES

To date, the following Muslim-majority countries[4] have acceded to the CISG: Egypt (1982), Syria (1982), Iraq (1990), Mauritania (1999), Lebanon (2008), Bahrain (2013), and the State of Palestine (2017).[5] Most have mixed legal systems in which *sharia* principles apply to varying degrees.[6] Other Muslim-majority countries

primary point of conflict, interest obligations are the sole focus of this article. Other issues are briefly raised below in Part VI(A) and will form the basis of a future study.

[4] For the purposes of this article, 'Muslim-majority countries' refers to countries where Muslims consist of more than 50% of the population: Forum on Religion & Public Life, Pew Research Center; The Future of the Global Muslim Population: Projections for 2010–2030 (Report, January 2011), 155 *https://www.pewforum.org/2011/01/27/future-of-the-global-muslim-population-muslim-majority/*, 20. 10. 2023.

[5] For dates of accession, see Status: United Nations Convention on Contracts for the International Sale of Goods ('CISG Accession Status'), *https://uncitral.un.org/en/texts/salegoods/conventions/sale_of_goods/cisg/status*, 20. 10. 2023.

[6] It is beyond the scope of this paper to discuss the role and degree of influence of Islamic law within Muslim-majority countries.

with largely secular legal systems have also acceded to the CISG, such as Bosnia and Herzegovina (1994), Uzbekistan (1996), Kyrgyzstan (1999), Guinea (1991), Albania (2009), Turkmenistan (2022), Turkey (2010) and Azerbaijan (2016).[7] However, the overwhelming number of Muslim-majority jurisdictions are yet to accede.[8] For jurisdictions where *sharia* applies to some degree, non-accession rates may be as high as 81%.[9]

An official version of the CISG is published in Arabic.[10] Reasons for non-accession may extend beyond prohibitions on interest, but the above high rates of non-accession indicate that reconciling concerns and perceptions about interest obligations underscores the potential for further accessions amongst Islamic countries.

III FUNCTIONS OF INTEREST AND INTEREST CALCULATION IN CISG & OTHER CONVENTIONS

The concern of Muslim-majority nations over interest obligations is not unique to the CISG; indeed, the CISG drafters anticipated this problem.

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[7] Country Profiles, Sharia Source at Harvard Law School, *https://beta.shariasource.com/projects/1*, 20. 10. 2023; See CISG Accession Status in footnote 5.

[8] This includes the following 26 Muslim-majority countries where *sharia* applies within the legal system in varying degrees: Saudi Arabia, United Arab Emirates, Qatar, Malaysia, Indonesia, Pakistan, Bangladesh, Iran, Algeria, Sudan, Morocco, Afghanistan, Yemen, Mali, Senegal, Tunisia, Somalia, Jordan, Libya, Oman, Kuwait, Gambia, Djibouti, Comoros, Maldives, and Brunei. Additionally, the following six largely secular Muslim-majority countries have not acceded to the CISG: Niger, Kazakhstan, Burkina Faso, Chad, Tajikistan and Sierra Leone; Country Profiles, op. cit.; CISG Accession Status, op. cit. As this article went to print on 21 August 2023, Saudi Arabia announced that it would accede to the CISG: see UNCITRAL, Saudi Arabia Accedes to the United Nations Convention on Contracts for the International Sale of Goods (Press Release UNIS/L/347, 21 August 2023), *http://unis.unvienna.org/unis/en/pressrels/2023/unisl347.html#:~:text=VIENNA%2C%2021%20August%20(UN%20Information,III%2C%20on%201%20September%202024*, 20. 10. 2023. It will enter into force on 1 September 2024. Notably, the Kingdom has made a reservation that will prevent application of Art. 78 CISG pending the outcome of a study by the Minister of Commerce regarding Art. 78 and the prohibition of *riba* under Islamic law. See also Saudi Arabia's Accession to the CISG: Changes and Impact, Dentons Newsletter, *https://www.dentons.com/en/insights/alerts/2023/august/21/saudi-arabias-accession-to-the-cisg-changes-and-impact, 20. 10. 2023*. For the purposes of an article focussing on Art. 78, Saudi Arabia can therefore still be considered a non-contracting state.

[9] See footnote 8 above, as well as the text accompanying footnote 5.

[10] Arabic is one of the six official languages of the United Nations Commission on International Trade Law ('UNCITRAL'). Hossam A El-Saghir, "The CISG in Islamic Countries: The Case of Egypt", *International Sales Law: A Global Challenge* (Ed. Larry A. DiMatteo), Cambridge University Press, 2014, 505, 511–512. El-Saghir points to inaccuracies in Arts. 25 and 36 of the Arabic version.

(A) Legislative History of CISG Article 78

Article 78 of the CISG states that '[i]f a party fails to pay the price or any other sum that is in arrears, the other party is entitled to interest on it, without prejudice to any claim for damages recoverable under Article 74'.

An obligation to pay interest arises also elsewhere in the CISG. Article 84(1) stipulates that '[i]f the seller is bound to refund the price, he must also pay interest on it, from the date on which the price was paid'. At the 1980 Vienna Diplomatic Conference, after some debate, 'it was decided that the rate of interest should not be stipulated'.[11] However, delegates anticipated the problem presented by the prohibition of *riba* within *sharia*-observant states, and many proposed solutions.

The Egyptian delegation acknowledged omission of the 'well-established practice' of interest obligations was unrealistic.[12] Instead, Mr Shafik of Egypt proposed a reservation to Article 78 to encourage signatories amongst nations where interest was forbidden.[13] Canada's Professor Ziegel proposed that Arab countries should be able to omit interest obligations or make them optional,[14] whilst Mr Sami of Iraq argued that interest obligations should be omitted from the CISG altogether, or alternatively, a reservation permitted.[15] Ultimately, the idea of a reservation never came to fruition.[16]

The Egyptian representative stated he was unaware of any refusal within Arab countries to charge interest on loans or credit in international relations, but that a more appropriate term might be used. Thus, he suggested that after 'interest' an additional phrase such as 'or any other corresponding fee' be added.[17] Had this been adopted, it perhaps would have more easily accommodated approaches within many Muslim countries regarding interest charges in international relations, as discussed below in Part V.

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[11] Maria Bhatti, *Islamic Law and International Commercial Arbitration*, Routledge, 2019, 190; Klaus Peter Berger, "International Arbitral Practice and the UNIDROIT Principles of International Commercial Contracts", *American Journal of Comparative Law,* Vol. 46, No. 1, 1998, 129, 134.

[12] United Nations Conference on Contracts for the International Sale of Goods, UN GAOR, 1st Comm, 34th mtg, Agenda Item 3, UN Doc A/CONF.97/C.1/SR.34 (3 April 1980) 416 [10] ('Diplomatic Conference'), *https://uncitral.un.org/sites/uncitral.un.org/files/media-documents/uncitral/en/a-conf-97-19-ocred-eng.pdf*, 23. 10. 2023.

[13] *Ibidem*.

[14] Diplomatic Conference, op. cit., 418 [23].

[15] Diplomatic Conference, op. cit., 418 [20]. See also M. Bhatti (2019), op. cit., 190.

[16] *Ibidem*.

[17] Diplomatic Conference, op. cit., 417 [14].

Professor Honnold of the USA argued omission of interest could be viewed as barring its recovery, and therefore an interest obligation was necessary.[18] Honnold later commented that Article 78 entitles parties to interest even if domestic law makes no reference to interest.[19] This naturally affects adoption of the CISG by Muslim-majority countries due to prevailing views that the CISG is incompatible with *sharia*.[20] Consequently, the question of incompatibility is tested and challenged within this article.

(B) Function and Calculation of Interest in Other Instruments

Interest is widely viewed as compensatory in nature. Its purpose in the commercial context is to place the injured party 'in the same position as it would have been in if no breach had occurred', thus it is compensatory and restitutionary rather than 'punitive or usurious'.[21]

This was reflected in *Iran v United States of America* where the Tribunal defined interest as 'compensation for damages suffered due to delay in payment'.[22] Professor Gotanda notes that the ability to award pre- and post-judgment interest in International Centre for Settlement of Investment Disputes ('ICSID') disputes reflects full compensation for lost time value of money,[23] and prevents benefits being gained by delayed compliance with awards.[24]

However, many international instruments do not clearly stipulate methods of calculation. Calculation is not clearly stipulated in the Convention on the Settlement

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[18] John O, Honnold, *Uniform Law for International Sales under the 1980 United Nations Convention 4th Edition*, Kluwer Law International, 2009, 602.

[19] *Ibidem*, 602–603.

[20] M. Bhatti (2019), op. cit., 189.

[21] Chartered Institute of Arbitrators, Drafting Arbitral Awards: Part II - Interest (International Arbitration Practice Guideline, 8 June 2016) 5, *https://www.ciarb.org/media/4208/guideline-11-drafting-arbitral-awards-part-ii-interest-2016.pdf,* 20. 10. 2023.

[22] *Iran v. United States of America* (Decision) (Iran–United States Claims Tribunal, Case No. A19, 30 September 1987) [12], quoting *Sylvania Technical Systems Inc v Iran* (Award) (Iran–United States Claims Tribunal, Case No. 64, 27 June 1985) [81].

[23] John Y. Gotanda, "A Study of Interest", *Villanova University Charles Widger School of Law Working Paper* No. 83, 2007, 4–5. See also Jack Coe Jr and Noah Rubins, "Regulatory Expropriation and the Tecmed Case: Context and Contributions", *International Investment Law and Arbitration: Leading Cases from the ICSID, NAFTA, Bilateral Treaties and Customary International Law* (Ed. Todd Weiler), Cameron May, 2005, 597, 631.

[24] J. Y. Gotanda (2007), op. cit., 4. See also M. Bhatti (2019), op. cit., 185–186.

of Investment Disputes ('ICSID Convention'),[25] and is largely discretionary within the World Intellectual Property Organisation Arbitration Rules ('WIPO Arbitration Rules'),[26] the 2021 International Dispute Resolution Procedures (Including Mediation and Arbitration Rules) ('ICDR Arbitration Rules'),[27] and the 2020 London Court of International Arbitration Rules ('LCIA Arbitration Rules').[28]

Indeed, the ICSID Convention fails to mention any right to interest altogether. However, case law shows contracting states are required to recognise awards of interest as pecuniary obligations.[29] ICSID tribunals have tended towards compound interest,[30] reasoning that the purpose of interest is to compensate for not having use of the money 'between the date when it ought to have been paid and the date of the payment'.[31] Nonetheless, rates applied by ICSID tribunals are diverse, from lending rates,[32] to rates which could have been earned,[33] to commercially reasonable rates.[34]

Some arbitral rules provide discretion regarding methods of calculation. Article 34 of the ICDR Arbitration Rules provides discretion to award pre- and post-award

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[25] Convention on the Settlement of Investment Disputes between States and Nationals of Other States, opened for signature 18 March 1965, 575 UNTS 159 (entered into force 14 October 1966) ('ICSID Convention').

[26] World Intellectual Property Organisation, WIPO Arbitration Rules, Schedule of Fees and Costs (Rules, July 2021) ('WIPO Arbitration Rules'), Art. 62, *https://www.wipo.int/amc/en/arbitration/rules/index.html*, 23. 10. 2023.

[27] International Centre for Dispute Resolution, American Arbitration Association, International Dispute Resolution Procedures (Including Mediation and Arbitration Rules) (Procedures, 1 March 2021) ('ICDR Arbitration Rules'), Art. 34(4), *https://www.adr.org/sites/default/files/ICDR_Rules_0.pdf*, 23. 10. 2023.

[28] London Court of International Arbitration, Arbitration Rules (Rules, 1 October 2020) ('LCIA Arbitration Rules'), Art. 26.4, *https://www.lcia.org/Dispute_Resolution_Services/lcia-arbitration-rules-2020.aspx*, 23. 10. 2023. See also M. Bhatti, op. cit., 187.

[29] See ICSID Convention, Art. 54(1).

[30] James Dow, "Pre-Award Interest", *The Guide to Damages in International Arbitration 4th Edition*, Law Business Research, 2020, 229, 309.

[31] *Hrvatska Elektroprivreda dd v. Slovenia* (Award) (ICSID Arbitral Tribunal, Case No. ARB/05/24, 17 December 2015) [547] ('Hrvatska Elektroprivreda dd'), quoting *Southern Pacific Properties (Middle East) Ltd v. Egypt* (Award) (1995) 3 ICSID Rep 189, 241 [219] ('Southern Pacific Properties').

[32] *Tenaris SA v Venezuela* (Award) (ICSID Arbitral Tribunal, Case No. ARB/11/26, 29 January 2016) where the forced loan approach was balanced by a '[c]ountry [r]isk approach': at [587].

[33] *Hrvatska Elektroprivreda* dd, [547].

[34] *Railroad Development Corporation v Guatemala* (Award) (ICSID Arbitral Tribunal, Case No. ARB/07/23, 29 June 2012) [279].

interest, simple or compound, as the tribunal 'considers appropriate, taking into consideration the contract and applicable law(s)'.[35] Similarly, WIPO Arbitration Rules Article 62(b) provides the tribunal is 'free to determine' the interest rate 'it considers to be appropriate' as well as the period for which it is due and may order simple or compound interest.[36]

The LCIA Arbitration Rules also give discretion in interest calculation, including simple or compound, at any 'rates as the Arbitral Tribunal decides to be appropriate' over any period it determines appropriate up to the date of compliance with the award.[37] Despite this 'wide latitude', LCIA awards tend to apply the rate and method pursuant to the law applicable pursuant to the conflict rules of the seat.[38] However, Scherer notes that because statutory interest rates are 'usually linked to a particular currency… it may not be logical to apply that interest rate to different currencies'.[39] Importantly, Scherer warns that 'governing law is particularly important if one of the laws in question is inspired by … *Shari'a* law … Parties should be aware that … awards ordering a party to pay interest might be unenforceable in a country applying Islamic law'.[40] In contrast, UNIDROIT Principles of International Commercial Contracts 2016 ('UNIDROIT Principles') Art. 7.4.9(2) rather prescriptively stipulates that:

> "[t]he rate of interest shall be the average bank short-term lending rate to prime borrowers prevailing for the currency of payment at the place for payment, or where no such rate exists at that place, then the same rate in the State of the currency of payment. In the absence of such a rate at either place the rate of interest shall be the appropriate rate fixed by the law of the State of the currency of payment."[41]

Despite the absence of a uniform approach to calculation, it is well-accepted in international commercial and investment arbitration that tribunals are

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[35] ICDR Arbitration Rules, Art. 34(4).

[36] WIPO Arbitration Rules, Art. 62(b).

[37] LCIA Arbitration Rules, Art. 26.4.

[38] Maxi Scherer, "Awards and Correction of Awards", *Arbitrating under the 2020 LCIA Rules: A User's Guide* (Eds. Maxi Scherer, Lisa Richman and Rémy Gerbay), Kluwer Law International, 2021, 391, 405–406.

[39] *Ibidem.*

[40] *Ibidem.*

[41] International Institute for the Unification of Private Law, UNIDROIT Principles of International Commercial Contracts (2016), Article 7.4.9(2), *https://www.unidroit.org/instruments/commercial-contracts/unidroit-principles-2016/*, 20. 10. 2023.

empowered to award interest either as damages or separately.[42] This is an important point to which we will return.

(C) Simple and Compound Interest in Other Instruments

Compound interest is defined as interest due on the total of the principal sum and any accrued amount of unpaid interest, calculated for each compounding period (e.g., annually).[43] Historically, tribunals and courts were hesitant to award compound interest or 'interest on interest', although it was more commonly awarded in arbitral cases that took many years to resolve.[44] Interestingly, compound interest often takes the form of damages.[45]

Prior to 2000, only two ICSID tribunals had awarded compound interest,[46] and non-allowance of compound interest was considered one of the 'better settled' rules of international law.[47] The Iran–US Claims Tribunal granted simple

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[42] Andrea Giardina, "Issues of Applicable Law and Uniform Law on Interest: Basic Distinctions in National and International Practice", *Interests, Auxiliary and Alternative Remedies in International Arbitration,* (Eds. Filip De Ly and Laurent Lévy), International Chamber of Commerce, 2008, 131, 138.

[43] Tomas Cipra, *Financial and Insurance Formulas*, Physica – Verlag, 2010, 11. See also Natasha Affolder, "Awarding Compound Interest in International Arbitration", *American Review of International Arbitration,* Vol. 12, No. 1, 2001, 45, 49. See generally: David J. Branson, Richard E. Wallace Jr., "Awarding Interest in International Commercial Arbitration: Establishing a Uniform Approach", *Virginia Journal of International Law*, Vol. 28, No. 4, 1988, 919; Martin Hunter, Volker Triebel, "Awarding Interest in International Arbitration: Some Observations Based on a Comparative Study of the Laws of England and Germany", *Journal of International Arbitration*, Vol. 6, No. 1, 1989, 7.

[44] Charles N. Brower, Jeremy K. Sharpe, "Awards of Compound Interest in International Arbitration: The *Aminoil* Non-Precedent", *Transnational Dispute Management,* Vol. 3, Issue 5, 2006, 155, 156–159. See also: Jeffrey Waincymer, *Procedure and Evidence in International Arbitration*, Kluwer Law International, 2012, 1186–1187.

[45] N. Affolder, op. cit., 91. Compare contractual compound interest on late payment of a debt to '[w]here interest is viewed as an item of damage'.

[46] *Atlantic Triton Co v Guinea* (Award) (1995) 3 ICSID Rep 13, 33; *Southern Pacific Properties*, op. cit., 243 [229]–[230]. See also Andrew Smolik, "The Effect of Shari'a on the Dispute Resolution Process Set Forth in the Washington Convention", *Journal of Dispute Resolution*, 2010, 151, 172; Florian Grisel, "The Sources of Foreign Investment Law", *The Foundations of International Investment Law: Bringing Theory into Practice* (Eds. Zachary Douglas, Joost Pauwelyn and Jorge E Viñuales), Oxford University Press, 2014, 213, 226–227.

[47] Marjorie M. Whiteman, *Damages in International Law*, United States Government Printing Office, 1997. See also: *RJ Reynolds Tobacco Co v Iran* (Partial Award) (1986) 7 Iran–US CTR 181 ('RJ Reynolds Tobacco'); Final Award, International Chamber of Commerce, Case No. 6230

interest noting that compound interest was appropriate where there were 'special reasons for departing from international precedents which normally do not allow the awarding of compound interest'.[48] Compound interest is also discouraged under the domestic law of civil law countries Switzerland, Germany and France, although arbitral awards of compound interest are enforceable.[49]

However, this trend is changing. Since 2000, international investment tribunals have generally awarded compound interest at market rates.[50] One ICSID Tribunal highlighted the significance of compound interest, acknowledging that 'while simple interest tends to be awarded more frequently than compound, compound interest certainly is not unknown or excluded in international law.…Rather, the determination of interest is a product of the exercise of judgment, taking into account all of the circumstances of the case at hand and especially considerations of fairness'.[51]

Commentators favour the growing trend toward compound interest by international arbitral tribunals. Professor Gotanda argues that '[i]n many cases … interest at a market rate and on a compound basis' ensures full compensation.[52] Professor Mann advocates compound interest as damages absent 'special circumstances'.[53] Brower and Sharpe agree it 'has a rightful place'[54] Sénéchal contends that

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of 1990 reported in (1992) 17 Yearbook – Commercial Arbitration 164; Final Award, International Chamber of Commerce, Case No. 6162 of 1990 reported in (1992) 17 Yearbook – Commercial Arbitration 153. See generally C. N. Brower, J. K. Sharpe, op. cit.

[48] RJ Reynolds Tobacco, op. cit., 191.

[49] Federal Act on the Amendment of the Swiss Civil Code (Part Five: The Code of Obligations) (Switzerland) 30 March 1911, SR 220, Articles 105(3), 314(3) [tr Swiss Confederation, 'Federal Act on the Amendment of the Swiss Civil Code (Part Five: The Code of Obligations) of 30 March 1911', Fedlex *https://www.fedlex.admin.ch/eli/cc/27/317_321_377/en*, 20.10.2023; Bürgerliches Gesetzbuch [Civil Code] (Germany) §248; Code civil [Civil Code] (France) Articles 1343-2 ('French Civil Code'). See footnote 254 below, as well as *Inter Maritime Management SA v. Russin & Vecchi* (Bundesgericht [Federal Supreme Court of Switzerland], 9 January 1995) reported in (1997) 22 Yearbook – Commercial Arbitration 789, 798; M. Hunter, V. Triebel, op. cit., 16–19.

[50] J. Y. Gotanda (2007), op. cit., 19. See also A. Smolik, op. cit., 172, discussing Southern Pacific Properties from footnote 31.

[51] *Compañía del Desarrollo de Santa Elena SA v Costa Rica* (Award) (2002) 5 ICSID Rep 153, 177–8 [103].

[52] J. Y.Gotanda (2007), op. cit., 3–4.

[53] F. A. Mann, "Compound Interest as an Item of Damage in International Law", *University of California Davis Law Review*, Vol. 21, Issue 3, 1988, 577, 586.

[54] C. N. Brower, J. K. Sharpe, op. cit., 160.

it 'reflects the majority of commercial realities, in … the loss of the use of that value' and that failure to recognise this may result in a 'windfall to the respondent'.[55]

Under English law, tribunals can award either simple or compound interest. The ICDR Arbitration Rules,[56] LCIA Arbitration Rules and WIPO Arbitration Rules enable tribunals to award compound interest.[57] Unless contractually agreed, tribunals may determine interest rates by applying the law of the contract or of the place of arbitration, or relevant Conventions or arbitral rules.[58] Born recommends the law of the arbitral seat regarding authority to award interest, but the law of the award currency for interest rates.[59]

The tendency to award compound interest in international investment disputes could be incompatible with *sharia* laws that forbid compound interest.[60] Different approaches of various Muslim-majority countries toward interest are discussed below.

IV INTEREST WITHIN THE CISG

The inclusion of the obligation to pay interest in Article 78 of the CISG simply creates an entitlement to interest but leaves open questions as to (A) whether the question of interest rates amounts to an internal or external gap in the CISG, (B) the applicable default interest rate and calculation method and related questions concerning the function of interest, and (C) how interpretation of Article 78 intersects with other relevant laws.

(A) Type of Gap

Absent party agreement on interest rates, the default rate falls to be determined. Article 78's silence on rates has led to debate over whether this is an 'external gap' in the CISG, to be determined by the law applicable through the forum's

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[55] Thierry J. Sénéchal, "Present-Day Valuation in International Arbitration: A Conceptual Framework for Awarding Interest", *Interests, Auxiliary and Alternative Remedies in International Arbitration* (Eds. Filip De Ly and Laurent Lévy), International Chamber of Commerce, 2008, 219, 230.

[56] Arbitration Act 1996 (UK), s 49.

[57] ICDR Arbitration Rules, Art. 34(4); LCIA Arbitration Rules, Art 26.4; WIPO Arbitration Rules, Art 62.

[58] A. Giardina, op. cit., 135.

[59] Gary Born, *International Commercial Arbitration 3rd Edition*, Kluwer Law International, 2021, 3363.

