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INSTITUTIONAL REFORM AND THE INFORMAL SECTOR
AT THE UNIVERSITY OF MARYLAND AT COLLEGE PARK
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IRIS CENTER OF UNIVERSITY RESEARCH CORPORATION, INTERNATIONAL

iris

QUARTERLY REPORT

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Institutional Reform and the Informal Sector (IRIS) Project

Quarterly Report: April 1 - June 30, 1994

INTRODUCTION

The Institutional Reform and the Informal Sector (IRIS) Project was authorized on May 24, 1990 for a period of five years, through a cooperative agreement between the U.S. Agency for International Development (USAID) and the IRIS Center at the University of Maryland at College Park. An accompanying basic ordering agreement allows for AID Missions to buy into the technical assistance activities, to meet objectives specific to the respective country. The goal of the IRIS project is to support institutional reforms that enhance competitive markets and democratic processes. The purpose of the Core cooperative agreement is three-fold and includes the following:

- To promote better institutions (legislative reform, regulatory reform, improved organizational structures, and strengthened decision-making processes);
- To build awareness of the role of institutions in economic development; and
- To expand the knowledge base on the relationship between institutions and economic growth and examine and examine new approaches to institutional reform.

The objectives of both the cooperative agreement and the respective basic ordering agreements are met with a variety of project inputs, defined by their appropriateness to the specific needs of a country or the international development community at large. Organizational development objectives are addressed through publications, workshops, technical assistance, and training. Collaborative research objectives call for designing technical assistance packages. Training needs are met with short term in-country and third-country programs, short-term US programs and/or internships. Information dissemination and outreach objectives are addressed through the IRIS clearing house and the IRIS newsletter. The development of a knowledge base for strategic approaches is furthered through working papers, books, monographs, articles, conferences, workshops, and seminars.

The status of project interventions and the resulting impact is reported to USAID on a quarterly basis, as defined in the cooperative agreement and eight (8) delivery orders currently in effect. The following report provides an overview of project activities and impact for the core project (Section One) and the respective field projects (Section Two) for the period April 1 - June 30, 1994.

SECTION ONE: CORE REPORT

I. PROGRESS TOWARD ACHIEVING THE PROJECT PURPOSES

1. Promoting better institutions

A. Legislative reform initiatives

a. Plans for reporting quarter

- **Nepal: Company Law.** The draft Company Law was expected to be tabled in Parliament for consideration in the summer session.

- **Nepal: Contract Law.** The first public workshop was planned for June.

- **Nepal: Monopoly Regulation/Consumer Protection.** The creation of draft reform legislation and a public awareness campaign were planned for the spring of 1994, with Parliamentary approval possible in the summer session.

- **Poland: Collateral Law.** The "Jablonna draft" collateral law would be presented to the Minister of Justice for review, before being presented to the Polish parliament for enactment.

- **Poland/Russia: Collateral Law Reform.** Preliminary plans were being made for a collateral law conference to be held in Warsaw during September 1994 to look at the reform process, followed in November by a conference in Russia that will look at legislation needed for launching reforms in the area of both movable and immovable collateral.

- **Russia: Civil Code.** IRIS was developing a series of meetings with the Research Center for Private Law to develop organized input into the drafting of Part Two of the Civil Code. A meeting in Moscow and, over the summer, in the Urals were to accomplish this. IRIS was also attempting to develop a mechanism for providing expert assistance to key officials in both the legislative and executive branches of government who must deal with the same set of issues.

- **Russia: Commercial Law.** The key legal scholars associated with the Research Center for Private Law would travel to the U.S. in April for a two-week session with leading

American commercial law specialists and practitioners.

b. Activities during quarter

- **Chad: Banking Secrecy Law.** IRIS/Chad project is collaborating with a Chadian government commission to propose a new banking secrecy law for the country. This law was recommended as a priority target for reform during the 1992 donors' roundtable on private sector issues, a forum spearheaded by the USAID mission in Chad with IRIS assistance. The banking secrecy reform measure has been approved by the Finance Minister and will be forwarded to the Chadian Council of Ministers for further review.

- **Nepal: Company Law.** The government crisis has postponed action until 1995.

- **Nepal: Contract Law.** IRIS has assisted Nepali lawyers in the drafting of a new contract law in Nepal, which will remove the legal impediments that prevent small firms from engaging in arm's length transactions with other firms. The draft legislation was introduced at a two-day public workshop in which representatives of the legal, accounting and academic communities were able to comment. The workshop received extensive media coverage. The final draft bill, incorporating comments received, is expected to be given to the government and presented to Parliament in late 1994.

- **Nepal: Consumer Protection.** IRIS/Nepal worked with representatives of consumer protection organizations, high-level government officials, and prominent manufacturers to complete a draft consumer protection law. IRIS input emphasized the need to construct the law so that it would support rather than subvert competition, and remove rather than erect barriers to entry. The draft law has been approved by the Cabinet for submission to Parliament, although the July disolution of Parliament and Novermber elections will push passage of the law into 1995. The Nepali Minister of Supplies has requested continued IRIS involvement in the regulatory process that follows the law's passage.

- **Poland: Collateral Law.** IRIS/Poland translated the draft collateral reform law in English, which was then distributed to parties including Polish banks and the European Bank for Reconstruction and Development. Comments received were incorporated into the draft, and commentaries were written by IRIS/Poland consultants, before the draft was submitted for inter-ministerial comment.

- **Poland: Collateral Law.** IRIS/Poland began supporting the Ministry of Justice and the Commission for the Reform of the Civil Code in planning a central lien registry, including co-sponsoring a June 10-11 conference on land registration reform. In addition, a public relations piece on the essentials of collateral law was translated into Polish and Lithuanian.

- **Poland: Intellectual Property Reform.** At the request of the State Committee for Scientific Research, IRIS/Poland produced a report on legal and management issues related to the development of the Internet network in Poland. In cooperation with the Center for Emerging Technology Enterprises, IRIS/Poland has drafted a series of model legal contracts for the protection of intellectual property in technology commercialization.

- **Russia: Civil Code.** IRIS workshops on sales, banking, and property law in the Russian Civil Code were held in Moscow on June 14-16 and 22, 1994. Professors Summers and White each addressed a mostly Russian audience of almost one hundred persons. Summers highlighted the specific articles in the UCC most worthy of consideration by the Russians, and he stressed the importance of educating lawyers and judges to implement the Code after its adoption, and not simply focusing on legislative drafting. Professor White addressed the dilemma of wanting to introduce the most advanced law with the necessity of introducing something geared to the local country's legal tradition and economic conditions. In this light, he noted how often attempts to transplant inappropriate models from one country to another fail. Furthermore, he observed that in most situations law does, and should, follow practice, not the other way around. This provides an important lesson for law makers and cautions them against assuming or ensuring that a body of law will not change frequently or significantly to keep up with business usage. White then discussed the three major principles central to American commercial law: 1) uniformity of law between the states, 2) freedom of contract, and 3) form versus substance.

- **Russia: Commercial Law.** IRIS/Russia is providing continuous advice to the Civil Code Drafting Commission and to the Research Center for Private Law, the institute within the Russian Presidential Administration that is coordinating the work on a market-oriented Civil Code. The Research Center and IRIS have formed a joint Working Group to respond to questions raised by the Commission, review draft texts, and facilitate the Commission's access to Western legal experts. In April, IRIS convened a workshop in the United States to enable the Russian drafters and American commercial law specialists to engage in an in-depth analysis of the Civil Code. IRIS has organized subsequent workshops in Moscow, focusing on issues of sales, contract, banking, and property law. IRIS/Russia continues work on the translation and publication of the Uniform Commercial Code into Russian, selecting translators, an editorial board, and sections of the Official Commentary to translate.

c. Plans for next quarter

- **Chad:** IRIS/Chad will continue to provide technical assistance to the Ministry of Finance on business law harmonization and banking secrecy law reform.

- **Nepal: Contract Law.** A draft law is expected to be completed in the next quarter.

- **Poland: Collateral Law.** Official comments will be received and evaluated by the Commission for the Reform of the Civil Code before the draft is ready for submission to Parliament. Planning will be completed for a conference on collateral law and bankruptcy.

- **Russia: Collateral Law.** IRIS/Russia, in collaboration with the European Bank for Reconstruction and Developement, will be engaged in planning for a late Fall international conference.

B. Regulatory reform activities

a. Plans for reporting quarter

- **Nepal: Stock Exchange.** IRIS would hold public meetings in which the operation and regualtion of the exchange would be reviewed.

b. Activities during quarter

- **Mongolia**: IRIS consultant William Kovacic and IRIS/Mongolia director James Anderson participated in a roundtable discussion on Mongolia's Competition Law sponsored by Boldbaatar (advisor to Prime Minister) and Bailykhuu (Privatization Commission). Over fifty people participated in the roundtable, including members of parliament, ministers, deputy ministers, and directors of privatized enterprises. In addition, Kovacic and Anderson consulted with officials from the National Development Board, including Minister Ulaan and members of the technology and investment department, about the state of the Competition Law.

- **Nepal: Environmental Policy.** IRIS, in collaboration with a Nepali research group, provided recommendations related to a study of pollution by Kathmandu valley carpet industry that sharpen policy recommendations and impose stricter economic rationality upon them.

- **Nepal: Stock Exchange.** Ravi Peiris, the IRIS expert advising the Nepali Stock Exchange, examined the operation of the newly opened exchange and market regualtory mechanisms.

c. Plans for next quarter

- **Nepal: Credit Rating Agency.** IRIS consultant Clara Lipson will examine the need for a credit rating agency. Preparations this quarter included meetings with the Deputy Governor of the Central Bank (S. P. Shrestha) and a representative of a local joint-venture bank.

- **Nepal: Fertilizer/Petroleum.** As a follow-up to a previous study, a workshop is planned to discuss issues related to subsidy and regulation.

- **Poland: Intellectual Property Reform.** A Fall 2-day seminar will bring together legal and technical experts to examine the legal infrastructure required for the development of the Internet, which would also support the creation of the central lien registry for collateralized lending that has been a major focus of IRIS/Poland.

- **Russia: Collateral Law.** Drawing in part on its experience in Poland, IRIS -- in collaboration with the European Bank for Reconstruction and Development -- will hold a conference in Russia to review the theory underlying secured lending and develop a model for a Russian collateral registry. As in the related effort in Poland, this initiative will attempt to help overcome many of the barriers that prevent small businesses from being able to borrow from banks.

C. Improved organizational structures

a. Plans for reporting quarter

- **Mongolia:** A second workshop, on "The Business Courts and the Relationship between Law and Economics," was to be held.

b. Activities during quarter

- **Mongolia: Civil Code.** A June 6-14 workshop in UlaanBataar provided Mongolian policy makers with an introduction to how the legal system can be used to promote economic efficiency. The workshop was designed to help government officials improve the writing of laws on business-related matters such as property rights and contract disputes, to help judges better understand the intent of the writers, and to facilitate substantive interaction between the two sides.

c. Plans for next quarter

- **Mongolia: Local Government Finance.** Participants in the first in the series of IRIS workshops will prepare a policy paper on intergovernmental grants.

- **Mongolia: Insurance.** The third in a series of workshops will address issues related to insurance. This topic is topical in that much of the Mongolian privatization program involved the distribution of livestock, much of which was killed in a severe winter in 1992-93. This disaster made salient the fact that private property involves risks as well as the possibility of profits, and underscores the need to develop mechanisms of risk-

spreading and risk-sharing.

D. Strengthened decision-making processes

a. Plans for reporting quarter

- **India: Enhanced dialogue on policy reform.** Selected conference papers would be edited and published in a book to enable a larger audience to be aware of the need for reform.

- **Nepal: Public Awareness for Legal Reform.** IRIS would sponsor public workshops on consumer protection and contract law.

b. Activities during quarter

- **India: Enhanced dialogue on policy reform.** The IRIS/India program is preparing a book on legal and regulatory constraints and other institutional impediments to industrial and trade policy reform.

- **Nepal: Public Awareness for Legal Reform.** IRIS/Nepal participated in two symposia: Contract Law, organized by the Nepal Law Society, and Consumer Protection, organized by Integrated Development Managers, Associated. These groups have worked on the drafting of the respective reforms. The symposia formed a crucial part of the public awareness and feedback campaign that IRIS encourages in all of its reform activity. The symposia, and statements of the IRIS representatives, were reported in many local newspapers, magazines, and in the evening news.

c. Plans for next quarter

- **India: Enhanced dialogue on policy reform.** The IRIS/India Working Paper series will begin in the upcoming quarter, developing policy-relevant research related to Indian reform efforts and increasing awareness of reform issues among scholars and donor organizations.

2. Disseminating information to build awareness of the role of institutions in economic development

A. Forums, conferences, presentations

a. Activities during quarter

Seminars co-sponsored by IRIS and the Washington Area Forum on Economic Reform (WAFER):

Sergei Alexeev (Chairman of the President's Civil Code Drafting Commission of the Russian Federation) "The Politics and Economics of Russian Legal Reform." (April 27)

Leszek Balcerowicz (Former Finance Minister of Poland) "The Transition to a Market Economy: Important Issues and Lessons." (April 29)

Peter Ordeshook (California Insitute of Technology) "Paradoxes of Russian Constitutionalism" (May 5)

IRIS Sponsored Seminars by Visiting Scholars:

Baskar Dutta (Indian Statistical Institute) spoke on "Human Development in India" at the University of Maryland at College Park on April 18th.

Victor Dozortsev (member of the Civil Code Research Center and Drafting Commission) spoke on the problems of corruption in Russian society and the role of legal codification in the reform process at the University of Maryland at College Park on April 26th.

Papers presented at Scholarly Meetings by IRIS staff and consultants:

Phillip Keefer (Public Choice Society, Austin, TX, April 9) "The Dilemma of Credibility: Institutional Difficulties in Garanteeing Property Rights and Reducing Rent-Seeking."

Mancur Olson (University of Minnesota, April 14) "Why Democracies Succeed"

Lane Blumenfeld presented papers on civil and collateral law reform in Russia at the annual meeting of the European Bank for Reconstruction and Development in St. Petersburg, April 15-19.

Mancur Olson (UCLA Workshop on the Ecopnomics of Transition, April 21) "Capitalism, Socialism, and Dictatorship."

Mancur Olson (Stanford University, April 22) "Why Is Economic Performance Even Worse After Communism Is Abolished?"

Mancur Olson (University of California at Davis Conference on Political Economy, April 23) "Optimization by Autocrats and Majorities."

Mancur Olson (Temple University, April 27) "Economic Growth under Dictatorship and

Democracy"

Mancur Olson (Cambridge University conference on World Economic Primacy, 1350-1990, May 6) "Capitalism, Socialism, and Dictatorship: Their Impacts on the Vitality of Nations"

Ron Dwight (Webster conference, May 11) spoke on foreign investment and the status of Polish collateral law reform.

Mancur Olson (University of Maryland at College Park, May 13) "Economics Reform in Latin America and Previously Centrally Planned Economies"

Mancur Olson (Oxford University, May 18) "Catch-Up Growth, Collective Action, and Social Learning."

Christopher Clague (National Economist Club, May 18) "From Socialism to a Market Economy: Approaches and Lessons"

Lane Blumenfeld (Inter-Volga International Business Conference, Togliatti, May 26) "The Efficiency of Ethics and Law in Business Transactions."

Lane Blumenfeld (Conference on the Development of the Legal Information System and the Future of the Real Property Market, Krakow, Poland, June 11) "Some Observations on Collateral Law and Institutions in Russia Today."

Professors Summers and White (Supreme Arbitration Court, Moscow, June 14) "Commercial Law and the New Russia -- An American Perspective on the Draft Russian Civil Code."

Conferences:

IRIS/IET: A research seminar was jointly sponsored by IRIS and the Institute for the Economy in Transition, in Moscow on May 24-25, 1994. Panels included: Institutional Changes and Economic Behavior, Social and Political Development, Financial Policy and Restructuring, Privatization and Competition Policy, and Political Economy. The seminar provided a forum for Russian scholars and political figures, members of the media, and officials from US and international agencies to review the broad spectrum of political and economic platforms in Russia.

USAID/Washington: A conference titled "Paradoxes of Poverty" was held on May 27th at the Department of State, Washington, DC. Speakers and their topics were:

Jagdish Bhagwati (Lehman Professor of Economics and Political Science at Columbia University, a leading expert in the fields of international trade and economic development, and author of *Protectionism* and *India in Transition*) "Strategies for Growth and Poverty Reduction"

Robert Klitgaard (Professor of Economics at the University of Natal, an expert on institutional reform in South Africa, and author of *Controlling Corruption*, *Tropical Gangsters*, and *Elitism and Meritocracy in Developing Countries*) "Unintended Consequences"

Christopher Clague (Professor of Economics at the University of Maryland and Research Director of the IRIS Center) "Paradoxes of Poverty: What Succeeds in Reducing Poverty?"

Mancur Olson (Distinguished Professor of Economics and Chair of the IRIS Center, and author of *The Logic of Collective Action* and *The Rise and Decline of Nations*) "Who Gains From Policies that Increase Poverty?"

Edited transcripts of the conference will be made available as an IRIS working paper.

Training Provided to Scholars from LDCs and the NIS:

- **Mongolia.** A June 6-14 workshop in UlanBataar provided Mongolian policy-makers and judges with an introduction to how the legal system can be used to promote economic efficiency. Specific topics of the workshop included the coordination of incentives accomplished by the market mechanism, property rights and contracts, forms of business organization, institutional structures to facilitate the implementation of the law, and public uses of resources in a system of private property rights.

- **Russia: Commercial Law.** A commercial law workshop was held in Ithaca, NY/Washington DC from April 17th to 29th. Attendees from the Civil Law Drafting Commission of the Russian Federation were Sergei Alexeev, Alexandre Makovski, Stanislav Khokhlov, Mikhail Gorbunov, Victor Dzortsev, Oxana Kozyr', and Georgui Goloubov (Russian Research Center for Private Law); Gainan Avilov (Legislative Institute), Victor Zvekov (Government of Russian Federation); and Alexandre Komarov (All-Russian Academy of Foreign Trade). The workshop was co-taught by Professor James J. White of the University of Michigan Law School and Professor Robert Summers of Cornell University Law School, the leading American experts on the Uniform Commercial Code and other laws governing commercial practice. The Workshop was designed both to convey a general background in American commercial law and to address the specific concerns of the Russians as they framed their civil code. Issues addressed included secured transactions, the economic foundations of transition processes

and law reform, government contracts, insurance, and bankruptcy.

- **Russia: Commercial Law.** Professor Patricia McCoy gave lectures on banking and the system of payments to students and faculty at Moscow State University.

b. Plans for next quarter

- **Russia: Civil Code.** A two-week program to train Russian judges from the federal and regional levels in commercial law is planned for September. This training -- which will address topics including court administration, civil procedure, and alternate dispute resolution -- will allow Russian judges to implement more efficiently the new Russian Civil Code.

- **Russia: Collateral Law.** A training seminar on collateral law for Russian loan officer trainees is planned for July. A study of commercial lending practices by Russian banks complements this project.

- **Core:** Preliminary plans are being made for a conference on "Institutional Approaches to Sustainable Development," to be held October 24-25 in Washington, DC. Speakers will include Samuel Huntington (Harvard University), Elinor Ostrom (Indiana University), Vernon Ruttan (University of Minnesota), and Robert Klitgaard (University of Natal).

Papers to be presented at Scholarly Meetings:

Mancur Olson (Oslo, Norway, August 24) "Scandanavia in the Perspective of the Rise and Decline of Nations"

Mancur Olson (New York, American Political Science Association, September 2) "Interest Group Power in East and West: Why the Transition from Communism Is So Difficult."

Mancur Olson (European Economic Association, Maastricht, September 4) "The Secular Increase in European Unemployment Rates: Increasing Sclerosis in Labor Markets."

Mancur Olson (UMCP Institute for Philospohy and Public Policy, September 30) Commentator, Conference on "Consumption, Global Stewardship, and the Good Life."

Mancur Olson (Economic History Association, Cincinati, October 10) "Unrealized Economic Growth."

Mancur Olson (Social Science History Association, Atlanta, October 14) "Capitalism, Socialism, and Democracy: Economic Performance under Dictatorship and Democracy in East and West."

B. Publications (articles, monographs, books, working papers, newsletter)

a. Activities during quarter

Working papers:

Georges Korsun and Peter Murrell, "The Politics and Economics of Mongolia's Privatization Program: A Brief History", IRIS Working Paper No. 103, April 1994.

Giuseppe Bertola and Allan Drazen, "Will Government Policy Magnify Capital Flow Volatility?" IRIS Working Paper No. 104, April 1994.

Edgardo Campos, Margaret Levi, and Richard Sherman, "Rationalized Bureaucracy and Rational Compliance," IRIS Working Paper No. 105, April 1994.

Mancur Olson, "The Varieties of Eurosclerosis: The Rise and Decline of Nations since 1982," IRIS Working Paper No. 106, May 1994.

Francis X. Diebold and Natalie Inman Shapiro, "Civil and Political Liberties over Space and Time: A Markov Model of Transition Dynamics," IRIS Working Paper No. 107, April 1994.

Marek Kaminski, "Coalition Structures, Duverger's Law, and the 'Split-Merger Stability' Hypothesis," IRIS Working Paper No. 108, May 1994.

Philip Keefer and Stephen Knack, "Institutions and Economic Performance: Cross-Country Tests Using Alternative Institutional Measures," IRIS Working Paper No. 109, May 1994.

Christopher Clague, "Bureaucracy and Economic Development," IRIS Working Paper No. 110, June 1994.

James E. Rauch, "Bureaucracy, Infrastructure, and Economic Growth: Evidence from U.S. Cities during the Progressive Era," IRIS Working Paper No. 111, June 1994.

Robert Klitgaard, "Institutional Reform and the Challenges Facing South Africa," IRIS Working Paper No. 112, June 1994.

Robert Klitgaard, "Do Better Polities Have Higher Economic Growth?" IRIS Working Paper No. 113, June 1994.

Robert Klitgaard, "An Approach to Institutional Reform in Higher Education," IRIS Working Paper No. 114, June 1994.

IRIS Reprints:

Mancur Olson, "From Communism to Market Democracy: Why Is Economic Performance Even Worse after Communism Is Abandoned?" *Overcoming the Transformation Crisis: Lessons for the Successor States of the Soviet Union*, Institut fur Weltwirtschaft an der Universitat Kiel, pp.1-31. IRIS Reprint No. 43

Paul H. Rubin, "Growing a Legal System in the Post-Communist Economies," *Cornell International Law Journal*, vol. 27, No. 1, Winter 1994. IRIS Reprint No. 44.

Herschel I. Grossman, "Production, Appropriation, and Land Reform," *The American Economic Review*, vol. 84 No. 3, pp. 705-712, June 1994. IRIS Reprint No. 45.

IRIS Country Report

Karen Dunn, William Kovacic and Robert Thorpe, "Analysis of Competition in Mongolia: Three Case Studies," IRIS Country Report No. 14, April, 1994.

To improve the accessibility of IRIS research, particularly for USAID missions and host country scholars and officials, summarys of all IRIS working papers, reprints, and country reports and full-text copies of selected ones are being made available electronically via anonymous FTP. Instructions for accessing this information will be included in the forthcoming newsletter and publications lists also to be distributed to USAID missions in the upcoming quarter.

A spring volume of the IRIS Update was mailed in June; a summer volume will be mailed to a expanded list of USAID personnel, including in particular many more mission economists than IRIS has previously reached, by mid-August. The possibility of electronic dissemination of newsletter material is being explored.

3. Expanding the knowledge base on the relationship between institutions and economic growth and examining new approaches to institutional reform.

A. Research

a. Activities during quarter

The IRIS Index Project: Broadening exposure of scholars to IRIS research and insitutional economics, two IRIS working papers from the IRIS/Index project are forthcoming in leading journals: Steve Knack, "Institutions and the Convergence Hypothesis: The Cross-National Evidence" (IRIS Working Paper No. 59, June 1993, revised May 1994), will appear in *Public Choice*; Philip Keefer and Stephen Knack, "Institutions and Economic Performance: Cross-

Country Tests Using Alternative Institutional Measures," (IRIS Working Paper No. 109, May 1994) is forthcoming in *Economics and Politics.*

Two research projects in progress, entitled "Institutions and Economic Performance: Property Rights and Contract Enforcement" and "Democracy, Autocracy, and Development: Some Empirical Findings," will be presented to an audience of scholars and development practitioners from USAID, international donors, and others in an October 24-25 conference in Washington, DC. The Knack-Keefer paper "Inequality, Property Rights, and Growth" will be presented at the Meetings of the American Economic Association in January.

Further interest in index-related research is demonstrated by numerous requests by outside researchers for data sets developed for the Index project, so that they may test, replicate, or extend the results of IRIS research.

The Economics and Institutions in Russia (Support for Policy Development During the Transition) Project: A first round of research papers developed by Russians scholars was presented in a May 24-25 conference in Moscow. These papers provided insight into the processes and challenges of political and economic reform. Areas addressed included trends in budget revenue and expenditures; structural changes in the Russian agriculture; the functioning of the Russian privatization program; differences between privatized and state-owned firms in terms of employment, price policy, sales, and investments -- together with implications for the attraction of investment capital, creation of efficient corporate control, and anti-monopoly policy. Additional areas considered areas included the political problems of Russian federalism in relation to the regions' economic profiles, as well as regional differences in income distribution and inequality in Russia. This conference involved Russian and American scholars, Russian government officials and members of parliament, and representatives of the international donor community to ensure that the research would have direct application to the policy challenges of the Russian government, that a variety of divergent perspectives would be presented, and that donor organizations would be informed.

Additional areas of on-going research by IRIS staff and fellows include an examination include an examination of the impact of caste on labor and tenancy markets in rural India (Anand Swamy and Brian Fikkert); the relation between income and literacy growth in India (Swamy); relationships among technology licensing, research and development, foreign investment, and industrial productivity (Fikkert); and several issues related to China's successful economic reforms, including industrial agglomeration and the effects of training and compensation on labor turnover. Mancur Olson (with Martin McGuire) is currently investigating taxation and public good provision in autocracies and democracies.

B. Scholarships/Internships

a. Activities during quarter

Russia: Young Scholars Program. A first round of 25 proposals were accepted (out of 87 submitted) in a research program jointly administered by IRIS and the Central Economic-Mathematical Institute of the Russian Academy of Sciences. This program will conduct both policy-relevant research on aspects of the transition and assist in training scholars at the graduate school and junior faculty levels, helping to provide the knowledge and analytical expertise neccessary to inform policy-makers guiding the reform process. The best research developed under this program will be nominated for publication in the journal *Ekonomika i Matematicheskie Methody*, and top scholars may receive scholarships for up to a year of study in the US. Topics to be addressed by the scholars include the socioeconomic development of depressed areas, investment in human capital under conditions of unemployment and inflation, institutional and informational factors related to emigration, and the investment behavior of privatized firms. A second round of proposals will be solicited and reviewed in September.

II. PROJECT IMPACT DURING REPORTING QUARTER:

India: Economic development. During the quarter IRIS obtained further evidence that IRIS activities in India have raised the awareness of the role of institutions in economic development among Indian scholars and that IRIS activities have had an impact on the focus of research by Indian scholars. In addition to inquiries about the program and an increasing number of applications from Indian scholars. IRIS received during the quarter a paper titled "Interest Groups, Government Size and Growth" by Dr. Ajit Karnik and Dr. Mala Lalvani of the University of Bombay for comments. In the paper the authors are testing Professor Olson's theories in the case of India. The impetus for their paper had been the IRIS Worldnet televideo conference between India and the United States in May 1993. Further, Mr. Srivatsa Krishna, a young economist and free-lance journalist who topped this year the Indian Civil Service Exam, had cited in his press interviews Professor Mancur Olson's work as a source of inspiration for him.

Mongolia: According to comments by participants, the second IRIS/Mongolia workshop -- which focused on the development and implementation of commercial law -- provided several benefits. Those from the legislative and executive branches expressed a better understanding of of the practical problems faced by judges in applying the laws, gained from their interaction with judges during the workshop. In turn, the Mongolian judges (who largely lacked training and experience in civil law) expressed greater ability to understand legislative intentions and apply them in the context of specific cases. The ability of the judiciary to support the economic rights of individuals within Mongolian society was greatly enhanced. In support of the central idea of the IRIS project that economic growth is encouraged when individuals believe that their investment in productive resources will be protected and upheld by the state, this workshop provided guidance on legal institutions more conducive to an efficient allocation of resources and an institutional framework that facilitates growth. Laws and documents relevant to this workshop have also been translated and made available through both the IRIS/Mongolia and UMCP offices, which will help inform both interested Mongolians and international agencies.

Poland: Polish TV1 has expressed interest in co-producing with IRIS educational films about collateral and copyright laws, reflecting both popular interest in the reform of legal institutions and the importance of IRIS's role in these efforts.

Russia: Civil Code. With the support of the joint working group which IRIS formed with Research Center for Private Law, Part I of the Russian Civil Code passed a first reading in the Duma. This part of the Code deals with the rights of ownership and the law of contracts. It is expected that by late July, it will have passed its second reading.[1] On July 1st, President Yeltsin officially authorized the Ministry of Justice and the Research Center to draft Part II of the Civil Code, which will address more specific aspects of commercial law.

With the effective passage of the Civil Code, Russia has taken a major step in the transition process by adopting a legislative framework to govern market transactions, replacing an ill-designed and outdated patchwork of parliamentary laws, presidential decrees, and governmental decisions, many dating back to the Soviet period.

IRIS coordiniated workshops and draft review sessions involving members of the Commission and US and European experts. In addition, commentaries on the Code are being prepared by Western commercial law experts, which are being translated into Russian and distrubuted to the drafters and other interested organizations, incuding the Russian parliament. As a result of the Cornell and Moscow workshops, the members of the Russian Drafting Commission now possess a better understanding of how commercial law functions in a market economy. Armed with this knowledge, these lawmakers can now generate a better final version of the new Russian Civil Code. Through briefings at the American Embassy in Moscow, the Department of State, and USAID/Moscow and USAID/Washington, IRIS was able to provide US policy-makers with current information on the content and legislative prospects of the Code.

Russia: Collateral Law. When the Russian State Duma adopted Part I of a new Civil Code on July 22, a key amendment was accepted creating the legal basis for pledging movables as collateral for loans. Equipment, inventories, receviables are all examples of movables and very often the main collateral with which small firms obtain credit. The earlier drafts of the Civil Code dealing with "pledge" had not allowed for this type of secured credit, a type which is common in market economies. Particularly in a society where people do not own their own homes and the ability of anyone to own land is still debated, this amendment is a significant improvement. When implemented it will create access to credit for millions of individuals and firms who lack connection to state subsidies or who rely on informal credit mechansisms.

The importance of this amendment was a key point made in two weeks of meetings between the Civil Code drafting group and U.S. technical experts from IRIS. Detailed follow-up

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[1] On July 22, the State Duma of the Russian Federation approved the second reading of the Draft Civil Code by a vote of 237-53. Although there will be a third reading in October, after the Duma's summer recess, the vote is widely considered to be a formality.

meetings emphasized the relationship of this provision to other parts of the Code and facilitated the development of the consensus for the change. IRIS has been working with the Civil Code drafters and others on development of the institutional framework for secure property rights and contract enforcement in Russia since October 1993. The emphasis on this particular provision was targeted in conjunction with experts from the Harvard Institute for International Development.

The impact of this amendment depends on two developments: the final adoption of the Code in the Fall session of the Duma (expected to be routine) and development of a workable registry for collateral. Such a system, common in the West, does not exist in Russia. Without some publicly accessible registry, the implementation of a pledge law is very difficult.

Russia: Support for Policy Development During the Transition. The joint IRIS/IET seminar in Moscow on May 24-25 brought together for a public forum representatives of different political platforms in a way that could contribute towards developing a consensus on contentious issues of economic policy in Russia. Yakov Urinson, the Deputy Minister of Economics, presented the government's "centrist" platform. Yegor Gaidar, the former acting Prime Minister, and at present the leader of the influential party "Russia's Choice," critiqued the goverment's policy. Sergei Glaziev, Chairman of the parliamentary committee on the economic policy, sharply criticized the government from the conservative position. Having mentioned unprecedented pace and scope of the program, Dmitry Vasiliev, Deputy Minister for Privatization, focused on development of secondary securities markets and on the opportunities for newly privatized firms to restructure and raise equity capital.The variety of opinions expressed by the speakers reflected significant polarization of Russian political forces, while also revealing some commonalities in views of Russian political rivals.

The new institutional economics which underlies the IRIS approach to economic and legal reform was introduced to a broader audience with the appearance of Jonathon Rauch's book Demosclerosis, which is largely derived from the work of IRIS Chair Mancur Olson. The book received extensive and favorable reviews in fora including the *New York Times*, *Time* magazine, *The Economist*, *Washington Post*, and *The New Republic*. This broader exposure of the "IRIS idea" should help build understanding of and support for development efforts related to institutional reform.

III. OTHER ISSUES: Administrative, technical, and/or financial issues that might need further explanation and/or USAID attention.

Chad: A planned December 1994 conference on governance, which was to review anti-corruption techniques for regional donor and host country participants, was canceled due to the pending closure of the USAID/Chad mission and to security and logistical concerns.

IRIS Staffing: The addition of three major projects in the CIS has necessitated an expansion of UMCP staff. Robert Thorpe is taking on full-time management of the Market Environment project. His place as Field Director will be taken in July by Margee Ensign, previously director

of the Development Studies Program and associate professor at Tulane University. Thierry van Bastelaer began in June as Associate Field Director for IRIS programs in Chad and Nepal. Leonid Polishchuk joined IRIS in April to direct IRIS's collaborative project with the Institute for the Economy in Transition. Kathleen Wiersma joined IRIS as Associate Director for Contracts.

SECTION TWO: QUARTERLY FIELD REPORTS:

Chad, India, Mongolia, Nepal, Poland, and Russia

Report Date: 7/29/94

IRIS/USAID Quarterly Budget Report

Data date: 7/28/94

General and Administrative

Category	Budget	Past Quarter (Estimate)	Past Quarter (Actual)	Past Quarter (Difference)	Project to Date	Next Quarter (Estimated)
Salaries						
College Park	$0.00	$0.00	$187,892.16	($187,892.16)	$2,091,885.49	$0.00
LTA	$0.00	$0.00	$0.00	$0.00	($10,833.06)	$0.00
Support Staff	$0.00	$0.00	$23,566.69	($23,566.69)	$214,953.70	$0.00
Total	$0.00	$0.00	$211,458.85	($211,458.85)	$2,296,006.13	$0.00
Fringe	$0.00	$0.00	$42,616.11	($42,616.11)	$454,917.10	$0.00
Total Personnel	$0.00	$0.00	$254,074.96	($254,074.96)	$2,750,923.23	$0.00
Travel						
Foreign	$0.00	$0.00	($570.45)	$570.45	$182,499.39	$0.00
Domestic	$0.00	$0.00	$1,728.53	($1,728.53)	$64,455.42	$0.00
Total	$0.00	$0.00	$1,158.08	($1,158.08)	$246,954.81	$0.00
Other Direct Costs						
Communications	$0.00	$0.00	$9,107.23	($9,107.23)	$115,256.14	$0.00
Supplies & Equip.(<$500)	$0.00	$0.00	$26,748.63	($26,748.63)	$432,966.65	$0.00
DBA/Medex	$0.00	$0.00	$8.00	($8.00)	$16,551.25	$0.00
Consultants	$0.00	$0.00	($1,712.00)	$1,712.00	$47,169.00	$0.00
Subcontracts	$0.00	$0.00	$527,222.00	($527,222.00)	$1,220,102.00	$0.00
Rent	$0.00	$0.00	$0.00	$0.00	$166,754.00	$0.00
Equiptment over $500	$0.00	$0.00	$4,235.00	($4,235.00)	$202,196.09	$0.00
Total ODC	$0.00	$0.00	$565,608.86	($565,608.86)	$2,200,995.13	$0.00
Indirect	$0.00	$0.00	$105,454.24	($105,454.24)	$958,218.21	$0.00
Totals	**7,809,000.00**	$0.00	$926,296.14	($926,296.14)	**6,157,091.38**	$0.00

IRIS/CHAD QUARTERLY PROGRESS REPORT NO. 7

I. ADMINISTRATIVE DATA

Reporting Period: April 1, 1994 - June 30, 1994
Date of Report: July 19, 1994
BOA No. ANE-0015-R-1019-00
Delivery Order No. 07
AID Project Office: G/EG/SMIE
AID Office Funding the delivery order: G/EG/SMIE
AID Office Project: Institutional Reform and the Informal Sector (IRIS) Project

II. PERFORMANCE INFORMATION

A. Project purpose summary statement

The purpose of the IRIS project in Chad is to support the Government of Chad's ("GOC") promotion of the private sector by providing technical assistance, conducting studies, identifying policy changes to be implemented and designing the follow-on institution-building efforts to implement the strategy and programs from the multi-donor private sector roundtable. This complements the broader purposes and scope of the IRIS project which are to promote better institutions, to build increased international awareness of the role of institutions in economic development and to expand the knowledge base on the relationship between institutions and economic growth and examine new approaches to institutional reform.

During this reporting quarter, the IRIS/Chad project concentrated efforts on three major fronts. First, the IRIS/Chad director provided technical assistance to a GOC Ministry of Finance commission to reform Chadian banking secrecy law. Second, advisory services were provided to the Executive Secretariat (the GOC private sector advocacy group) and to the newly-created entrepreneurs network in Chad. Third, initial design work was begun for the "good government" conference scheduled for December, 1994 and aimed at providing anti-corruption techniques to regional donor and host country participants.

B. Progress report

1) Project Administration

Activities Planned for Reporting Quarter	Current Status	Explanations
Extend PACD	Achieved	AID/W
Submit quarterly report	Achieved	4/94
Submit PIO/T on good government conference to USAID/Chad	Achieved	5/94
Submit revised project phase out plan to USAID/Chad	Achieved	4/94

Planned Activities for Next Quarter	Estimated Completion Date	Acting Agent
Submit quarterly report	7/94	IRIS/Chad
Submit annual work plan	8/94	IRIS/Chad
Project evaluation	8/94	USAID/Chad

2) Technical Implementation

Activities Planned for Reporting Quarter	Current Status	Explanation
Initial design of "good government" conference	Achieved	Canceled USAID/Chad
Financing of secretary general, counterpart, and logistical support for Executive Secretariat	Pending	UNDP action
Distribution of final version of customs fraud study	Pending	IRIS/UMCP action
Provide technical assistance to Entrepreneurs Network	Ongoing	IRIS/Chad
Provide technical assistance to Executive Secretariat	Ongoing	IRIS/Chad
Banking secrecy law reform	Ongoing	Ministry of Finance
Devaluation impact	Ongoing	Interviews
Assist USAID/Chad private sector training activities	Ongoing	IRIS/Chad
Reconnaissance Visits	Ongoing	IRIS/Chad

Planned Activities for Next Quarter	Estimated Completion Date	Action Agent Responsible
Distribute customs fraud study	8/94	IRIS/Chad IRIS/UMCP
Provide technical assistance on business law harmonization	2/95	IRIS/Chad
Provide technical assistance on banking secrecy law reform	2/95	IRIS/Chad
Provide technical assistance to Executive Secretariat	2/95	IRIS/Chad
Provide technical assistance to Entrepreneurs Network	2/95	IRIS/Chad
Assist USAID/Chad private sector training activities	12/94	IRIS/Chad

C. Other problems/issues and intended steps toward resolution

The closing of the USAID/Chad mission scheduled for September, 1995 continues to impact the IRIS/Chad project. Increased violence and political uncertainty in Chad during the last reporting quarter as well as additional administrative burden from decreasing staff number prompted USAID/Chad acting representative to request earlier termination dates for most USAID-supported projects in Chad. Consultations among IRIS/UMCP, AID/W, IRIS/Chad and USAID/Chad during June of this reporting quarter concluded with an agreed departure date of February 15, 1995 for the IRIS/Chad program director. If necessary, follow-on project activities, to be designated in an annual work plan and revised budget, may be continued by the IRIS/Chad director at IRIS headquarters in College Park.

Security, logistical, technical and administrative concerns prompted USAID/Chad to cancel the "good government" conference planned by the IRIS/Chad project for December, 1994. This conference, aimed at providing anti-corruption techniques to regional government and donor participants, was to have been a major IRIS activity in Chad, as indicated in last year's annual work plan. The Mission has since de-obligated conference funding.

A lingering government strike, government cabinet changes and general economic decline within the country have also constrained IRIS project efforts in Chad to effect legal and institutional reform. A proposed banking secrecy law, submitted to the Minister of Finance during this reporting quarter, must now be reviewed by the newly appointed minister. Although similar problems and delays are plaguing the Executive Secretariat, there has been some progress by the Secretary General in getting this private sector advocacy group operational.