[60] M. Bhatti, op. cit., 187. See below Part V.

conflict rules,[61] or an 'internal gap' to be filled by interpretative means,[62] including general principles underlying the CISG.[63] The former has been the predominant view.[64] Advocates argue interest rates fall outside the scope of the CISG.[65] On the other hand, Professor Ferrari argues interest rates were not stipulated not due to insufficiency of the CISG's scope, but due to inability to agree on a formula.[66] Likewise, the CISG Advisory Council surmises that its drafters did not intend '[t]o arrest the development of the CISG in the … 1970's' and that external gaps should be avoided whenever possible.[67] It concluded failure to add interest rates to Article 4 'can be interpreted as a delegation of this issue to future adjudicators'.[68] Thus, the Council favours treatment as an 'internal gap' to avoid the uncertainty wrought by turning to domestic law for interest rates.[69] The same concern is evident in *Cold-Rolled Metal Sheets Case II* which preferred reliance on general principles for this purpose since

> "immediate recourse to a particular domestic law may lead to results which are incompatible with the principle embodied in [a]rt 78 of the CISG, at least in the cases where the law in question expressly prohibits the payment of interest".[70]

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[61] Anthony J. McMahon, "Differentiating between Internal and External Gaps in the UN Convention on Contracts for the International Sale of Goods: A Proposed Method for Determining 'Governed by' in the Context of Article 7(2)", *Columbia Journal of Transnational Law*, Vol. 44, No. 3, 2006, 992, 993–994.

[62] Opinion No. 14, 5–6 [3.1]–[3.2].

[63] Hossam A El-Saghir, "The Interpretation of the CISG in the Arab World", *CISG Methodology* (Eds. André Janssen and Olaf Meyer), Sellier European Law Publishers, 2009, 355, 356–357. El-Saghir argues that judges should also review decisions made globally as compiled in international databases such as CLOUT, the CISG database at Pace University School of Law's Institute of International Commercial Law, and UNILEX.

[64] Opinion No. 14, 16 [3.27].

[65] Fritz Enderlein, Dietrich Maskow, *International Sales Law: United Nations Convention on Contracts for the International Sale of Goods*, Oceana Publications, 1992, 312. See also N. Affolder, op. cit., 66.

[66] Franco Ferrari, "Uniform Application and Interest Rates under the 1980 Vienna Sales Convention", *Georgia Journal of International and Comparative Law,* Vol. 24, No. 3, 1995 467, 473–478; See also K. P. Berger, op. cit., 134.

[67] Opinion No. 14, 5–6 [3.2].

[68] *Ibidem.*

[69] Opinion No. 14, 16 [3.29]. See also J. O. Honnold, op. cit., 604–605 [421].

[70] Award, Vienna International Arbitral Centre of the Austrian Federal Economic Chamber, Case No. SCH-4366, 15 June 1994, *https://www.unilex.info/cisg/case/55*, 20. 10. 2023.

Treatment as an internal gap appears the most sensible approach to Article 78, but still leaves the open question of which interest rate.

(B) Function and Calculation of Interest

The viewpoint within other international instruments as to the primacy of the compensatory function of interest is echoed also in the context of Article 78 of the CISG. The CISG Advisory Council confirms that the interest obligation reflects the time value of money,[71] and prevents benefit to the debtor from retaining money for longer than they are legally entitled.[72] Accordingly, within the CISG, interest functions primarily as compensation for delayed payment and secondarily to prevent unjust enrichment.[73]

But what of the rate of interest? Where parties expressly agree on contractual interest rates, arbitral tribunals will generally enforce them unless they violate public policy or domestic laws on arbitrability or validity.[74] However, default rates of interest and default methods of calculation are the main focus of attention.

Uniformity requires a relatively predictable rule for determination of interest rates. Various rules have been proposed: interest rate of creditor's place of business, debtor's place of business, currency of the claim, international or regional rates,[75] or the rule in Article 7.4.9(2) of the UNIDROIT Principles as a supplement to the CISG.[76] Worldwide, CISG cases have not produced a consistent approach.[77] Decisions have relied upon various approaches, including a benchmark

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[71] Opinion No. 14, 18 [3.35].

[72] Opinion No. 14, 6 [3.3].

[73] *Ibidem,* See also M. Bhatti (2019), op. cit., 185.

[74] Final Award, International Chamber of Commerce, Case No. 11849 of 2003 reported in (2006) 31 Yearbook – Commercial Arbitration 148, 169 [78]–[79]; Award, China International Economic and Trade Arbitration Commission, Case No. CISG/2000/13, 6 December 2000 [tr Meihua Xu and John Zhu, 'China December 6, 2000, Institute of International Commercial Law, *https://iicl.law.pace.edu/cisg/case/china-december-6-2000-translation-available*, 20. 10. 2023.

[75] Opinion No. 14, 15 [3.26].

[76] K. P. Berger, op. cit., 135, discussing Award, International Chamber of Commerce, Case No. 8128 of 1995; Klaus Bacher, "Article 78 CISG: Obligation to Pay Interest", *Commentary on the UN Convention on the International Sale of Goods (CISG)* (Eds. Ingeborg Schwenzer and Ulrich G. Schroeter), Oxford University Press, 2022, 1349, 1360 [39].

[77] Tom McNamara, "UN Sale of Goods Convention: Finally Coming of Age?", *Colorado Lawyer*, Vol. 32, No. 2, 2003, 11, 19.

of 'reasonableness',[78] domestic law as determined by the governing law of the contract determined by the conflict rules of the forum,[79] and the domestic law of the seller's place of business.[80] The Foreign Trade Court of Arbitration of the Serbian Chamber of Commerce, inspired by the UNIDROIT Principles, has tended to apply the average interest rate for short-term loans in the currency of payment in the seller's country in CISG cases.[81] Sénéchal argues that to fully compensate, interest must reflect inflation and market risk premiums, compounded annually.[82]

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[78] *Shantou Real Lingerie Manufacturing Co Ltd v Native Group International Ltd* (SD NY, No. 14cv10246-FM, 23 August 2016) slip op 4. See *Chicago Prime Packers Inc v* N*ortham Food Trading Co*, 320 F Supp 2d 702, 715–716 (ND Ill, 2004). For a comprehensive list of cases taking various approaches, see Opinion No. 14 addendum.

[79] Landgericht Aachen [Aachen District Court], 42 O 68/93, 28 July 1993; Landgericht Aachen [Aachen District Court], 41 O 111/95, 20 July 1995 [tr Peter Feuerstein and Ruth M Janal, 'CISG-Online 169', CISG-Online, *https://cisg-online.org/files/cases/6145/translationFile/169_63112903.pdf,* 20.10.2023. See also Opinion No. 14, [3.27].

[80] Award, International Commercial Arbitration Court at the Chamber of Commerce and Industry of the Russian Federation, Case No. 54/2006, 29 December 2006 [tr Andriy Kril, Russian Federation December 29, 2006, Institute of International Commercial Law, [1.4], *https://iicl.law.pace.edu/cisg/case/russian-federation-december-29-2006-translation-available*, 20. 10. 2023. See also Final Award, International Chamber of Commerce, Case No. 16369 of 2011 reported in (2014) 39 Yearbook – Commercial Arbitration 169.

[81] Award, Spoljnotrgovinska arbitraža pri Privrednoj komori Srbije [Foreign Trade Court of Arbitration of the Chamber of Commerce and Industry of Serbia], Case No. T-9/07, 23 January 2008, [7.3] [tr Jovana Stevovic, Vladimir Pavic and Milena Djordjevic, 'Serbia January 23, 2008 [Translation Available]', Institute of International Commercial Law, *https://iicl.law.pace.edu/cisg/case/23-january-2008-foreign-trade-court-arbitration-attached-serbian-chamber-commerce*, 20. 10. 2023; Award, Spoljnotrgovinska arbitraža pri Privrednoj komori Srbije [Foreign Trade Court of Arbitration of the Chamber of Commerce and Industry of Serbia], Case No. T-23/08, 10 November 2009, [VI.1.3] [tr Marija Šcekic, Milena Djordjevic and Marko Jovanovic, 'Serbia November 10, 2009 [Translation Available]', Institute of International Commercial Law, *https://iicl.law.pace.edu/cisg/case/10-november-2009-foreign-trade-court-arbitration-attached-serbian-chamber-commerce*, 20. 10. 2023; Award, Spoljnotrgovinska arbitraža pri Privrednoj komori Srbije [Foreign Trade Court of Arbitration of the Chamber of Commerce and Industry of Serbia], Case No. T-6/08, 19 October 2009, [VI.3.3] [tr Marija Šcekic, Milena Djordjevic and Marko Jovanovic, 'Serbia October 19, 2009 [Translation Available]', Institute of International Commercial Law, *https://iicl.law.pace.edu/cisg/case/19-october-2009-foreign-trade-court-arbitration-attached-serbian-chamber-commerce*, 20. 10. 2023; Award, Spoljnotrgovinska arbitraža pri Privrednoj komori Srbije [Foreign Trade Court of Arbitration of the Chamber of Commerce and Industry of Serbia], Case No. T-5/09, 6 May 2010, [V.2] [tr Uroš Živković, Milena Djordjevic and Marko Jovanovic, 'Serbia May 6, 2010 [Translation Available]', Institute of International Commercial Law, *https://iicl.law.pace.edu/cisg/case/6-may-2010-foreign-trade-court-arbitration-attached-serbian-chamber-commerce*, 20. 10. 2023.

[82] T. J. Sénéchal, op. cit., 219, 224–229.

As to how interest is to be calculated under Article 78 CISG, because CISG cases have frequently applied the domestic law otherwise governing the contract to determine interest calculation methods, simple interest or statutory interest rates have often been awarded.[83] Whilst far from universal,[84] the trend under the CISG has been not to award compound interest.[85] This is in contrast with the general 'trend in [international] investment disputes … for tribunals to award interest at market rates … on a compound basis'.[86]

Nonetheless, it has been recognised that, in circumstances where the party can prove that a loss of interest was a consequential loss from the breach of contract, the latter is recoverable as damages under Art. 74.[87] Thus, Art. 74 may provide damages compensating interest costs expended for bank loans necessitated by the breach.[88] In considering how the CISG interacts with other relevant laws, this capacity for further compensation under Article 74 is critical.

(C) CISG Advisory Council Views on Interest

The lack of uniformity amongst decided cases led to the CISG Advisory Council proposing a uniform approach to interest. In Opinion No. 14, the Council considers the above questions, and to some degree, how interest obligations within

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[83] Noting this trend generally in relation to all international commercial disputes: J. Y. Gotanda (2007), op. cit., 19.

[84] Final Award, International Chamber of Commerce, Case No. 8502 of 1996, November 1996 reported in (1999) 10(2) ICC International Court of Arbitration Bulletin 72, 74; Final Award, International Chamber of Commerce, Case No. 8908 of 1998, December 1998 reported in (1999) 10(2) ICC International Court of Arbitration Bulletin 83, 87. '[U]nder the CISG, compound interest is not accorded automatically and the claimant … [must] prove that it is entitled to compound interest': Hof van Beroep Antwerpen [Antwerp Court of Appeal], 2002/AR/2087, 24 April 2006, [A.5.2] [tr Kristof Cox, 'Hof van Beroep [Court of Appeal] Antwerp: GmbH Lothringer Gunther Grosshandelsgesellschaft für Bauelemente und Hozwerkstoffe v NV Fepco International', CISG-Online, *https://cisg-online.org/files/cases/7181/translationFile/1258_24722246.pdf*, 20. 10. 2023.

[85] Opinion No. 14, 21–22 [3.45].

[86] M. Bhatti (2019), op. cit., 187, citing J. Y, Gotanda (2007), op. cit., 19.

[87] Petra Butler, "Damages Principles under the Convention on Contracts for the International Sale of Goods", *Damages in International Arbitration Guide* (Ed. John A Trenor), Law Business Research, 2022, 55, 94; Opinion No. 14, 2, 23–4 [3.51]–[3.52]; Oberlandesgericht Hamburg [Hamburg Court of Appeal], 12 U 39/00, 25 January 2008 [tr Jan Henning Berg and Daniel Nagel, 'CISG-Online 1681', *CISG-Online, https://cisg-online.org/files/cases/7600/translationFile/1681_96061344.pdf*, 20.10.2023, ('*Café Inventory Case*'), where a party showed they were 'entitled to claim an interest rate of 9% which they had to expend for a bank loan'.

[88] *Café Inventory Case*, 12 [46].

the CISG interact with other relevant law. The CISG Advisory Council's Rule 9 recommends a single uniform rule for default interest rates, being that which a 'court [in] the creditor's place of business would grant in a similar contract … not governed by the CISG'.[89] Rule 8 reiterates parties may contractually determine interest rates by agreement.[90]

The Council reasoned that Article 78 fulfilled a compensatory function, and that this aligned most closely with the creditor's place of business as the place where funds would likely have been reinvested, thereby providing the closest approximation to loss suffered due to lost time value of money.[91] It rejected the debtor's place of business as more aligned to disgorgement,[92] whilst other proposed solutions created greater uncertainty by leading to many potential rates and/or lacked sufficient nexus to the compensatory function.[93] Opinion No. 14 sets out a simple, predictable rule that promotes uniformity and certainty by carefully avoiding reliance on unpredictable conflicts rules.[94] The approach within Opinion No. 14 conforms with the main function of interest: to provide compensation for the time value of money to the creditor.[95] It still ultimately refers to domestic laws to ascertain rates,[96] but creates a simplified rule reflecting the ultimate outcome observed in 38% of surveyed CISG cases.[97] The Council also clarified that where the default interest rate failed to reflect market conditions, any residual undercompensation can be claimed in damages under Article 74, due to the compensatory nature of CISG interest.[98] However, unlike Article 78 where loss is presumed reflected by applicable rates, Article 74 claims for actual loss must be proven.[99] The Advisory Council made certain comments which must be interpreted as addressing the interaction between the CISG and *sharia*. We shall examine these in Part VI.

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[89] Opinion No. 14, 2.

[90] *Ibidem.*

[91] Opinion No. 14, 6–8 [3.3]–[3.7].

[92] Opinion No. 14, 16 [3.30].

[93] Opinion No. 14, 17–18 [3.31]–[3.34].

[94] Opinion No. 14, 18–19 [3.35]–[3.36].

[95] Opinion No. 14, 18 [3.35]. See above Part III(B).

[96] Opinion No. 14, 19 [3.37].

[97] Directly or indirectly via conflict rules: *Ibidem*, See also Opinion No. 14 Addendum; M. Bhatti (2019), op. cit., 193.

[98] Opinion No. 14, 2, 21 [3.43].

[99] Opinion No. 14, 2, 21 [3.43], 24 [3.52].

In the next section, we elucidate more clearly the nature of relevant prohibitions within *sharia* law, and the reasons for their differing interpretations. Importantly, we identify differences in their practical application amongst a sample of Muslim-majority nations.

V RELEVANT SHARIA PROHIBITIONS: INTERPRETATION AND PRACTICAL APPLICATION

It is important to understand that *sharia* is not a uniform body of law. Whether or not a conflict with the CISG exists depends not only on interpretation of the latter, but also on how Islamic law is interpreted and applied within (1) the place of the creditor's business and/or the applicable law, and (2) the place of the forum. Below we consider the key Islamic finance principles, bases for variances in their interpretation, and finally, differences in how they are applied in practice.

(A) Prohibition against Interest/Usury (Riba) and Speculation (Gharar)

The prohibition against *riba* arises from the sources of Islamic law, being verses of the Koran[100] and the Hadith.[101] These sources view *riba* as exploitative and an illicit profit contrary to Islamic principles of fairness.[102] *Gharar* is defined by Islamic scholars as speculation or excessive uncertainty,[103] and is thus prohibited under Islamic law, especially uncertainty in sales involving 'price, deliverability, dates of exchange or possession of goods'.[104]

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[100] The Qur'an, translated by M.A.S. Abdel Haleem, Oxford University Press, 2005, 32, ('*The Qur'an*').

[101] See generally 'Search Results – Riba', Sunnah.com, *http://sunnah.com/search/?q=riba*, 20.10.2023. Although this specific Hadith collection is followed by Sunni Muslims, *riba* is also considered forbidden for Shia Muslims.

[102] Abdullah Saeed, "The Moral Context of the Prohibition of Riba in Islam Revisited", *American Journal of Islamic Social Sciences*, Vol. 12, No. 4, 1995, 496, 499–500.

[103] Sudin Haron, Wan Nursofiza Wan Azmi, *Islamic Finance and Banking System: Philosophies, Principles & Practices*, McGraw-Hill, 2009, 424; Mahmoud A El-Gamal, "An Economic Explication of the Prohibition of Gharar in Classical Islamic Jurisprudence" *Islamic Economic Studies*, Vol. 8, No. 1, 2001, 29, 33–34; Nayla Comair-Obeid, *The Law of Business Contracts in the Arab Middle East: A Theoretical and Practical Comparative Analysis (with Particular Reference to Modern Legislation)*, Kluwer Law International, 1996, 57, citing Nabil A Saleh, *Unlawful Gain and Legitimate Profit in Islamic Law: Riba, Gharar and Islamic Banking*, Graham & Trotman, 1992, 62.

[104] M. Bhatti (2019), op. cit., 143.

On the other hand, a *murabaha*, or cost-plus sale, is viewed by most Muslim scholars as being *sharia*-compliant. A *murabaha* transaction consists of an Islamic financial institution selling a commodity to a purchaser at a cost-plus mark-up profit rate which is pre-determined, as opposed to interest.[105] To be *sharia*-compliant the profit must be agreed upon when the contract is entered, thus avoiding *gharar* (speculation).[106]

The prohibition against *riba* in particular attracts much debate amongst Islamic scholars. Under a strict interpretation of *sharia* both simple and compound interest are forbidden.[107] Thus, the Islamic Fiqh Academy in Jeddah notes that:

> "[i]f the buyer/debtor delays the payment of instalments after the specified date, it is not permissible to charge any amount in addition to his principal liability, whether it is made a pre-condition in the contract or it is claimed without a previous agreement, because it is *'[r]iba'*, hence prohibited in *Shari'a*".[108]

According to this 'strict interpretation' of *riba*, penalties may be included in financial contracts, but if the penalty relates to a debt, it is characterised as '*riba*',[109] due to the Koranic verse: '[i]f the debtor is in difficulty, then delay things until matters become easier for him; still, if you were to write it off as an act of charity, that would be better for you, if only you knew'.[110] Similarly, Usmani contends that no material difference exists between interest and late payment fees charged as compensation.[111] He states that *sharia* prohibits claims for any

[105] M. Bhatti, "Taxation Treatment of Islamic Finance Products in Australia", *Deakin Law Review*, Vol. 20, No. 2, 2015, 263, 274; Abdullah Saeed, *Islamic Banking and Interest: A Study of the Prohibition of Riba and Its Contemporary Interpretation*, EJ Brill, 1996, 77, citing Nabil A. Saleh, *Unlawful Gain and Legitimate Profit in Islamic Law*, Cambridge University Press, 1986, 94.

[106] M. Bhatti (2015), op. cit., 277–278. Additionally, the bank should have constructive possession of the goods before they are sold to the customer, the subject matter sold must not be forbidden under *sharia*, and legal title to the goods must be transferred to the customer.

[107] M. Bhatti (2019), op. cit., 170.

[108] Islamic Fiqh Academy, *Resolutions and Recommendations of the Council of the Islamic Fiqh Academy 1985–2000*, Islamic Development Bank, 2000, 104.

[109] Islamic Fiqh Academy, op. cit., 252.

[110] *The Qur'an*, op. cit., 32.

[111] Muhammad Taqi Usmani, *An Introduction to Islamic Finance*, Kluwer Law International, 2002, 57; M. Bhatti (2019), 170.

additional amounts from debtors such that penalties may issue against defaulting parties, but no compensation lies for lost opportunity to invest money owed.[112] However, Arfazadeh argues that *sharia* law:

> "offers a broad range of alternative claims or remedies that could constitute valuable substitutes for a claim for interest …[in] the form of damages for late payment or late performance, claims for sharing or disgorging profits made by the defaulting party, as well as other forms of penalty as provided for by contract or custom".[113]

These possibilities warrant further elaboration.

(B) Permitted Charges of 'Gharamah' and 'Ta'widh'

Islamic scholars differ on the acceptability of financial penalties for late payment, known by the Arabic term *gharamah*.[114] Views range from acceptance as compliant, to compliant only if channelled to charities, to rejection as noncompliant.[115] However, *gharamah* must be distinguished from *ta'widh*, which describes compensation for losses incurred due to delayed payment.[116]

In practice, the Shariah Advisory Council of Bank Negara Malaysia ('SAC') considers compensation for late payment (*ta'widh*) as *sharia*-compliant[117] based on the saying of the Prophet Muhammad that '[p]rocrastination (delay) in repaying debts by a wealthy person is injustice'.[118] The SAC thus considers *ta'widh*

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[112] M. T. Usmani, op. cit., 57.

[113] Homayoon Arfazadeh, "A Practitioner's Approach to Interest Claims under Sharia Law in International Arbitration", *Interests, Auxiliary and Alternative Remedies in International Arbitration* (Eds. Filip De Ly and Laurent Lévy), International Chamber of Commerce, 2008, 211, 213.

[114] Securities Commission Malaysia, *Resolutions of the Shariah Advisory Council of the Securities Commission Malaysia*, 5–6, *https://www.sc.com.my/api/documentms/download.ashx?id=eadeb8bb-4c43-418a-9777-1986bb8bf56c*, 20. 10. 2023. ('2022 Resolutions').

[115] It is beyond the scope of this article to examine these positions in detail. See generally Ezani Yaakub *et al.*, "A Revisit to the Practice of Late Payment Charges by Islamic Banks in Malaysia", *Jurnal Pengurusan*, Vol. 42, 2014, 185, 187.

[116] 2022 Resolutions, 5–6.

[117] Securities Commission Malaysia, *Resolutions of the Securities Commission Shariah Advisory Council* (2nd Edition, 2006), 125–6, *https://www.sc.com.my/api/documentms/download.ashx?id=511180c4-b0f1-49e3-9f92-46efe55457bc*, 20. 10. 2023.