III. FINANCIAL DATA

Financial reports of the IRIS/Chad project current through May, 1994 have been submitted to the USAID/Chad Controller and the GDO/SP. The USAID/Chad Controller has been submitting bills of collection for approval to the IRIS/Chad project director who has forwarded them to IRIS/UMCP for payment. No payment delays have occurred during this reporting quarter. Given the anticipated February 15, 1995 departure date for the IRIS/Chad director, a revised budget for the remainder of project funds will be drafted during the next reporting quarter.

Report Date: 7/29/94

IRIS/USAID Quarterly Budget Report

Data date: 7/28/94

Chad III

Category	Budget	Past Quarter (Estimate)	Past Quarter (Actual)	Past Quarter (Difference)	Project to Date	Next Quarter (Estimated)
Salaries						
College Park	$0.00	$0.00	$787.67	($787.67)	$30,620.99	$1,682.00
LTA	$0.00	$0.00	$33,696.01	($33,696.01)	$120,716.77	$27,480.00
Support Staff	$0.00	$0.00	$0.00	$0.00	$0.00	$0.00
Total	$273,256.00	$0.00	$34,483.68	($34,483.68)	$151,337.76	$29,162.00
Fringe	$60,117.00	$0.00	$6,817.84	($6,817.84)	$27,755.18	$6,533.00
Total Personnel	$333,373.00	$0.00	$41,301.52	($41,301.52)	$179,092.94	$35,695.00
Travel						
Foreign	$0.00	$0.00	$0.00	$0.00	$50,677.47	$0.00
Domestic	$0.00	$0.00	$20.10	($20.10)	$1,443.00	$27.00
Total	$71,280.00	$0.00	$20.10	($20.10)	$52,120.47	$27.00
Other Direct Costs						
Communications	$0.00	$0.00	$1,502.18	($1,502.18)	$8,313.38	$1,846.00
Supplies & Equip.(<$500)	$0.00	$0.00	$8,024.29	($8,024.29)	$130,231.91	$7,333.00
DBA/Medex	$0.00	$0.00	$0.00	$0.00	$7,376.50	$0.00
Consultants	$0.00	$0.00	$150.00	($150.00)	$105,917.93	$10,000.00
Subcontracts	$0.00	$0.00	$0.00	$0.00	$0.00	$0.00
Rent	$0.00	$0.00	$0.00	$0.00	$12,951.68	$12,952.00
Equiptment over $500	$0.00	$0.00	$0.00	$0.00	$4,591.75	$0.00
Total ODC	$474,865.00	$0.00	$9,676.47	($9,676.47)	$269,383.15	$32,131.00
Indirect	$120,472.00	$0.00	$12,231.45	($12,231.45)	$94,403.75	$15,126.00
Totals	**$999,990.00**	$0.00	$63,229.54	($63,229.54)	**$595,000.31**	$82,979.00

Quarterly Field Report: IRIS-INDIA

I. ADMINISTRATIVE DATA

Reporting Period: April 1, 1994 - June 30, 1994
BOA Number: ANE-0015-1019-00
Delivery order Number: 13
AID Project Office: G/EG/SMIE (R. Mitchell, 300 SA-2)
AID Office funding delivery order: G/EG/SMIE
AID Office project: Institutional Reform and the Informal Sector (IRIS) Project

II. PERFORMANCE INFORMATION

1. Project purpose summary statement:

A. Project Purpose: The objective of this program is to increase the understanding and awareness of the institutional aspects of economic issues in India and to generate a better knowledge base for decisions about economic policy. This will be achieved by carrying out a collaborative research program between Indian and American scholars. The program examines the current institutional framework in India, explores whether this framework constrains the economic liberalization process and determines whether there is need for reform. IRIS will disseminate the research results on the effects of institutions on economic growth to the research community, to politicians and government officials, to the media and the public in India.

B. Relationship to USAID Program Strategy: The USAID program strategy in India is to help India make progress towards sustainable development by focusing on three primary program objectives: accelerating broad-based economic growth, stabilizing population growth, and protecting the environment. IRIS activities in India--as a part of the Mission's Technical Assistance and Support Project (TASP)--contribute to Mission objectives, especially to the objective of accelerating broad-based economic growth by providing economic policy research results and advocacy to increase the competitiveness of the Indian economy and to improve financial and regulatory environment.

C. Progress toward Project Purpose during the Reporting Period: The purpose of this project, namely increasing the understanding and awareness of the role of institutions in economic development in India and generating a better knowledge base for decisions about economic policy, has been furthered in many ways during the reporting period. One short paper commissioned earlier was completed. The March 1994 conference papers and proceedings were printed and distributed. The work on the book which will include the best papers of the program was also commenced. During the quarter IRIS also obtained evidence that IRIS activities in India have raised the awareness of the role of institutions in economic development among Indian scholars and that IRIS activities have had an impact on the focus of research by Indian scholars. In addition to several inquiries about the program and an increasing number of applications from Indian scholars, IRIS received during the quarter a paper titled "Interest Groups, Government Size and Growth" by two professors of the University of Bombay for comments. In this paper, which was initiated and completed without IRIS financial support, the authors are testing Professor Mancur Olson's theories in the case of India. The impetus for their paper had been the IRIS Worldnet tele-video conference between India and the United States in May 1993. This is an example of the impact that initiating high profile discussion on policy related matters can have on broader scholarly effort.

2. Progress report

A. Technical Implementation[1]

Activities Planned for Reporting Quarter	Current Status	Explanations (Problems, steps to resolve, etc.)
One (1) Short Paper Completed	1	See, Attachment I.

[1] Status of activities as defined in the delivery order.

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Seminar on "Human Development in India" by Professor Bhaskar Dutta of the Indian Statistical Institute on April 18, 1994 at IRIS	1	See, Attachment II.
March 1994 Conference Papers Printed and Distributed	1	
Indian Visitors at IRIS	1	Dr. Ashok Gulati of the National Council for Applied Economic Research visited IRIS on April 26, 1994.
Book	2	IRIS is editing the best policy research papers and publishing them as a book(s).
Press on IRIS/India	1	See, Attachment III.
Worldnet Tele-Video Conference	3	Postponed for the fall 1994.
Preparation of Brief Background Paper on the Deregulation of the Indian Telecommunications Sector	2	IRIS Summer Intern working on the paper.

Current Status Key:

(1) Action Completed
(2) Action in process
(3) Action delayed
(4) Action cancelled

Planned Activities for Next Quarter	Estimated Completion Date	Entity Responsible for Action
Completion of Policy Papers	9/30/94	Scholars
Book	11/94	IRIS and the Publisher

Launching of IRIS-India Working Paper Series	9/30/94	IRIS
Preparation of Brief Background Paper on the Deregulation of the Indian Telecommunications Sector	9/30/94	IRIS Summer Intern

B. Project Administration

Activities Planned for Reporting Quarter	Current Status	Explanations (Problems, steps to resolve, etc.)
Follow-on Financial Management of the March Conference (travel reimbursements, honoraria etc.)	1	
Preparation and Submission of a Proposal for a Follow-On Comprehensive Collaborative Policy Research Program for USAID/India	1	
Identify Indian Co-Coordinators for the Proposed Comprehensive Collaborative Policy Research Program	1	Selected Co-Coordinators: * Centre for Development Economics (CDE) at the Delhi School of Economics * National Institute of Public Finance and Policy (NIPFP)

Current Status Key:
(1) Action Completed
(2) Action in process
(3) Action delayed
(4) Action cancelled

Planned Activities for Next Quarter	Estimated Completion Date	Entity Responsible for Action
Follow-On Work on Proposal for a Comprehensive Collaborative Policy Research Program submitted to USAID/India	11/94	IRIS, USAID, Government of India
Financial Management of Completed Contracts	11/1994	IRIS

3. Other problems/issues and intended steps toward resolution: Explain any less-than-anticipated accomplishments, problems or constraints, and actions proposed to remedy/address them (in addition to those addressed in preceeding charts.)

III. FINANCIAL DATA

Following page.

IV. ATTACHMENTS

Attachment I: List of Short Papers Completed and Copies of Papers

Attachment II: Press Clip of Professor Dutta's seminar

Attachment III: Press Clips on IRIS/India

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Report Date: 7/29/94

IRIS/USAID Quarterly Budget Report

Data date: 7/28/94

India II

Category	Budget	Past Quarter (Estimate)	Past Quarter (Actual)	Past Quarter (Difference)	Project to Date	Next Quarter (Estimated)
Salaries						
College Park	$0.00	$0.00	$7,482.04	($7,482.04)	$30,057.41	$14,886.00
LTA	$0.00	$0.00	$0.00	$0.00	$0.00	$0.00
Support Staff	$0.00	$0.00	$9.52	($9.52)	$9.52	$0.00
Total	$53,443.00	$0.00	$7,491.56	($7,491.56)	$30,066.93	$14,886.00
Fringe	$11,758.00	$0.00	$1,203.70	($1,203.70)	$5,290.56	$3,275.00
Total Personnel	$65,201.00	$0.00	$8,695.26	($8,695.26)	$35,357.49	$18,161.00
Travel						
Foreign	$0.00	$0.00	* ($19,094.79)	$19,094.79	$49,861.99	$0.00
Domestic	$0.00	$0.00	$100.50	($100.50)	$130.50	$100.00
Total	$49,560.00	$0.00	($18,994.29)	$18,994.29	$49,992.49	$100.00
Other Direct Costs						
Communications	$0.00	$0.00	$457.11	($457.11)	$3,799.68	$550.00
Supplies & Equip.(<$500)	$0.00	$0.00	$5,785.66	($5,785.66)	$16,044.94	$1,850.00
DBA/Medex	$0.00	$0.00	$0.00	$0.00	$10.25	$0.00
Consultants	$0.00	$0.00	$0.00	$0.00	$0.00	$19,000.00
Subcontracts	$0.00	$0.00	$0.00	$0.00	$54,000.00	$21,900.00
Rent	$0.00	$0.00	$0.00	$0.00	$0.00	$0.00
Equiptment over $500	$0.00	$0.00	$0.00	$0.00	$0.00	$0.00
Total ODC	$150,923.00	$0.00	$6,242.77	($6,242.77)	$73,854.87	$43,300.00
Indirect	$41,421.00	$0.00	* ($11,649.21)	$11,649.21	$27,055.04	$15,390.00
Totals	**$307,105.00**	$0.00	* ($15,705.47)	$15,705.47	**$186,259.89**	$76,951.00

*Negative numbers are due to the liquidation of prior period encumbrances.

Quarterly Field Report: Mongolia

I. ADMINISTRATIVE DATA

Reporting Period: April 1 - June 30, 1994
BOA Number: ANE-0015-B-00-1019-00
Delivery order Number: 10
AID Project Office: G/EG/SMIE (R. Mitchell, 300 SA-2)
AID Office funding delivery order: G/EG/SMIE
AID Office project: Institutional Reform and the Informal Sector (IRIS) Project

II. PERFORMANCE INFORMATION

1. Project purpose summary statement:

A. The project endeavors to strengthen the capacity of key Mongolian decision makers from all spheres of the country's economic life to design and implement institutional reforms during the country's transition to a market economy. To accomplish this purpose a series of workshops and follow-up activities will address topical policy issues and present both general background materials and discussions of specific policy options for development and implementation.

B. The USAID Program Strategy in Mongolia emphasizes encouragement and strengthening of the process of democratization and the promotion of economic growth. The project actively promotes these broad goals in the following ways. The workshops target a broad spectrum of Mongolians in order both to enable individuals from different sectors to better understand and articulate concerns and to enhance policy discussion and its results. The topical policy issues and corresponding points of institutional reform involve ingredients crucial to economic growth.

The second workshop, "Business Law: Development and Implementation", addressed both goals within the Mongolia Program Strategy. First, the ability of the judiciary to support the economic rights of individuals within Mongolian society was greatly enhanced. Second, a central idea of the IRIS project is that economic growth is encouraged when individuals believe that their investment in productive resources will be protected and upheld by the state. This workshop focused on legal institutions more conducive to an efficient allocation of resources and an institutional framework that facilitates growth.

C. The purpose of the project, namely "strengthening capacity of Mongolian decision-makers to design and implement institutional reforms", has been furthered during the reporting period by the second in a series of workshops held in UlaanBataar. The June 6-14 workshop provided an introduction to how the legal system can be used to promote economic efficiency, pursue distributive justice or ideals of equity, and must also handle the problems of administrability. Specific topics of the workshop included the coordination of incentives accomplished by the market mechanism, property rights and contracts, forms of business organization, institutional structures to facilitate the implementation of the law, and public uses of resources in a system of private property rights. More information on this workshop is provided in Attachments 1 through 3.

2. Progress report

A. Technical Implementation[1]

Activities Planned for Reporting Quarter	Current Status	Explanations (Problems, steps to resolve, etc.)
Meeting of Advisory Council.	1	Objective was to suggest individuals for participation in second workshop and suggest potential topics for future workshops.
Prepare additional suggestions of people to participate in the second workshop for the USAID Representative to Mongolia.	1	Low attendance at the Advisory Council meeting required subsequent polling of other members. The resulting list of participants was still far smaller that our target. Additional names of appropriate individuals were identified and suggested.

1 Status of activities as defined in the delivery order.

Prepare analysis of Advisory Council suggestions for future workshops, suggest modifications, and submit to the USAID Representative.	1	IRIS suggestions submitted on June 13, 1994. Shortly thereafter, William Nance informed IRIS of his decision. The third workshop will be on the topic of insurance and will be held in College Park.
Background research on business law in Mongolia.	1	Research included interviews with government officials, judges, legal consultants, political party representatives, academics, members of parliament, and the foreign assistance community.
Translation and compilation of laws and documents relevant to the second workshop.	1	Copies of these documents can be accessed by contacting James Anderson in Ulaanbaatar or Georges Korsun in College Park.
Design of second workshop, College Park.	1	Tasks included selection of lecturers, curriculum design, and lecture preparations.
Logistical preparations for second workshop, Ulaanbaatar.	1	Tasks included the selection of facilities for the second workshop, local travel arrangements, and hiring translators. Although a suitable site outside of Ulaanbaatar was identified, the distance from Ulaanbaatar proved troublesome for some participants. Ultimately, it was decided that the workshop would be held at the Supreme Court in Ulaanbaatar.
Conducted second workshop	1	The workshop was well-received by the participants as being timely, relevant, and useful. Several participants requested additional assistance.

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Participation in roundtable discussion on Mongolia's Competition Law sponsored by Boldbaatar (advisor to Prime Minister) and Bailykhuu (Privatization Commission)	1	Ancillary activity conducted by William Kovacic and James Anderson. Over fifty people participated in the roundtable including members of parliament, ministers, deputy ministers, directors of privatized enterprises, etc. Professor Kovacic was the keynote speaker.
Consulted with officials from the National Development Board about the state of the Competition Law.	1	Ancillary activity conducted by William Kovacic and James Anderson. Kovacic and Anderson had two meetings at the request of Minister Ulaan. The first included the Minister and several staff members. The second included members of the technology and investment department which has been drafting the procedures for implementing the law.
Preparation of Policy Paper on Intergovernmental Grants	3	The key Mongolians responsible for the policy paper were unusually busy with the finish of the spring session of Parliament.

Current Status Key:

(1) Action Completed
(2) Action in process
(3) Action delayed
(4) Action canceled

Planned Activities for Next Quarter	Estimated Completion Date	Entity Responsible for Action
Preparation of Policy Paper on Intergovernmental Grants	9/1/94	Workshop 1 Participants; IRIS-Mongolia
Forward participant requests for follow-up technical assistance to the AID Representative in Mongolia.	8/15/94	Workshop 2 Participants; IRIS-Mongolia

Meeting of Advisory Council to suggest participants for third workshop.	8/10/94	Advisory Council: IRIS-Mongolia
Preparation and Presentation of Third Workshop	9/30/94	IRIS-Mongolia
Early Preparation for the Fourth Workshop	On-going	IRIS-Mongolia

B. Project Administration

Activities Planned for Reporting Quarter	Current Status	Explanations (Problems, steps to resolve, etc.)
Mid-course evaluation of workshop techniques by the entire IRIS-Mongolia project staff.	1	Field Coordinator travelled to College Park for group meetings on workshop methodology.
Obtain approval for a no-cost extension from the USAID Mission Representative	1	Verbal approval granted. Written approval will be requested directly by Robert Mitchell, USAID.

Current Status Key:
(1) Action Completed
(2) Action in process
(3) Action delayed
(4) Action canceled

Planned Activities for Next Quarter	Estimated Completion Date	Entity Responsible for Action
Hire new Project Assistant for the Field Office to replace the resigning Ms. Minjin.	7/30/94	IRIS-Mongolia Field Coordinator

3. Other problems/issues and intended steps toward resolution. IRIS staff continue to report their findings from previous follow-up efforts or IRIS core-sponsored research. One report and one working paper were completed during the quarter: Karen Dunn, William Kovacic and Robert Thorpe, "Analysis of Competition in Mongolia: Three Case Studies," IRIS Country Report No. 14, April, 1994; and Georges Korsun and Peter Murrell, "The Politics and Economics of Mongolia's Privatization Program: A Brief History", IRIS Working Paper No. 103, April 1994.

III. FINANCIAL DATA

Following page.

IV. ATTACHMENTS

1. Trip Report, Cynthia Clement, June 1994.

2. Description of Workshop on "Business Law: Development and Imnplmentation" June 6-14.

3. Workshop Evaluation Questionnaire.

4. Trip Report, James Anderson, June 1994.

Report Date: 7/29/94

IRIS/USAID Quarterly Budget Report

Data date: 7/28/94

Mongolia II

Category	Budget	Past Quarter (Estimate)	Past Quarter (Actual)	Past Quarter (Difference)	Project to Date	Next Quarter (Estimated)
Salaries						
College Park	$0.00	$0.00	$48,088.83	($48,088.83)	$151,535.37	$28,000.00
LTA	$0.00	$0.00	$14,815.08	($14,815.08)	$59,399.15	$12,800.00
Support Staff	$0.00	$0.00	$2,369.92	($2,369.92)	$2,369.92	$0.00
Total	$362,388.00	$0.00	$65,273.83	($65,273.83)	$213,304.44	$40,800.00
Fringe	$86,108.00	$0.00	$14,193.58	($14,193.58)	$47,765.40	$12,000.00
Total Personnel	$448,496.00	$0.00	$79,467.41	($79,467.41)	$261,069.84	$52,800.00
Travel						
Foreign	$0.00	$0.00	$26,984.32	($26,984.32)	$65,317.90	$40,000.00
Domestic	$0.00	$0.00	$17.02	($17.02)	$80.24	$0.00
Total	$284,927.00	$0.00	$27,001.34	($27,001.34)	$65,398.14	$40,000.00
Other Direct Costs						
Communications	$0.00	$0.00	$1,977.05	($1,977.05)	$7,003.75	$2,000.00
Supplies & Equip.(<$500)	$0.00	$0.00	$4,480.79	($4,480.79)	$27,890.62	$2,700.00
DBA/Medex	$0.00	$0.00	$51.50	($51.50)	$2,757.25	$600.00
Consultants	$0.00	$0.00	$15,936.80	($15,936.80)	$26,568.56	$11,500.00
Subcontracts	$0.00	$0.00	$0.00	$0.00	$0.00	$3,000.00
Rent	$0.00	$0.00	$0.00	$0.00	$5,120.00	$2,000.00
Equiptment over $500	$0.00	$0.00	$0.00	$0.00	$2,799.00	$0.00
Total ODC	$278,031.00	$0.00	$22,446.14	($22,446.14)	$72,139.18	$21,800.00
Indirect	$241,005.00	$0.00	$26,064.22	($26,064.22)	$87,260.63	$28,650.00
Totals	**1,252,459.00**	$0.00	$154,979.11	($154,979.11)	**$485,867.79**	$143,250.00

Quarterly Field Report: Nepal

I. ADMINISTRATIVE DATA

Reporting Period: April - June 1994
BOA Number: ANE-0015B-00-1019-00
Delivery order Number: 367-0161
AID Project Office: G/EG/SMIE
AID Office funding delivery order:
AID Office project: Institutional Reform and the Informal Sector (IRIS) Project

II. PERFORMANCE INFORMATION

1. Project purpose summary statement:

A. Project Purpose: To help the Government of Nepal formulate and implement policies that support a pro-market, private sector-led economy by providing financial and technical assistance, identifying policy changes to be implemented, and advocating the need for crucial institutional reforms in the judicial and regulatory areas.

B. Relationship to USAID Program Strategy: The USAID program strategy in Nepal is to help the economy enter a new era of economic prosperity by promoting market reform and addressing women's rights and the health, education and other needs of the poor. IRIS activities in Nepal contribute to Mission objectives by assisting with expertise on policy reform initiatives conducive to the growth of the private sector. IRIS assistance on institutional and regulatory reform is especially helpful for small and micro enterprises which are crucial to the success of any poverty alleviation scheme.