[118] 43: Loans, Payment of Loans, Freezing of Property, Bankruptcy, Sunnah.com, *http://sunnah.com/bukhari/43/16*, 20. 10. 2023.

to be 'compensation [for] actual losses suffered'.[119] Banks may charge *ta'widh* and retain its proceeds in the context of financial transactions,[120] which must be calculated (for defaults after maturity date) at 'not … more than the prevailing daily overnight Islamic Interbank Money Market rate on the outstanding balance (outstanding principal and accrued profit)'.[121] In addition, *gharamah* may be charged provided the combined *ta'widh* and *gharamah* do not exceed 10% of the outstanding amount.[122]

The SAC also accepts the legitimacy of *ta'widh* upon arbitration or judgment debts, stipulating a court may impose a late payment charge from judgment date to the date judgment debt is settled 'at the rate provided by the court rules', provided however, that *ta'widh* and *gharamah* are observed.[123] *Ta'widh* for late payment of judgment debt 'shall be based on the daily overnight Islamic Interbank rate as stated in the website of Islamic Interbank Money Market … fixed on the date when … judgment was made and calculated monthly based on a daily rest basis'.[124] The judgment creditor is only entitled to receive *ta'widh*, thus if the late payment penalty imposed by the court is greater than *ta'widh*, any excess is *gharamah* and must be 'channelled to charitable bodies'.[125] Late payment charges must not exceed the outstanding principal, and must be calculated only on the outstanding principal before any pre-judgment late payment charges.[126]

It follows that the SAC accepts late payment penalty charges (*gharamah*) as a permissible method to disincentivise defaults,[127] because proceeds are 'channelled to [certain] charitable bodies'.[128] The rationale behind acceptance of this late payment charge is that Islamic banks would be adversely impacted by the absence of any deterrent to late payment and default by clients.[129] Nonetheless, the difficulty is in balancing this against the view that customers cannot be charged *riba*.[130]

[119] 2022 Resolutions, 5.

[120] 2022 Resolutions, 6.

[121] 2022 Resolutions, 5.

[122] That is, 10% or 'as may be determined by the SAC from time to time'; 2022 Resolutions, 7.

[123] 2022 Resolutions, 5.

[124] *Ibidem.*

[125] *Ibidem.*

[126] 2022 Resolutions, 6.

[127] *Ibidem.*

[128] *Ibidem.*

[129] E. Yaakub *et al*., op. cit., 189.

[130] *Ibidem.*

There are different approaches. Some Islamic scholars such as Abd Sattar Abu Ghuddah contend that while the financial penalty may be imposed, it must be channelled to a charity, based on the notion that a penalty distributed to charity is no longer considered *riba*.[131] Others such as Mustafa al-Zarqa and Muhammad Sadiq al-Dharir argue that *gharamah* is not *riba* at all, pointing to classical Islamic principles to argue that under Islamic law, the public must not delay payment.[132]

The internationally influential *Shari'ah* Board of the Accounting and Auditing Organization for Islamic Financial Institutions ('AAOIFI')[133] also accepts *gharamah*. The AAOIFI produces standards to promote harmonisation of *sharia* issues in finance which are often adopted by significant Islamic finance institutions.[134] AAOIFI Standard No. 8 permits *gharamah* within *murabaha* contracts in the form of an obligation 'to pay an amount of money or a percentage of the debt, on the basis of undertaking to donate it in the event of a delay on his part in paying instalments on their due date'.[135] Likewise, the State Bank of Pakistan also allows *gharamah* through contractual stipulation of penalties to be paid to charitable institutions calculated on a percentage per day or *per annum*, and clarifies that banks may seek court orders of solatium for costs but not opportunity cost.[136]

Interestingly, some arbitration rules remain silent on issues of *gharamah* and *ta'widh*. The International Islamic Centre for Reconciliation and Commercial Arbitration ('IICRA') was founded in the United Arab Emirates ('UAE') in 2005.[137] It aspires to facilitate dispute resolution where parties select *sharia* to govern proceedings.[138] The IICRA Arbitration & Reconciliation Rules are silent on whether or not

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[131] *Ibidem.*

[132] *Ibidem.* As mentioned earlier, other Islamic scholars reject *gharamah* altogether.

[133] Accounting and Auditing Organization for Islamic Financial Institutions, *http://aaoifi.com/?lang=en*, 20.10.2023.

[134] Accounting and Auditing Organization for Islamic Financial Institutions, *Shari'ah Standards: Full Text of Shari'ah Standards for Islamic Financial Institutions as at Safar 1437 AH – December 2015 AD* (Dar AlMaiman for Publishing & Distributing, 2015) 10 ('*AAOIFI Standards*').

[135] AAOIFI Standards, 214 [5/6].

[136] State Bank of Pakistan, *Essentials of Islamic Modes of Financing* (Guidelines, 16 April 2004), 5, *www.sbp.org.pk/press/2004/Islamic_modes.pdf*, 20. 10. 2023.

[137] Munawar Iqbal, "International Islamic Financial Institutions", *Handbook of Islamic Banking* (Eds. M. Kabir Hassan and Mervyn K. Lewis), Edward Elgar, 2007, 361, 380.

[138] M. Iqbal, op. cit., 380–381; Legal Framework, International Islamic Centre for Reconciliation and Arbitration, *https://www.iicra.com/about-iicra/#about-legal*, 20. 10. 2023.

interest, compensation (*ta'widh*) or late payment charges (*gharamah*) may be awarded. However, they permit tribunals to apply (*inter alia*) Islamic Fiqh academies' or AAOIFI's standards absent party agreement on law applicable to the merits.[139] As mentioned earlier, the latter permit *gharamah*. While the Saudi Center for Commercial Arbitration's SCCA Arbitration Rules are also silent, their appendix notes arbitration fees deposits do not yield interest.[140]

However, the Kuala Lumpur-based Asian International Arbitration Centre's 2021 i-Arbitration Rules ('AIAC i-Arbitration Rules') are more comprehensive.[141] Unless parties have agreed otherwise, r 13.5(o) expressly empowers tribunals to award on sums of money awarded 'a late payment charge in accordance with the principles of *Ta'widh* and *Gharamah* or such similar charges that the Arbitral Tribunal considers appropriate, for any period ending no later than the date of payment'.

It can be concluded that late payment charges in the nature of *gharamah* are widely accepted as *sharia*-compliant.[142] However, acceptance of *ta'widh* by the SAC and under the AIAC i-Arbitration Rules in Malaysia stands in contrast to the strict interpretation of Islamic scholars such as Usmani and the Islamic Fiqh Academy in Jeddah who, as discussed above, argue that compensation (*ta'widh*) is equivalent to interest.[143]

(C) Calculation of Permissible Penalties

From the divergence in approaches outlined above, it must be concluded that if a contract to which the CISG applies is found to contain *riba* or *gharar* then

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[139] International Islamic Centre for Reconciliation and Arbitration, *IICRA Arbitration & Reconciliation Rules* (Rules, 30 December 2020), Article 35(2), *https://www.iicra.com/wp-content/uploads/2023/04/IICRA-Arbitration-and-Reconciliation-Rules-1.pdf*, 20. 10. 2023. ('*IICRA Arbitration Rules*').

[140] Saudi Center for Commercial Arbitration, *Arbitration Rules* (Rules, 31 July 2016) Article 8(1) *https://www.sadr.org/assets/uploads/download_file/Arbitration_and_Mediation_Rules_EN1.pdf*, 20. 10. 2023.

[141] Asian International Arbitration Centre, i-Arbitration Rules (Rules, 1 November 2021) *https://www.aiac.world/Arbitration-Arbitration*, 20. 10. 2023. ('*AIAC i-Arbitration Rules*'). The prefix 'i' indicates *sharia* compliance.

[142] AAOIFI Standards, 214 [5/6]; *2022 Resolutions* (n 114) 5; AIAC i-Arbitration Rules, r 13.5(o); IICRA Arbitration Rules, Article 35(2) (arguably indirectly).

[143] Taqi Usmani is chairman of the Shari'ah Board of AAOIFI: 'Shari'ah Board Members', Accounting and Auditing Organization for Islamic Financial Institutions, *http://aaoifi.com/members-2/?lang=en*, 20. 10. 2023.

it might be considered invalid or void under strict interpretations of *sharia* such as the AAOIFI's standards or by the Islamic Fiqh Academy in Jeddah. However, this may not be true under Islamic rules on banking and arbitration such as those of the SAC or the AIAC i-Arbitration Rules. Moreover, simple interest may be permissible in some Muslim-majority countries, as discussed below in Part. V(D)(1).

Of considerable influence on calculation of permissible charges are the views of Abd Al-Razzaq Ahmad Al-Sanhuri. This Egyptian scholar viewed the major prohibition as against compound interest (*riba al-jahiliyya*),[144] being 'interest … upon interest which has accumulated',[145] whilst lesser prohibitions on interest (*riba al-nasi'a* and *riba al-fadl*) were merely designed to prevent *riba al-jahiliyya*.[146] Sanhuri's distinction between permissible simple and forbidden compound interest is reflected by the laws of many Muslim-majority nations.[147] Islamic scholars Tantawi and Wasil also argue simple interest is a form of profit - sharing on investments rather than *riba*.[148] Such views thus take permissibility a step beyond mere compensation (*ta'widh*) to allow simple interest.

We now survey the degree of variance between Muslim-majority jurisdictions in relation to interest and compensation for late payment.

(D) Survey of Interest Approaches in Domestic Laws of Muslim-Majority Jurisdictions

In the above discussion we highlighted differences in scholarly opinion (and certain banking and arbitration rules) on the permissibility of interest and compensation for late payment. It follows that the impact of *sharia* varies depending on which scholarly interpretation is preferred within the nation concerned. This section surveys a selection of Muslim-majority countries and discusses whether interest or compensation for time value of money can be awarded under their domestic laws. Jurisdictions surveyed can, for convenience, be divided into three categories (with Kuwait appearing twice due to characteristics which overlap more than one category):

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[144] Emad H. Khalil, Abdulkader Thomas, "The Modern Debate over Riba in Egypt", *Interest in Islamic Economics: Understanding Riba* (Ed. Abdulkader Thomas), Routledge, 2006, 68, 72.

[145] *Ibidem.*, quoting Abd Al-Razzaq Ahmad Al-Sanhuri, *Masadir Al-Haqq fil-Fiqh al-Islami,* Sources of Law in Islamic Jurisprudence, Manshurat al-Halabi al-Huquqiyah, 1998, 44.

[146] E. H. Khalil, A. Thomas, op. cit., 72.

[147] E. H. Khalil, A. Thomas, op. cit., 71.

[148] Sina Ali Muscati, "Late Payment in Islamic Finance", *UCLA Journal of Islamic and Near Eastern Law*, Vol. 6, No. 1, 2007, 47, 62.

Group A: Countries influenced by a liberal scholarly approach to *riba*, whereby awards of interest are permitted, such as Egypt,[149] Kuwait,[150] Syria,[151] Iraq,[152] and Libya.[153]

Group B: Countries which permit interest in commercial matters but prohibit or limit interest charges in civil matters,[154] including Algeria, Oman,[155] the UAE,[156] Bahrain,[157] Kuwait,[158] and Yemen.[159]

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[149] See Civil Code (Egypt), *http://www.wipo.int/wipolex/en/details.jsp?id=8362*, 20. 10. 2023. [tr Perrott, Fanner & Sims Marshall, The Egyptian Civil Code: Promulgated by Law No. 131 of 1948 in Force since the 15 October 1949 (Tipografia Dell'istituto Don Bosco, 1952)] ('Egyptian Civil Code').

[150] See Commercial Code (Kuwait) [tr Hilmar Krüger, 'Kuwaiti Commercial Code, Act No. 68 of 1980' Trans-lex, *https://www.trans-lex.org/602600/_/kuwaiti-commercial-code-act-no-68-of-1980*, 20. 10. 2023. ('Kuwaiti Commercial Code').

[151] See Mohamed S. Abdel Wahab, "Construction Arbitration in the MENA Region", *The Guide to Construction Arbitration* (Eds. Stavros Brekoulakis and David Brynmor Thomas), Law Business Research, 4th Edition, 2021, 356, citing Civil Code (Syria), Article 227 ('Syrian Civil Code') and Commercial Code (Syria), Article 108. See also Florentine Sonia Sneij, Ulrich Andreas Zanconato, "The Role of Shari'a Law and Modern Arbitration Statutes in an Environment of Growing Multilateral Trade: Lessons from Lebanon and Syria", *Transnational Dispute Management,* Vol. 12, No. 2, 2015, 1875-4120:1–19, 11–18.

[152] See Civil Code (Iraq), *http://www.refworld.org/docid/55002ec24.html*, 20. 10. 2023. ('Iraqi Civil Code').

[153] Civil Code (Libya) [tr Meredith O Ansell and Ibrahim Massaud al-Arif, The Libyan Civil Code: An English Translation and a Comparison with the Egyptian Civil Code (Oleander Press)] ('Libyan Civil Code').

[154] In countries discussed in this section, 'civil matters' refers to contractual and tortious claims between natural persons. See Chibli Mallat, *Introduction to Middle Eastern Law*, Oxford University Press, 2007, 234–235.

[155] *Ayman Abdel Fattah Rady v Muhammad Abdel Razzak Muhammad Khorshid*, Egyptian Court of Cassation, 65/121, 12 June 2007 [tr Jalal El Ahdab (ed), 'Ayman Abdel Fattah Rady v Muhammad Abdel Razzak Muhammad Khorshid, Egyptian Court of Cassation, Annulment, 65/121, 12 June 2007' (2009) 1(1) International Journal of Arab Arbitration 243]; 'Oman's Civil Code: It's Impact on Banking and Finance Transactions', Dentons *https://www.dentons.com/en/insights/alerts/2014/january/23/omans-civil-code-its-impact-on-banking-and-finance-transactions*, 20. 10. 2023.

[156] See Federal Law No. 18 of 1993 concerning the Commercial Transactions Law (United Arab Emirates) [tr Dawoud Sudqi El Alami, The Law of Commercial Procedure of the United Arab Emirates (Graham & Trotman, 1994)] ('UAE Code of Commercial Practice').

[157] Law of Commerce (Bahrain) Legislative Decree No. 7 of 1987, art 81 [tr Gulf Translations WLL, 'The Law of Commerce: No. 7 of 1987', Ministry of Industry and Commerce, *https://www.moic.gov.bh/en/RegulationsAndAgreements/Regulations/Regulation%20New/The%20Law%20of%20Commerce%20No.%207%20of%201987.pdf*, 20. 10. 2023. ('Bahrain Law of Commerce').

[158] Kuwaiti commercial and civil law was influenced by Sanhuri, thus it also falls within Category A: see Isa A. Huneidi, "Twenty-Five Years of Civil Law System in Kuwait", *Arab Law Quarterly*, Vol. 1, No. 2, 1986, 216, 216.

[159] *Desert Line Projects LLC v Yemen* (Award) (ICSID Arbitral Tribunal, Case No. ARB/05/17, 6 February 2008) [294] ('Desert Line (Award)').

Group C: Countries that generally prohibit interest, but which permit compensation (*ta'widh*) for delayed payments, such as Saudi Arabia, Iran,[160] and Qatar.[161]

1) Group A: Liberal Approach to Interest with Prohibition of Compound Interest.

Simple interest is permissible in Group A countries. The domestic laws of Egypt, Syria, Iraq, Kuwait, and Libya were influenced by the Egyptian scholar, Sanhuri, who, as discussed earlier,[162] distinguished between the major prohibition against *riba al-jahiliyya* (arguably compound interest)[163] and simple interest.

Sanhuri drafted the Egyptian Civil Code[164] and significantly influenced the civil codes of Syria,[165] Iraq,[166] Libya,[167] and the Commercial Code of Kuwait.[168] Thus, Article 226 of the Egyptian Civil Code permits damages inclusive of interest for delay in payment:

> "When the object of an obligation is the payment of a sum of money of which the amount is known at the time when the claim is made, the debtor shall be bound, in case of delay in payment, to pay the creditor, as damages for the delay, interest at the rate of four percent in civil matters and five percent in commercial matters. Such interest shall run from the date of the claim in Court, unless the contract or commercial usage fixes another date".[169]

A 1985 challenge to Article 226 argued that it violated *sharia* within Article 2 of the Egyptian Constitution.[170] However, in reasoning criticised by scholars,[171]

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[160] Iran and Saudi Arabia are examined in more detail below in Part V(D)(3).

[161] Hani Al Naddaf, Interest on Loans under Qatari laws, Al Tamimi & Co, *https://www.tamimi.com/law-update-articles/interest-on-loans-under-qatari-laws/*, 20. 10. 2023.

[162] See above footnotes 144–145 and accompanying text.

[163] E. H. Khalil, A. Thomas, op. cit., 72.

[164] *Ibidem.*

[165] See M. S. A. Wahab, op. cit., 356. See also F. S. Sneij, U. A. Zanconato, op. cit., 11–18.

[166] Articles 171 and 172 of the Iraqi Civil Code are similar to Articles 227 and 228 of the Syrian Civil Code, however the maximum interest rate is 7%.

[167] Articles 229–231 are similar to the Egyptian Civil Code, except that the Libyan Civil Code interest rate is stipulated at 10%: at art 230, as opposed to 7% in the Egyptian Civil Code.

[168] See Kuwaiti Commercial Code, Article 102.

[169] Egyptian Civil Code, Art. 226.

[170] *Rector of the Azhar University v President of the Republic* (Supreme Constitutional Court of Egypt, Case No. 20 of Judicial Year No. 1, 4 May 1985) [tr Saba Habachy, 'Supreme Constitutional Court (Egypt): Shari'a and Riba' (1985) 1(1) Arab Law Quarterly 100].

[171] El-Saghir (2014), op. cit., 513; Saleh Majid, Faris Majid, "Application of Islamic Law in the Middle East: Interest and Islamic Banking" *International Construction Law Review*, Vol. 20, No. 1, 2003, 177, 190–191.

the Egyptian Supreme Constitutional Court held Article 226 preceded the Constitution and therefore prevailed over *sharia*, and that the Constitution had no retroactive impact. Article 227 of the Egyptian Civil Code permits parties to contractually agree to a maximum interest rate of 7% but characterises this as damages for delayed payment.[172] However, Article 232 prohibits compound interest and caps total interest:

> "Subject to any commercial rules or practice to the contrary, interest does not run on outstanding interest and in no case shall the total interest that the creditor may collect exceed the amount of the capital".[173]

2) Group B: Interest Permitted in Commercial but Not Civil Matters.

Group B countries of Oman, the UAE, Bahrain, Kuwait, Yemen, and Morocco allow interest to be charged in commercial, but not civil matters (in which interest is prohibited). Consequently, between individuals in the private sphere, interest is forbidden, but may be permitted in dealings involving businesses. Thus Kuwait, Bahrain,[174] Oman,[175] and Yemen[176] permit and regulate interest within their commercial laws.[177] Morocco permits interest in transactions involving corporations.[178]

Article 547 of the Civil Code of Kuwait prohibits interest on loans in civil matters;[179] however, Articles 110–11 and 113 of the Kuwaiti Commercial Code

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[172] Egyptian Civil Code, Article 227.

[173] Egyptian Civil Code, Article 232.

[174] Bahrain Law of Commerce, Article 81. See Law of Commerce, Economic Development Board of Bahrain, *https://bahrainbusinesslaws.com/laws/Law-of-Commerce*, 20. 10. 2023.

[175] Ahmed Al Barwani, Richard Baxter, Thomson Reuters, Doing Business in Oman: Overview, *https://uk.practicallaw.thomsonreuters.com/w-007-5872?transitionType=Default&contextData=(sc.Default)&firstPage=true*, 20. 10. 2023. In Case No. 1/2007, the Arbitral Tribunal ordered payment of interest of 7% from 1 November 2007 to the date of the award. The award was upheld by the Court of Appeal: Court of Appeal (Muscat), 34/2009, 27 April 2009 [tr Jalal El Ahdab (ed), '*Not Indicated v. Not Indicated,* Court of Appeal, Commercial, 34/2009, 27 April 2009' (2009) 1(3) International Journal of Arab Arbitration 245].

[176] Desert Line (Award) where, in proceedings under the ICSID Arbitration Rules, the Tribunal rejected a compound interest claim and instead awarded simple interest at 5% since compound interest was prohibited under governing Yemeni law: at [292]–[298].

[177] Interest is also permitted in banking and finance sectors.

[178] See generally Mahat Chraibi, Morocco: Corporate – Withholding Taxes, *http://taxsummaries.pwc.com/uk/taxsummaries/wwts.nsf/ID/Morocco-Corporate-Withholding-taxes*, 20. 10. 2023; Fatima Akaddaf, "Application of the United Nations Convention on Contracts for the International Sale of Goods (CISG) to Arab Islamic Countries: Is the CISG Compatible with Islamic Law Principles?", *Pace University School of Law International Law Review*, Vol. 13, No. 1, 2001, 55.

[179] Civil Code of Kuwait, Article 547 [tr Nicholas Karam, The Civil Code of Kuwait: Decree Law No. 67 of 1980 (Lexgulf Publishers, 2011) 126].

permit interest in commercial matters, and interest, where not provided in the contract, is fixed for commercial loans at 7% by Article 102 of the Kuwaiti Commercial Code.[180]

The constitutionality of Kuwaiti laws permitting interest in commercial matters was challenged in an appeal before the Kuwaiti Constitutional Court which argued that Articles 110 and 113 of the Kuwaiti Commercial Code were unconstitutional, being in violation of the *sharia*.[181] The Court rejected this argument. It held that Article 2 of the Constitution provided that *sharia* was a source of law, but the legislature was permitted to rely on other sources. Furthermore, *sharia* was a source of law only in the absence of express legislative provisions. It followed that the express provisions in Articles 110 and 113 were constitutional.[182]

Sharia is also a primary source of law in the UAE. Yet, interest is provided for within the UAE's Federal Law No. 18 of 1993 concerning the Commercial Transactions Law ('UAE Code of Commercial Practice'),[183] Article 76 of which permits awards of interest, where not otherwise specified in the contract, at prevailing market rates capped[184] at 12%.[185] In a case decided under its predecessor, the Civil Courts Procedures Law No. 3 of 1970, it was argued that interest and compound interest were prohibited by *sharia*.[186] The UAE Federal Supreme Court held that *sharia* only applied in the absence of express legislative provisions, and that pursuant to the express legislative provisions, parties could validly agree on interest rates, provided they did not agree to compound interest.[187]

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[180] M. Bhatti (2019), op. cit., 177, discussing Kuwaiti Commercial Code Articles 110–111, 113.

[181] S. Majid, F. Majid, op. cit., 191–192, citing a 28 November 1992 decision of the Kuwait Constitutional Court.

[182] *Ibidem.*; Hind Tamimi, "Interest under the UAE Law and as Applied by the Courts in Abu Dhabi", *Arab Law Quarterly*, Vol. 17, No. 1, 2002, 50, 52, discussing Federal Supreme Court Abu Dhabi, No. 245/20, 7 May 2000.

[183] UAE Code of Commercial Practice.

[184] See H. Tamimi, op. cit., 52.

[185] See Award, International Chamber of Commerce, Case No. 12580 of 2006, 30 May 2006 reported in (2010) 2(3) International Journal of Arab Arbitration 270, 292. This case, in which Emirati law was applicable, involved Emirati, Lebanese and Indian corporations. The claimant sought 12% interest per Articles 76 and 88 of the UAE Code of Commercial Practice. The Tribunal rejected the argument that, because compromise was impermissible under Article 203 of Federal Law No. 11 on the Civil Procedures Law (United Arab Emirates) 24 February 1992, interest was not arbitrable. It held interest was permitted and usual in arbitral practice in Abu Dhabi and ordered simple interest of 5%.

[186] Federal Supreme Court of the United Arab Emirates, No. 14/9, 28 June 1981, discussed in H. Tamimi, op. cit., 50.

[187] H. Tamimi, op. cit., 50.

Although holding that arbitral awards may be set aside for violation of *sharia*,[188] the Dubai Court of Cassation has noted that the Federal Law No. 3 of 1987 on Issuance of the Penal Code Article 409 public policy prohibition on usury is limited to transactions between natural persons.[189] This was confirmed in another Dubai Court of Cassation decision, which held that, where a corporation is involved, UAE courts have no jurisdiction to set aside foreign arbitral awards on the basis that interest is forbidden by *sharia*.[190]

From the above survey of Group A and B jurisdictions it is clear that simple interest is generally permitted in commercial transactions in many countries whose Constitutions refer to *sharia*. Nonetheless, some 1980s ICC decisions ostensibly defer to *sharia* in refusing awards of interest. Thus, in *Parker Drilling Co v Sonatrach*, arbitrators refused interest because parties had selected Algerian law.[191] The Tribunal determined that the Algerian *Code de procédure civile* [Code of Civil Procedure] ('Algerian Civil Code') prohibited interest on loans between individuals but permitted interest in business contracts.[192] Despite this, the Tribunal held that

[188] Federal Law No. 5 on the Civil Transactions Law (United Arab Emirates) 15 December 1985, Articles 3, 27. The UAE acceded to the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards, opened for signature 10 June 1958, 330 UNTS 3 (entered into force 7 June 1959) ('New York Convention') in 2006, and in 2018 adopted the UNCITRAL Model Law on International Commercial Arbitration, UN Doc A/61/17 (7 July 2006) Annex I ('UNCITRAL Model Law').

[189] Dubai Court of Cassation, Petition No. 146 of 2008, 9 November 2008 reported in Summaries of UAE Courts' Decisions on Arbitration (Eds. Hassan Arab, Lara Hammond and Graham Lovett), International Chamber of Commerce, 2013, 94, 96, quoting Federal Law No. 3 of 1987 on Issuance of the Penal Code (United Arab Emirates) 8 December 1987, Art. 409 ('UAE Federal Penal Code'), which states: 'Any natural person who deals in usury with another natural person in any civil or commercial transaction shall be punished with imprisonment for no less than three months and with a fine of no less than 2,000 Dirhams.'

[190] Dubai Court of Cassation, Petition No. 132 of 2012, 22 February 2012 reported in Summaries of UAE Courts' Decisions on Arbitration (Eds. Hassan Arab, Lara Hammond and Graham Lovett), International Chamber of Commerce, 2013, 123, 124. See Richard Price and Essam Al Tamimi, *United Arab Emirates Court of Cassation Judgments: 1998–2003* (Ed. Mark SW Hoyle), Brill, 2005, 205, discussing Dubai Court of Cassation, Judgment No. 321/99, 19 December 1999. See also UAE Federal Penal Code ['Federal Law No. (3) of 1987 on Issuance of the Penal Code', Al Mubasheri Advocates & Legal Consultancy, http://mublegal.com/wp-content/uploads/2014/07/Federal-law-penal-code.pdf. 20. 10. 2023.

[191] (Award, International Chamber of Commerce, Case No. 4606 of 1985), discussed in D. J. Branson, R. E. Wallace, op. cit., 937–940. *Cf Grove-Skanska v Lockheed Aircraft International AG* (Award, International Chamber of Commerce, Case No. 3903 of 1981), discussed in D. J. Branson, R. E. Wallace, op. cit., 933–937.

[192] Code de procédure civile [Code of Civil Procedure] (Algeria) Ordinance No. 66-154, 8 June 1966 ('Algerian Code of Civil Procedure').

the overarching role of *sharia* in the Algerian Civil Code meant interest could not be awarded, regardless of the commercial context.[193] A similar approach was taken by the Tribunal in ICC Case No. 5277 of 1987.[194] Since the 1980s, Algerian arbitration law has been reformed and no recent ICC cases applying Algerian law have refused to award interest.[195]

As the CISG only governs contracts between commercial parties, Group A and B jurisdictions are effectively equivalent for the purposes of assessing potential conflict between the CISG and *sharia*. Both permit simple interest in commercial transactions.

3) Group C: Prohibition on Interest, Allowing Compensation for Late Payment.

Unlike Groups A and B which permit simple interest for commercial contracts, the Group C countries of Saudi Arabia and Qatar generally prohibit all interest but permit compensation for late payment. In Qatar, Shafiey *et al.* advise that default interest is prohibited, but that:

> "Generally, Qatari law applies the principle of full compensation for the damage suffered (including losses, lost profits and moral damages, but not indirect damages) (Articles 263 and 264, Civil Code). However, contractual liquidated damages are admitted (Article 263, Civil Code), and punitive damages do not exist under the Qatari legal system. Awarding interest is uncommon, but there is no express provision preventing the enforcement of an [arbitral] award on interest".[196]

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[193] D. J. Branson, R. E. Wallace, op. cit., 939.

[194] Second Interim Award, International Chamber of Commerce, Case No. 5277 of 1987 reported in 13 (1988) Yearbook – Commercial Arbitration 80, where the Tribunal noted: 'It is not, however, possible in our view for the prohibition on interest to be circumvented by describing it as a claim for damages for loss of the use of the money. We accept the evidence of Dr A that a court in country X would not uphold a claim for interest even though it was dressed up in such a way': at 90 [25]. See also Omar M.H. Aljazy, "Jurisdiction of Arbitral Tribunals in Islamic Law (*Shari'a*)", *Liber Amicorum: Bernardo Cremades* (MÁ Fernández-Ballesteros and David Arias), La Ley, 2010, 65, 79; G. Born, op. cit., 3362–3363.

[195] In 2008, the Code de procédure civile et administrative [Code of Civil and Administrative Procedure] (Algeria), 25 February 2008, Journal officiel de la Republique algerienne (No. 21, 23 April 2008) replaced the Algerian Code of Civil Procedure. See generally Nasr Eddine Lezzar, "Algeria", *Arbitration in Africa: A Practitioner's Guide* (Ed. Lise Bosman), Kluwer Law International, 2013, 277.

[196] Hasan El Shafiey *et al.*, Thomson Reuters, Arbitration Procedures and Practice in Qatar: Overview, *https://uk.practicallaw.thomsonreuters.com/w-011-1052?transitionType=Default&contextData=(sc.Default)&firstPage=true*, 20. 10. 2023.

Indeed, Article 268 of Qatar's Law No. 22 of 2004 regarding Promulgating the Civil Code permits the court to award compensation in the form of an indemnity for losses due to non-payment:

> "Where the obligation is the payment of money and the obligor fails to make such payment after being notified to do so, and provided that the obligee proves he has incurred damages due to such non-payment, the court may order the obligor to pay indemnity, subject to the requirements of justice".[197]

As Tannous explains, Qatari courts are now not only more willing to enforce arbitral awards of interest, but are themselves prepared to compensate losses suffered due to late payment:

> "The Qatar Court of Cassation has found that an arbitral award that included an award of interest was valid and not contrary to public policy in Qatar. The award was challenged on the basis that the award of interest was incompatible with *Sharia* law and therefore unenforceable. The Court's judgment, Court of Cassation number 24 of 2018 handed down on 27 February 2018, is noticeable because it marks a clear shift in the court's approach with respect to awards of interest.…
>
> The Qatari Courts have traditionally refused to award interest for two main reasons: the courts either found that payment of interest is prohibited under the principles of *Sharia*; or considered the claim for payment of interest as a claim for compensation flowing from either late payment or a failure of the obligor to uphold contractual obligations. Instead of awarding interest on late or defaulted payments, the Qatari Courts have directed the relevant obligor to pay the obligee a lump sum of compensation as determined by the Court. However, there has been a gradual shift in this approach. In recent judgments, the Court of Cassation upheld decisions of the Court of First Instance and the Court of Appeal stating that the interest awarded by an arbitral tribunal amounts to compensation for breach of contract and, as such, is not contrary to public policy in Qatar".[198]

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[197] Law No. 22 of 2004 regarding Promulgating the Civil Code (Qatar) ['Law No. (22) of 2004 regarding Promulgating the Civil Code' Al Meezan: Qatari Legal Portal, *https://www.al-meezan.qa/LawArticles.aspx?LawTreeSectionID=8936&LawID=2559&language=en*, 20. 10. 2023.

[198] Noelle Tannous, The Qatari Courts' Approach to Awarding Interest, Al Tamimi & Co, *https://www.tamimi.com/law-update-articles/the-qatari-courts-approach-to-awarding-interest*, 20. 10. 2023.

Although Qatar is still developing its approach, for present purposes, it can be observed that in practice Qatari law supports lump sum compensation for losses due to delayed payment.

The Saudi prohibition of interest has been inconsistent. In Saudi Arabia, profit is charged in the banking and finance sector, despite the absence of any express provision for interest in Saudi regulations due to the prohibition against *riba*. Regardless of the practice within the banking and finance sector, courts have discretion to annul the interest aspect of contracts if found to be '*riba*' and therefore in violation of *sharia*.[199]

Non-Saudi courts applying Saudi law have also considered the issue. In *National Group for Communications and Computers Ltd v Lucent Technologies International Inc*, a United States District Court found expectation damages were noncompliant with Saudi law because they were uncertain and therefore breached the prohibition against *gharar*.[200] Similarly, an ad hoc tribunal applying Saudi law rejected the interest claim 'since this is charged on a basis … not sanctioned [by] public law … derived from the *Shari'a* Islamic Law'.[201]

In spite of the largely conservative approach outside Saudi Arabia itself, some non-Saudi adjudicators have awarded interest.[202] In ICC Case No. 7063 of 1993, the issue was whether interest could be awarded on damages.[203] The Tribunal determined that:

> "anything in the nature of usury or unjust taking of interest, as well as compound interest, are barred by this doctrine under *Shari'a* law. But we do not accept that it also bars all awards of compensation for financial loss due to a party not having had the use of a sum of money to which it would have otherwise been entitled, e.g., as a result of late payment".[204]

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[199] Abdulrahman Yahya Baamir, *Shari'a Law in Commercial and Banking Arbitration: Law and Practice in Saudi Arabia*, Ashgate, 2010, 167.

[200] 331 F Supp 2d 290 (D NJ, 2004) 297.

[201] Final Award, Mohammad Hassan Al-Jabr, Saudi MA Shawwaf and Abdullah Al-Munifi, 20 November 1987 reported in (1989) 14 Yearbook – Commercial Arbitration 47, 68 [68] (emphasis added).

[202] In *Midland International Trade Services Ltd v Sudairy* (England and Wales High Court – Queen's Bench Division, Hobhouse J, 11 April 1990), English and Saudi parties had agreed the Saudi company would pay interest on sums advanced. After the Riyadh Committee for the Settlement of Negotiable Instruments Disputes refused to award interest, a successful claim was initiated before the English courts. However, in this case English law governed the contract: A. Y. Baamir op. cit., 174.

[203] Final Award, International Chamber of Commerce, Case No. 7063 of 1993 reported in (1997) 22 Yearbook – Commercial Arbitration 87, 89.

[204] Final Award, Case No. 7063 [6].

The Tribunal noted that modern commercial life in Saudi Arabia reflects conventional standards, and that commercial banks charge interest for loans.[205] However, in deference to *sharia*, the Tribunal only awarded compensation at the annual inflation rate being 5% per annum, as opposed to commercial interest rates, and referred to this as 'compensation' for financial loss suffered due to inflation.[206] The same approach was taken in ICC Case No. 8677/FMS, where the Tribunal noted compensation was allowed under *sharia* and was not considered 'interest in the technical Islamic sense relating to a contract of loan'.[207]

Iran is also an interesting case study given that Islamic law was introduced in Iran after the 1979 Islamic Revolution.[208] The Constitution of the Islamic Republic of Iran Article 43(5) prohibits 'usury,[209] and other invalid and forbidden interactions' and Article 49 stipulates that '[t]he government is responsible for confiscating illegitimate wealth resulting from usury'. However, the Guardian Council issued a notice ('Guardian Council's Opinion') which allowed:

> "[r]eceiving interest and damages for delay in payment from foreign governments, institutions, companies and persons, who, according to their own principles of faith, do not consider [interest] as being prohibited, is permitted under religious [Islamic] standards; therefore claiming [and] receiving such funds is not against the Constitution…"[210]

Thus, pursuant to Iranian law, interest may be received by Iranian nationals in transactions with foreigners.[211] This view is consistent with Islamic scholars

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[205] *Ibidem.*

[206] Final Award, Case No. 7063, 90 [7].

[207] Award, International Chamber of Commerce, Case No. 8677/FMS, 26 September 1997 reported in Vol. 1, No. 4, *International Journal of Arab Arbitration*, 2009, 333, 352.

[208] James D. Fry, "Islamic Law and the Iran–United States Claims Tribunal: The Primacy of International Law over Municipal Law", *Arbitration International,* Vol. 18, No. 2, 2002, 105, 118, citing *Constitution of the* Islamic Republic of Iran, Preamble, Art. 4 ('*Iranian Constitution*'). See generally Nima Nasrollahi Shahri, Amirhossein Tanhaei, "An Introduction to Alternative Dispute Settlement in the Iranian Legal System: Reconciliation of Shari'a Law with Arbitration as a Modern Institution", *Transnational Dispute Management*, Vol. 12, No. 2, 2015, 1875-4120: 1–23.

[209] Constitution of the Islamic Republic of Iran, Arts. 43(5), 49 [tr Firoozeh Papan-Matin, 'The Constitution of the Islamic Republic of Iran (1989 Edition)' (2014) 47(1) *Iranian Studies* 159, 173–174].

[210] Muscati, op. cit., 51, quoting Guardian Council, *Ruznamehi Rasmi Jumhuri Islami Iran*, The Official Gazette of the Islamic Republic of Iran, (Notice No. 53018, 4 October 1987); Guardian Council, *Ruznamehi Rasmi Jumhuri Islami Iran*, The Official Gazette of the Islamic Republic of Iran, Notice No. 12515, 7 February 1988).

[211] J. Y. Gotanda, "Awarding Interest in International Arbitration", *American Journal of International Law*, Vol. 90, No. 1, 1996, 40, 49.

from the Jafari and Hanafi schools of thought, who argue Muslims may receive interest from non-Muslims, but Muslims cannot pay interest in any situation.[212] In relation to this, Gotanda observes:

> "It is unclear whether Iranian courts would limit the applicability of the Guardian Council's opinion to the situation specified by the Prime Minister (i.e., where interest has been sought by Iranian parties and its payment has been provided for in, or may be inferred from, the contract), or whether they would give it broad application to allow for interest to be paid to, or received from, a foreigner when the foreign party's law does not consider the awarding of interest to be prohibited."[213]

In ICC Case No. 7263, the Iranian buyer sought damages and compound interest from a US seller.[214] The US seller argued Articles 43 and 49 of the Iranian Constitution did not permit payment of interest.[215] However, the Iranian buyer relied upon the Guardian Council's Opinion to argue receipt of interest from foreign companies whose laws allowed interest was permitted under Iranian law. The Tribunal decided the Guardian Council's Opinion was 'discriminatory towards non-Iranian citizens, as they cannot claim such interest against Iranians in Iranian courts'.[216] It also found the policy was not 'addressed to nor implementable by foreign and international arbitral organs and institutions, such as the present Arbitral Tribunal'.[217] It held that any application of discriminatory rules would contradict 'general principles of international public order which this Tribunal is bound to respect and implement'.[218] Thus, applying Iranian law, the Tribunal nonetheless denied an award of interest on the basis that the Guardian Council's Articulation of *sharia* was inconsistent with international public policy.[219]

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[212] Muscati, op. cit., 50. See generally S. H. Amin, "Banking and Finance Based on Islamic Principles: Law and Practice in Modern Iran", *Islamic and Comparative Law Quarterly*, Vol. 9, No. 1, 1989.

[213] J. Y. Gotanda (1996), op. cit., 49.

[214] Final Award, International Chamber of Commerce, Case No. 7263 reported in (2004) 15(1) *ICC International Court of Arbitration Bulletin*, 71.

[215] Final Award, Case No. 7263 [119].

[216] Final Award, Case No. 7263 [122].

[217] Final Award, Case No. 7263 [122].

[218] Final Award, Case No. 7263 [122].

[219] However, it is unclear to which 'general principles of international public order' the Tribunal was referring. Article 18 of the UNCITRAL Model Law and Article V(1)(b) of the New York

The Tribunal in ICC Case No. 7373 took a different approach.[220] It ordered an Iranian company to pay interest on amounts due upon rightful termination by a British company despite the prohibition under Articles 43 and 49 of the Iranian Constitution. It noted that:

> "care should be taken in the wording of the relevant claim so as to cover compensation for loss of use of money (and not interest) and to provide proof of costs (such as the costs of borrowing money), so as to establish that the borrowing was directly mandated by, and that the loss suffered was a direct result of, the contractors' failure to receive payments when due".[221]

The decision was based on Articles 221 and 228 of the Civil Code of the Islamic Republic of Iran, which permit compensation for losses.[222] The Tribunal ordered compensation for lost income that 'would have been earned … [calculated] from the date of the loss to the date of payment'[223] and held that interest rates reflect accurate compensation due to the impacts of inflation on capital value and rates of return on capital.[224] It observed that denial of interest would be unjust in international commercial relations, and that interest was commonly awarded by arbitral tribunals in Middle East oil concessions.[225] It relied on *McCollough & Co Inc v Ministry of Post, Telegraph and Telephone,*[226] in which the Iran–US Claims Tribunal applied Iranian law and awarded 10% interest per annum on the basis that this would compensate for delay at a reasonable rate in the circumstances.[227] A similar approach was taken in ICC Case No. 5082 of 1989,

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Convention embody concepts of procedural fairness, due process and equal treatment. Alternatively, the reference could be to transnational public policy principles.

[220] Final Award, International Chamber of Commerce, Case No. 7373 of 1997 reported in (2004) 15(1) *ICC International Court of Arbitration Bulletin,* 72 ('ICC Case No. 7373').

[221] Final Award, Case No. 7373 [345], quoting Nancy B. Turck, "Resolution of Disputes in Saudi Arabia", *Arab Law Quarterly*, Vol. 6, No. 1, 1991, 3, 30.

[222] Civil Code of the Islamic Republic of Iran, Articles 221, 228 [tr MAR Taleghany, The Civil Code of Iran (Fred B Rothman, 1995) 32–33].

[223] Final Award, ICC Case No. 7373, [347].

[224] Final Award, ICC Case No. 7373, [347].

[225] Final Award, ICC Case No. 7373, [347].

[226] Iran–United States Claims Tribunal, Award No. 225-89-3, 22 April 1986) reported in (1988) 11 Iran–US CTR 3.

[227] Iran–United States Claims Tribunal, Award No. 225-89-3, op. cit., [98]–[99], [104], discussed in ICC Case No. 7373 (footnote 220) [348].

where Iranian law applied. There, the Arbitral Tribunal found that whilst *riba* was prohibited, compensation was allowed and therefore a fixed rate of 9% per annum was awarded.[228]

(E) Analysis

We can conclude from the above survey that simple interest is permitted in many Muslim countries in commercial contexts, irrespective of constitutional reference to *sharia*. This underscores the pragmatic approach prevalent in most Muslim-majority countries, represented by Groups A and B above. In Group C countries, interest is usually impermissible. While Iranian law permits Iranian entities to receive interest, arbitral tribunals may refuse to apply this discriminatory rule. However, even in Group C countries such as Saudi Arabia, Qatar and Iran, compensation for delayed payment (*ta'widh*) is acceptable in commercial matters.

The above analysis confirms that it would be naive to simply conclude that the CISG is incompatible with *sharia* law without taking into account differences in interpretation and application of Islamic law in practice. A more nuanced approach is required. With this in mind, we next consider scholarly views on potential conflicts between the CISG and *sharia*.

VI CISG AND SHARIA: INEVITABLE CONFLICT OF INTERESTS?

In this section, the views of scholars on the question of compatibility of the CISG and *sharia* are considered. We also revisit Opinion No. 14 and propose an extension or adaptation that more fully reconciles the variety of practical applications of *sharia* with the CISG.

(A) Scholarly Views on Compatibility

A variety of views have previously been expressed about the CISG and Islamic law. El-Saghir and Akaddaf argue that the CISG is generally compatible with Islamic principles of good faith, sanctity of contract, specific performance and recognition of *lex mercatoria*.[229] Akaddaf interprets CISG 'good faith' as compatible with *sharia*, because it safeguards against 'speculation at seller's expense by requiring

[228] Partial Award, International Chamber of Commerce, Case No. 5082 of 1989 reported in (2004) 15(1) ICC International Court of Arbitration Bulletin, 63.

[229] H. El-Saghir (2014), op. cit., 515–16; F. Akaddaf, op. cit., 30–31, 35.

[the] buyer to mitigate losses or by limiting the right to specific performance', consistent with good faith, certainty and honesty under *sharia*.[230] Article 7(1) aside, Koneru points out that many CISG provisions reflect variants of good faith such as 'reasonableness' or 'fair dealing'.[231] Akaddaf observes that CISG Article 40 concretises the good faith in a seller's duty to disclose non-conformities.[232]

On the other hand, Associate Professor Bell argues that the CISG is not compatible with *sharia* and that the CISG should be excluded if parties want their '*murabaha* contract to be valid under Islamic law'.[233] Bell points to the prohibitions of *riba* and *gharar*,[234] arguing that compliant *murabaha* contracts cannot permit interest or uncertainty of price or goods.[235] Contrary to El-Saghir, Akaddaf and Koneru, Bell also asserts that the *sharia* good faith concept is wider than that within the CISG.[236]

However, as we have seen, there are differing interpretations of *sharia* in practice. Compatibility between the CISG and *sharia* depends entirely on the style of *sharia* within relevant jurisdictions. As observed in *Shamil Bank of Bahrain EC v Beximco Pharmaceuticals Ltd*[237] and *Islamic Investment Co of the Gulf (Bahamas)*

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[230] F. Akaddaf, op. cit., 33, citing John Fitzgerald, "CISG, Specific Performance, and the Civil Law of Louisiana and Quebec", *Journal of Law and Commerce*, Vol. 16, No. 2, 1997, 291, 296.

[231] Phanesh Koneru, "The International Interpretation of the UN Convention on Contracts for the International Sale of Goods: An Approach Based on General Principles", *Minnesota Journal of Global Trade*, Vol. 6, No. 1, 1997, 105, 140, discussed in F. Akaddaf, op. cit., 32–33. Arguably this broad view contrasts with the prevailing scholarly view that contends the role of art 7(1) is confined to interpretation of the *CISG*: Pascal Hachem, "Article 7 CISG: Interpretation of Convention and Gap-Filling", *Commentary on the UN Convention on the International Sale of Goods* (Eds. Ingeborg Schwenzer and Ulrich G. Schroeter), Oxford University Press, 5th Edition, 2022, 135, 137.

[232] F. Akaddaf, op. cit., 32–33.

[233] Gary F. Bell, "New Challenges for the Uniformisation of Laws: How the CISG Is Challenged by "Asian Values" and Islamic Law", *Towards Uniformity*: *The 2nd Annual MAA Schlechtriem CISG Conference* (Eds. Ingeborg Schwenzer and Lisa Spagnolo), Eleven International Publishing, 2011, 11, 28.