C. Progress towards Project Purpose: IRIS/Nepal Project continues to provide Government and private sector organizations expertise on reform initiatives that further economic liberalization. Reform activities that IRIS has been associated with in the last quarter include the relocation of the carpet industry, a report on the elimination of fertilizer/POL products, capital market development, and establishment of a credit rating service. Advocating the need for institutional reform to further the process of economic liberalization is another IRIS objective. Legal reform is one element of this agenda. The Company Law bill that IRIS helped draft has received cabinet approval for tabling in the summer session of Parliament. IRIS also held national-level workshops to discuss drafts of consumer protection legislation and a revised contract act.

The IRIS/Nepal representative continues to spend afternoons at the Ministry of Finance to help improve communications between the government and donor agencies, and between the government and private sector. His focus during the last quarter has been on advocating and helping to implement banking reform, and working on VAT activities and capital market development. He has also helped the Ministry prepare the annual Economic Survey and the Finance Bill (budget), which has included negotiations with the IMF and World Bank on budgetary and related issues.

2. Progress report

A. Technical Implementation[1]

Activities Planned for Reporting Quarter	Current Status	Explanations (Problems, steps to resolve, etc.)
Tabling of Company Law in Parliament	3	Government crisis has postponed action into 1995.
Tabling of Consumer Protection Act in Parliament	3	Government crisis has postponed action into 1995.
Conference on Contract Law draft	1	
Completion of Contract Law	2	The Nepal Law Society is incorporating comments from a national conference into the draft.
Fertilizer/POL products study	1	
Carpet Industry Relocation Study	1	Steering committee has reviewed recommendations; the final report will incorporate comments from the committee and private sector groups.
Assistance in establishing a Central Depository System at Nepal Stock Exchange	3	Pending the move of the stock exchange into a new building.

[1] Status of activities as defined in the delivery order.

Financial Sector Reform	2	IRIS/Nepal is working with the Central Bank and the Privatization Cell of the Ministry of Finance in the privatization of two public sector banks
Workshop for Policy makers on Stock Market	2	
Policy Analysis Wing (PAW)	2	PAW has submitted two monthly reports on the macroeconomic situation and a study of the Nepali tourism industry.
Study of octroi reform	2	Policy Analysis Wing, IRIS/Nepal
Liaison with government officials	2	Facilitating communication between USAID and the Ministry of Finance concerning annual Economic Survey, budget, and banking and capital market reform.

Current Status Key:

(1) Action Completed
(2) Action in process
(3) Action delayed
(4) Action cancelled

Planned Activities for Next Quarter	Estimated Completion Date	Entity Responsible for Action
Advocacy of Company Law	on-going	Ministry of Industry, IRIS/Nepal
Completion of Contract Law	8/15/94	Nepal Law Society, IRIS/Nepal
Workshop on Fertilizer/POL products study	9/15/94	ESEC, IRIS/Nepal
Workshop for policymakers on the stock market	9/15/94	UTI/India, Nepal Stock Exchange, IRIS/Nepal
Study of need for credit-rating agency	9/94	IRIS/Nepal

Study of reform of income tax law	10/15/94	NPC, IRIS/Nepal

B. Project Administration

Activities Planned for Reporting Quarter	Current Status	Explanations (Problems, steps to resolve, etc.)
Hiring local director	4	IRIS representative to renew contract for additional year.
Installing E-mail	2	Local firm is evaluating fees and services.

Current Status Key:

(1) Action Completed
(2) Action in process
(3) Action delayed
(4) Action cancelled

Planned Activities for Next Quarter	Estimated Completion Date	Entity Responsible for Action
Installation of air conditioners	7/15/94	IRIS/Nepal

3. Other problems/issues and intended steps toward resolution:

None currently.

III. Financial information

Following page.

IV. ATTACHMENTS

I. Keefer/van Bastelaer trip report, May 20 - June 1

Report Date: 7/29/94

IRIS/USAID Quarterly Budget Report

Data date: 7/28/94

Nepal II

Category	Budget	Past Quarter (Estimate)	Past Quarter (Actual)	Past Quarter (Difference)	Project to Date	Next Quarter (Estimated)
Salaries						
College Park	$0.00	$0.00	$0.00	$0.00	$0.00	$0.00
LTA	$0.00	$0.00	$22,838.93	($22,838.93)	$141,424.06	$18,626.00
Support Staff	$0.00	$0.00	$0.00	$0.00	$0.00	$0.00
Total	$161,868.00	$0.00	$22,838.93	($22,838.93)	$141,424.06	$18,626.00
Fringe	$35,610.00	$0.00	$4,867.82	($4,867.82)	$28,508.61	$4,541.00
Total Personnel	$197,478.00	$0.00	$27,706.75	($27,706.75)	$169,932.67	$23,167.00
Travel						
Foreign	$0.00	$0.00	$0.00	$0.00	$2,965.00	$10,000.00
Domestic	$0.00	$0.00	$0.00	$0.00	$0.00	$0.00
Total	$0.00	$0.00	$0.00	$0.00	$2,965.00	$10,000.00
Other Direct Costs						
Communications	$0.00	$0.00	$0.00	$0.00	$0.00	$0.00
Supplies & Equip.(<$500)	$0.00	$0.00	$730.00	($730.00)	$24,559.77	$1,000.00
DBA/Medex	$0.00	$0.00	$0.00	$0.00	$7,585.00	$0.00
Consultants	$0.00	$0.00	$0.00	$0.00	$0.00	$0.00
Subcontracts	$0.00	$0.00	$0.00	$0.00	$0.00	$0.00
Rent	$0.00	$0.00	$0.00	$0.00	$5,040.19	$3,060.00
Equiptment over $500	$0.00	$0.00	$0.00	$0.00	$0.00	$0.00
Total ODC	$42,016.00	$0.00	$730.00	($730.00)	$37,184.96	$4,060.00
Indirect	$59,874.00	$0.00	$7,109.19	($7,109.19)	$52,429.57	$6,733.00
Totals	**$299,368.00**	$0.00	$35,545.94	($35,545.94)	**$262,512.20**	$43,960.00

Report Date: 7/29/94

IRIS/USAID Quarterly Budget Report

Data date: 7/28/94

Nepal III

Category	Budget	Past Quarter (Estimate)	Past Quarter (Actual)	Past Quarter (Difference)	Project to Date	Next Quarter (Estimated)
Salaries						
College Park	$0.00	$0.00	$5,776.52	($5,776.52)	$11,144.78	$1,507.00
LTA	$0.00	$0.00	$0.00	$0.00	$0.00	$0.00
Support Staff	$0.00	$0.00	$0.00	$0.00	$0.00	$0.00
Total	$59,877.00	$0.00	$5,776.52	($5,776.52)	$11,144.78	$1,507.00
Fringe	$13,172.00	$0.00	$955.65	($955.65)	$1,966.20	$373.00
Total Personnel	$73,049.00	$0.00	$6,732.17	($6,732.17)	$13,110.98	$1,880.00
Travel						
Foreign	$0.00	$0.00	$31,839.18	($31,839.18)	$35,881.73	$14,885.00
Domestic	$0.00	$0.00	$0.00	$0.00	$4,907.65	$0.00
Total	$67,032.00	$0.00	$31,839.18	($31,839.18)	$40,789.38	$14,885.00
Other Direct Costs						
Communications	$0.00	$0.00	$952.93	($952.93)	$4,111.52	$1,378.00
Supplies & Equip.(<$500)	$0.00	$0.00	$29.16	($29.16)	$207.09	$85.00
DBA/Medex	$0.00	$0.00	$44.75	($44.75)	$44.75	$44.00
Consultants	$0.00	$0.00	$15,940.00	($15,940.00)	$94,623.00	$20,470.00
Subcontracts	$0.00	$0.00	$0.00	$0.00	$39,117.00	$0.00
Rent	$0.00	$0.00	$0.00	$0.00	$0.00	$0.00
Equipment over $500	$0.00	$0.00	$0.00	$0.00	$0.00	$0.00
Total ODC	$181,809.00	$0.00	$16,966.84	($16,966.84)	$138,103.36	$21,977.00
Indirect	$77,872.00	$0.00	($17,087.18)	$17,087.18	$16,712.17	$34,095.00
Totals	**$399,762.00**	$0.00	$38,451.01	($38,451.01)	**$208,715.89**	$72,837.00

Quarterly Field Report: POLAND

I. ADMINISTRATIVE DATA

Reporting Period: April 1, 1994 - June 30, 1994
BOA Number: ANE-0015-B-1019-00
Delivery Order Number: 11
AID Project Office: G/EG/SMIE (R. Mitchell, 300 SA-2)
AID Office funding delivery order: EUR/RME (Alexandra Braginska 4733 NS)
AID Office project: Institutional Reform and the Informal Sector (IRIS) Project
(Robert Mitchell)

II. PERFORMANCE INFORMATION

1. Project purpose summary statement:

A. Project Purpose: The purpose of the IRIS-Poland II project is to benefit the formation and development of Polish small business through reform of the institutional framework under which small businesses operate. This purpose is being accomplished through legal and regulatory reform processes concentrating on areas of critical importance to the health of small business in Poland. The emphasis is not on benefiting specific small businesses, but rather on improvement of the private sector institutional environment especially important to them.

B. Relationship to USAID Program Strategy: Poland has been one of the most successful of the C&EE countries in its transition to a market economy. There continue, however, to be great needs to create employment and to expand the private sector, especially the SME sector where most new job creation occurs.

An important constraint to job creation and private sector expansion is the lack of credit. Numerous USAID financed studies and projects, the World Bank and the European Bank for Reconstruction and Development have identified the absence of a modern commercial banking system as one of the principal blocks to further development. Without it, private capital cannot flow into the region for lending to credit worthy firms. This has not happened because Poland, and indeed each of the countries of C&EE, lack an effective collateral law

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which would enable banks to do asset-based lending to new and existing firms. At present, the only effective collateral is cash on deposit at the lender. Banks fear to lend, knowing collection is very uncertain and difficult. If an effective collateral law with a central registry to prevent fraud were enacted, commercial lending to the private sector would increase dramatically.

The IRIS-Poland II project is assisting Poland in drafting and implementing its own collateral law. IRIS has encouraged the participation of local legal and banking associations in reforming their societies, leveraged upon other assistance and programs of the World Bank and EBRD to the financial sectors, and will lead to sustainable economic development by making bank credit available to new and existing businesses starved for credit.

C. Highlights of program progress during the reporting period:

1. *Bank Collateral Law Reform.* The major focus of the IRIS-Poland Project continues to be Polish collateral law reform.[1] Since its inception, IRIS has been working with the top legal experts of Poland who form the advisory Commission for Reform of the Civil Code [CRCC], the Polish Ministry of Justice [MOJ], the National Bank of Poland [NBP] and Polish and foreign legal scholars to draft a collateral law which can be presented to the Polish Parliament for enactment. The main accomplishment of IRIS-Poland has been to create and support a local Polish-led coalition of academic, government, and business leaders interested in collateral law reform.

During the second quarter of 1994, the main activities concentrated on follow up to three-day working seminar in Jabłonna from March 25th to 27th where the CRCC finished the collateral law draft. IRIS-Poland then convened for a week to translate the draft into clear, intelligible legal English. Such translations are difficult and require extensive footnotes, since many legal institutions have no exact parallels in Anglo-American law. Once finished, this draft was distributed to many

[1] Collateral law (sometimes called "secured transactions" or the creation of "charges" or "liens") is the legal institution whereby a creditor can take a "collateral interest" in certain goods (often those purchased by means of the loan) of the debtor. In case of default, the creditor is allowed to repossess and sell those goods ahead of other creditors to satisfy the loan.

interested parties including the Association of Polish Banks, the EBRD, and individual large Polish banks. It was also formally presented at the annual EBRD meeting in St. Petersburg where both Dr. Ronald Dwight and Dr. Tomasz Stawecki made presentations on Polish collateral law reform.

After the EBRD meeting, smaller meetings were organized by Dr. Stawecki to discuss specific points in the collateral law and small improvements and clarifications were made throughout the draft before it was presented to Minister of Justice Cimoszewicz and Deputy Minister of Justice Zieliński for approval. IRIS-Poland consultants, Prof. Maciej Tomaszewski and Prof. Zedler wrote, with IRIS support, commentaries to the draft which accompany it. By the end of June, the draft was distributed for inter-ministerial comment. By summer's end, official comments will have been received and evaluated by the CRCC before the draft is ready for submission to the Parliament.

IRIS-Poland began supporting the MOJ and the CRCC in planning the central lien registry. IRIS began working closely with Norway, SA. This is a group connected with the Norwegian MOJ's corporation which manages their various registries supporting their activities by wholesaling the information. The management of such registries is not only self-financing but also budget supporting. On June 10-11, IRIS co-sponsored with AID, the East European Real Estate Institute, a conference organized by the Krakow Real Estate Institute on land registration reform. The Norwegian paradigm was showcased at this conference. A spin-off was the agreement of officials from the Ministry of Finance to discuss the problem of secret tax liens. Other specific activities are outlined in the attached technical implementation report.

2. *Intellectual Property Reform.* At the request of the State Committee for Scientific Research's Director, Prof. Witold Karczewski, IRIS produced a paper called VISION 20/20 concerned with legal and other issues involved in information highway issues. This is closely connected to IRIS-Poland's work in planning the central lien registry, which will be one part of Poland's future information highway plans. Connected to this are legal and management issues of how Internet should be organized and run in Poland. IRIS began planning for a fall two-day seminar where legal and

technical experts would meet to discuss the legal infrastructure needed for proper development of the Internet network in Poland. At present, the network is a big drain on the state budget. This could be easily avoided with proper planning for business access to this presently academic network.

The Center for Emerging Technology Enterprises is producing with IRIS cooperation a series of model legal contracts for protection of intellectual property in technology commercialization projects. About half the models are now complete and being reviewed by IRIS consultants. The State Committee for Scientific Research has expressed interest in printing the models as a book.

Finally, Polish TV has expressed in writing its intention to produce two TV programs: one involving intellectual property issues and technology commercialization; and the other focused on banking reform, collateral law and bankruptcy law.

2. Progress report

A. Technical Implementation

Activities Planned for Reporting Quarter	Current Status	Explanations (Problems, steps to resolve, etc.)
Presentation on SME development (April 5)	1	IRIS Ron Dwight briefs Mr. Dine, USAID representative.
IRIS assists AID with Internet (April-June)	1	IRIS starts and finishes advising AID on the use of Internet.
Presentation to Polish Chamber of Commerce about venture facilitation services (April 8)	1	Unisphere makes presentation to encourage new Polish SME ventures (future funding of Unisphere project turned down by AID and IRIS).

Insol International/ United Nations Commission on International Trade Law: Cross-Border Insolvency Colloquium (April 17-19)	1	IRIS Representative, Gerard Sodach attends conference in Vienna, Austria.
EBRD Meeting (April 16-19)	1	St. Petersburg. Ron Dwight gives collateral law presentation and meets with EBRD General Counsel to coordinate collateral law assistance by EBRD and USAID.
IRIS-Gemini meeting (April 20)	1	IRIS representative meets with Gemini to encourage cooperation between Gemini and the American Small Business Advisory center in training bank officers how to evaluate loans for SMEs.
Farming Foundation meeting with IRIS (April 22)	1	IRIS presents 150 copies of "Vademecum Small Buznesu" to assist in training of entrepreneurs in the country-side community.
Vision 20/20 meeting (April 26 and forward)	2	A series of meetings and papers given on Polish information highway.
Briefing of AID on Vision 20/20 (April 27)	1	Ronald Dwight briefs Frederick Biegański, an AID representative from Washington D.C. on the information highway.

Trip to Bratislava, Slovakia (April 26-29)	1	At the request of the Slovakians, IRIS representative, Pamela Pollak, reviewed the history, purposes and the status of collateral law in Poland.
Copyright Law Seminar (May 4)	1	Two IRIS consultants, Prof. Ryszard Markiewicz and Prof. Janusz Barta critically analyze the copyright law bill and point out its errors at a training seminar organized by Kopernikus Associates. IRIS representative, Justyna Radczyńska-Misiurewicz attended this training.
IRIS/Ministry of Science meeting about intellectual law (May 5)	1	Ronald Dwight and Minister Karczewski discuss the NASK project, Vision 20/20 and Internet.
CETE meeting about intellectual property manual (May 6)	2	Manual to contain examples of contracts and legal documents necessary to the process of technology commercialization.
Briefing of Don Pressley (May 10)	1	Ronald Dwight updates and informs Don Pressley, director, AID Warsaw, about intellectual law projects.
GAO meets with IRIS (May 10)	1	Ron Dwight briefs GAO on commercial law U.S. assistance program in Poland.

Webster Conference (May 11)	1	Ron Dwight speaks about Foreign Investment in Poland and the status of Polish collateral law reform.
Polish Higher Education Business Forum (May 11-12)	1	IRIS representative attends seminar on fundraising techniques. These techniques may be useful for various organizations with which IRIS works.
Meeting with Vice Minister of Justice Zdziennicki (May 12)	1	Meeting to discuss the Minister of Justice's participation in the Krakow land registration reform conference.
Polish Lawyers Association (ZPP) Annual Meeting (May 16-19)	1	Ron Dwight gives several presentations on collateral law.
Forum of Entrepreneurship (for officials in organizations that serve Polish SMEs) (May 16)	1	Gdynia: IRIS representative meets with Solidarity Foundation and AID. IRIS' role is highlighted and praised at conference. Solidarity project is formally terminated in June. IRIS representative, along with others, decide to meet informally.

CAL Project- USAID-contractors relationship project (April and May)	2	A series of meetings are held by Don Pressley and CAL to enhance relations with contractors. IRIS-Poland director, Ron Dwight, briefs one meeting to assist AID in rationalizing its relationships with contractors.
Solidarity Foundation project formally terminated (June 8)	1	AID sponsored project ended. IRIS representative, along with others decide to continue to meet informally.
Collateral Law in a Nutshell: a public relations piece for other countries to explain essentials of collateral law. (Early June)	2	Translated into Lithuanian and Polish: other translations to follow.

Krakow Land Registry Conference with the Minister of Justice's participation, sponsored by the Krakow Real Estate Institute, the Eastern European Real Property Foundation and the IRIS-Poland Project (all USAID projects) and the Keystone Group of Norway (June 10-11)	1	Two-day conference to air problems on legal information systems and their effect on real property market in Poland. IRIS representative, Ron Dwight spoke about collateral reform. The conference was opened by the Honorable Nicholas Rey, U.S. Ambassador to Poland. Patricia Shapiro, Chief of the Legal and Financial Reform Division in the Office of Economic Restructuring Department of the Europe bureau of USAID, attended. IRIS pursued with Stewart Title some of the issues concerning the establishment of a central registry.
IRIS testifies at the SEJM (June 14)	1	At the request of the Business Center Club, Ronald Dwight testifies for two hours before Polish Parliament committee considering a bill to require membership in the Polish Chamber of Commerce.
Technology Commercialization Group approved by the Ministry of Industry and Trade (June 17)	2	Ministry of Industry recommends that the group consider a proposal on tax exemptions for high-tech companies.

IBA meeting (June 18-22)	1	Sofia, Bulgaria. Ronald Dwight discusses collateral law at the conference as well as meets with important Bulgarian players in legal reform process.
Meeting with Polish Chamber of Commerce of Chicago (June 20)	1	IRIS representative, Pamela Pollak meets with Chamber representatives to discuss the use of the Chamber's newsletter to disseminate information about the IRIS-Poland project. In addition, the Chamber has invited IRIS representatives to speak at future seminars and breakfast meetings.
Educational films about collateral law and copyright law in process of production (May-June)	2	Polish TV1 has expressed interest in co-producing these films for the public and will contribute one-half of the budget. The TV contract may be signed after approval of the scripts.
Jabłonna Conference Report	1	This report was given to the conference participants as well as forwarded to USAID.

(1) Action completed
(2) Action in process
(3) Action delayed
(4) Action cancelled

Planed Activities for Next Quarter	Estimated Completion Date	Entity Responsible for Action
Collateral Law and Bankruptcy Conference planned for 6/30/94 postponed	9/94	IRIS
Poland III	7/95	IRIS-CP & IRIS-Poland to set up new program
Polish Collateral Law Draft	7/94	Update translation with newest vocabulary
Plan Collateral Law Conference	9/94	IRIS-Poland

B. Project Administration

Planned Activities for Reporting Quarter	Current Status	Explanations (Problems, Steps to resolve, etc.)
Terminate Polish lawyer	2	Notice given June 14
Hire new Polish lawyer	2	Review candidates

Current Status Key:
(1) Action Completed
(2) Action in process
(3) Action delayed
(4) Action cancelled

Planned Activities for Next Quarter	Estimated Completion Date	Entity Responsible for Action
Hire new Polish Lawyer	7/94	Director, IRIS-Poland
Hire new Polish coordination CP	7/94	Charles Cadwell
Hire 3 new country directors	9/94	Director, IRIS-Poland and USA

III. FINANCIAL DATA

Following page.

IV. ATTACHMENTS

Attachment I: Program from the Conference on the "Development of the Legal Information System and the Future of the Real Property Market in Poland."

Attachment II: Listing of press coverage of the above Cracow conference

Attachment III: Letter from the Cracow Real Estate Institute thanking IRIS-Poland for its outstanding contribution to the Cracow conference

Attachment IV: Picture from the Cracow conference

Attachment V: Program from the Fourth Eastern European Regional Conference on "Privatization in Central and Eastern Europe: Five Years On" in Sofia, Bulgaria

Attachment VI: Collateral law in a nutshess, English versions (2 pages and 4 pages)

Report Date: 7/29/94

IRIS/USAID Quarterly Budget Report

Data date: 7/28/94

Poland II

Category	Budget	Past Quarter (Estimate)	Past Quarter (Actual)	Past Quarter (Difference)	Project to Date	Next Quarter (Estimated)
Salaries						
College Park	$0.00	$0.00	$1,699.75	($1,699.75)	$10,501.58	$0.00
LTA	$0.00	$0.00	$33,933.06	($33,933.06)	$94,007.32	$0.00
Support Staff	$0.00	$0.00	$28.56	($28.56)	$28.56	$0.00
Total	$145,265.00	$0.00	$35,661.37	($35,661.37)	$104,537.46	$0.00
Fringe	$31,959.00	$0.00	$7,278.15	($7,278.15)	$19,297.51	$0.00
Total Personnel	$177,224.00	$0.00	$42,939.52	($42,939.52)	$123,834.97	$0.00
Travel						
Foreign	$0.00	$0.00	$17,285.70	($17,285.70)	$50,980.24	$0.00
Domestic	$0.00	$0.00	$0.00	$0.00	$261.45	$0.00
Total	$31,120.00	$0.00	$17,285.70	($17,285.70)	$51,241.69	$0.00
Other Direct Costs						
Communications	$0.00	$0.00	$5,766.51	($5,766.51)	$19,898.99	$0.00
Supplies & Equip.(<$500)	$0.00	$0.00	$47,487.89	($47,487.89)	$158,217.65	$0.00
DBA/Medex	$0.00	$0.00	$719.56	($719.56)	$6,977.62	$0.00
Consultants	$0.00	$0.00	$25,835.48	($25,835.48)	$92,303.33	$0.00
Subcontracts	$0.00	$0.00	$0.00	$0.00	$0.00	$0.00
Rent	$0.00	$0.00	$12,294.90	($12,294.90)	$53,942.29	$0.00
Equiptment over $500	$0.00	$0.00	$9,162.74	($9,162.74)	$18,554.50	$0.00
Total ODC	$338,145.00	$0.00	$101,267.08	($101,267.08)	$349,894.38	$0.00
Indirect	$132,120.00	$0.00	$38,471.36	($38,471.36)	$122,324.84	$0.00
Totals	**$678,609.00**	$0.00	$199,963.66	($199,963.66)	**$647,295.88**	$0.00

IRIS-RUSSIA PROJECT

AND THE COMMERCIAL LAW REFORM INITIATIVE

QUARTERLY REPORT NO. 4

QUARTERLY REPORT FOR PERIOD
APRIL 1, 1994 - JUNE 30, 1994

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DATE OF REPORT: JULY 7, 1994
PROJECT TITLE: RUSSIA COMMERCIAL LAW PROJECT
PROJECT NO. 110-0007
BOA NO. ANE-0015-B-00-1019-00
DELIVERY ORDER NO. 12

USAID PROJECT OFFICER, PRE/SMIE--ROBERT MITCHELL
USAID CONTRACTING OFFICER, OP/B/PCE--GARY KINNEY
USAID LIAISON OFFICER, WASHINGTON/NIS TASK FORCE--KEITH HENDERSON
USAID LIAISON OFFICER, AID/MOSCOW MISSION--PAUL SCOTT

Quarterly Field Report: Russia Commercial Law Project

I. ADMINISTRATIVE DATA

Reporting Period: April 1, 1994 - June 30, 1994
BOA Number: ANE-0015-B-00-1019-00
Delivery Order Number: 12
AID Project Office: G/EG/SMIE (R. Mitchell, 300 SA-2)
AID Office funding delivery order: Democracy and Governance
AID Office project: Institutional Reform and the Informal Sector (IRIS) Project

II. PERFORMANCE INFORMATION

1. **Project purpose summary statement**:

A. Project Purpose

The objective of the IRIS-Russia Project's Commercial Law Reform Initiative is to assist and train Russian law makers, judges, and legal practitioners at the Federation level as they develop the components of a commercial law regime essential for Russia's transition to a market economy. Specifically, IRIS-Russia is concentrating its efforts in the following four areas:

1) Consultation with the drafters of the new Russian Civil Code;
2) Creation of the legal framework for a secured collateral registry;
3) Translation and dissemination of commercial law materials; and
4) Sponsorship of forums on the legal, institutional and economic foundations of commercial law.

B. Relationship to USAID Program Strategy

The IRIS approach in Russia is similar to its approach in other countries, namely, to strengthen indigenous capacity to understand and carry out needed legal reforms. Therefore, the assistance provided will not only be directed toward crafting legislation, but will also emphasize the broader economic and market principles that form the foundation of an effective commercial law regime.

Additionally, IRIS will encourage Russian policy makers and draftsmen to open the legislative process to include input and discussion from private sector groups most affected by the laws. Finally, IRIS recognizes the critical role Western advisors play in the reform process. They should not, however, attempt to dictate the reform agenda or take the place of Russian draftsmen. Therefore the foreign assistance component of Russian legal reform should be less and less visible as local experts and political leaders lead and complete the process. IRIS will provide policy makers with the tools necessary to accomplish this task.

C. Progress toward Project Purpose

The draft Civil Code of the Russian Federation is separated into two parts. Part I has passed a first reading in the State Duma. The joint working group which IRIS formed with the Research Center for Private Law, the institute attached to the office of the President that is coordinating the development of the Civil Code, helped to accomplish this goal. IRIS has coordinated workshops and draft review sessions between the members of the Commission and several distinguished commercial law experts from the United States and Europe. IRIS has now organized workshops in Ithaca, NY, Washington, DC, and Mosocw, Russia on Parts I and II of the Code and on the legal and economic principles of commercial law. IRIS is also providing commentaries on the Code prepared by leading commercial law experts to the drafters.

IRIS is working with the Research Center to translate the American Uniform Commercial Code into Russian. Furthermore, IRIS is also working on developing a commentary section tailored to the Russian legal tradition. This commentary, which will include official comments from the UCC, will help Russians interpret their new Civil Code, just as annotations to the UCC assist the American legal community in understanding its commercial code.

Although the Russian government is officially working on establishing a land title registry, it is not currently addressing the more complicated issue of how to register movable property in a systematic manner. Thus, IRIS-Russia and one of the principal drafters of the new Russian Civil Code met with the General Counsel of the European Bank for Reconstruction and Development to plan a

Conference on International Collateral Law which will be held in Russia in October or November of this year. IRIS and the EBRD will co-sponsor this conference which will review the theory underlying secured lending and develop a model for a Russian collateral registry.

At the request of the Supreme Arbitration Court, IRIS will hold a two-week workshop in the United States in September for Russian judges from the federal and regional levels. These judges will be trained in commercial law and market economics, arbitration and alternate dispute resolution mechanisms, civil procedure, and court administration. This training will allow Russian judges to more efficiently implement the new Russian Civil Code.

In order to enhance the understanding of the economic underpinnings and incentive structure which a commercial regime should reflect, IRIS is running an on-going series of lectures to examine these issues with government officials, academics, and the private sector. IRIS has already run seminars on commercial law and banking issues for students and the law faculty at Moscow State University. In June, Professors Summers and White, the authors of the most widely used hornbook on U.S. Commercial Law, gave a lecture to the Moscow legal community about the American perspective on the draft Russian Civil Code.

2. Progress report

A. Technical Implementation[1]

[1] Status of activities as defined in the delivery order.

Activities Planned for Reporting Quarter	Current Status	Explanations (Problems, steps to resolve, etc.
1. Civil Code Collaboration		
Civil Code Workshop in Ithaca, NY and Washington, DC 4/18 - 5/6	1	Studied the principles underlying an effective commercial law regime in a market economy; Reviewed Parts I and II of the Draft Russian Civil Code; Addressed questions posed by drafters on specific issues of law and economics governed by the Code.
Civil Code Workshop in Moscow 6/13 - 6/17	1	Professors Summers and White discussed Sales, Secured Transactions, and Banking with the drafters.
Civil Code Workshop in Moscow 6/22 - 6/23	1	Professors Rose and Ellickson discussed Property Law with the drafters.
Commentaries on Draft Civil Code	2	Collecting commentaries on the draft civil code prepared by Western commercial law experts; Have already received commentaries from several experts; Some have been distributed to the drafters; All commentaries are being translated into Russian and will be distributed to other Russian organizations interested in the Civil Code, including the Parliament.

Civil Code Briefing to USAID and State Department in Washington, DC	1	IRIS and drafters discussed status and prognosis for the Civil Code.
Civil Code Briefing to AmEmbassy Moscow and USAID Moscow in Moscow	1	IRIS and Professors Summers and White discussed status and prognosis for the Civil Code.
2. <u>Public Forums, Addresses, and Articles</u>		
Russian Law Reform Panel Discussion, Cornell University 4/18	1	Blumenfeld and Professors Makovsky, Diuzheva, and Domrin on Russian law reform.
Civil Law Reform in Russia, Cornell Law School 4/21	1	Talk by Makovsky on the creation of the new Civil Code to law faculty and students.
Advisory Council Keynote Address, Cornell Law School 4/24	1	Blumenfeld and Makovsky addressed the Advisory Council of Cornell Law School on Russian reform efforts.
Washington Area Forum for Economic Reform (WAFER): The Politics and Economics of Russian Legal Reform 4/27	1	Dr. Sergei Alekseev, Chair of the Research Center and member of the Presidential Civil Code Drafting Commission, gave a lecture at the Carnegie Endowment for International Peace to members of the foreign affairs community.
Central European Russian Area Forum (CERA) at the University of Maryland 4/26	1	Research Center and Drafting Commission member Victor Dozortsev discussed the importance of legal codification to the reform process and the problems of corruption present in Russian society.

The Efficiency of Ethics and Law in Business Transactions (address given at the Intervolga International Business Conference '94) 5/26	1	Blumenfeld addressed Russian business leaders on the role of firm reputation in encouraging contract performance.
Some Observations on Collateral Law and Institutions in Russia Today (Krakow, Poland) 6/11	1	Blumenfeld addressed the Conference on Development of the Legal Information System and the Future of the Real Property Market in Krakow, Poland.
Commercial Law in the New Russia -- An American Perspective on the Russian Civil Code 6/14	1	Professors White and Summers addressed the Moscow legal community at the Supreme Arbitration Court of the Russian Federation.
"A Hole in the Bucket: The Unavailability of Financial Credit Due to the Lack of a Registry in Russian Collateral Law"	1	Article written by Blumenfeld was published in *Law in Transition*, Winter/Spring 1994, in English and Russian.
3. <u>Conferences Attended</u>		
EBRD Annual Meeting 4/16	1	Blumenfeld and Professor Makovsky attended session on Secured Transactions; Held meetings with the EBRD General Counsel to plan a conference on Collateral Law.
The Enactment of the Civil Code - The Basis for Develpment of Market Relations in Russia 6/20	1	Conference attended by Dimitry Labin, IRIS Staff Member.

Civil Legislation of the Russian Federation: Status, Problems, and Perspectives 3/19-20	1	Blumenfeld and Labin attended conference.
Intervolga International Business Conference '94 Togliatti, Russia 5/23-26	1	Blumenfeld attended conference of business leaders from the Volga region.
Development of the Legal Information System Krakow, Poland 6/10-11	1	Blumenfeld attended conference sponsored by IRIS-Poland.
4. <u>Uniform Commercial Code: Translation and Publication</u>		
Translation	2	In the process of selecting translators; Decided to translate entire UCC, not just 3 articles.
Editorial Board	2	Being formed.
Publication	2	Working with USIA; Obtaining authors' rights from Conference for Uniform Legislation; Working with Research Center on publication issues.
Comparative Study of 1969 Translation and 1990 Code	1	20 page report prepared on differences.
Examination of Relevant Portions of Official UCC Commentary	2	Examining sections of the UCC Official Commentary to translate into Russian.

5. Collateral Registry Law on Pledge	2	The provision on Pledge, part of the Civil Code, has been drafted; Drafters are being provided comments prepared by experts; IRIS has focused intensively on the pledge issues during the Civil Code Workshops.
Statute on Registry	3	No Russian gov't. agency is addressing this issue.
Conference	2	Agreed to co-sponsor with EBRD a conference on collateral law this coming Oct. or Nov.
Commercial Lending Practice Study	2	Interviewing banks on their lending practices.
6. Training/Seminars Judicial Training in Commercial Law	2	2 week program for Russian judges in U.S. is planned for Sept.
Moscow State University	1	Professor Patricia McCoy gave 2 lectures on System of Payments and Banking to law students and faculty.
7. Private Sector Outreach Foreign Lawyers Ass'n.	2	IRIS Director meets monthly with Western legal community.
Law and Business Forum	3	Forum has been established; Actual meetings will begin in the Fall.

Current Status Key:
(1) Action Completed
(2) Action in process
(3) Action delayed
(4) Action cancelled

Planned Activities for Next Quarter	Estimated Completion Date	Entity Responsible for Action
Training Seminar on Collateral Law for Russian Loan Officer Trainees	July	IRIS-Russia IRIS-Poland
Business Law Roundtable	Fall	IRIS-Russia
Judicial Training	September	IRIS-Russia
Civil Code Commentaries	July	IRIS-Russia
Hold Seminars and Workshops on Sales, Leases, Banking Transactions, Wills and Estates, Issues in Torts, Intellectual Property, and Conflicts of Law	September-November	IRIS-Russia
Lecture/Seminar Series	Times TBA	IRIS-Russia
Parliamentary Workshop/Roundtable on Civil Code	Time TBA	IRIS-Russia
Continuing Work on Translation and Publication of the UCC	ongoing	IRIS-Russia
International Collateral Law Conference	October or November	IRIS-Russia and the European Bank for Reconstruction and Development
Write Article on Draft Civil Code to be Published in the *Journal of the Supreme Arbitration Court of the Russian Federation*	September	IRIS-Russia

B. Project Administration

Activities Planned for Reporting Quarter	Current Status	Explanations (Problems, steps to resolve, etc.)
Computer Network	1	Networked office computers.
Registration	2	Preparing paperwork; Working with law firm to register.
Implement new accounting system	1	Implemented.
Translation of Code Commentaries	2	Being translated.
Opening a Bank Account	4	Alternative solution: use less expensive wire transfers
Conference Logistics, Ithaca/DC	1	Scheduled meetings, planned conference, prepared materials.
Translation of Code Workshop Minutes	2	Being translated.
Logistical Support for Code Workshops	1	Provided.
Hire summer interns (American law students)	1	2 American law students hired.
Office renovations, new office furniture	1	Office refurnished/renovated.
Hire Russian lawyer	3	To be completed by Fall 1994.
Renting of additional office space	1	Rented.

Current Status Key:
(1) Action Completed
(2) Action in process
(3) Action delayed
(4) Action cancelled

Planned Activities for Next Quarter	Estimated Completion Date	Entity Responsible for Action
Hire Car and Driver	July	IRIS-Russia
Hire Russian Lawyer	August	IRIS-Russia
Install Satellite Line	July	IRIS-Russia
Complete Registration	July	IRIS-Russia

3. Outstanding problems and issues and intended steps toward resolution

No current insurmountable problems.

III. FINANCIAL DATA

To Be Defined.

IV. ATTACHMENTS

Attachment I: Public Forums (Program Announcements)

A. "Legal Reform in Russia: A Work in Progress" -- Panel Discussion with Lane Blumenfeld and Professors Dormin, Dyuzheva, and Makovsky at Cornell Law School, Ithaca, NY, on April 18, 1994.

B. "Civil Law Reform in Russia" -- Lecture by Professor Makovsky at Cornell Law School, Ithaca, NY, on April 21, 1994.

C. "The Politics & Economics of Russian Legal Reform" -- WAFER Lecture by Sergei Alexeev at The Carnegie Endowment for International Peace, Washington, DC, on April 27, 1994.

D. "The Efficiency of Ethics and Law in Business Transactions" -- Lecture by Lane Blumenfeld at the Intervolga International Business Conference, Togliatti, Russian Federation, on May 26, 1994.

E. "Some Observations on Collateral Law and Institutions in Russia Today" -- Lecture by Lane Blumenfeld at the Conference on Development of the Legal Information System, Krakow, Poland, on June 11, 1994.

F. "Commercial Law in the New Russia -- An American

Perspective on the Russian Civil Code" -- Lecture by Professors Robert Summers and Jim White at the Supreme Arbitration Court of the Russian Federation, Moscow, Russian Federation, on June 14, 1994.

Attachment II: Articles

A. "A Hole in the Bucket: The Unavailability of Financial Credit Due to the Lack of a Registry in Russian Collateral Law" Article written by Lane Blumenfeld published in the EBRD Newsletter Law in Transition, Winter/Spring 1994, in English and Russian.

V. ANNEXES

Annex 1: Reports

A. June 26, 1994 Report on the "IRIS Workshop on Issues of Commercial Law in the Russian Civil Code" held in Ithaca, NY and Washington, DC, April 18 - May 6, 1994.

B. July 6, 1994 Report on the "IRIS Workshop on Commercial Law Issues in the Russian Civil Code -- Sales & Banking Law" held in Moscow, June 14 - 16, 1994.

C. June 29, 1994 Report on the "IRIS Workshop on the Russian Civil Code: Property -- Provisions, Implementation and Impact" held in Moscow on June 22, 1994.

Annex 2: Civil Code Commentaries

A. June 20, 1994 Memorandum regarding Commentaries on the Draft Civil Code of the Russian Federation.

B. Commentaries provided by Stephen Butler, Esq., Professors John Spanogle, Carol Rose, Patricia McCoy, Robert Ellickson, and the members of the Presidential Civil Code Drafting Commission.

Annex 3: Workshop Minutes

A. Minutes from Workshop on Issues of Commercial Law in the Russian Civil Code held in Ithaca, NY, April 18 - 23, 1994.

B. Minutes from Workshop on Issues of Commercial Law in the Russian Civil Code, Sales and Banking Law, held in Moscow, Russian Federation, June 14 - 16, 1994.

Report Date: 7/29/94

IRIS/USAID Quarterly Budget Report

Data date: 7/28/94

Russia I - Commerical Law

Category	Budget	Past Quarter (Estimate)	Past Quarter (Actual)	Past Quarter (Difference)	Project to Date	Next Quarter (Estimated)
Salaries						
College Park	$0.00	$0.00	$20,786.17	($20,786.17)	$53,666.07	$10,000.00
LTA	$0.00	$0.00	$13,283.39	($13,283.39)	$32,410.48	$10,000.00
Support Staff	$0.00	$0.00	$442.25	($442.25)	$442.25	$0.00
Total	$225,792.00	$0.00	$34,511.81	($34,511.81)	$86,518.80	$20,000.00
Fringe	$49,674.00	$0.00	$6,153.51	($6,153.51)	$15,912.89	$4,400.00
Total Personnel	$275,466.00	$0.00	$40,665.32	($40,665.32)	$102,431.69	$24,400.00
Travel						
Foreign	$0.00	$0.00	$102,901.62	($102,901.62)	$127,836.90	$5,000.00
Domestic	$0.00	$0.00	$3,356.09	($3,356.09)	$3,595.87	$0.00
Total	$159,108.00	$0.00	$106,257.71	($106,257.71)	$131,432.77	$5,000.00
Other Direct Costs						
Communications	$0.00	$0.00	$1,852.54	($1,852.54)	$3,577.33	$3,000.00
Supplies & Equip.(<$500)	$0.00	$0.00	$14,617.32	($14,617.32)	$28,789.38	$8,250.00
DBA/Medex	$0.00	$0.00	$236.25	($236.25)	$1,912.25	$0.00
Consultants	$0.00	$0.00	$24,931.00	($24,931.00)	$37,934.07	$5,000.00
Subcontracts	$0.00	$0.00	($32,830.00)	$32,830.00	$0.00	$192,500.00
Rent	$0.00	$0.00	($24,500.00)	$24,500.00	$26,550.00	$4,800.00
Equiptment over $500	$0.00	$0.00	$4,659.20	($4,659.20)	$12,150.00	$12,000.00
Total ODC	$290,298.00	$0.00	($11,033.69)	$11,033.69	$110,913.03	$225,550.00
Indirect	$173,869.00	$0.00	$19,212.53	($19,212.53)	$64,819.33	$21,712.50
Totals	**$898,741.00**	$0.00	$155,101.87	($155,101.87)	**$409,596.82**	$276,662.50

INSTITUTIONAL REFORM AND THE INFORMAL SECTOR
AT THE UNIVERSITY OF MARYLAND AT COLLEGE PARK
2105 Morrill Hall, College Park, Maryland 20742
IRIS CENTER OF UNIVERSITY RESEARCH CORPORATION, INTERNATIONAL

QUARTERLY REPORT

ANNEXES

Reporting Period: April 1 - June 30, 1994
BOA Number: ANE-0015-B-00-1019-00
AID Project Office: G/EG/SMIE (R. Mitchell, 300 SA-2)
AID Office funding delivery order: G/EG/SMIE
AID Office project: Institutional Reform and the Informal Sector (IRIS) Project

CHAD:

No attachments.