[234] G. F. Bell, op. cit., 23.

[235] G. F. Bell, op. cit., 26–28. Unfortunately, due to limitations of space, there is insufficient room in this article to discuss Associate Professor Bell's views on the compatibility of issues beyond interest obligations, which will be explored in a future study.

[236] G. F. Bell, op. cit., 27. Bell also contends nonconformity may lead to rescission under *sharia*, since it would breach the prohibition of *gharar*, whereas nonconformity under the CISG will not permit avoidance unless it amounts to a fundamental breach: at 27–28, citing CISG, Articles 25 and 49(1)(a).

[237] [2004] 1 WLR 1784, 1801 [54]–[55].

Ltd v Symphony Gems NV,[238] jurisdictions which do not adopt classical *sharia* may enforce *murabaha*. As discussed in Part V(D), many jurisdictions (such as those in Groups A and B) take a pragmatic approach to interest, recognising its significance in modern commerce, thus removing any real conflict in practice between the CISG and *sharia*. A fine-grained, nuanced approach is necessary to determine the true extent of compatibility. With this in mind, we argue below that Islamic law as implemented within Muslim-majority jurisdictions in practice may be compatible with the CISG. We begin by returning to Opinion No. 14.

(B) Advisory Council: Comments on Prohibitions

As discussed earlier in Part. IV(C), Opinion No. 14 favoured a single rule for interest rates under CISG Article 78: that interest is to be determined in accordance with the creditor's place of business. Importantly for present purposes, Opinion No. 14 addresses two relevant situations pertaining to the single rule, these being where the creditor's law prohibits compound interest, and where it prohibits interest altogether.

Concerning compound interest, Opinion No. 14 states that if forbidden by the law of the creditor's place of business, compound interest should not be awarded under Article 78 but potentially claimed as a loss under Article 74.[239] Likewise, it states that where interest is prohibited by the law of the creditor's place of business 'the tribunal should not award any interest based on Article 78. In such cases, the losses of the creditor can only be compensated subject to the prerequisites of Article 74'.[240]

These statements attempt to reconcile the CISG and *sharia* to some extent. As discussed in Part. V(D)(3), a form of compensation for losses due to late payment is acceptable in some *sharia*-observant jurisdictions. Reference to the potential alternative of compensation pursuant to Article 74 in the face of prohibitions within the law of the creditor's place of business alludes to this possibility, but understandably, Opinion No. 14 does not delve into a detailed analysis of the extent to which this is feasible.

Opinion No. 14 also acknowledges that despite Rule 8,[241] contractual agreements on interest rates may 'violate applicable national law provisions on validity,

[238] [2002] All ER (D) 171 (Feb).

[239] Opinion No. 14, 22 [3.45]. See also M. Bhatti (2019), op. cit., 193. Any contractual stipulation for compound interest would also be subject to validity concerns.

[240] Opinion No. 14, op. cit., 21 [3.43].

[241] Opinion No. 14, op. cit., 2.

especially usury (Article 4 CISG) or public policy'.[242] This nod to validity issues affecting express agreements on interest where the applicable law forbids *riba* further explains how the CISG and *sharia* might interact.

Whilst these clarifications are most welcome, their utility suffers from two limitations. It was not within the remit of Opinion No. 14 to deal with these issues, but any roadmap of the extent of conflict between the CISG and *sharia* requires they be taken into account.

The first limitation is absence of detail regarding the nature of relevant prohibitions on *riba*. As we have seen in Part. V, it is far from inevitable that every *sharia*-observant jurisdiction prohibits interest in commercial matters.

The second limitation is one of scope. Opinion No. 14 only deals with interactions between the CISG and prohibitions within the law of the creditor's place of business or the applicable law. However, in our view, conflicts can arise between the application of the CISG and the mandatory domestic law of the forum, where the latter contains relevant prohibitions.

(C) Types of Conflicts: Impact of the Forum

Assuming Opinion No. 14's interpretation holds, it might be thought that awards of simple interest under CISG Article 78 are *sharia*-compatible if simple interest is recognised in the creditor's jurisdiction (Group A and B countries). Where a relevant prohibition precludes this, pursuant to Opinion No. 14, compensation in lieu of interest pursuant to Article 74 may in any event be awarded if loss is proven. It might be therefore thought that this would be *sharia*-compliant if the creditor's jurisdiction accepts *ta'widh* (Group A, B or C countries).

However, the potential for conflict between *sharia* prohibitions and the CISG is not confined to prohibitions within the law of the creditor's place of business. A relevant prohibition may arise due to the mandatory law of the forum: where enforcement of a contract governed by the CISG is sought in a forum which applies or is bound by *sharia* law that holds such contracts invalid or void for *riba* or *gharar*.[243] Likewise, enforcement of an award or judgment applying the CISG may be refused within a jurisdiction that adopts *sharia*, on the basis of public policy.[244] It is therefore also necessary to consider fora in Muslim-majority jurisdictions in assessing the impact of the prohibitions.

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[242] Opinion No. 14, 14 [3.22].

[243] See generally: AAOIFI Standards, 221–231.

[244] Even under New York Convention, Article V(2)(b).

It should be noted that the Advisory Council only suggests the compensatory approach under Article 74 when the law of the creditor's country results in a zero-interest rate, or where the rate in that country leads to under-compensation compared with actual loss.[245] Conversely, the forum law might forbid interest (or compound interest), whilst the law of the creditor's place of business permits it.[246]

On its face, Opinion No. 14 provides no resolution, since it does no more than create a 'uniform rule' that the creditor's rate is to be applied to calculate interest under Article 78. Similarly, the alternative compensation under Article 74 is available for additional losses only if the creditor's law forbids interest (or its rate leads to under-compensation).

Consequently, the potential for conflict between *sharia* and the CISG is not fully addressed by Opinion No. 14.

(D) Suggested Adaptations to Interpretation of the CISG

In our view, the interpretation of the CISG within Opinion No. 14 can be extended so as to minimise potential conflicts due to the mandatory law of the forum. We suggest two interpretive solutions to address different gaps within Opinion No. 14: an interpretive 'extension' of the rule within Opinion No. 14 to account for forum public policy, and a 'flexible' approach adapting the rule in light of the jurisdiction of enforcement.

1) Extension of Alternative Compensation Availability: Forum Public Policy Grounds.

We suggest an extension to circumstances under which the 'alternative' of compensation for proven time value losses pursuant to CISG Article 74 is permitted. As discussed earlier, Opinion No. 14 approves of Article 74, but only where the uniform rule for Article 78 interest leads to a rate within the creditor's place of business that is either zero or inadequate to compensate for actual loss.

In our view, a further circumstance should also open the door to Article 74 compensation. Specifically, the Article 74 alternative should be available to a forum where, due to prohibitions within its own jurisdiction, the forum is rendered incapable of ordering Article 78 relief or is confined to simple interest under Article 78 where proven loss exceeds that rate.

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[245] See above footnotes 239–240 and accompanying text.

[246] Moreover, Opinion No. 14 only refers to invalidity arising from domestic law in the context of express agreements to charge interest: see above footnote 242 and accompanying text.

This one slight extension turns on an appreciation of the almost universal acceptance of *ta'widh* in countries surveyed in Part. V. Given that the forum law will accept the validity of awards in the nature of *ta'widh*, then notwithstanding the fact the creditor's law would permit interest under the uniform rule, the CISG should be interpreted as allowing the alternative compensation path. In our view this adaptation merely extends Opinion No. 14's logic regarding the functions of interest as primarily compensatory in nature, and its reasoning regarding the interrelation between Articles 74 and 78. The adaptation must, however, be confined to situations where the forum law's *ordre public* otherwise precludes operation of the single uniform rule for Article 78.

Note that for Group A and B countries, simple interest is permitted, subject to specific caps. Where enforcement is envisaged in these countries, Article 78 awards of compliant interest could be made, with resort to Article 74 in addition where necessary.

This interpretation ensures greater compatibility by allowing Article 74 compensation (*ta'widh*) as an alternative to Article 78 interest, but only in limited circumstances where the forum's hands are tied by public policy forbidding *riba* yet permitting *ta'widh*. Admittedly, formal uniformity is reduced to a slight degree within relevant situations, but the interpretation has the distinct advantage of reducing opportunities for conflict between the CISG and *sharia*, facilitating CISG application within fora located in Muslim jurisdictions, and encouraging greater accession to the CISG in Islamic countries.

2) Flexibility of Award Structure Given Enforcing Jurisdiction Public Policy.

A more awkward problem is where the awarding forum appreciates that enforcement of its award will likely be sought before a Muslim-majority state forum. This is not a problem unique to the CISG.

One solution would be an interpretation that permits adjudicators flexibility to fashion awards more likely upheld by the forum before which enforcement would likely to be sought, where the enforcing jurisdiction includes a relevant prohibition. As we have already seen, some arbitral tribunals already structure their awards with this in mind.[247] Were the enforcing jurisdiction a Group A or B country, the adjudicator might award simple interest under Article 78 with additional compensation under Article 74 for proven losses beyond that rate. Were it a Group C country, the adjudicator might opt to only award compensation under Article 74.

[247] See above Part V(D)(3) for a discussion of the cases.

This flexible approach admittedly stands on less conceptually solid ground than the earlier suggestion. It bends the uniformity of the single rule regarding interest rates further still. The adjudicator in these situations is not precluded from rendering an award pursuant to the Opinion No. 14 approach yet is permitted flexibility to follow the alternative compensatory course. On the other hand, it seeks to fulfil the compensatory function of interest in a manner less likely to fall foul of *sharia* in the enforcing jurisdiction. We now explore how these suggestions might operate in practice.

VII PRACTICAL OPERATION OF SUGGESTED INTERPRETATIONS

In combination with the interpretation in Opinion No. 14, the 'extension' and 'flexible' adaptations suggested above would help harmonise outcomes in the two situations not covered by the Advisory Council: that is, when a court located in a jurisdiction subject to Islamic law is seized of a case involving a contract governed by the CISG or enforcement of an award which includes interest under the CISG. We consider the effect of these interpretations within Group A, B and C countries below. However, it is important to first recall how the status of the forum jurisdiction as either a CISG or non-CISG contracting state affects outcomes.

(A) Fora in CISG and Non-CISG Muslim-Majority States

If the jurisdiction of the forum has not acceded to the CISG, the court retains discretion to deny enforcement due to *gharar* or *riba*. It may find the contract invalid or void or decline enforcement of a foreign arbitral award on public policy grounds including in jurisdictions which have acceded to the United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards ('New York Convention').[248] However, this discretion need not be exercised. Indeed, if it determines that no real conflict between the CISG and *sharia* exists, the forum may uphold the contract or award, despite not being bound to do so. Were the above suggestions adopted, a court subject to *sharia* could comfortably reach such a conclusion.

In contrast, a court in a Muslim-majority jurisdiction which has adopted the CISG must navigate the waters between *sharia* and the CISG. It cannot simply determine the matter on the basis of validity. Article 4 excises validity from the scope of the CISG, but only to the extent the CISG fails to address a matter,

[248] New York Convention, Article V(2)(b).

and Article 78 clearly does just that. A court in a contracting state is bound to uphold it, including the interest obligation.[249]

This alone might explain reticence towards CISG accession amongst Muslim-majority states. However, in our view, this reticence is not entirely justified. In Part V, we demonstrated that the practical application of *sharia* provides approaches which can now be reconciled with the suggested CISG interpretation in Part VI. The following considers each category of jurisdiction in light of those recommendations.

(B) Hypothetical Transaction

Consider a sale between a French party and Muslim-majority state party, where parties have selected French law without agreeing to exclude the CISG.[250] Would a CISG interest obligation be imposed? And if so, how?

1) Court Located in Group A or B Country.

Courts located in Group A or B countries can award interest under Art. 78. As discussed in Part V(D), the hallmark of the prohibition against *riba* in these countries is that it does not apply to commercial transactions.[251] It follows that in Egypt, Kuwait, Syria, Iraq, Libya, Oman, the UAE, Bahrain, Yemen, and Morocco, the CISG and *sharia* are compatible on the question as to whether or not interest may be awarded. However, Opinion No. 14 demands courts apply the interest rate applicable in the creditor's place of business.[252] Where the creditor is from a Group

[249] Interestingly, Opinion No. 14 states that jurisdictions prohibiting interest (or compound interest) may refuse to enforce for invalidity an express agreement by parties on interest within Rule 8: see above footnote 242 and accompanying text. It does not specifically contemplate the position of a jurisdiction which both prohibits interest (or compound interest) and is a contracting state to the *CISG*.

[250] It might be suggested that parties could reduce the risks of falling foul of prohibitions against *riba* by modifying the *CISG* to remove the application of Article 78 by agreement, or by opting out of the *CISG* altogether: see CISG, Article 6. However, neither solution would preclude imposition of interest obligations from (non-*CISG*) domestic law, unless parties carefully select a domestic law which accords with their preferred articulation of *sharia*: see T. S. Twibell, "Implementation of the United Nations Convention on Contracts for the International Sale of Goods (CISG) under Shari'a (Islamic Law): Will Article 78 of the CISG Be Enforced when the Forum Is in an Islamic State?", *International Legal Perspectives*, Vol. 9, No. 1–2, 1997, 25, 80–81.

[251] See above Parts V(D)(1)–(2).

[252] The interest rate is that which a court in the creditor's place of business would grant in a similar contract: Opinion No. 14, 2.

A or B country, this does not create a problem, since the simple interest rate applicable in the creditor's home country will apply.

However, if the creditor is French, the single rule in Opinion No. 14 leads to the French rate,[253] which might be, for example, 5.3% compounded annually.[254] Opinion No. 14 leads to that compound interest becoming due,[255] although forbidden within Group A and B nations. Opinion No. 14 does not address this conflict between the CISG and *sharia*, because it permits Article 74 compensation only where the creditor's interest rate is zero or inadequately compensates loss. The suggested 'extension' of Opinion No. 14 resolves the dilemma.[256] It accepts the forum law's prohibition on compound interest as justification for the Group A or B court to instead award limited Article 78 simple interest up to any maximum rate within the forum's jurisdiction.[257] Awards of interest under Article 78 have the advantage of compensating lost money value without proof of loss.[258] Where actual losses exceed Article 78 simple interest, further compensation may lie under Article 74,[259] in accordance with Opinion No. 14 and the concept of *ta'widh*, provided requirements of proof of loss, foreseeability, and mitigation are met.[260] This CISG interpretation is entirely compatible with the interpretation of *sharia* in Group A and B forum states. Obviously the 'extension' interpretation empowers Group A or B courts in CISG states to easily navigate the CISG waters in a *sharia*-compliant manner.

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[253] The interest rate which a court in France would award in relation to a similar non-*CISG* contract is hereinafter referred to as 'the French rate' for convenience.

[254] For the sake of argument, it has been assumed that a compounding rate would be awarded. However, while French courts can award compound interest, they may choose to award simple rates, which could be compatible in Group A and B countries but would be problematic in Group C countries: see French Civil Code, Article 1343-2; *Code de commerce* [Commercial Code] (France) Article L441-10; J. Y. Gotanda, "Compound Interest in International Disputes", *Law and Policy in International Business,* Vol. 34, No. 2, 2003, 393, 404–405. See also Directorate of Legal and Administrative Information (Prime Minister), Calculation of Legal Interest, *République française, https://www.service-public.fr/particuliers/vosdroits/F783?lang=en*, 20. 10. 2023.

[255] Opinion No. 14, 2.

[256] See above Part VI(D)(1).

[257] See above Part V(D).

[258] Opinion No. 14, 2 [3.20].

[259] Opinion No. 14, 2.

[260] Opinion No. 14, 24 [3.52]. See generally at 16 [3.30], 20 [3.40], [3.45]. The question arises whether a court located in a Group A or B country would permit a claim for the equivalent of compound interest as a loss pursuant to art 74 of the *CISG*. A party might seek to prove their losses included a compounding rate on a loan that was necessary in lieu of the missing payment. How a court in Egypt – a *CISG* state – deals with this dilemma will be of great interest.

This is important because some have acceded to the CISG. Thus, Egyptian, Iraqi, and Bahraini courts are bound to apply its provisions.[261]

Yet, the same approach may be taken (albeit at their discretion) by courts in jurisdictions that have not adopted the CISG. Thus, a UAE court would not be bound to apply the CISG, but it could, pursuant to its own conflict of law rules, uphold the choice of French law and apply the CISG in exactly the same manner as suggested above, completely in alignment with its own jurisdiction's interpretation of *sharia*. Thus, the suggested interpretative 'extension' of the Opinion No. 14 rule promotes greater certainty for contracting parties in international trade with the Muslim world.

2) Debtor Located in Group A or B Country.

Let us now consider what would happen were the matter heard by a French court and an Iraqi party were the creditor. This presents no problem under Opinion No. 14. The French court would award interest under CISG Article 78 pursuant to the Iraqi simple interest rate. However, if the Iraqi party were the debtor, a conflict quickly arises under the unmodified Opinion No. 14 rule. A French court would be bound to apply Article 78, as part of domestic French law,[262] and would order the Iraqi debtor to pay interest at the French rate, which might be a compounding rate. Under the 'flexible' interpretation suggested above,[263] a French court, mindful that enforcement would be within Iraq,[264] might instead tailor orders to be *sharia*-compliant: that is, a simple interest rate pursuant to Article 78 within the bounds of the Iraqi maximum rate of 7%,[265] with additional compensation under Article 74 for proven further losses.[266] For example, it might award a lump sum reflecting inflation rates beyond the simple interest, which would be acceptable in Iraq as equivalent to *ta'widh*.

Whilst the suggested adaptations may slightly reduce uniformity in application of the CISG compared with an unmodified application of the rule in Opinion

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[261] H. El-Saghir, op. cit., 510–511. El-Saghir observes Egypt has not applied the *CISG* in an autonomous way, but instead Egyptian law is applied in parallel with the *CISG* or the *CISG* is ignored altogether.

[262] Lisa Spagnolo, "*Iura* No*vit Curia* and the CISG: Resolution of the Faux Procedural Black Hole", *Towards Uniformity: The 2nd Annual MAA Schlechtriem CISG Conference* (Eds. Ingeborg Schwenzer, Lisa Spagnolo), Eleven International Publishing, 2011, 181, 195–196.

[263] See above Part VI(D)(2).

[264] It is beyond the scope of this article to comment upon the obvious difficulties of enforcement of foreign judgments.

[265] See above footnote 166.

[266] See above footnotes 259–260 and accompanying text.

No. 14, this must be weighed against the significant advantages which flow from their adoption. The extended and flexible interpretations result in the CISG being applied in an effectively uniform manner across CISG and non-CISG states, ensure its interpretation is compatible with *sharia* in all Group A and B countries, and provide a path for CISG accession in *sharia*-compliant jurisdictions (as discussed below in Part VIII).

3) Debtor Located in Group C Country.

Let us once again place the matter before a French court, with the Muslim-majority party being from Saudi Arabia. Where the Saudi party is the creditor, Opinion No. 14 leads to a *sharia*-compatible outcome for Group C countries. The French court would not award any interest under Article 78 since the Saudi rate is 0%. Nonetheless, compensation for proven losses could be awarded under Article 74 consistent with *ta'widh* concepts considered valid within the enforcement jurisdiction. If the Saudi party were the debtor, a French court following Opinion No. 14 without modification would apply the French interest rate.[267] This would be unacceptable within the enforcement jurisdiction of Saudi Arabia. However, if the French court adopted the suggested 'flexible' interpretation,[268] it would not apply Article 78 in situations where enforcement is likely in a Group C country. Existence of public policy prohibitions in the enforcement jurisdiction would permit the court flexibility to instead order compensation for proven losses due to late payment entirely within Article 74. This ensures the compensatory function is still fulfilled by only awarding compensation in a manner which aligns with permitted *ta'widh* for Group C countries, such as a lump sum reflecting inflation rates.

A deeper understanding of the practical operation of *sharia* and a more sensitive interpretation of the CISG could thus bring about a compatible interpretation that maximises potential enforceability of awards.[269]

4) Courts Located in Group C Country.

If the hypothetical dispute were brought before a Saudi court, it would not be bound to apply the CISG, because it is not located in a contracting state. Thus, Saudi courts have discretion not to apply the CISG if considered contrary to Saudi law.

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[267] The 'French rate' could in reality be a simple interest rate: see footnote 254 above. However, this would still fall foul of the prohibition in Group C nations: see above Part V(D)(3).

[268] See above Part VI(D)(2).

[269] Which explains why such approaches have been adopted by some tribunals: see above Part V(D)(3).

If the creditor were Saudi, the interest rate would be 0%, and the alternative Article 74 compensation path under Opinion No. 14 would open, allowing an award consistent with accepted concepts of *ta'widh*.[270] Even though the Saudi court is not bound to apply the CISG, it may do so in a *sharia*-compliant way.

If the creditor were French, it would be impossible for a Saudi court to apply Opinion No. 14 without modification. It would naturally decline to award French rates of interest pursuant to Article 78 as a violation of *sharia* as interpreted in Saudi Arabia. Opinion No. 14 offers no viable options since the alternative Article 74 compensation route only opens where the creditor's interest rate is zero or inadequate to compensate for loss; clearly, the French rate does not fulfil these criteria.[271]

However, a Saudi court could adopt the interpretive 'extension' suggested above to render a *sharia*-compliant award.[272] Due to the prohibition within the forum's law against awarding any interest whatsoever, the extension would merely open the door to Article 74 compensation for the Saudi court. It could therefore order lump sum compensation for delayed payment under CISG Article 74 in a manner aligned to local interpretation of *ta'widh*, such as a lump sum for proven losses due to inflation. This would accord with *sharia* as implemented in all Group C countries.

The same position could be taken by Qatari and Iranian courts. Whilst an Iranian court might actually be willing to impose Article 78 interest obligations upon a French debtor (as discussed in Part V(D)), the 'extension' of Article 74 compensation as an adaptation of Opinion No. 14 is still preferable as a less discriminatory pathway, thereby providing greater consistency between arbitral and court decisions.

In our view, even in the most challenging situation of a Group C non-CISG contracting state court, the *sharia* and CISG can be reconciled with only slight adaptations to Opinion No. 14. At the time of writing, no Group C nation has acceded to the CISG. However, as we have shown, courts in these countries can still apply the CISG to award Article 74 compensation in accordance with *sharia* in Group C countries.[273] Reconciliation of the *sharia* and CISG is desirable to promote fairness and importantly, commercial predictability. As discussed below, it could also encourage greater CISG accession to further enhance international trade.

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[270] See above Part V(D)(3) for discussions regarding issues with the clarity of Saudi law.

[271] Of course, as a forum in a non-contracting state, the Saudi court need not first conclude, as was suggested by the Advisory Council, that a 0% interest rate would apply under the creditor's law before applying the alternative compensation approach: Opinion No. 14, 21 [3.43].

[272] See above Part VI(D)(1).

[273] See above Part V(D)(3).