ATTACHMENT I to the IRIS-India Quarterly Report for April-June 1994

List of Short Papers Completed and Copies of Papers

Isher Judge Ahluwahlia, Center for Policy Research:
"Industrial and Trade Policy Reforms in India."

APRIL, 1994

INDUSTRIAL AND TRADE POLICY REFORMS IN INDIA

BY

ISHER JUDGE AHLUWALIA

CENTRE FOR POLICY RESEARCH
NEW DELHI

The past three years have seen some fundamental economic reforms in the industrial and trade policy regime in India. About the same time that China set out on a historic path of economic reforms in the late seventies, some observers of the Indian economy both within the government and outside were developing serious misgivings about the effectiveness of the industrial and trade policy instruments in achieving the targets set by our planners and policy makers[1]. But, unlike China, in India it took over a decade to develop the resolve for change and that too after a severe balance of payments crisis in 1991.

Some major aspects of the policy regime, i.e., its extreme inward orientation, the dominance of the public sector, and the extensive domestic regulation had all contributed in good measure to the high cost industrial structure that had developed in India over time. Labour laws which provided little flexibility in hiring and firing and the competition among the numerous trade unions with their different political affiliations further added to the cost pressures.

It was not surprising then that in spite of the impressive increases in the saving and investment rates in the economy (these rates had more than doubled between 1950 and 1980 as shown in Table 1), the growth rate of the economy remained stagnant throughout the period. The downward slide of the growth of GDP from 4.1 per cent per annum in the fifties to 3.8 per cent per annum in the sixties and 3.3 per cent per annum in the

seventies is a witness to how the gains on the resource mobilisation front were eaten away by the losses on the productivity front. The erosion of competitiveness was also reflected in a secular decline in India's share of world exports from a small enough 2 per cent in 1950 to less than 0.5 per cent in 1980 (Chart 1).

Unlike China, however, India in the eighties opted for a slow correction on an experimental basis for a few sectors and that too within the confines of a deeply inward oriented regime. Several policy changes were made to mitigate the rigours of the control regime. Direct taxes were lowered; private sector was given a larger scope for participation in the growth process; market forces were allowed to play a somewhat larger role in encouraging better utilisation of investments that had already been made; and licensing controls on foreign trade and investment were liberalised gradually. But the very high degree of protection from foreign competition continued throughout this period and the anti-export bias of the trade regime was sought to be offset by increasing the subsidies for exports.

The reorientation of the industrial and trade policy regime had the effect of significantly raising the growth rate of GDP to 5.6 per cent per annum in the eighties compared with 3.3 per cent in the seventies. Growth of value added in industry accelerated from 4.8 per cent per annum in the seventies to over 7 percent per annum in the eighties (Table 1).This was mainly on account of productivity gains. Total factor productivity growth

in Indian manufacturing responded very well to the policy reorientation of the eighties. After a long-term trend decline of 0.5 per cent per annum in the sixties and the seventies, total factor productivity grew at a rate of 2.8 per cent per annum in the eighties[1]. But the sustainability of the better growth performance was being put to test by the deteriorating macro-economic environment. This was largely a reflection of the growing fiscal profligacy of the Government of India during the eighties.

The Gulf war of 1990 and the political instability at the turn of the decade further contributed towards the collapse of international confidence in the Indian economy and the result was the balance of payments crisis of 1991. Inflation was rising, industrial production was declining, foreign exchange reserves at $1 billion were at their lowest level ever, and the possibility of international default was a very real one. The crisis helped to focus the mind on the need for widespread economic reforms directed at fiscal stabilisation as well as micro-level changes including industrial and trade policy reforms.

One advantage of being a latecomer is that you can learn from others' mistakes. Indeed, for India in 1991 there were lessons to be learnt from other economies. The East Asian miracle was there for all to see. China had already completed a decade of economic reforms through opening up to foreign trade and investment, and with splendid results. GDP of China grew by

close to 10 per cent per annum between 1979 and 1992. The economies of Eastern Europe were also well on their way to market orientation and globalisation. Above all, the consequences of inaction could also be seen in the disintegration of the Soviet Union. It underscored the urgency of economic reforms if India were to avert similar disaster.

If international examples were many, India's own experience with deregulation in the eighties provided further inspiration for the reforms. Nevertheless, during the almost three years since June 1991, economic reforms in India have been fast by the standards that we in India are used to, but slow by international standards. Perhaps this is inevitable in a democracy with strong entrenched interests favouring the continuation of the old regime. But the direction has been firmly set and a consensus is emerging in favour of change.

1. Trade and industrial policy reforms

Industrial and trade policy reforms of the nineties are designed to improve the productivity performance of Indian industry by attempting to inject more competition from within the economy as well as from outside. The objective is to strengthen the growth capability of the economy in the medium run and help Indian industry in the process of becoming internationally competitive.

(i) Trade Policy Reforms

Trade policy reforms have been at the centre of the New

Economic Policies of the nineties. Recognising that exporting within the shackles of an import substitution regime will not be possible, a process of dismantling this regime began in earnest three years ago. For the first time the policy makers have attempted to integrate the Indian economy with the world economy by doing away with the complex system of import licensing and making an open commitment to lower the tariff rates on imports in a phased manner to bring them in line with those prevailing in other developing economies.

In a major initiative towards convertibility of the Indian rupee, import licensing has been done away with for most goods other than consumer goods. The bureaucratic delays, inefficiencies and corruption possibilities associated with the licensing regime were eliminated in one broad sweep of this initiative. For consumer goods, however, the restrictive regime of import licensing remains more or less intact and is combined with very high tariffs.

The customs duty reduction has followed a consistent pattern along the lines indicated by the Chelliah Committee's Report (1992)[3]. In 1991, the peak rate of customs duty exceeded 200 per cent. Even capital goods imports were subject to tariff rates of around 100 per cent which was much higher than the range of 5 to 15 per cent prevailing in most other developing economies. This had a cascading effect on the industrial cost structure in India.

With the most recent tariff reductions in the budget for 1994-95, the maximum tariff rate has been lowered to 65 per cent.

The government has not been deterred by the revenue shortfalls in the budget for 1993-94 from pursuing the course of tariff reforms. The import-weighted average tariff rate on the intermediate goods is around 30 per cent and on capital goods around 38 per cent. These are still higher than in most other developing economies, but much lower than three years ago. The budget for 1994-95 has also taken some major corrective action to remove the anomalies of an inverted tariff structure facing the indigenous capital goods industry and imposed countervailing duties on imported capital goods to ensure a level playing field to the domestic producers.

The gradual removal of the anti-export bias through dismantling the import substitution regime has been combined with some positive measures to promote exports. This includes tax exemption on earnings from exports and provision of concessional finance for exports. In particular, greater thrust has been provided to exports from agriculture and labour-intensive sectors. The negative list for exports has been significantly pruned. As an added incentive, export-oriented units (EOU's) in agriculture and allied sectors have been allowed to sell upto 50 per cent of their total output in the domestic market. The minimum export price for basmati rice,a superior variety of rice, has been eliminated and export restrictions on superior quality of rice have been relaxed.

The reduction of subsidies to agriculture in developed countries as part of the implementation of the Uruguay Round should benefit India's emerging exports of agricultural and allied products. The phasing out of the Multi-Fibre Arrangement over 10

years will also make it possible for Indian exporters of garments and textiles to increase their market shares in product categories where they have comparative advantage.

(ii) Industrial Policy Reforms

Domestic deregulation has been a central feature of the industrial policy reforms. These reforms have been designed to provide to the private sector larger scope for participation in the growth process. They are also characterised by a new approach towards foreign investment. Two important areas of weakness relate to exit policy for non-viable nonrevivable sick units and public sector reforms.

(a) Industrial Delicensing

Industrial licensing policy has seen the most dramatic changes. The system of industrial licensing which involved permission from the government of India for new investments as well as capacity expansions has been virtually abolished. The parallel but separate controls over large industrial houses through the Monopolies and Restrictive Trade Practices Act have also been eliminated. The many inefficiencies of this system - carefully documented by Bhagwati and Desai as early as 1970 - are now truly a thing of the past, although barriers to entry at the level of the state governments still remain.

An associated area crying out for reforms is that of reservation in production of certain items for the small scale

sector. Introduced in 1969, reservation policy for the small scale sector has protected small scale units from competition from the large scale units in the poduction of certain items. The winds of liberalisation have not touched this aspect of policy so far. This is a serious handicap for certain export-oriented industries such as garments and leather products including leather footwear. In the areas where India has inherent comparative advantage, policies of reservation are holding entrepreneurs back from exploiting the economies of scale to exploit opportunites in the world market.

(b) Opening up to Foreign Investment

The opening up to foreign trade has been combined with a policy of opening up to foreign investment. The new policy towards foreign investment goes beyond ''permitting'' foreign investment to a policy of ''actively seeking'' and ''promoting'' foreign investment particularly in the infrastructure sectors.

Direct foreign investment is permitted in virtually every sector of the economy. Majority foreign investment (up to 51 per cent) is freely allowed in most industries. In industries reserved for the small scale sector foreign equity upto 24 per cent is permitted. Foreign equity upto 100 per cent is encouraged in export-oriented units in the power sector, electronics and software technology parks. In other industries also, foreign equity upto 100 per cent is permitted on merit. There is no restriction on the use of foreign brand names/trademarks for internal sale. Restrictive provisions earlier applicable to FERA companies, i.e., companies with more than 40 per cent foreign equity, have been

abolished.

A foreign investor has to seek "government approval" in one of two ways. A simple fast track mechanism or "automatic approval" is available for projects of certain kinds, e.g. upto 51 per cent equity in units in Export Processing Zones and also in 100 per cent export-oriented units and all foreign technology agreements which meet certain economic parameters. For all other proposals, applications are processed by a high level Foreign Investment Promotion Board (FIPB). With its record of speedy clearances, the Board has approved a total volume of foreign equity of $ 3 billion in the first two years. All this is in sharp contrast to the approvals of only about $ 150 million per year only a few years ago. India has joined the Multilateral Investment Guarantee Agency (MIGA) and is currently negotiating bilateral investment treaties with several countries.

Even as the attitude and policy towards foreign investment is changing radically, there is still a degree of ambivalence when it comes to foreign investment in consumer goods. This is very different from the approach followed by China which stresses that as long as foreign investment generates employment, economic activity and exports, the questions of whether it is in consumer goods or any other industry, high-tech or low-tech, are of secondary importance. Indeed, in the first seven-eight years of the opening up in China, foreign investors flocked to light consumer goods industries and thereby made significant contribution to the export boom from China. They could do this because the scales of production were geared to the global market.

In India, a major impediment to the emergence of the global scales of production in consumer goods has been the very high protective wall built with a combination of high tariffs and restrictive import licensing, on the one hand, and reservation policy for certain items for the small scale sector, on the other. The protective wall separates the highly profitable domestic market from the world market. Sub-optimal scales of production have therefore been set up to cater to the sheltered domestic market. If foreign investment or for that matter domestic investment is to be encouraged in consumer goods with a global vision, it is extremely important to replace the import licenses and the very high tariff rates by specified moderate rates of tariff on the imports of consumer goods and relax the reservation policy. Only then can India develop a manufacturing base for the export of consumer goods.

(c) Exit Policy

A major lacuna in the reforms of industrial policy is the persistence of the barriers to exit for non-viable sick units. The Board for Industrial and Financial Reconstruction (BIFR) was set up in 1987 to attend to the widespread incidence of industrial sickness in the private sector. It was assigned the task of separating the non-viable sick enterprises from the revivable ones and provide rehabilitation packages for the one set and effective solutions for exit to the other. The fact that the BIFR comes into the picture at a fairly advanced stage of sickness and that its powers are not mandatory have meant that it has not been effective in facilitating the exit of the nonviable sick units

within the existing institutional constraints.

To some extent this reflects the inherent complexity of the issues faced in any attempt at industrial restructuring. The challenge is not only that of overcoming the resistance from organised labour. While this is important, this can be attempted by offering packages of financial compensation and opportunities for training and redeployment of labour which is adversely affected in the process of restructuring. An additional challenge is posed by the rigidities of the institutional framework including the legal system which stands in the way of easier flow of resources from one industry to another. The recently submitted report by the Goswami Committee (1993) has also emphasised the constraining role of the inflexible judicial system.

It is widely recognised now that amendments in the Industrial Disputes Act, the Companies Act and the Urban Land Ceiling Act are vital if the legal framework is to provide the necessary flexibility in moving resources away from the unproductive and economically non-viable sectors to the more vibrant sectors. Amendments in the Companies Act would facilitate mergers of sick companies with healthy ones and also cut short the long drawn process of liquidation of firms. The Companies Act Amendment was in fact introduced in Parliament in 1993, but the government is proposing to submit a new Bill in its place to take account of certain concerns expressed by Indian industry.

The Industrial Disputes Act requires a firm to seek permission from the state government before any retrenchment of

labour and the permission is typically held back. Amendments in the Industrial Disputes Act would allow retrenchment of labour without the rigidities of securing permission from the state government. The Urban Land Ceiling Act is a major constraint in the functioning of the market for land and buildings in urban areas since land in excess of the ceiling cannot be sold without specific government permission which is often not forthcoming. Amendments in this Act will enable nonviable sick firms to sell their real estate to settle the claims due to their creditors and make it easier for them to exit. Once these legislative reforms are undertaken, the BIFR would also be able to function more effectively in helping the process of industrial restructuring.

(d) Public Sector Reforms

The urgency of the reform of public sector enterprises arises from the fact that the government does not have budgetary resources to continue to subsidise the loss-making enterprises. A compelling situation has been created by the inability of the government to continue to subsidise the public sector through budgetary support. The contribution of budgetary support to the plan investment of public enterprises declined from 23.5 per cent in 1991-92 to 13.8 per cent in 1993-94. More and more, public enterprises have to approach the capital market for their resource requirements on the strength of their performance.

As the economic environment is being made more conducive to cost and quality considerations and attempts are being made to foster competition, pressure on performance orientation in the

public sector is mounting and so is the need for reforms. But the resistance from the organised labour and the bureaucracy and pleadings from ideological quarters have stood in the way. As a result, the policy response in the form of public sector reforms by the central government has been slow.

The low if not negative rates of return on the investments made in a large number of public sector enterprises are well known and well documented in a number of official reports[1]. The profitability of PSU's in terms of gross profits to capital employed actually declined from 12.1 per cent in 1981-82 to 11.4 per cent in 1992-93. The net profitability has fluctuated around 2 per cent in recent years. If petroleum and power sectors are excluded, the net profitability was -0.7 per cent in 1991-92 and virtually nil in 1992-93 (Table 2).

The financial performance of the state public sector undertakings has been much worse. The heavy losses incurred by the state electricity boards (SEB's) alone are estimated to be of the order of Rs 45.3 billion in 1991-92 which amount to 14 per cent of the total anticipated annual plan outlay of all states and union territories. The SEB's have all along failed to realise the 3 per cent statutory rate of return on their assets. This is significant because the resource generation capacity of the SEB's has a direct bearing on their capacity to invest and contribute to the crucial infrastructure needs of the economy.

Much store has been laid by the signing of MoU's (Memoranda of Understanding) between a public enterprise and the

administrative ministry which controls the enterprise. While designed to distance the ministry from the day-to-day running of the enterprise, experience has shown that the MoU's have not really worked in providing effective autonomy to the public sector enterprises. A change of attitude in the new era of liberalisation may lead to some improvement in results in the years to come, but much more is needed than MoU's to distance the government from the actual running of the public enterprises.

A policy of ''greenfield privatisation'' has prompted private industrialists to venture into areas earlier reserved for the public sector, e.g., power, aviation, hydrocarbon development, telecommunications equipment and more recently even specialised telecommunication services (cellular phones).The number of areas exclusively "reserved" for the public sector has been whittled down to just 6 which covers areas such as defence, atomic energy, minerals going into atomic energy, coal and lignite, mineral oils and railway transport. Virtually all other areas have been opened to private investment.

Steps have also been taken towards the marketisation of public enterprises with a view to making these enterprises behave like commercial units. A successful example of corporatisation can be seen in the Mahanagar Telephone Nigam Ltd. (MTNL) in the telecommunications sector. This move raised expectations of more corporatisation, but further action has been slow. The loss making sick public enterprises have also now been brought under the ambit of BIFR. However, this by itself does not hold out much promise as the BIFR is already facing numerous problems dealing

with the sick private sector units.

The government established a National Renewal Fund (NRF) in 1992 to ensure that the cost of restructuring of sick public sector units does not fall too heavily on the workers. This Fund with a corpus of about $350 million is to provide assistance to cover the cost of retraining and redeployment of labour and also provide compensation to labour affected by industrial restructuring. In fact the Fund has been utilised more for voluntary retirement compensation than for retraining and redeployment. The National Textiles Corporation, a central government undertaking which has the portfolio of 49 sick textile mills taken over by the government at various points of time, has negotiated a package with labour whereby 60,000 workers have already been retrenched. There have also been mergers of a few mills as part of the restructuring exercise. But of late the process has slowed down. There has been little modernisation and even the progress of the voluntary retirement scheme seems to have slowed down.

Privatisation has not really formed part of the strategy of liberalisation in India. The policy of marginal disinvestment of the equity of public enterprises in the last two years has been dominantly governed by the compulsions of financing the fiscal deficits. The whole disinvestment approach is so incremental and so thinly spread that it fails to address the basic issue of how to improve the very low returns on the capital invested in the public sector. It is based on the tall assumption that the induction of private shareholders will alter the corporate culture in these

enterprises and provide them a stronger commercial orientation in response to normal shareholder expectations.

One of the major recommendations of the Rangarajan Committee (1993) which was set up to look into the question of disinvestment of shares in public sector enterprises was for privatisation by divesting upto 74 per cent of the equity of the public sector enterprises which are not in the sectors reserved for the public sector. It is high time that the government acted on this recommendation.

2. Broader Policy Environment

If reforms in the industrial and trade policy regime are designed to shake Indian industry out of its lethargy of functioning in a sheltered sellers' market and make it internationally competitive on cost and quality grounds, then it is extremely important that the gains on competitiveness are not offset by inflationary pressures in the economy. The stability of the macro-economic environment is crucial for the success of the structural reforms. Indeed the Indian policy makers learnt the hard way when the fiscal profligacy of the eighties resulted in the severe balance of payments crisis in May-June 1991. The New Economic Policies of 1991 were therefore designed with a dual thrust on fiscal stabilisation and structural adjustment.

The fiscal stabilisation programme started very well when

the fiscal deficit was brought down from a level of 8.4 per cent of GDP in 1990-91 to 5.9 per cent in 1991-92. This was achieved by cutting down the fertiliser subsidy, eliminating the export subsidy and reducing plan expenditures. In 1992-93, fiscal adjustment was of a much smaller order and that too mainly focussing on plan expenditures rather than subsidies. Fiscal deficit was brought down slightly to 5.7 per cent of GDP in that year. But there has been major deterioration in 1993-94. It seems that with a perception that the immediate crisis of the balance of payments is over has come a yearning for the bad old ways on the part of the government. Fiscal deficit in 1993-94 was targeted to be 4.6 per cent of GDP but the revised estimates show an overshooting by more than 50 per cent so as to bring the deficit to 7.3 per cent. The inflationary consequences of such a course can be very destabilsing for the structural reforms and must be avoided at all costs.

If fiscal policies have deviated from the path that was charted out in the New Economic Policies, the exchange rate policy has played a very active and supportive role. The trade policy reforms have been supplemented by a gradual movement towards a unified exchange rate. The exchange rate was initially devalued by 24 per cent in June 1991 while export subsidies were simultaneously abolished. After a brief sojourn with a dual exchange rate system in 1992, the exchange rate was unified in March 1993 and was effectively floated to be a market determined rate. In the budget for 1994-95 the government has announced its intention to make the Indian rupee convertible on current account transactions which is a significant step forward towards the liberalisation of the foreign exchange markets.

The need for an efficient and modern banking system for effective restructuring of the industrial sector was also recognised early enough in the new regime so that the Narasimham Committee (1991) was set up with the purpose of making recommendations for financial sector reforms. The committee underscored the importance of commercial orientation in the functioning of the banking system, deregulation of the interest rate structure and less pre-emption of banking funds to cover the fiscal deficits of the government if the banking system is to rise to the challenges of servicing a modern industrial sector. In keeping with the Committee's recommendations, a start was made in several areas, but the pace was adversely affected by the securities scam of 1992. Capital market reforms also suffered a setback during this period. Now that the Joint Parliamentary Committee has submitted its report to the Parliament and the government has also proposed a fresh agenda for reforms in the financial sector there should be more action on financial sector reforms.

A significant recent initiative has been the opening up of the capital market for portfolio investments. Indian companies have been allowed to access international capital markets by isuing equity abroad through the mechanism of Global Depository Receipts. Foreign institutional investors managing pension funds or other broad based institutional funds have been allowed to invest directly in the Indian capital markets. Favourable tax treatment has been granted to such investments to encourage capital inflows through these routes. At the same time the Securities and Exchange Board of India is working towards establishing a fair, transparent

and independent regulatory structure to protect the interest of investors who today number 15 million, and to facilitate the efficient functioning of the capital market.

3. Challenges ahead

As India has moved from a crisis management phase to a more durable phase in its reforms, the policy makers have faced tough challenges from several quarters. The performance during the first phase which lasted till about March 1993 was very impressive indeed. Unlike many economies going through structural adjustment with negative growth in the early years, India was able to avoid a major collapse of growth as GDP grew by 1 per cent in the first year and 4 per cent in the second year of the reforms(Table 2).The second phase has proved to be more difficult what with the weakening of the will in the face of the abating of the balance of payments crisis and building of resistance on the part of the vested interests which is only to be expected in a democracy.But the direction is firmly set while the pace has been varied to suit the political exigencies.

The success in managing the balance of payments has been impressive indeed. Foreign exchange reserves have increased from $1.2 billion in June 1991 to over $15 billion in March 1994. This has been achieved by strong export performance in 1993-94 and larger private capital inflows as confidence in the new economic policies has grown . Inflation was reduced from a peak of 17 per cent in August 1991 to half that rate within two and a half years. More recently, as the fiscal deficit has gone out of gear , the

inflation rate is rising once again and the year 1993-94 has seen inflation of a little over 10 per cent. The containment of the fiscal deficit is the toughest challenge facing the government today. This would call for a number of tough measures including a reduction in subsidies and elimination of wasteful expenditures.

Exports have begun to respond very well to the new trade and exchange rate policy regime. Export performance in the first two years of reforms was severely adversely affected by the collapse of the former Soviet Union which had been a major trading partner of India. Exports (measured in US dollars) declined by 1.5 per cent in 1991-92 and increased by less than 4 per cent in 1992-93 (Table 2). But with the effect of this disruption over, the underlying structural transformation is coming to surface. Exports are beginning to respond to the new policies, growing in dollar terms by 21 per cent in the first eleven months of 1993-94. The number of companies achieving international quality standards by obtaining certification from ISO 9000 series today stands at over 220 compared with less than 5 only three years ago.

With the restoration of international confidence has come a surge of investor interest in India both for direct foreign investment and portfolio investment. By the end of 1993 India had attracted actual direct foreign investment of $1.3 billion and approvals of over $4 billion. Compared with direct

foreign investment inflows of the order of $150 million in 1990-91 and 1991-92, the subsequent two years have seen inflows of $343 million and $600 million, respectively(Table 3). As international fund managers are diversifying their portfolios by investing in "emerging capital markets", India has also benefitted from this trend. Inflows from international equity issues by Indian companies in 1993-94 are estimated to be about $2.5 billion, while institutional investors have invested about $1.5 billion in the domestic capital markets.

Industrial revival, however, has been slower than expected. A transition to a higher and sustainable growth path requires a revival in investment. This has been slow in coming. Public investment has been low because of severe resource constraints, while private investment has been depressed as the corporate sector is reorienting its investment strategy to the new liberalised economic environment.As is to be expected, there has been some resistance from established industry to the pressure to compete. There is also reluctance to let go of the family control over established companies. There are demands for "level playing field" on the part of those who have seen nothing but great walls of protection all these years. But even they realise that the time for change has come, while the not-so-established ones are trying to make use of the new liberal economic environment.

Industrial growth at 2.4 per cent per annum in the nine months April-December of 1993 was only marginally higher than the

growth during the same period of 1992-93 (Table 2). The recession was particularly severe in capital goods (particularly electrical machinery) and sugar. In particular, capital goods production was adversely affected by the paucity of funds in the public sector and certain anomalies in the tariff structure which arose during the process of reforms.

The budget for 1994-95 has explicitly addressed the problems of the capital goods industry including the anomalies in the tariff structure. More generally, the sweeping reform of the indirect tax regime and the growth-orientation of the budget is designed to elicit a strong response from the private sector. The fact that the public sector is in a better position to raise funds should also help in the revival of investment by the public sector enterprises. There are indications that private investment activity is picking up. Sanctions from financial institutions have shown very strong improvement in the last quarter of 1993-94. Industrial Credit and Investment Corporation of India (ICICI) alone showed an increase of 50 per cent in its sanctions to industry during January-March 1994. Disbursements also showed a strong pick up although not as much as the sanctions.

In fact in industries other than capital goods and sugar, there were distinct signs of recovery even during 1993-94 as can be seen from the disaggregated picture in Table 4.When this picture is combined with the more recent indicators on investment intentions, it seems that the mood for wait and watch is turning into a mood for action.There is also reason to believe

that Indian industry is developing global vision. The best personnel of companies is being deployed in the export divisions of the companies rather than in the liasion division as in the past. The sharp increase in the number of companies obtaining ISO 9000 series certification for quality standards is another proof of the same phenomenon.

An important factor in the management of the transition to a more liberal economy has been the favourable weather for agricultural growth. If the Gods continue to be on the reformers' side, the next phase will be more manageable than otherwise.But there is no getting away from harsh decisions in the next phase of reforms.

First and foremost, the restoration of macro-economic stability requires that the government gets back to the path of fiscal rectitude . Or else, the resulting inflation will eat into the gains being attempted on productivity front. There is also need for a dispassionate and open debate on the desirability of privatisation. If the government does not have the resources to support or revive loss-making enterprises in areas which are neither strategic nor of social importance such as health, education , rural development and poverty alleviatiion, and if the enterprises are not in a position to raise resources from the market, should they be allowed to die a slow and agonising death or is privatisation an option ? Is it desirable to privatise such enterprises and use the funds raised thereby to meet the needs of investments in the social sectors ? What role can the

needs of investments in the social sectors ? What role can the state governments play in carrying the reforms to the ground level ? Indeed it is extremely important that the reforms are carried through to the level of the state governnments. Bringing about a quiet economic revolution within a democratic framework is the challennge. It is a long haul and India has just begun the journey.

Table 1

MACRO-ECONOMIC INDICATORS

A: SELECTED GROWTH RATES[1]
(per cent per annum)

Year	Real GDP Total	Industry	Agriculture
50-51 to 60-61	4.1	5.3	3.0
60-61 to 70-71	3.8	5.0	1.8
70-71 to 80-81	3.3	4.8	2.1
80-81 to 89-90	5.5	7.1	3.2
90-91	4.9	8.3	4.8
91-92	1.1	0.0	-2.0
92-93	4.0	1.9	4.9
93-94[2]	3.8	2.4	n.a.

B: SELECTED RATIOS
(per cent of GDP)

Year	Saving	Investment	Current Account BOP	Fiscal Deficit (Centre, States & U. Current	Overall
50-51	10.4	10.2	-	-	-
60-61	12.7	15.7	-2.4	0.5	na
70-71	15.7	16.6	-1.0	0.3	na
80-81	21.2	22.7	-1.2	0.1	-7.
89-90	24.0	26.7	-2.8	-3.4	-9.
90-91	24.0	27.4	-3.3	-4.5	-10.
91-92	23.1	24.2	-0.9	-3.7	-8.
92-93	22.3	24.5	-2.1	-2.7	-6.

[1] Data are for fiscal years. Thus, 1950-51 refers to the period from Aril 1, 1950 to March 31, 1951.

[2] April 1993 to December 1993.

Source: Economic Survey, Ministry of Finance, and National Accounts and ~~Indian Economic~~ Statistics.

TABLE 2

RECOVERY FROM CRISIS

	1990-91	1991-92	1992-93	1993-94
		(growth rate)		
GDP	4.9	1.1	4.0	3.8
Industrial production	8.3	0.1	1.9	2.4a
Exports ($)	9.2	-1.5	3.8	21.4b
Imports ($)	13.5	-19.4	12.7	0.7b
Prices (WPI)	12.1	13.6	7.0	9.1b
		(per cent of GDP)		
Current Account deficit (BOP)	- 3.3	- 0.9	- 2.1	- 0.5
Fiscal Deficit(Central Government)	8.4	5.9	5.7	7.3
Savings	24.0	23.1	22.3	-
Investment	27.4	24.2	24.5	-
Foreign Exchange Reserves ($ billion)	2.2	5.6	6.4	15.0
Exchange rate (Rs/$)	17.9	24.7	29.0	31.4

a April 1993 to December 1993. Industrial growth is 6 per cent per annum if capital goods are excluded.

b April 1993 to January 1994.

Source : Economic Survey 1993-94, Ministry of Finance, Government of India.

TABLE 3

FOREIGN INVESTMENT INFLOWS

(in million $)

	1990-91	1991-92	1992-93	1993-94
Total	165.0	148.0	585.0	4600
Direct Foreign Investment	165.0	148.0	343.5	600
Other Foreign Investment	0.0	0.0	241.5	4000
Foreign Institutional Investors	(0.0)	(0.0)	(1.0)	(1500)
Euro-issues	(0.0)	(0.0)	(240.5)	(2500)a

a Estimates based on actual inflow of $ 2100 million upto March 4, 1994.

Source : Ministry of Finance, Government of India.

Table 4

Industrial Recovery : A Close Up
(per cent per annum growth)

Industrial Production	April-December 1992-93	1993-94
Basic goods	[illegible].3	3.2
Intermediate goods	5.0	10.3
Capital goods	8.7	-6.4
Consumer goods	0.5	2.3
Durables	-0.6	13.5
Nondurables*	0.8	2.6

* excluding sugar.

Source : Central Statistical Organisation, Government of India.

End-notes

1. The first major study to spell out the serious shortcomings of the policy regime was by Bhagwati and Desai (1970). This was followed by a detail study of the Indian foreign trade regime by Bhagwati and Srinivasan (1975) which reinforced the finding of ineffectiveness of the policy instruments to achieve the set targets of growth and development. Reports of official committees headed by Alexander (1978) and Dagli (1979) conveyed a similar message.

2. For a detailed discussion of the productivity trends in Indian Manufacturing, see Ahluwalia (1991). The updated results are given in Ahluwalia (1992).

3. Chelliah Raja (1992), Chairman Tax Reform Committee, Department of Revenue, Ministry of Finance, Government of India.

4. Annual Reports of the Bureau of Public Enterprises provides the information base for these reports.

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ATTACHMENT II to the IRIS-India Quarterly Report for April-June 1994

Press Clip of Professor Dutta's Seminar

Visiting Indian Scientists in Physics

Collaboration Produces New Book

UMCP Physics Professor Chuan Sheng Liu and visiting professor Vipin Tripathi of the Indian Institute of Technology (IIT) in Delhi, who have been collaborating in the area of plasma physics since 1976, recently co-authored a book, ***Interaction of Electromagnetic Waves with Electron Beams and Plasmas*** (World Scientific Publishing Company, 1994).

The pair's collaboration dates back to Tripathi's appointment as a Fellow in UMCP's Center for Theoretical Physics from 1976 to 1978. He remained at UMCP as a research associate until 1983, when he returned to India as a Physics Professor at IIT Delhi. Between 1976 and 1983, he and Liu conducted research on radio frequency heating of plasmas. Since 1985, Tripathi has returned to UMCP for approximately two months each summer to continue working with Liu and the Laboratory for Plasma Research. They are currently working on projects in the areas of laser-plasma interaction and free electron lasers. Tripathi holds a Ph.D. in physics from IIT Delhi.

Tripathi will be at UMCP until the end of July. For more information, he can be reached at 301-405-1471.

Solid State Chemist Working with Greene

Dr. Jagannatha Gopalakrishnan, Professor in the Solid State and Structural Chemistry Unit of the Indian Institute of Science, is spending May 1 to July 31, 1994 as a visiting professor at UMCP's Department of Physics, where he is working with Professor Richard L. Greene on giant magneto-resistance. Co-author of the book, ***New Directions in Solid State Chemistry*** (Cambridge University Press, 1986), and author or co-author of over 160 research papers, Gopalakrishnan specializes in the synthesis of oxide materials, especially superconducting oxides and structure/property relations. He has worked as a senior Alexander von Humboldt Foundation fellow at the Technical University of West Berlin (1974-75), and as a visiting scientist at the Dupont Company in Delaware (1987-89). He received his Ph.D. in inorganic chemistry from the Indian Institute of Science in Bangalore. For more information, contact Richard Greene at 301-405-6128.

UMCP Participation in U.S.-Korea Science and Technology Cooperation Forum II

UMCP was one of 10 supporting organizations that helped stage the "U.S.-Korea Science and Technology Forum 2," a two-day meeting in May, 1994 of 250 Korean and American leaders with interests in building science and technology links between the two countries. Conference sessions included possibilities for cooperation in nuclear energy, aerospace, electronics, environmental, biotechnical and basic sciences, as well as a general overview of strategic alliances for science and technology cooperation and R & D cooperation in strategic technologies.

The conference was co-chaired by Jay W. Khim, a UMCP alum who is current CEO and Chairman of the Board of JWK International, and former Congressman James Symington.

California Congresswoman Anna G. Eshoo addressed the pre-conference dinner for conference panelists and their guests.

Indian Economist Bhaskar Dutta at IRIS

The noted Indian economist Bhaskar Dutta (*below, right*) presented a seminar c "Human Development in India" at UMCP's Center for Institutional Reform a the Informal Sector (IRIS) in April. Dutta is Professor of Economics at the Indian Statistical Institute (ISI) in New Delhi and was previously Professor of Economics at the Delhi School of Economics before joining ISI. He has been a visiting Professor at the University of California, Davis, and the Institute of Economic Analysis, Universitat Autonoma Barcelona. He is currently visiting the Center of Research in Conflict and Negotiation, Pennsylvania State University. Dutta has done research in social choice, game theory, and development economics. He is on the editorial boards of the journals ***Mathematical Social Science, Choice and Welfare***, and ***Economic Design***. For more information about Dutta's visit, and the work of IRIS in India, contact Satu Kähkönen at 301-405-3051.

Inchon Educators at UMCP

A group of four professors and administrators from the University of Inchon (Korea) visited UMCP in January, as part of a U.S. study program involving several American cities, to discuss budgeting and administration of large public universities, in preparation for Inchon's impending transition from being a private university to one run by the city of Inchon A member of the Korean delegation, Dr. Young K. Kim, is show here (*right*) meeting with UMCP Director of Undergraduate Admissions Linda Clement. For more information about the visit, contact Marcus Franda at 405-4772.

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ATTACHMENT III to the IRIS-India Quarterly Report for April-June 1994

Press Clips on IRIS/India

THE HINDUSTAN TIMES INDIA

Economic jingoism

By Srivatsa Krishna

DO all nations really need to protect their economies, before they grow?

Jingoism of any sort is rancid. Not only because of any antipathy to the doctrine that it preaches but also because of the way it preaches it, which says this is the only right path. While this is often observed and well understood in politics — when, for instance, Hindu or Muslim jingoists say that their thought alone is the gospel, while all others are wrong — its pernicious effects are not so easily observable in economics. Indeed, jingoism exists in economics as well, for all nations, at some time or the other, resort to some form of protection or economic nationalism, presumably to bring home economic growth. But with certain glorious exceptions — where other extraneous factors played a decisive role — they almost always impair economic efficiency and stifle growth.

Protection

While economic theory postulates that a period of protectionism is necessary for all firms to acquire skills and technology in order to be able to compete in a fiercely competitive market place, what happens in practice is actually quite different. Conventionally the critics believe that protection insulates domestic industry from competition, bringing with it all the well known economic ills. Protection creates vested interests.

Traditional economic theory has always focused only on the height of tariffs, seldom on its length or mileage. But recent literature in institutional economics — especially the work of Mancur Olson — clearly and brilliantly demonstrates that the mileage of tariffs is perhaps more important than their height. While it is well known that the level of protection in the developed world was amongst its highest in the inter war period, than before or after, this is seldom seen as a cause for economic stagnation. Yet another often overlooked fact is that protection appears to affect the bigger economies much less than the smaller ones. The principal economies enjoy a huge unfettered internal market. In other words, the greater the mileage of the tariff wall, the bigger is the economic space contained within it, thereby freeing trade within it and thus spurring growth.

The central argument put forth by Mancur Olson is that the most significant periods of the freeing of trade have come from national unification and other developments that have created larger jurisdictions ('jurisdictional integration') within which there was free trade even though such jurisdictions were protected by tariffs from rest of the world. Olson furnishes evidence for this in the form of rapid growth in Germany (after the creation of Zollverein or a customs union in the 1830s and after), post-Meiji Japan, and the United States after its Constitution came into effect in 1789 which outlawed internal tariffs. Thus, despite high external barriers all through the 19th century up to 1930, the American economy achieved tremendous economic growth, because of the creation of a huge free domestic market.

The reason for such superior performance goes beyond conventional arguments of comparative or even competitive advantage. All nations, during the course of time, accumulate various special interest groups, whose principal occupation is to lobby the government for benefits to its members. Depending on the internal organisational strength of each group, one may be more effective than another as a lobby, thereby skewing all economic policy-making towards it, rather than each nullifying the other.

Special interests

Such special interest lobbies are difficult to organise, but once in place they are almost impossible to destroy or disband except under a totalitarian regime or after a war wherein they are decimated completely. To extend the same argument to jurisdictional integration, once internal tariffs are removed and a bigger market is created, the existing special interests are rendered like them, each as useless as the other. Since it takes considerable periods of time before new associations for collective action are formed and indeed formed sustainably, the intermittent periods are those of rapid economic growth. Olson offers substantial proof to support the above thesis that the extent of damage done by special interest groups will be much less after there has been a huge domestic freeing of trade either through 'national unification, a common market or unilateral action', despite the presence of external tariff walls. Further, the evidence he furnishes also stands testimony to the fact that after national cataclysms and violence, which destroy such organised interests, there is unusually rapid economic growth.

Competition

The hidden cost of economic nationalism is that organised special interests are quite content to sell in a protected domestic market rather than face the icy winds of competition. 'Our market is big enough', is the common refrain that one hears, though on closer inspection one can discover that it is a diehard protectionist who often uses market size as a cloak to mask his true fears. The evidence that is available corroborates this fact that countries with high levels of protection for manufacturing, without a single exception, export very little of their manufactures, while countries with lower levels of industrial protection often export more.

Indeed, most special interests — especially in a country like America, where liberalism and free markets are the watchwords — have internalized the fact that protection is a four-letter word! Thus, rather than openly clamour for protection, they wear yet another mask of 'fair' trade — whatever that means! — only to demand protection. For, if they lobby the US Congress and ask for protection they will probably never get it. But on the other hand, if they claim they are asking for a 'level playing field' or that their closest rival is playing unfair, they are saying everything that a good Congressman protection they desire.

Such vested interests rely zero-sum fallacy that inte tional trade is a zero-sum g where one nation's gain n sarily means another's loss. ignores the fact that muc R&D and investment in hu capital is in the nature of a p good and as such its benefit non-appropriable. If one tion's workers become wise bound to help add to the ec mic prosperity of the world whole. Similarly, everyone nefits from advances in fibr tics and robotics, not ju chosen few. It is simply imp ble to imprison knowledge in the confines of a na through any form of econ nationalism and thus the for it is flawed.