5) Arbitral Tribunals.

Arbitrators are not bound by the CISG or state private international law principles,[274] unless parties have agreed on the CISG or law of a contracting state as the governing law of the contract. Absent agreement between parties, tribunals may apply the CISG pursuant to conflict of laws, supported by Article 28(2) of the UNCITRAL Model Law on International Commercial Arbitration ('UNCITRAL Model Law')[275] or similar provisions.[276]

Arbitral awards are more likely to be enforceable than court judgments within foreign jurisdictions, due to wide adoption of the New York Convention.[277] Ratifying and/or signatory countries include Algeria, Bahrain, Djibouti, Egypt, Iran, Jordan, Kuwait, Lebanon, Malaysia, Mauritania, Morocco, Oman, Palestine, Qatar, Saudi Arabia, Syria, Tunisia and the UAE.[278] Yet as seen in Part V(D)(2), many tribunals have historically declined interest awards in deference to *sharia*.

The above interpretations adapt the Opinion No. 14 rule to render the CISG compatible with *sharia*. We suggest that arbitral tribunals adopt the 'flexible' interpretation,[279] so that awards are appropriately sensitive to *sharia*, thus avoiding enforcement issues. Thus, where the CISG is applicable but the party against whom enforcement will be sought is located within a Group A, B or C nation, the tribunal, whilst not bound to do so, would be wise to adopt the suggested flexible extension of the rule in Opinion No. 14. Were enforcement likely within a Group A or B country, this would mean ordering interest at a simple interest rate pursuant to Article 78 within the bounds of the maximum allowable rate within that country, with additional lump sum compensation under Article 74 only for proven further losses in a manner aligned with acceptable *ta'widh* in that country. Were enforcement likely in a Group C country, the flexible interpretive extension of Opinion No. 14 would lead to the tribunal refraining from ordering any Article 78 interest,

[274] L. Spagnolo, op. cit., 199–200; André Janssen, Matthias Spilker, "The CISG and International Arbitration", *International Sales Law: A Global Challenge* (Ed. Larry A DiMatteo), Cambridge University Press, 2014, 135, 140.

[275] UNCITRAL Model Law, Article 28(2).

[276] See, e.g., LCIA Arbitration Rules Article 22.3; International Chamber of Commerce, Arbitration Rules (Rules, 1 January 2021) Article 21, which stipulate that if the parties have not agreed on the law governing the merits of the dispute, the arbitral tribunal may apply the laws or rules of law that it considers appropriate. See generally L. Spagnolo, op. cit., 200–201; A. Janssen, M. Spilker, op. cit., 140.

[277] New York Convention.

[278] New York Convention, Contracting States.

[279] See above Part VI(D)(2).

and instead awarding compensation only for proven losses within Article 74 to the extent permitted by *ta'widh* within that country.

VIII IMPLICATIONS FOR ACCESSION

A more realistic re-evaluation of the feasibility of accession to the CISG for *sharia*-observant nations is now possible. Rather than a generalised evaluation that assumes *sharia* and the CISG must always collide, or are compatible on a conceptual level alone, a more nuanced approach can consider viability of accession in light of (a) the practical implementation of *sharia* in particular jurisdictions, and (b) viable interpretations of the CISG that are compatible with *sharia*.

Could the above interpretations, which demonstrate compatibility between *sharia* and the CISG, lead more Muslim-majority countries to accede to the CISG? Can such jurisdictions accede without fear of violation of their own mandatory prohibitions on interest?

As we have seen, the main ramification of accession is that courts within the acceding jurisdiction would become bound to apply it whenever conditions for its application are met. Indeed, this is already true in some Group A and B countries, such as Egypt, Iraq, and Bahrain, which have already acceded. Courts in jurisdictions which have not acceded currently retain discretion to decline to award Article 78 interest. Unlike the UNCITRAL Model Law, adopted by the new 2012 Saudi Law of Arbitration and by the UAE,[280] the CISG is a convention, with no reservation available to opt out of Article 78.

The natural concern is conflict with the *sharia*. However, we have demonstrated that this need not be so. Compatibility with the CISG is possible. Indeed, in light of a detailed examination of how *sharia* is applied in practice, only slight adaptations to the approach in Opinion No. 14 are required to achieve this, and these are only required in instances where the single uniform rule leading to the application of the creditor's rate conflicts with the mandatory forum law.

In Group A and B countries, compound interest is forbidden, but simple interest is permitted in commercial transactions. In Part VII(B)(1) we explained that an 'extension' of Opinion No. 14's interpretation could apply whenever the forum's law mandatorily prohibits compound interest, enabling the court to instead award

[280] The UAE acceded to the New York Convention in 2006 and adopted the UNCITRAL Model Law in 2018. The UNCITRAL Model Law was adopted as the Law of Arbitration (Saudi Arabia) Royal Decree No. M/34, 16 April 2012 and Saudi Arabia acceded to the New York Convention in 1994 subject to a declaration restricting its applicability to awards made in contracting states.

simple interest under Article 78, and additional compensation under Article 74 where simple interest is insufficient to compensate for proven losses.

In Part VII(B)(4) we proposed that the same 'extension' to Opinion No. 14 would arise in Group C countries where any form of interest is mandatorily prohibited by the forum's law and would allow a court to order Article 74 compensation for proven losses due to late payment rather than Article 78 interest.

These solutions render *sharia* and the CISG compatible in a way that encourages accession without fear of violation of *sharia*. If embraced, we contend that there is no reason to believe that countries in Group A, B or C could not comfortably reconcile their interpretations of *sharia* with accession to the CISG to facilitate legal frameworks that further support foreign trade and investment in their jurisdictions.

One further point regarding accession: at the time of drafting, Islamic views were not given sufficient weight. It is now more important than ever that more Muslim voices be counted in shaping the future of the CISG. By joining, Muslim-majority state courts will be amongst the global community whose decisions report on the CISG, sometimes called the '*jurisconsultorium*', to which all courts should refer when interpreting the Convention.[281]

Moreover, whether Group A, B or C nations accede or not, courts in non-Islamic CISG contracting state courts may continue to order businesses from Muslim-majority countries to pay interest (including compound interest) pursuant to Article 78. Remaining outside the CISG will not alter this.[282] Conversely, addition of more Muslim voices within the CISG 'family' will bring to bear *sharia*-sensitive interpretations of the CISG such as those advanced above.

IX CONCLUSION

Lack of accession by 81%[283] of Muslim-majority states to the CISG is a cause for concern. The main obstacle to accession is the perceived incompatibility of the CISG and *sharia* in relation to interest. However, those perceptions are based on a generalised view of both the CISG and *sharia*, which does not necessarily ring true when a more detailed examination is undertaken.

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[281] Camilla Baasch Andersen, "The Uniform International Sales Law and the Global Jurisconsultorium", *Journal of Law and Commerce,* Vol. 24, No, 2, 2005, 159.

[282] In the hypothetical scenario referred to earlier in Part VII(B), a French court might apply the CISG by virtue of Article 1(1)(a) rather than Article 1(1)(b) were Saudi Arabia to accede, but the outcome would be the same.

[283] See footnote 8 and text accompanying footnote 5.

True conflict between *sharia* and the CISG is far less likely than might be assumed. The survey of Muslim-majority states with legal systems which apply *sharia* law in this paper points to adoption of pragmatic solutions to Islamic prohibitions throughout jurisdictions across the Muslim world.

However, in recent years, Muslim-majority nations have increasingly embraced commercial law internationalisation and modernisation to attract and diversify international trade and investment. An important aspect of this has been increasing adoptions of United Nations Commission on International Trade Law ('UNCITRAL') uniform texts. These are attractive as they provide standardised modern global trading platforms. Recently there have been notable adoptions of the UNCITRAL Model Law and New York Convention,[284] and establishment of excellent international centres for dispute resolution, such as in the UAE, Malaysia and Qatar. The same reasoning should now prompt reconsideration of the possible adoption of the original UNCITRAL uniform text, the CISG, as a relatively modern sales law for international trade that is predictable, fair and uniform.

The suggestions in this paper are designed to promote a more flexible interpretation of the CISG that facilitates compatibility with *sharia* law. To achieve this, we have eschewed broad notions of prohibitions against *riba* to examine how *sharia* is actually implemented in practice within Muslim-majority states. It is this fine-grained analysis that enables *sharia* in its various forms to be reconciled with the CISG.

We have also recommended slight adaptations to the approach in Opinion No. 14 that would permit courts in jurisdictions with mandatory domestic prohibitions (either against imposition of interest or compound interest) options to award compensation under Article 74, without first requiring that the law of the creditor lead to a zero interest rate for Article 78, and would allow courts in jurisdictions which permit simple but not compound interest to fashion a combination of both simple interest and compliant compensation under Article 74. This slight 'extension' fulfils the compensatory function of interest in a manner sensitive to *sharia* law. We have also suggested tribunals, courts in non-CISG states, and CISG state courts in non-Muslim-majority jurisdictions consider 'flexible' approaches when enforcement in *sharia*-observant jurisdictions is likely. The flexible adaptation of the approach in Opinion No. 14 would similarly lead to compensatory outcomes acceptable within *sharia* law in the enforcement nation.

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[284] See footnote 278. Legislation based on the UNCITRAL Model Law has been adopted by the following Muslim-majority countries: Bahrain, Egypt, Iran, Malaysia, Oman, Qatar, Saudi Arabia, Tunisia, Turkey, United Arab Emirates. UNCITRAL Model Law on International Commercial Arbitration (1985), with Amendments as Adopted in 2006', United Nations Commission on International Trade Law, *https://uncitral.un.org/en/texts/arbitration/modellaw/commercial_arbitration/status?*, 20. 10. 2023.

We contend that it would be appropriate for courts and tribunals to adopt these more nuanced interpretations of the CISG in the circumstances indicated. The adaptations slightly deviate from formal uniform application of the CISG but do so in a manner which extends the logic of the Advisory Council's Opinion No. 14 to address gaps within it. They therefore retain the compensatory function of the interest obligation but adjust its operation to account for the practical interpretation of Islamic law within the Muslim-majority nations surveyed. The outcome achieved by the interpretative adaptations suggested is more predictable substantive uniformity in application of the CISG whenever it intersects with the Muslim world, as well as greater acceptability and enforcement of the CISG within it.

In turn, we argue that these approaches to CISG interpretation open a pathway to accession for more Muslim-majority states that might otherwise remain hesitant. Recognition that *sharia* and the CISG can be entirely compatible creates new opportunities for more Muslim contracting states, whose courts can then in turn influence future interpretations of the CISG throughout the world by contributing decisions through the shared international *jurisconsultorium*.[285]

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SUKOB INTERESA IZMEĐU ŠERIJATSKOG PRAVA I MEĐUNARODNE PRODAJE ROBE: JESU LI INTERESI BEČKE KONVENCIJE USKLAĐENI SA ISLAMSKIM ZAKONOM?

Rezime

Iako je obaveza plaćanja kamate široko prihvaćena, u zemljama u kojima je većinsko stanovništvo islamske veroispovesti koje poštuje šerijatsko pravo, ona obično nije dozvoljena. Stoga, imajući u vidu da čl. 78 Konvencije Ujedinjenih nacija o međunarodnoj prodaji robe (Bečka konvencija) predviđa obavezu plaćanja kamate, mnoge takve zemlje nisu bile voljne da postanu njene potpisnice. Ni Savetodavno telo za tumačenje Bečke konvencije nije se u celosti izjasnilo u pogledu ovog pitanja, pa dilema da li Bečku konvenciju to čini inkompatibilnom sa šerijatskim pravom ostaje nerešena. Ovaj članak nastoji da utvrdi da li su šerijat i Bečka konvencija po pitanju kamate ipak pomirljivi, ispitujući osnove islamskih zabrana *ribe* i *gharara*, i analizirajući različite pristupe zemalja

[285] C. Baasch Andersen, op. cit., 159.

sa većinskim stanovništvom islamske veroispovesti ovoj tematici. U radu se takođe detaljno razmatra tumačenje obaveze plaćanja kamate u okviru pravila same Bečke konvencije. Zaključak ove analize je da bi Bečka konvencija i šerijatsko pravo bez sumnje postali kompatibilni ukoliko bi se u Mišljenje broj 14 Savetodavnog tela za tumačenje Bečke konvencije unele odgovarajuće manje izmene, a pomenute zemlje bi, težeći da usvoje zakone koji pospešuju međunarodnu trgovinu, imale podsticaj za pridruživanje Bečkoj konvenciji.

Ključne reči: kamata, Bečka konvencija, šerijatsko pravo, usklađenost, međunarodna trgovina

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APPLICATION OF THE CISG TO INTERNATIONAL GOVERNMENT CONTRACTS FOR THE PROCUREMENT OF GOODS

Harmonization is one of the most sought goals in international transactions and one of the main purposes of international treaties and agreements dealing with international commerce. The United Nations Convention on Contracts for the International Sale of Goods of 1980 (CISG) can offer benefits to government procuring agencies in their international purchases. Conversely, some of its characteristics require the attention of state parties. International government purchases and sales are under the scope of the CISG. Procuring agencies must be aware of the CISG's potential benefits and special requirements. In international government purchases or sales in which the provisions of the CISG are not excluded or derogated, the parties will be subject to the effects of the CISG. This article is based on existing case law, current practice of certain national governments and international agencies, and on a joint interpretation of the CISG and international public procurement models. It aims to discuss the interaction between the CISG and public procurement regulations and to delve into the potential gains for government procuring entities in adopting the uniform contract regulation of the CISG to govern their international transactions with goods. It examines

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potential difficulties in public procurement proceedings when the CISG applies alongside domestic public procurement legislation.

Key words: *CISG, harmonization, international government purchases, public procurement regulations, uniform contract regulation*

INTRODUCTION

The United Nations Convention on the International Sale of Goods (CISG) originates from the efforts of UNCITRAL – United Nations Commission on International Trade Law. This UN Commission is generally charged with recording information and disseminating knowledge regarding the CISG.

It is interesting to realize that the same commission has developed an entirely separate body of rules and recommendations concerning government procurement. This takes the form of a model law, not a convention for a uniform law such as the CISG. The obvious difference is that, while the CISG becomes national uniform law when it is signed and ratified, the UNCITRAL Model Law on Public Procurement is only a reference for national legislators. Nonetheless, the model law is widely acknowledged as an important tool in shaping many countries' regulations of government purchases.[1]

Some states have gone beyond the mere use of the model law as guidance and have joined the Government Procurement Agreement (GPA) under the World Trade Organization (WTO) framework. This is an international convention that creates harmonized rules based on common principles of fairness and probity. It also ensures national treatment to foreign bidders from the other Parties. The GPA was revised in 2011 and the revision entered into force in April 2014. Prior to its future accession, each prospective new member is required to negotiate with all the others to define coverage and legislative harmonization.

Many governments also rely on funding from international financial agencies such as the IRDB – International Reconstruction and Development Bank (World Bank) or any of the other various similar institutions. While they make funding available, such institutions also ensure that the expenditure of such funds

[1] For several aspects of international public procurement, including the UNCITRAL Model Law and the GPAWTO, see Sue Arrowsmith, John Linarelli Jr., Don Wallace, *Regulating Public Procurement. National and International Perspectives*, Kluwer Law International, 2000; Sue Arrowsmith, Martin Trybus, *Public Procurement: The Continuing Revolution*, Kluwer Law International, 2003; Peter Trepte, *Regulating Procurement*, Oxford University Press, 2004. On the changes introduced in the 2011 version of the Model Law see Caroline Nicholas, *The 2011 UNCITRAL Model Law on Public Procurement*, UNCITRAL Secretariat, 2012, 21 P.P.L.R., NA111.

by the recipient government does not discriminate against nationals of other member states. This is achieved through the mandatory application in many cases of certain guidelines issued by the financial agencies themselves.

International government procurement has therefore been the subject of attention by governments, international organizations, and potential suppliers in a variety of forms and angles. The most attention is directed to the harmonization of rules and the avoidance of nationality-based discrimination. The purposes are to ensure access to a global marketplace and give international suppliers a minimum level of foreseeability in the applicable rules.

The CISG has similar purposes from a contractual standpoint. It aims to provide legal uniformity as an instrument to facilitate and foster international commercial transactions. It is somewhat surprising that such international instruments or institutions do not explicitly adopt more often (or rather hardly ever adopt) the CISG as a tool for international harmonization.[2] Some of the reasons for this omission are discussed below.

This article aims at examining certain effects of the CISG on government contracts. It also intends to shed light on the potential benefits of the CISG and to discuss the rights of individual suppliers when the CISG is affirmatively adopted or not effectively excluded or derogated in international government purchases.

SPHERE OF APPLICATION

Articles 1 to 3 CISG generally define the Convention's sphere of application. Article 1(1) provides that "[*t*]his Convention applies to contracts of sale between parties whose places of business are in different States" when both states are CISG contracting states or when the conflict of law rules lead to the application of the laws of a contracting state. International treaty law determines whether a certain country is a contracting state under the CISG. In accordance with Article 99(2) CISG, the Convention enters into force with regard to any state "on the first day of the month following the expiration of twelve months after the date of the deposit of its instrument of ratification, acceptance, approval or accession". Therefore, all the discussion in this article relates to the possible application of the CISG only

[2] See UNCITRAL, Guide to Enactment of the UNCITRAL Model Law on Public Procurement, 61-62, *https://uncitral.un.org/sites/uncitral.un.org/files/media-documents/uncitral/en/guide-enactment-model-law-public-procurement-e.pdf*, 20.10.2023. The commentary to Article 3 of the Model Law does not yet address the CISG as a possible international commitment with impact on public procurement.

when a given contract falls under the sphere of application arising from Articles 1 to 3 CISG. If, for instance, one of the countries involved in the relevant contract is not a CISG contracting state and the CISG is not applicable under its Article 1(b), either because the applicable law is that of the non-contracting state or the other country is also not a contracting state, domestic law or other international instruments will apply, and the discussion in this article will be irrelevant.

Article 1(3) complements the provisions regarding the sphere of application and commands that "[…] nor the civil or commercial character of the parties or of the contract is to be taken into consideration in determining the application of this Convention". The exclusions in Article 2 and the clarifications in Article 3 further define the scope of application of the CISG.

The provision concerning the irrelevance of the civil or commercial character of the parties, or the contract is especially interpreted to mean that the CISG governs any international sales – or, conversely, purchases – of goods, regardless of the nature of the parties or the contract. Government entities are active in international sales, mostly as buyers but potentially also as sellers.[3] Therefore, the CISG sphere of application comprises contracts concluded by national governments at central or sub-central levels. It also comprises contracts subject to either private or public law in states that acknowledge such distinction.[4]

GOVERNMENT PURCHASES AND THE CISG

Applicability of the CISG to Government Purchases

The international interpretation of the CISG assumes generally that the CISG is fully applicable to contracts to which states are parties. This encompasses government departments or agencies, such as those responsible for defense purchases, and any type of government-owned or government-controlled corporations found in many jurisdictions. The state entity can be a purchaser or a seller; oil and gas contracts can often involve government entities as sellers, for instance.

Some of the main international commentators of the CISG have examined this topic and are in favor of the potential application of the CISG to government

[3] In many countries, government entities may be involved in the international supply of goods, especially commodities such as metals or oil and gas. The commercial or administrative nature of such transactions is a matter governed by domestic law. However, they all fall under the general scope of application of the CISG.

[4] In the CLOUT Case No. 1824, the Swiss Federal Supreme Court applied the CISG to a contract entered into by a Swiss state-owned entity.

contracts.[5] Ulrich Schroeter advances a persuasive explanation regarding the context of international purchases in which a supplier is selected through a tender process:

> "The CISG furthermore also applies to international sales contracts concluded with a seller which has been selected by way of a call for tender (invitation to tender, call for bids). This form of contract initiation is frequently employed for purchases by private companies but, occurs particularly often in cases in which the buyer is either a government authority (public procurement) or a private company acting in order to fulfill a contract with a government. Domestic laws which govern call for tender often impose certain rules designed to guarantee the fair selection of the successful tenderer (e.g., principle of non-discrimination, preference for the tender which offers the lowest price or is the 'economically most advantageous'). Within the EU, such rules are often based on EU Procurement Directives, which seek to protect foreign tenders (sellers).
>
> Since domestic laws in this field primarily aim at regulating the phase leading up to the selection of the successful tenderer, the contract can subsequently be concluded in accordance with arts 14–24 without resulting in any conflict between the two sets of rules. The tenders accordingly constitute offers under art. 14(1), among which the successful tender is accepted by way of the award decision which at the same time constitutes the acceptance under art.18(1). Domestic provisions declaring null and void such contracts which have been concluded in violation of public procurement information duties or time periods can be applied to CISG contracts by virtue of art. 4, sentence 2(a).

[5] Peter Schlechtriem, "Unification of the Law for the International Sale of Goods", *German National Reports (Private Law and Civil Procedure) XIIth International Congress of Comparative Law*, Nomos, Baden-Baden, 1987, 126-127; Ingeborg Schwenzer, "Introduction", *Commentary on the UN convention on the international sale of goods (CISG)* (Eds. I. Schwenzer, U. Schroeter), 5th Edition, Oxford University Press, Oxford, 2022, 8 ("Classifying a public body's procurement contracts as 'matters subject to public law' could curtail or exclude the application of the CISG or its individual rules almost at will"); John O. Honnold, Harry M. Flechtner, *Uniform Law for International Sales Under the 1980 United Nations Convention*, 4th Edition, Wolters Kluwer, London, 2009, 180-183; Jacob Ziegel, "The Scope of the Convention: Reaching out to Article One and Beyond, *Journal of Law and Commerce*", Vol. 25, 2005/2006, 59-73; Ulrich Schroeter. "Grenzfragen des Anwendungsbereichs und international einheitliche Auslegung des UN-Kaufrechts (CISG): Zugleich Anmerkung zu Appellationsgericht Basel-Stadt vom 24.8.2018 – ZB.2017.20 (AG.2018.557)", *Internationales Handelsrecht (IHR)*, 2019, 135–136; Daan Willems, "Application of the CISG to Contracts with Public Authorities", *EU and Private Law*: *Trending Topics in Contracts, Successions, and Civil Liability* (Eds. B. Heiderhoff, I. Queirolo), Editoriale Scientifica, Napoli, 2023, 170.

> If, on the contrary, the domestic law on (public or private) calls for tender provides for remedies which are incompatible with the Convention's rules – as, e.g., claims for damages for failure to enter into a contract in situations in which the offer was freely revocable under the CISG – such remedies are pre-empted by the Convention."[6]

These remarks explain in part why one cannot find internationally a large number of cases applying or discussing the CISG in matters involving government entities.[7] In many national laws, unlike in most Latin American countries[8] and in the United States, the specific regulation of government procurement focuses only on the selection of the contractor, not on the formation of the contract or the subsequent contract administration or performance (rights and obligations of the parties). This restriction is also true in multinational systems such as the EU Directives, the UNCITRAL Model Law and the GPA/WTO. In addition, larger or more complex purchases are often made through local vendors or with suppliers with places of business in the country of the purchasing government. In Brazil, to use this country as an example, to supply goods under a contract that requires substantial local activities in Brazil – such as assembly, commissioning, and post-sale support – a foreign company must be previously "authorized to operate in Brazil" (Article 1134 of the Brazilian Civil Code). This may eliminate the international character of the sale and make the CISG inapplicable unless (a) the vendor is able to obtain such authorization regardless of not having a local

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[6] Ulrich Schroeter, "Introduction to Articles 14–24 CISG: General Questions Regarding the Formation of the Contract" *Commentary on the UN Convention on the International Sale of Goods (CISG)*, 5th Edition, Oxford University Press, Oxford, 2022, 294-295.

[7] Regarding this topic under Brazilian law, see Cesar Pereira, "Aplicação da CISG a licitações e contratos administrativos de compra internacional de mercadorias", *CISG, Brasil e Portugal* (Eds. I. Schwenzer, P. Costa e Silva, C. Pereira), Almedina, São Paulo, 2022, 137-160; Flavia Faermann, *Estudo sobre a CISG e seus reflexos na ordem interna*, LL.M. Federal University of Rio Grande do Sul, Faculty of Law, Supervisor: Vera Maria Jacob de Fradera, Porto Alegre, 2018; Melina Kurcgant, "Os contratos administrativos e a Convenção de Viena sobre venda e compra internacional de mercadorias", *Fórum de Contratação e Gestão Pública,* Belo Horizonte, Vol. 13, No. 152, 2014, 54–64.

[8] For Brazil as a reference for similar regulations in Latin America, see Marçal Justen Filho, Cesar Pereira, *Infrastructure Law of Brazil*, 3rd Edition, Forum, Belo Horizonte, 2012; For the US government procurement regulation concerning contract formation and administration, see John Cibinic Jr., Ralph C. Nash, James F. Nagle, *Administration of Government Contracts*, 4th Edition, Wolters Kluwer, London, 2006; John Cibinic, Jr., Ralph C. Nash, Cristopher R. Yukins, *Formation of Government Contracts*, 4th Edition, Wolters Kluwer, London, 2011; Steven W. Feldman, *Government Contract Guidebook*, 4th Edition, Thomson Reuters Westlaw, 2013; W. Noel Keyes, *Government Contracts under the Federal Acquisition Regulation*, 3rd Edition, Thomson West, 2003.

basis (place of business) in Brazil or (b) the seller's relevant place of business, as defined by Article 10(a) CISG, is outside Brazil.

The acknowledgment that government contracts are in the sphere of application of the CISG is just a starting point for understanding the problems regarding international government purchases. The CISG is primarily a body of dispositive rules, which can be excluded or derogated by the will of the parties and applied only in the absence of contrary agreement, with only a few exceptions. Nonetheless, this acknowledgment is an essential element to ensure clarity regarding the rules governing such transactions, especially in view of the CISG rules of which the parties cannot voluntarily contract out of or around.

There are significantly fewer reported court and arbitral decisions dealing with government contracts and the CISG than the economic significance of such marketplaces would suggest. International experts estimate a country's government procurement market at around 10–15 per cent of the country's GNP (Gross National Product). Many of the world's largest economies take part in the GPA/WTO, which among other things ensures access to a substantial portion of each country's government procurement marketplace. In addition, in many large economies such as China and certain countries in Latin America and the Middle East a significant part of the economy's transactions involves government-controlled companies subject to government procurement regulations. There is a constant interplay between government procurement rules and the law governing international transactions, namely the CISG.

Government Purchases under Article 2 CISG

Government contracts are also not excluded by Article 2 CISG. Article 2(b) CISG excludes sales made through "auctions". In many countries, such as in Brazil, reverse auctions or procurement auctions are one of the most used procurement methods. In addition, government agencies often sell in auctions goods that are no longer in use or that have been apprehended in criminal actions. One could object to the applicability of the CISG by assuming that no sale or purchase made through an auction of any kind would be covered by the Convention. However, this argument has been examined and rejected by commentators given the limited purpose of the Article 2(b) CISG exclusion.[9] The same goes for framework agreements or

[9] Pascal Hachem comments on Article 2(b) CISG and explains that "[…] a contract 'awarded' to the highest bidder in a public (international) procurement bid can very well be governed by the CISG"; Pascal Hachem, *Commentary on the UN Convention on the International Sale of Goods (CISG)* (Eds. I. Schwenzer, U. Schroeter), 5th Edition, Oxford University Press, Oxford, 68.

IQID (indefinite quantity, indefinite delivery) contracts: they are covered by the CISG when governments are involved in the same way and with the same restrictions as when the parties are private.

Article 2(a) CISG exclusion does not extend to international purchases made by governments. Although a government entity will not ordinarily purchase the goods for resale or as inputs for industrial activities, it does not generally meet the requirements for treatment as a consumer (purchaser for personal, family or household use) under the CISG.[10] In addition, the exclusion of Article 2(a) CISG is not dependent on the concept of consumer transactions given by each country's own domestic consumer law.[11] Even if a government entity can be protected as a consumer under its own law and for certain specific purposes,[12] it does not follow that its international purchases or sales will be excluded as consumer transactions under Article 2(a) CISG.[13]

Current Standpoint: International Case Law and Practice

The existing international case law often upholds the premise that government contracts are generally within the CISG's sphere of application. The Hilaturas Case, which was resolved in 2008, stands out in this regard.[14] It dealt with the supply

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In the same sense, Stefan Kröll, Loukas Mistelis, María del Pilar Perales Viscasillas. *UN Convention on Contracts for the International Sale of Goods*, 2nd Edition, C. H. Beck, Hart, Nomos, 2018, 47.

[10] See P. Hachem (2022), op. cit., 62-68.

[11] For the relationship between the CISG and domestic consumer law, see Ana Carolina Aguiar Beneti, "A Convenção de Viena sobre Compra e Venda Internacional de Mercadorias (CISG) e a questão do Direito do Consumidor", *CISG, Brasil e Portugal* (Eds. I. Schwenzer, P. Costa e Silva, C. Pereira), Almedina, São Paulo, 2022, 87-102.

[12] Marçal Justen Filho shows that government contracts are not covered by consumer protection law, only by government procurement law and the provisions of the solicitation and the contract. Consumer law could only apply in exceptional circumstances of a purchase of goods or services directly in the marketplace (Marçal Justen Filho, *Comentários à Lei de Licitações e Contratações Administrativas*, 2nd Edition. RT Thomson Reuters, São Paulo, 2023, 994). The Brazilian Superior Court of Justice ruled in 2010 that consumer law is not generally applicable to government contracts. It will only apply in exceptional circumstances when the government entity is the weaker party in the contract due to specific circumstances of the contract at hand (STJ, RMS 31.073, Rel. Min. Eliana Calmon, Ruled on August 26, 2010).

[13] For the CISG prevalence over domestic consumer protection law, see P. Hachem, op. cit., 66-67.

[14] *Hilaturas Miel, S.L. v. Republic of Iraq*, 573 F. Supp. 2d 781 (S.D.N.Y. 2008), CISG-online No. 1777. The case is also reported by U. Schroeter, op. cit., 294, fn. 401.

of goods to the Iraqi government by a Spanish supplier under the Oil for Food program. The case was ruled in favor of the Iraqi government with grounds on the CISG. Another similar case is ETECSA (Empresas de Telecomunicaciones de Cuba S.A.), involving the purchase by a Cuban mixed-capital company – controlled and partly owned by the government – of cell phones supplied by a South-African vendor. The case was heard by Sala de lo Económico del Tribunal Supremo Popular in Havana, Cuba, on June 16, 2008.[15] A third case discussing the CISG involving government entities is *Agropodderzhka Trade House LLC v. Sozh State Farm Complex*, heard by the Economic Court of the Gomel Region of Belarus on March 6, 2003.[16]

Other cases often mentioned by scholars illustrate ordinary situations involving international government transactions and their relationship with the CISG. In the Russian submarine case, the Russian government sold a decommissioned submarine to a foreign party as scrap material. The decision applied the exclusion of Article 2(e) CISG to conclude that the sale of a ship or vessel was not covered by the CISG, and that the good at issue was still a ship even if considered inactive by the seller.[17] In a case in which the state of Slovenia purchased weapons from an Austrian supplier, a private local Slovenian company intermediated the transaction, but the negotiations were conducted by the then recently formed government (in 1993).[18] The Diversitel case dealt with a subcontract for the purpose of finally supplying certain pieces of equipment to the Canada Department of Defense. The delay in performance by a vendor located in California was considered a fundamental breach because it prevented the Canadian buyer Diversitel from timely performing its supply contract with the Canadian government.[19]

In 2019, the Swiss Federal Supreme Court held that the CISG was applicable to a contract between a Swiss state-owned company and a Slovenian supplier subsidiary in Switzerland.[20]

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[15] Cuba – Jurisprudencia, *http://www.cisgspanish.com/seccion/jurisprudencia/cuba/*, 20.10.2023.

[16] CLOUT Case No. 496.

[17] Russia, 18 December 1998, Maritime Commission Arbitration proceeding 1/1998.

[18] Austria, 24 February 1999, Appellate Court Graz (Military Weapons Case).

[19] Ontario Supreme Court of Justice, *Diversitel Communications Inc. v. Glacier Bay Inc*. This case is reported by U. Schroeter, op. cit., 295, fn. 402.

[20] CLOUT Case No. 1824 (Abstract by Ulrich Schroeter); CISG-online No. 4463. Commentary to the 2018 decision of the Swiss Court of Appeal Canton Basel-Stadt (CISG Case Number 3906) in the Electronic Electricity Meters Case, later confirmed by the Swiss Federal Supreme Court: Ulrich Schroeter, "Grenzfragen des Anwendungsbereichs und international einheitliche Auslegung des UN-Kaufrechts (CISG): Zugleich Anmerkung zu Appellationsgericht Basel-Stadt vom 24.8.2018 – ZB.2017.20 (AG.2018.557)", *Internationales Handelsrecht (IHR)*, 2019.

The Brazilian government frequently uses offices in the United States, usually in Washington, D.C. or in New York, for military purchases. The corresponding contracts provide for the application of the local law of the District of Columbia or New York, with the express exclusion of the CISG. Although the exclusion rules out the application of the CISG – and, for the reasons explained later in this text, it should be reviewed by the Brazilian government –, it is an important recognition that such international contracts are covered by the CISG, which only does not govern them in view of the exclusion allowed by Article 6 CISG.

The active role performed by state-owned entities in transactions related to the Covid-19 pandemic shed light to the possible applicability of the CISG to public procurement of goods. The EU-AstraZeneca contract for the purchase of vaccines in the European Union ("APA") is one prominent example.[21] The APA concluded in 2020 was governed by the laws of Belgium, a Contracting State to the CISG. When the European Union brought a claim relating to the APA before the Belgian courts, the Court of First Instance of Brussels merely stated that "[*t*]he agreements must be interpreted with regard to the common intention of the parties, in accordance with Article 1156 of the former Civil Code"[22], thus not resolving the question of the applicability of the CISG.[23]

At least one of the agreements signed by the Brazilian government concerning the international purchase of vaccines during the Covid-19 pandemic came to public knowledge upon its conclusion.[24] Its language revealed a choice of law clause that does not appear to exclude the CISG ("All disputes shall be governed by the Laws of the State of New York, USA, excluding, however, its conflict of law provisions other than Section 5-1401 of the Law New York General Obligation Bonds, except that any dispute regarding arbitrability or the scope and application of this Section shall be governed by the United States Federal Arbitration Act" – item 12.4 of the Agreement 52/2021).[25]

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[21] Advance Purchase Agreement (APA) for the Production, Purchase and Supply of a Covid-19 Vaccine in the European Union, *https://commission.europa.eu/system/files/2021-01/apa_astrazeneca.pdf*, 21.10.2023.

[22] *European Union v. AstraZeneca AB*, Court of First Instance of Brussels, Decided on 18 June 2021. Original in French: "Les conventions doivent être interpretées au regard de l'intention commune des parties, conformément à l'article 1156 de l'ancien Code Civil".

[23] The issue was addressed in scholarly writing: Ben Köhler, "Global sales law in a global pandemic: The CISG as the applicable law to the EU-AstraZeneca Advance Purchase Agreement?", *Conflict of Laws.net*, 2021.

[24] The agreements signed by the Brazilian government are listed and available in Portuguese, *https://www.gov.br/saude/pt-br/acesso-a-informacao/licitacoes-e-contratos/coronavirus*, 23.10.2023.

[25] Regarding the non-existence of exclusion of the CISG by reference to "New York State Laws", see New York Governing Law in US-Style Commercial Agreements. *https://www.jdsupra.com/legalnews/new-york-governing-law-in-us-style-22799/*, 23.10.2023, and Court Analyzes Application of

In a 2022 decision, the Supreme Court of New York applied the CISG to a public procurement of masks tendered in the early stages of the pandemic. The court held the CISG is a "self-executing" treaty and there was no clear intention to exclude the applicability of the CISG.[26]

Lastly, many governments and procuring agencies already acknowledge the application and relevance of the CISG in government purchases. In a classic work on the US Federal Acquisitions Regulation (FAR), W.N. Keyes discusses the CISG as part of the rules applicable to international purchases ("international acquisitions" in the book's terminology).[27] In 2005, G. Bell reported that the Singapore government had started to define the CISG as applicable law in its international contracts.[28] In an unpublished paper dated 2013, Hanson mentions the New Zealand practice, which takes into consideration the manual prepared for the New Zealand government as guidance for foreign bidders. The material expressly mentioned the CISG as part of the system of rules governing such purchases, and the New Zealand government included the reference in an explanation of rules relating to international tender procedures. The provision was removed in a later version of the handbook, which alluded instead to the "common law of contracts"[29] – thus including the CISG only implicitly. The World Bank standard tender rules for the purchase of goods recommended the adoption, as applicable law, of the purchasing country's law, without making reference to any exclusion of the CISG.[30] Therefore,

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UN Convention on Contracts for International Sale of Goods, *https://www.schlamstone.com/blogs/commercial/2015-10-28-court-analyzes-application-of-un-convention-on-contracts-for-international-sale-of-goods,* 23.10.2023.

[26] Matter of New York State Dept. of Health (Rusi Tech. Co., Ltd.). Supreme Court of New York [Trial Court]. Decided on January 25, 2022.

[27] W. Noel Keyes, *Government Contracts Under the Federal Acquisition Regulation*, West Group Publishing, 2003, 566–569.

[28] Gary Bell, "Why Singapore Should Withdraw its Reservation to the United Nations Convention on Contracts for the International Sale of Goods (CISG), *Singapore Year Book of International Law*, 2005, 55–73, fn. 36: "A happy exception is now found in the standard procurement contract terms of the Government of Singapore which, in most cases, no longer excludes the CISG. The standard choice of law clause now reads: 'This Contract shall be deemed to be made in Singapore and shall be subject to, governed by and interpreted in accordance with the Laws of the Republic of Singapore for every purpose'"; See Guide to Singapore Procurement, issued by the Government of Singapore, *https://www.gebiz.gov.sg/singapore-government-procurement-regime.html#guide-for-suppliers*, 20.10.2023.

[29] New Zealand Government Procurement, Principles, Charter and Rules, *https://www.procurement.govt.nz/procurement/principles-charter-and-rules*, 23.10.2023.

[30] World Bank, Policy & Procedure Framework, *https://policies.worldbank.org/en/policies/all/ppfdetail/a3656cb7-8847-417b-886f11fa0235216e*, 23.10.2023.

if the purchasing country is a CISG contracting state or if the applicable private international law leads to the application of the law of a contracting state (CISG, Article 1(a) and 1(b), respectively), the World Bank rules should lead to the application of the CISG unless the parties have agreed otherwise under Article 6 CISG.

This brief review of scholarly writings and case law leads to the conclusion that international purchases made by government entities are comprised in the CISG abstract sphere of application. This conclusion is a starting point for a detailed discussion of the many problems arising from the interplay between the CISG and the domestic and international regulation of government procurement.

The CISG is generally applicable to international sales regardless of whether government entities are involved. A *lex specialis* argument to favor domestic government procurement law over the CISG is not persuasive. If the government procurement law may be considered special because it deals with public sales whether domestic or international, the CISG is equally special because it deals with international sales whether public or private. The CISG prevails with regard to international sales because it is the outcome of an international treaty. The full application of the CISG, excluded or derogated only in accordance with its own Article 6, corresponds to a commitment made by each contracting state toward each and all the others.

APPLICATION OF THE CISG TO GOVERN ITS OWN EXCLUSION OR DEROGATION

In strict legal terms, the main and most immediate consequence of the conclusion that government contracts for the international purchase or sale of goods are within the CISG's sphere of application is that the CISG's secondary rules[31] (rules of structure or competence – the ones dealing with interpretation of contracts and construction of the parties' conduct) will always apply. These are the CISG rules that govern the Convention's own exclusion or derogation.

In most situations, the CISG allows the parties to agree on the exclusion or derogation of its provisions. Therefore, the CISG will only govern a certain transaction between a seller and a buyer if the parties have not effectively excluded its application. The CISG is the legal source of the validity and effectiveness of the parties' actions that exclude or derogate the CISG's own provisions. Such actions are interpreted within the framework of the CISG, including the principle of uniform

[31] The reference is to H. L. A. Hart. Hart's classification of rules in its Concept of Law: primary rules govern conduct; secondary rules govern the enactment, modification, interpretation, application, and enforcement of primary rules.

international application (Article 7 CISG). This guideline will require attention to international commentary and case law from the parties and the domestic decision-maker. Otherwise, domestic views concerning the power to exclude or derogate may undermine the application of uniform law and the CISG's international character. This concern is especially true in jurisdictions where government entities are considered to have certain extraordinary prerogatives in government contracts, in affiliation with the French notion of administrative contract (*marché public* and *contrat administratif*). The introduction of the CISG in a certain national context creates normative restrictions to the exercise of government prerogatives. The structural provisions contained in Articles 6 to 9 will generally govern the extent to which the parties – typically a government entity and a private supplier – will have excluded or derogated from the CISG.

The main structural provisions (secondary rules) of the CISG are those dealing with exclusion or derogation (Article 6), interpretation and related principles such as uniformity and internationality (Article 7), broad admissibility of evidence and guidelines for the qualification of a party's conduct (Article 8) and uses and practices as source of duties (Article 9). Even if the government entity deliberately opts to exclude or derogate from certain provisions of the CISG, as allowed by Article 6 CISG, this option will be recognized, construed, and given legal significance in accordance with the CISG own provisions. As Pascal Hachem put it, "[*t*]he formation and interpretation of the exclusion of the CISG is subject to the rules of the Convention, as the CISG determines its sphere of application autonomously".[32] In a later work, Pascal Hachem further explains this issue as follows:

> "Where the CISG is objectively applicable, its rules on the formation of contracts must also govern the question of whether an agreement on the exclusion of the Convention has been formed. This notion appears to be undisputed. However, the exclusion of the CISG is typically part of a choice of law clause which at the same time designates the law the parties intend to apply instead of the Convention. The prevalent rule in private international law is that it is the law designated by the parties which governs the formation of the positive choice of law, that is the choice of the law that is intended to apply to the contract. It seems to me that while clearly it is the role of the CISG to decide whether the parties managed to opt out of it, it is just as clearly not the role of the CISG to decide whether the parties also successfully opted into the chosen law."[33]

[32] P. Hachem (2022), op. cit., 119.

[33] P. Hachem, "Applicability of the CISG – Articles 1 and 6", *Current Issues in the CISG and Arbitration* (Ed. I. Schwenzer, Y. Atamer, P. Butler), Eleven, 2014, 37. Hachem concludes that

RELATIONSHIP BETWEEN THE CISG AND DOMESTIC GOVERNMENT PROCUREMENT LAW

Governments in general usually adopt in their government contracts a reference to their domestic public procurement laws and regulations. They also tend to use detailed contracts to carefully describe the rights and obligations of each party. Article 6 CISG governs the relationship between such choices and the CISG general provisions. The reference to domestic law and detailed contractual provisions amount to an exclusion or derogation of the CISG, as seen below in this article.[34]

International commentary points out that the two main points of contact between the CISG and any domestic government procurement law are the issues of *validity* (Article 4 CISG) and *freedom of form* (Articles 11, 12 and 13 CISG). Validity is generally excluded from the scope of the CISG, and it is closely related to issues of agency – or, in administrative law terminology, competence and mandate of the procuring agency or official. Freedom of form could, in theory, lead to oral agreements between a government agency and its suppliers.

Article 4 excludes validity from the CISG's sphere of application. Therefore, the selection method for determining the contractor or supplier is normally considered to be outside the scope of the CISG. In countries where domestic procurement law does not govern the content of the contract, only the selection of the contractor, the application of the CISG to international government purchases should be commonplace and not raise any specific concern.

The same reasoning explains the situation of agent-principal relationship – or competence of the procuring agency and respective officials. Domestic administrative law will define who the competent official is to act on behalf of the government. This definition is outside the CISG and has no bearing in the application of the CISG. This is why commentators strongly stress that the identification of true agency or competence issues must be strict. An undue confusion between issues of *competence* and *form* can lead to an improper expansion of the field that is excluded from the CISG's sphere of application.

On the other hand, the *freedom of form* enshrined in Article 11 is generally seen as a point of potential conflict with domestic government procurement

"one may interpret an exclusion of the CISG to have been made under the caveat that the choice of law option must, at the same time, be successful", 38.

[34] D. Willems refers to the mention of Belgian regulations on public procurement of goods in contracts as an example of exclusion of the CISG by reference to a specific national body of law, since there are conflicting provisions that render the CISG excluded (D. Willems, op. cit., 165).

regulation. Domestic procurement laws generally require government contracts to be made in writing.

Honnold points out that scholars adopt one of two possible interpretations about the interplay between Articles 4 and 11 CISG regarding government contracts required to be made in writing by domestic law.[35]

One line of thinking considers that the freedom of form (Article 11 CISG) is overridden by the domestic law requirement since this is an issue of validity, and Article 4 CISG excludes validity from the sphere of application of the CISG. However, this will take place only if the written form requirements under domestic law are justifiable and not merely a formality.

The other view considers that Article 11 CISG is an exception admitted by Article 4 CISG. This latter provision defines that "[…] except as otherwise expressly provided in this Convention, [*the CISG*] is not concerned with: (a) the validity […]". By providing that "[*a*] contract of sale need not be concluded in or evidenced by writing and is not subject to any other requirement as to form", Article 11 CISG is an exception to Article 4 CISG. Therefore, it provides for freedom of form even when domestic law requires written form for government contracts. In this view, the CISG freedom of form supersedes the domestic form requirement and makes it inapplicable. It is not a matter of validity under Article 4 because Article 11 is an exception to Article 4 and places this issue under the coverage of the CISG.

This paper takes the latter view. However, as demonstrated below, the adoption of a domestic government procurement law may amount to a derogation from the CISG under Article 6 CISG. In this context, Article 11 CISG will not apply because of the Article 6 derogation, not due to the Article 4 exclusion.

DOMESTIC GOVERNMENT PROCUREMENT LAW AS A DEROGATION FROM THE CISG (ARTICLE 6)

In general, a government contract will be made in writing and contain reference to the applicable domestic law.[36] It will also contain as contractual clauses many or most of the applicable legal provisions regarding each party's obligations and the consequences of their breach.

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[35] J. Honnold, H. M. Flechtner, op. cit., 181–183.

[36] For instance, the standard Belgian public procurement provides for the applicability of specific national regulations, namely "Public Procurement Act of 17 June 2016, Legal Protection Act of 17 June 2013, RD Award of 18 April 2017 and RD Performance of 14 January 20013" (D. Willems, op. cit., 165).

Such references and clauses may be construed as contractual exclusions or derogations from the CISG in accordance with Article 6 CISG.

It follows that the criteria laid out by the CISG for the interpretation of the exclusion or derogation will apply to determine the effectiveness and the extent of the derogation of the CISG by the domestic government procurement law or by the contractual provisions. International scholarship and case law set forth requirements for such interpretation, such as (i) the need of clear intent to exclude or derogate, so that the CISG will remain applicable in the absence of an unambiguous choice to avoid such application[37] and (ii) the application of the CISG rules on the formation and interpretation of contracts for the construction of the agreement to exclude or derogate, including Articles 8 and 9 CISG. As pointed out below in this article, the standards of proof for the exclusion of the CISG in unilaterally drafted government contracts may be higher due to the constitutional protection of the counterparty's trust and legitimate expectations or, when such protection is not available, due to the *contra proferentem* doctrine.

Whether the CISG is excluded or derogated by a contractual reference to domestic public procurement laws depends on a case-by-case analysis of the compatibility between the CISG and the adopted domestic public procurement laws, as these domestic regulations tend not to regulate most aspects of contractual law. The prevailing view construes a contractual reference to a domestic body of law as an Article 6 exclusion, rather than a derogation.[38] However, none of the known cases

[37] The need for a clear and unambiguous exclusion is generally recognized. See *Forestal Guarani, SA v Daros International, Inc.* (CISG-online 1779), *Easom Automation Systems, Inc v Thyssenkrupp Fabco, Corp* (CISG- online 1601), *Cedar Petro chemicals, Inc v Dongbu Hannong Chemichal Co, Ltd* (CISG-online 1509), *Property Casualty Company of America et al v Saint-Gobain Technical Fabrics Canada Limited* (CISG-online 1435), *TeeVee Toons, Inc et al v Gerhard Schubert GmbH* (CISG-online 1272) and *Ajax Tool Works, Inc v Can-Eng Manufacturing Ltd* (CISG-online 772).

[38] Case law on the exclusion of the CISG suggests that incorporating a specific domestic law in the agreement will generally amount to an exclusion, not a derogation, of the CISG. For instance, see: Teslas Case, Oberlandesgericht München (Court of Appeal Munich), 7 U 4810/21, 12 December 2022, CISG-online No. 6210; *Del Gaudio France S.A. v. Agrenfrut S.L.*, International commercial chamber at the Paris Court of Appeal (CCIP-CA), 20/00977, May 18, 2021, CISG-online No. 5790; *SMS Ersanlar Tarim v F.lli Rinaldi s.n.c.* Tribunale (District Court of Foggia), December 27, 2021, CISG-online No. 5787; Porsche Cayenne Case, Oberlandesgericht Koblenz (Court of Appeal Koblenz), 5 U 781/15, 20 January 2016, CISG-online No. 2741; The Linz Appellate Court decision on 23 January 23 2006 displays the early stages of the discussion (Oberlandesgericht (OLG) (Appellate Court of Linz). 6 R 160/05z. 23 January 2006). The court ruled that the reference to the Austrian Consumer Protection Act and the Austrian Commercial Code (HGB) in the seller's standard terms did not amount to an exclusion of the CISG since these terms were primarily concerned with domestic transactions. The decision was later overturned by the Austrian Supreme Court on the grounds

addresses the application of public procurement laws. Government contract laws generally do not contain a comprehensive and autonomous body of rules of contract law, but rather regulate specific aspects of a government contract while relying on general principles of contract law found elsewhere in the applicable law. Therefore, a contractual reference to domestic public procurement laws will in principle not amount to an Article 6 exclusion but to a derogation of the conflicting provisions of the CISG.

The incorporation of government procurement law into the contract may cause the contract to be governed by the CISG but with most of its substantive provisions having been derogated by domestic public procurement law. This solution may be undesirable but is acceptable under Article 6 CISG. There is only a difference in degree between the derogation of only one provision of the CISG and the derogation of most of its provisions. If the incorporation by reference of the contrary conditions of the domestic public procurement law renders inapplicable all but one provision of the CISG (e.g., Article 11 about freedom of form), this will still be important and useful for the party invoking the CISG for its protection.

One point that may be relevant in practice is precisely the freedom of form under Article 11 CISG. Even if the original contract is generally in writing, as is the international practice in government contracts, there can arguably be amendments made with freedom of form. If the parties have not either expressly or by incorporation excluded oral amendments, these will be valid in accordance with Article 11 CISG.

Frequently in public procurement conflicts contractors invoke the exchange of correspondence or other acts from the state agency or entity as the basis for modifications to contractual obligations.

In U.S. government procurement practice, scholars and case law adopt the idea of constructive changes as opposed to formal changes to the contract. The former are inferred from conduct rather than derived from formal agreements.[39] Equivalent concepts exist in other jurisdictions. It is generally common for contractors in disputes with procuring agencies to use letters exchanged between

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that the reference to specific domestic regulations implied an exclusion of the CISG (Oberster Gerichtshof (Supreme Court), 2 Ob 95/06v. 4 July 2007). The prevailing understanding seems to encompass the reasoning in the Advisory Council Opinion No. 16: "It is not necessary for the purposes of exclusion of CISG for the choice of law clause to refer to the specific non-uniform Sales Law within a Code. A reference to a Code containing the purely domestic sales law should be sufficient, provided the Code does not also enact the CISG".

[39] See Steven W. Feldman, *Government Contract Guidebook*, 4th Edition, Thomson Reuters Westlaw, 2013, especially 532-535 (Formal Changes) and 535-545 (Constructive Changes).

the parties or other actions attributable to the government entity as grounds to establish constructive changes. Article 11 CISG will apply in such situations to give the nature of a binding agreement to such actions intended to modify the original contract even if they do not take the form of written agreements. It will provide an extra ground of validity by attributing contractual character to acts performed even if in a different form from that of the original contract. The solution will depend on the limits of the CISG derogation observed in each case.

POSSIBLE VIOLATION OF BIDDERS' RIGHT TO EQUAL TREATMENT

In accordance with Article 1 CISG, the Convention will only apply to contracts between parties with places of business in different states. Internationality is one of the requirements for the CISG to apply. In a certain tender process initiated by a national procuring agency of a contracting state, and assuming that the conflict of laws rules lead to the application of such state's law (Article1(1)(b) CISG), the CISG will apply if the contract is awarded to an international supplier. However, there may be international and domestic bidders. This will lead to a situation in which each bidder may be subject to a different set of substantive rules depending on whether it is domestic or international.

A principle that is internationally accepted in government procurement is the equal treatment of the bidders. All national systems that follow international standards avoid discriminatory provisions that submit bidders to different treatments without reasonable justification. Many countries adopt benefits for small and medium enterprises (SME), create preferences for locally made goods or services ("buy national") or use public procurement as a public policy tool (green procurement, for instance). These benefits and preferences must follow certain requirements and above all must not merely result from arbitrary discrimination against certain bidders, products, or services.

A question one must address is whether equal treatment is violated when a procuring agency tenders out a contract that may be subject to the CISG or to domestic law depending on who the winning bidder is. Putting it in another way, is the government entity required to have tenders only with international suppliers (subject to the CISG) or only with domestic suppliers to avoid this possible breach to equal treatment?

In the situation above, there is no breach to equal treatment and no requirement for a separate tender process for each category of supplier. The difference in applicable law (CISG or domestic law) simply reflects a factual difference between the suppliers. Being in different countries, they are subject to a variety of different

burdens and benefit from a variety of different advantages. The bidder will be allowed to choose whether to take part in the tender as an international company or to set up a place of business in the procuring country. This arrangement is not different from any other tax or corporate structure the bidder may adopt. The bidder is responsible for the consequences of its choice.

This leads to the application of Article 10(a) CISG, which deals with parties that have more than one place of business. The rule provides for the criteria to determine which place of business is material and decisive to the contract.[40] In a 2019 decision, the Swiss Federal Supreme Court examined a situation in which a foreign supplier, in a contract with a Swiss state-owned entity, established a subsidiary in Switzerland. It was held that the sellers' places of business were relevant in determining the applicability of the CISG, and that the presence of a foreign company ensured the application of the CISG.[41]

The application of different rules for the contract depending on the relevant place of business of the winning bidder is possible and lawful. It leads to no invalidity or defect of the tender process. However, it is convenient that the rules are substantially the same to allow for a better comparison between the various bids. In the international practice, it is widely acknowledged that the CISG has been serving as inspiration for the reform of domestic law on the purchase and sale of goods.[42]

Uniformity may lead to important gains for the procuring agency. The government can create uniformity by adopting contractually agreed-upon rules that are substantially the same for domestic and international suppliers. This will reduce the possible and otherwise lawful discrepancy between the different sets of rules to which each potential party may be subject.

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[40] See P. Hachem, Article 10 CISG: Place of Business, *Commentary on the UN convention on the international sale of goods (CISG)* (Eds. I. Schwenzer, U. Schroeter), 5th Edition, Oxford University Press, Oxford, 2022, 218-223. Hachem in another work mentions that the preferable view "operates on a case-by-case basis and relies on the domicile of the place of business which has the strongest influence on the contractual relationship. The strongest influence will typically be exerted by the place of business where customer complaints are ultimately handled, not merely filed, and in particular where the decisions on the next steps to take in handling disputes, including legal measures, are made"; P. Hachem (2014), op. cit., 34.

[41] CLOUT Case No. 1824 (Abstract by Ulrich Schroeter); CISG-online No. 4463; Commentary to the 2018 decision of the Swiss Court of Appeal Canton Basel-Stadt (CISG Case Number 3906) in the Electronic Electricity Meters Case, later confirmed by the Swiss Federal Supreme Court: U. G. Schroeter, "Grenzfragen des Anwendungsbereichs und international einheitliche Auslegung des UN-Kaufrechts (CISG): Zugleich Anmerkung zu Appellationsgericht Basel-Stadt vom 24.8.2018 – ZB.2017.20 (AG.2018.557)", *Internationales Handelsrecht (IHR)*, 2019.

[42] See P. Hachem (2022), op. cit., 218-223.

NEED FOR CLARITY IN GOVERNMENT CONTRACTS

The CISG as default applicable law will combine with domestic procurement law and specific contractual provisions, since this domestic law and these provisions will be incorporated as Article 6 derogations from the CISG. This combination will establish the rules ultimately applicable to a certain government contract. This arrangement is valid and legally effective, but it can be inconvenient. Ideally, the procuring government agency should have a clear definition in its contracts of the points on which the CISG provisions will be replaced with domestic law or contractual provisions. Ambiguities or uncertainties are legally resolved in favor of the application of the CISG due to the international commitments the Convention is designed to carry out.

In addition to being required by the CISG as a condition for the effectiveness of any exclusion or derogation, clarity in the adoption, derogation, or exclusion of the CISG is part of any contracting state's commitment upon joining the CISG system. In the international context, the accession of any country to the CISG community creates in the international counterparties the legitimate expectation that their contracts with the other country's nationals will be governed by the CISG. This expectation must not be frustrated, especially by the government agencies themselves when they are the contractual parties. Therefore, they should avoid using ambiguous contractual language and (or) creating an uncertainty for international suppliers as to what law and other conditions will apply.

The consequence of these premises is that the general criteria for recognition of an effective exclusion or derogation will apply. Scholars and case law have extensively developed such criteria. In general, both explicit and implied agreements are admitted to exclude or derogate. For instance, whilst case law does not consider a choice of "Brazilian law" as an exclusion of the CISG (since the Convention is part of that law), a choice of "Brazilian Civil Code" may amount to an exclusion under Article 6 CISG if it reflects the intent of the parties to adopt an entirely different system of rules, rather than the CISG. But even in light of said general criteria, this conclusion is not absolute. According to Hachem, certain limitations in the statute governing the contract may retain the CISG as the applicable law.[43]

[43] P. Hachem, op. cit., 129-130: "It seems common ground that the reference to a set of non-unified domestic sales provisions sufficiently indicates an intention to derogate from the entire Convention – e.g. 'this contract is governed by the provisions of the German Civil Code (BGB)'. Such reference may, however, fail to effect a derogation from the entire CISG where the set of rules designated is only applicable to 'merchants' as defined by the domestic set of rules envisaged and this requirement is not fulfilled by both parties."

Such reasoning is not immediately and entirely applicable to government contracts, in which a higher standard of clarity is required for an exclusion to take place. International suppliers to a state entity may expect their contracts to be in principle governed by the uniform law adopted by the state. This amounts to a legitimate expectation covered by the protection of trust. By adopting the CISG, a state makes a promise to its potential international suppliers – or buyers, when the state is a seller – that the uniform law will be applicable. This promise does not make it impossible for the state to exclude or derogate from the CISG under Article 6. However, it sets a higher standard of proof for the intent to exclude. Protection of trust is generally acknowledged as a derivation of widely accepted public law principles,[44] including some arising from international treaties that interfere in administrative law.[45] It entitles the counterparties in a government contract for the international sale of goods to expect the CISG to apply unless clearly and expressly excluded. This is a matter of validity of exclusion based on domestic public law standards, which are incorporated by Article 4 CISG.

The same conclusion can be reached from a *contra proferentem* perspective, provided that the relevant government entity in a given transaction unilaterally defines the terms of its contract under public law. This goes beyond the notion that in doubt the application of the CISG should be favored. It requires the contract to be interpreted in any case in favor of the application of the CISG unless the opposite clearly arises from the language of the contract.

In a legal system in which no protection of trust is available and in which government contracts are negotiated without any prevalence of the government position – i.e., in which the fundamental terms are not unilaterally set by the procuring agency – a higher standard of proof for exclusion or derogation will not exist. Conversely, in systems that recognize such a higher standard of transparency applicable to government action, an exclusion of the CISG in a government contract must be express and explicit, and the usual standards for exclusion by implication will not apply. The CISG will then apply given that the contract will be in its sphere of application.

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[44] Paul Reynolds, "Legitimate Expectations and the Protection of Trust in Public Officials". *Public Law*, Vol. 2011, 330. Similarly, Stephen W. Schill argues: "[*c*]ustomary international law, however, offers, as part of the international minimum standard, some substantive protection to the foreign party's rights under a public contract, provided the breach of the contract or a change of the governing law constitute an independent tort under international law *vis-à-vis* the foreigner's home State" (Stephen W. Schill, "The impact of international investment law on public contracts", *Amsterdam Law School Legal Studies Research Paper*, No. 2017-08).

[45] Eberhard Schmidt-Asmann, *La Teoría General des Derecho Administrativo como Sistema*, Marcial Pons, Madrid, 2003, 59.

ROLE OF BID PROTESTS AND CHALLENGES

Most domestic procurement laws provide for mechanisms for bidders to interfere in the drafting of the solicitation or the contractual documents. Although this varies from country to country, the potential bidders are generally allowed to object to conditions in the solicitation documents or to challenge specific decisions by the procuring agency. Depending on each domestic system, such challenges may be escalated to higher ranks within the government or ultimately be taken to courts.

The phase after the advertisement of the tender and the actual bidding session is the appropriate period for this form of participation. This is the drafting stage in which the procuring agency will finalize the solicitation and make all necessary decisions that will guide the entire process. If a bidder considers that the provisions concerning the applicable law are not sufficient, it should exercise its right to protest to request the application of the CISG or of part of its rules to the contract at issue.

ADVANTAGES FOR THE PROCURING AGENCY IN APPLYING THE CISG

Another angle to explore is how convenient it may be for the procuring agency to opt to keep the CISG as applicable law for the formation and content of the international sale contract, refraining from excluding or derogating its rules.

Any country that joins the CISG is in a way affirming the virtues of the Convention. This does not entail a duty to apply the CISG provisions. However, it does require the decision to exclude or derogate to be reasonable and grounded on sound legal reasons. Otherwise, a country's own government will be denying the conditions to fulfill the international expectations regarding such country's disposition in adopting the uniform legislation.

There are important advantages in the total or partial adoption of the CISG to govern international purchases made by government entities.[46]

Firstly, there are CISG provisions that give reassurance to the international supplier and facilitate transactions. Its rules result from extensive discussion and the reconciliation of different legal systems. Three important examples are (i) the duty to inspect the goods and to give notice of non-conformity within a reasonable period (Articles 38 and 39 CISG), (ii) the provision that a party is liable only for

[46] For a comprehensive overview of why parties should apply or exclude the CISG, albeit not specifically focused on government contracts, see Lisa Spagnolo, *CISG Exclusion and Legal Efficiency*, Wolters Kluwer, London, 2014. especially 78-100 (Substantive Advantages and Disadvantages of the CISG) and 101-148 (Non-Substantive Advantages and Disadvantages).

damages that the party "foresaw or ought to have foreseen at the time of the conclusion of the contract" (Article 74 CISG) and (iii) the duty to mitigate one's losses as a requisite for full recovery (Article 77 CISG). Derogation from these or other rules will cause contractual insecurity and may discourage responsible suppliers from bidding on a certain procuring agency's tender process.

In addition, there is the issue of subcontracting. In many situations, a party supplying international goods to a government agency will have subcontracts that are subject to the CISG. When the government agency can foresee that this may be the case, it is especially important that the CISG applies also to the contract between the government agency (ultimate buyer) and the immediate supplier. This will make it easier for the supplier to manage its contractual relationships with its own subcontractors. One of the cases mentioned above relating to the CISG in government transactions is Diversitel. The case involved an international sale in the defense sector for the ulterior purpose of supplying the item to Canada's Ministry of Defense. Even if the CISG does not directly apply to the supply contract, its provisions can inspire a contractual arrangement that is like the subcontract. In Diversitel, for instance, the immediate contractor was Canadian and, therefore, not subject to the CISG; the Convention applied primarily to the subcontract.

These advantages may impact on the price to be paid. Although there are no known specific statistics about this issue, one may infer that an increase in the assurances given to the international bidder will result in reduction of price.

International banks or development agencies also play a role in this matter by analyzing and approving contracts for the use of funds that are donated or loaned. Another of the most well-known cases involving the CISG in government contracts involves a Spanish supplier and the Iraqi government within the program Oil for Food, with international funding.

A government procuring agency must not take the easy road of simply excluding directly or indirectly the application of the CISG. Either because of the international commitment the CISG represents or the many advantages of the uniform law, the government agency is obligated to examine specifically the CISG and decide in a rational manner on its full application or possible derogation.

CONCLUSION

The CISG's sphere of application under Articles 1 to 3 CISG generally covers contracts concluded by government agencies or entities. When a government agency or entity from a CISG contracting state makes an international purchase (or, more rarely, a sale), the CISG will apply unless the relevant contract excludes

or derogates from the CISG in accordance with Article 6 CISG or one of the exclusions of Article 2 or 3 CISG is in place. The effectiveness and scope of any exclusion or derogation will be assessed and construed according to Articles 7 to 9 CISG. The constitutional protection of the private counterparty's trust or legitimate expectations may lead to a higher standard of proof for the exclusion of the CISG. A contractual reference to a state's domestic government procurement law will primarily not be interpreted as an agreed-upon exclusion of the CISG, but rather only as a derogation of the conflicting CISG provisions based on Article 6 CISG. The CISG provisions will apply especially in the areas in which the incorporated domestic government procurement law is silent.

In most national systems, the main areas of potential conflict between the CISG and international government procurement regulation are the issues of agency (Article 4 CISG) and freedom of form (Article 11 CISG). However, contract administration issues may be relevant in states in which government procurement legislation comprises not only the selection of the contractor, but also the formation and content of the contract, such as in most Latin American countries and the United States. In the latter states, the role assigned to domestic procurement law is greater, and there will naturally be less space for possible application of the CISG. Government transparency and effectiveness require clarity in the exclusion of the CISG. The lack of clear exclusion will allow a private contractor to rely on the CISG provisions that have not been derogated by contractual provisions or by incorporation of domestic government procurement rules into the contract.

Government agencies and entities must weigh the benefits of adopting the CISG and should avoid unfounded or unreasoned exclusions. Bidders and interested third parties, such as citizens in systems that recognize the citizen's standing to challenge bidding procedures, have a role under national legislation to participate in the effective adoption of the CISG by submitting protests and challenges to tender solicitation. These tools give bidders the means to influence the final language of the contract regarding the application or derogation of the CISG.

The CISG interferes directly with any government's international purchases. No government entity in a CISG contracting state may ignore the uniform law. Governments and international bidders must be aware of this legislation and its impact on their international transactions. The application or possible derogation of the CISG in each specific case must be clearly discussed and decided in a rational manner.

Domestic laws generally provide the tools for each government's agencies to make informed decisions and for bidders to interfere directly in the process of creating the solicitation for tenders. These tools comprise the ability to cause the procuring agency to reflect and decide upon the application of the CISG based

on rational reasons. In countries in which the accession to the CISG is relatively recent, the foreseeable inertia of government agencies to adjust to the CISG may be generally overcome by the active, careful, and attentive conduct of the suppliers that potentially take part in the government's procurement proceedings.

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PRIMENA BEČKE KONVENCIJE O MEĐUNARODNOJ PRODAJI ROBE NA MEĐUNARODNE VLADINE UGOVORE O JAVNIM NABAVKAMA

Rezime

Konvencija Ujedinjenih nacija o ugovorima o međunarodnoj prodaji robe iz 1980. godine (CISG) vladinim agencijama koje obavljaju nabavke u međunarodnom kontekstu može doneti brojne koristi. Da bi ih one što bolje iskoristile, moraju biti svesne potencijalnih prednosti, ali i posebnih zahteva koje primena Bečke konvencije nameće, naročito imajući u vidu da se na ovakvu vrstu prodaje Bečka konvencija načelno primenjuje – u slučaju javnih nabavki ili prodaja u međunarodnom kontekstu. Oslanjajući se na postojeću sudsku praksu, trenutnu praksu pojedinih vlada i međunarodnih agencija, kao i brojna tumačenja Bečke konvencije i modela međunarodnih javnih nabavki, autor u radu analizira odnos između Bečke konvencije i propisa o javnim nabavkama. Pored toga, analizirane su i potencijalne koristi za one koji se odluče za usvajanje jedinstvene regulative ugovora na koje se primenjuje Bečka konvencija. Najzad, u radu su obrađene i potencijalne teškoće u postupcima javnih nabavki, konkretno u slučajevima kada se Bečka konvencija primenjuje zajedno sa domaćim zakonodavstvom o javnim nabavkama.

Ključne reči: Bečka konvencija o međunarodnoj prodaji robe, harmonizacija, međunarodne javne nabavke, propisi o javnim nabavkama, uniformna regulativa ugovora

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