The above thesis is fur corroborated by the impre success of so many coun with relatively lower level protection in developing petitive manufacturing in tries and indeed exports manufactures, even when lack natural resources and o raw material basic to such deavours. However the nian thesis itself concedes the above arguments must n converted, carte blanche, to clude that such a nexus betw protection and special inte is the entire explanation for correlation between openne imports of manufactures jurisdictional integration on one hand, and success in veloping competitive manu turing industry on the other

Hard truth

Yet there is no escaping hard truth that while protec is regarded as a four-letter by many liberal nations, yet unabashedly practise aggres economic nationalism, nay nomic jingoism, at peril to th selves and the prosperity of whole world. If one moves a from the traditional static an sis of trade and takes a dyna institutional view of it, its hid costs and pernicious s effects become more tran rent. However, intellec transparency has rarely b either a necessary or a suffic

SRIVATSA KRISHNA

The power of positive thinking

Excerpts from an interview with the 26-year-old versatile Srivatsa

Why IAS?

An IAS officer's contribution is more central to the affairs of the nation. He has a broader canvas to paint on. He has a wide brush with which he can make his strokes. If he makes his strokes well, I think the nation can be pictured quite well. There are constraints in the IAS also. Yet within those constraints if each individual does his job honestly, a tremendous amount of contribution can be made by each person. That is why I chose it.

Second, it is the Indian Administrative Service. The key word here is 'service'. I see IAS as an instrument to serve the people, which I consider as the ultimate masters, to make a positive difference to their lives. That is the essence of what I wanted to be involved with. I feel there are tremendous unfinished tasks within the country. Take a look at any sector — there is so much work to be done. I think I can make a contribution as an economist.

On his exam preparation

Personally, I tend to take everything quite easy. I'm made that way. For my preparation, I first studied the papers of the past years. You will find that over the years the CS papers are becoming increasingly analytical. They make you think, which is necessary. It is your perception built up over the years that is being tested. What is the quality look at an issue from many sides? Can you link up and correlate events, issues, draw lessons from various things? Can you relate them to everyday life? These are the aspects they are interested in. My schooling helped me develop the ability to analyse. Plus, participation in debating activities — at the national and international levels — gave me a lot of confidence.

On the exam itself

The real key of cracking the CS exam is that on the d-day your brain should be razor sharp. You should be prepared for any question; you should be specially prepared for questions outside the syllabus, for questions which tickle the mind, for questions which might have little immediate relevance to what you have read. Whatever may be the case, you should be able to think laterally, horizontally. You should be able to connect, link up cogently, analyse and write out the answers clearly, probably saying something original which someone else won't say.

Second, I think there is no need to do the course once, twice or thrice, as most people do. Simply because in this exam they are not testing your factual knowledge. It's more a question of how you think. This exam is a way of life. It is not as though you pick up a book, read it and spew it all out to get marks. I think the exam has a lot to do with our perception of life — how we perceive issues and arguments — and of our upbringing. I think these things

selective.

On Economics (first optional in Mains)

My subject in graduation, it naturally was my first choice. I looked at most of the World Bank reports, papers and documents. Read books by Atul Kohli, Mancur Olson, Pranab Bardhan, Amiya Guha, Ashok Desai and Nimal Jain. Doing book reviews for magazines and newspapers gave me the opportunity to read whatever new was published. Beyond these books, you don't require anything else for the Mains Economics papers.

On Public Administration (second optional in Mains)

I chose this because I felt I should know something about administration, particularly as I want to become an administrator. Public Administration is a second optional for most CS candidates. Since there are very few graduates in the subject, we are all on an even keel. It has a smaller syllabus which is also why many find it very attractive.

In choosing your optionals, I feel you should opt for something you are comfortable with, even if it's not scoring. Interest should determine your choice. This bit about 'scoring' or 'non-scoring' subject is dangerous. The pattern varies from year to year. One year it's Public Administration, the next year it could be Anthropology or Sociology...

Ultimately, cracking the *Mains* is analysis then and there, instant thinking and cogent and clear writing. You have to be very quick on your 'feet'. Plus you have to be extremely original in your answers — show that you are a thinking person. The examiner after reading two papers should say, OK, this guy has something different to write. Remember, everyone is reading the same books and will say the same things.

On the Personality Test

It is a personality test, hence you cannot prepare for it. You have a personality you have developed over the years. They either like it or don't like it. They are not looking for knowledge here but for your values, principles, etc. Which they gauge from your responses. Of course, you have got to be generally aware of what is in the news.

The CS interview board manages to create an atmosphere where the environment is extremely cool and calm. Then slowly the pressure is turned on you. They will suddenly put you in a tight spot. The questions will see-saw from one subject to another. The idea is to see how you react to pressure. Can you take stress? How rapidly do you think? Can you change your mental gears quickly? They are also looking for originality in your thinking; for integrity and honesty in your approach. Do you have strength of character? If an administrator doesn't have this, with the amount of discretion available to him, he can make or mar anything. If one's strength of character doesn't come shining through, then I think it's very difficult to convince the panel.

Times India June

Attachment 1
Trip report - Cynthia Clement
June 1994

IRIS-Mongolia Workshop Coordinator Cynthia Clement and three IRIS consultants, Professor Robert Cooter of the University of California, Berkeley, Professor William Kovacic of George Mason University, and Professor Paul Mahoney of the University of Virginia, travelled to Mongolia in early June to conduct the second workshop in the current project's series. The topic covered was "Business Law: Design and Implementation". In attendance were fifteen judges from various levels of the court system, ten law-drafters from various offices, including the Hural, the Ministry of Justice, the Privatization Commission, and the National Development Board, two lecturers from the Mongolian State University and the Economics College, and two lawyers. The Supreme Court of Mongolia provided meeting rooms. The workshop was conducted in English with consecutive translation by Ms. Yanjemaa, Mr. Bathoyag, and Ms. Hailuna. A list of workshop sessions and invited participants is presented as Attachment 2.

Two procedures were used at the conclusion of the workshop to evaluate its effectiveness. The participants were asked to divide themselves up into four groups that would meet separately to discuss a policy issue of their choosing. The groups also were asked to choose a representative who would report the groups' findings to the whole audience. The overall conclusion drawn from these oral reports was that several key ideas had become clearer to the participants, and that they could see important changes that needed to be made.[1] The participants were also asked to complete written evaluation questionnaires; copies of the questions and the responses collected are presented as Attachment 3.

The oral reports and the written evaluations addressed the format of the workshop, in terms of the range of topics presented and the choice of participants. Most participants expressed appreciation for the overview provided by the design of the workshop; the combination of a focus on fundamental issues supplemented by discussion of a few relatively more complex topics was well-received. They found the comparisons of the civil law tradition and the common law tradition useful for understanding the context of the legal system as a whole. They appreciated the attention paid by instructors to developing examples specific to Mongolian custom and laws. The overall conclusion was that the primary focus of the workshop on contract law, property rights, and dispute settlement had proved very useful; their major complaint was that they desired even more details and examples on these topics. They also expressed strong interest for more of the same kinds of discussions on company law and bankruptcy, two issues that could only be partially developed because of time constraints.

Some participants thought it would be easier to organize a workshop for people from a single organization, but all expressed appreciation that judges and policy-makers had been given the

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[1] The representative who spoke were asked to provide the IRIS-Mongolia Project with copies of their notes; at the time this report was written some had been collected, but their translation into English was not yet finished.

opportunity to work together. Judges in Mongolia frequently complain about imprecise language and inconsistencies among recently-enacted laws on such business-related matters as property rights, contract disputes, and bankruptcy. They believe that the legislature and the ministries who write laws and pass resolutions are not providing them with laws that can be implemented. On the other side, members of the legislative and executives branches complain that the judges are too poorly trained to understand the laws and adequately interpret them in the context of specific cases. Nearly all judges studied law in the context of the former system of central planning, and for the large majority, their previous training and experience fell only in the areas of criminal and family law. Consequently, the workshop was designed to both help improve the writing of laws and to help the judicial branch better understand the intent of the law-drafters.

As measured by comments made during their presentations, the Mongolian participants gained the following from the workshop. The judges expressed their appreciation for discussions of the role of the judiciary in common law systems; they are interested in finding ways to explain their problems in implementing laws to the writers of law within the context of the civil law tradition. One area of reform that they identified concerned the amount of direction that lower level judges are given in the interpretation of new laws. It was suggested that the Supreme court justices could expand on their tradition of providing commentary on laws to include more background material and specific examples for economic laws so that lower-level judges improve their decisions. Both judges and law-drafters expressed an increased recognition for the role of default rules in contracts; they appreciated that such mechanisms could simplify the writing of laws as well as provide private parties options for the conduct of their transactions. The judges realized that their role in dispute settlement was to help parties achieve the original intentions of the bargainers, except where criminal intent was present. Some participants were interested in further exploring the responsibilities of lawyers in representing clients, especially under the conditions of transition where a large majority of people are unexperienced and uneducated in business practices.

The success of the workshop in meeting specific needs of the participants is due in large part to the preparatory activities of the IRIS-Mongolia Field Staff, namely Mr. James Anderson and Ms. Hashbat Minjin. Their work in interviewing prospective participants and providing translations of Mongolian laws and documents made it possible to quickly focus on the most important issues and provide detailed examples relevant to current Mongolian conditions. Their work also prevented logistical problems from detracting attention away from the substance of the workshop.

ATTACHMENT TWO

IRIS-Mongolia Workshop, June 6 - June 14

BUSINESS LAW: DEVELOPMENT AND IMPLEMENTATION

Introduction: The first session presented an overview of the topics to be covered within the workshop and explained the objectives to be pursued. The session introduced the instructors and the participants. Both law-drafters and judges attended together, and the session was led by Cynthia Clement.

Goals of a Legal System: The legal system can be used to promote economic efficiency, pursue ideals of equity, and must also handle the problems of administrability. This session discussed these goals in the context of contract law and explored the tradeoffs inherent between them. The session addressed both groups and was led by Robert Cooter.

Basic Economic Concepts: Economic theory provides useful concepts which help explain why and when laws are successful. This session, led by Cynthia Clement, described incentives to buy, sell, and exchange, and the coordination of incentives accomplished by the market mechanism. It also further developed the concept of economic efficiency and the ways that government actions can promote or hinder efficient results. Each group discussed this topic separately.

The Components of a Legal System: This session, led by Paul Mahoney, described the various components of a well-functioning legal system and demonstrated their interdependence. Both the differences and the similarities between systems based on the civil law and the common law traditions were explored. A list of various laws that relate to business activity was elaborated. Each group discussed this topic separately.

Economic Analysis of Property Rights and Contract Law: The purpose of this day-long session, led by Robert Cooter, was to explain in greater detail the economic function of laws that define property rights and guide the use of contracts. The obstacles which often hinder voluntary exchange, such as poorly defined property rights and uncertainties inherent in exchange, were illustrated, as were the solutions provided by law. The distinction between efficient and inefficient interference with a property owner's rights and the kinds of legal rules that can protect property owners from interference were covered. The session also explored why contracts sometimes are broken and discussed the role of a neutral arbitrator such as a court in such cases. The various legal remedies available when contracts are broken were evaluated in terms of economic incentives. Each group discussed this topic separately.

Statutory Models of Property Rights and Contract Law: This day-long session, jointly led by William Kovacic and Paul Mahoney, worked through examples of laws relevant to defining property rights and contracts. The examples included parts of the current Mongolian Civil Code and its amendments and the U.S. Uniform Commercial Code. The examples were used to define and illustrate the key concepts that such laws should embody. Each group discussed this topic separately.

Statutory Models of Business Organization: Paul Mahoney addressed the law-drafters and discussed issues that arise in the legal definition of various forms of business organizations. Examples were taken from the laws of other countries and from the laws currently in effect in Mongolia.

A Case Study of a Contract Dispute: William Kovacic addressed the judges and worked through a hypothetical case study of a contract dispute in Mongolia. The case study illustrated the role that judges play and the procedures that could be utilized to resolve disputes. Comparison between American and Mongolia practices were made.

Government Procurement and Supply Contracts: William Kovacic described the special concerns present when a government agency is one party to a contract and how these concerns are addressed in U.S. law. The issues which are particularly relevant to Mongolia were highlighted. Some special concerns of enforcing law were also illustrated within the context of this topic, which was discussed by both group together.

The Role of Bankruptcy Law in a Market Economy: Paul Mahoney discussed the purposes that bankruptcy law serves in a market economy and illustrated the connections between contract law and bankruptcy law. The special issues of bankruptcy in a transition economy were identified. Both groups discussed this topic together.

Working Groups on Specific Areas of Mongolian Law: The participants and instructors wee divided into four groups, each including writers, judges, and instructors. Each group discussed the status of the Mongolian legal system relating to a specific policy issue; topics included laws relating to economic entities and corporate organization, the role of the courts in writing law in a civil law tradition, the potential role of a specialized court to handle business cases, corruption, and courts versus administrative regulation. The goal of each working group was to prepare a statement to share with the other groups, describing what issues of concern are present relevant to their topic.

Reports on Specific Areas of Mongolia Law: A Mongolian representative from each working group presented findings on their assigned policy issue to the other groups. Discussion of these findings followed. The instructors provided their own assessments of Mongolia's current legal system and its needs and fielded questions from participants.

INVITEES FOR SECOND WORKSHOP		
NAME	AFFILIATION	GENDER
B. Narandolgor	Bayanzurkh District Court	female
B.Sarantuya	Suhbaatar District Court	female
B.Undrah	Bayangol District Court	female
Batbold	Ardyn Bank	male
D. Tungaleg	Deer District Court	female
J.Enhtuya	Chingeltei District Court	female
L. Oyun	Bayangol District Court	female
Monknasan	Union of Advocates	female
Batkhuu	Ministry of Justice	male
Rinchin	Mongolian State University, advisor to Union of Productive and Service Cooperatives	male
Sara	Private lawyer	female
Bayarsaikhan	Hural Member	male
G. Ganbold	Hural Member	male
Narantuya	Legal consultant to the Hural	female
Nyamdorj	Hural Member	male
Batjargal	Mongolian Chamber of Commerce International	female
Erdenechimeg	Legal Consultant to the Hural	female
Altantsetseg	Mongolian Chamber of Commerce International	female
Amarsanaa	Institute of Administration and Management Development	male
B.Iderchuluun	Songinohairhan District Court	male
Bailykhuu	Privatization Commission	male
Bayasgalan	National Development Board	male
Boldkhuu	Ministry of Justice	male

Ch. Zorigt	Ulaanbaatar City Court	male
H.Batbayar	Han-Uul District Court	male
I. Tumenjargal	Songinokhairkhan District Court	female
L. Sarangerel	Khan Uul District Court	female
M. Tserenbaljir	Sukhbaatar District Court	female
Minjuur	Central Council of Consumer's Cooperatives	male
Ochbadragch	Privatization Commission	male
R.Jaminchoijil	Supreme Court	male
Sh.Tugsgerel	Bayanzurh District Court	female
Soyolerdene	Economic College	female
T.Gariima	Ulaanbaatar City Court	female
Turbayar	Ministry of Justice	female
Chinbat	Legal Advisor to Chairman of the Hural	male
Delgertsetseg	Hural Member	male
Dolgor	Legal Consultant to the Hural	female
Dugerjav	Ministry of Justice	female
Enkhbaatar	private lawyer, MPRP	male
Naranchimeg	Mongolian National State University	female
Soughar	Deputy Minister of Justice	male
Tsanjit	Legal advisor to the Chairman of the Hural	male
Tumur	Hural Member	male

ATTACHMENT THREE

IRIS-Mongolia Workshop
Business Law: Design and Implementation
Evaluation Questionnaire

Your opinions about the workshop would be very helpful to us as we plan future activities for the IRIS-Mongolia project. Please answer the following questions honestly; comments and criticism are welcome wherever you feel it is appropriate.

1. Which workshop sessions were most useful to you and why?

R.Cooter's sessions on the law development analysis were very interesting. They give me a methodology for my work. Also sessions on the requirement on setting limits/restrictions of the government, contract law and economic concepts.

Business law. The law doesn't exist yet in Mongolia. It was interesting to learn how to draft this law, amend and implement it.

Property and contract laws. Because property and contract disputes arise everyday in my practice, I found the above mentioned topics very useful.

Contract and property, components of a legal system. they are needed in our everyday work.

Especially topics on practical comparing the American and Mongolian systems of using laws.

For a judge, the most important were economic concepts and property and contract issues.

Market economic contracts and issues related to them, also property issues.

As for a member of the working group drafting the Civil Code the issues connected with the Civil Code -property law, contract law etc - were most useful.

Contract law as it is very important in a market economy.

I most enjoyed the contract law, its explanation and examples.

Business organization by Mahoney. Reason: I'm working on drafting amendments to the company law.

Property rights and economic analysis of the contract law. I learned a lot about analysis.

The most interesting was on how to use laws and on contract law.

All sessions were important. The most important was on contract law.

Property rights and economic analysis of the contract law, models of business organization. For lawyers who lack economic knowledge this information is crucial. I also received many answers to the questions

which need to be regulated in the amendments to the law on business organizations.

1) Property rights 2) Legal aspects of contracts
Reason: these two issues are the two most important issues in business law

Contract and business laws. This kind of knowledge becomes crucial in the transitional period in our country. These sessions were very useful and enriched our previous knowledge.

I understood the possible ways of resolving cases in the transitional period to a market economy through the lessons on business law and its purpose and contract rights.

Contract law. There are a lot of disputes concerning contracts in the Mongolian courts at the moment.

Property rights and contract law. For judges it is very important to have developed property and contract laws since we resolve these kind of disputes on their basis.

2. Which workshop sessions were least useful to you and why?

All topics were useful to me to a certain extent. But company organizational structure and securities law sessions were not complete.

No useless sessions.

There were no useless topics. Almost every session dealt with the issues we face everyday.

There were no useless sessions

No useless sessions

Each session gave me specific information, so there were no useless sessions for me.

There were no useless sessions.

No question.

No question.

No useless issues.

Honestly, there were no unuseful sessions and discussions.

There were no useless sessions.

I received certain and useful information on all sessions.

All sessions proved to be useful and informative.

All the seminar topics concentrated on business law, thus
all sessions were useful.

I think that all the sessions will be useful to a certain degree.

All the sessions were interesting and useful.

Since all the sessions covered the main topic of the transition period there were no useless sessions.

3. Was the overall level of discussion satisfactory, too advanced, or too simplistic for you?

It was not difficult to understand. The examples helped a lot to understand better what was being explained.

Satisfactory

The organization of the workshop allowed the participants express their views and opinions freely. Overall, it was at the level of ordinary discussion.

I would like to say that the seminar attracted us by the way the explanations and discussions were held -very clear and comprehensive.

Everything was comprehensive and clear.

It was clear.

The discussion on comparing two countries legislative systems was very appropriate.

There is no question about it. All sessions were interesting.

Because the examples were clear and certain, the sessions were comprehensive.

All discussions were useful. Especially the one on different ways of resolving contracts.

Sufficient

The level was suitable to me.

Sufficient

The level was, maybe, too simplistic. But I do not deny it if it was connected with a certain methodology.

In general, it was satisfying, but there was much repeating in some obvious and clear questions/problems.

Satisfactory.

enough

Satisfactory

Satisfactory and good.

It was very good. All the questions were explained clearly and in a comprehensive way.

4. **Would you recommend any changes in the format of future workshops? For instance, number of sessions, types of handouts, involvement of participants, etc.**

The sessions can be more specific (only contract, only property etc). The number of the participants was precise.

Wouldn't it be easier to organize a seminar for employees of one organization? E.g., only judges, only legal consultants.

The same format would be good, but maybe involving people of the same specialization would give more positive results.

Everything was fine except that the legal field topics could have been in one trend.

This type of seminars would be appropriate.

This seminar was very sufficient, maybe in the future the topics could be discussed more in detail/specifically.

In the future seminars, in my opinion, the number of participants should be around 20 and the lessons could have a wider framework.

The same format would be good. Perhaps, if the topics could be more narrow.

The same format would be good for achieving good results. It would be also useful, perhaps, to involve the same participants.

It would be good to keep the same format. Perhaps, giving more examples would be advantageous.

The number of participants, in my opinion, should be decreased, thus the rooms could be smaller. Also in order to give the people a chance to attend all sessions and to be far from the work place, to hold a seminar outside of the city.

I suggest sessions be more specific (narrower topics): e.g. Land law, Apartment privatization.

To keep the same format and add more comparative discussions.

If you could narrow the topics, it would be even more useful. E.g. only, contracts, only property rights.

I think that the next seminar should embrace a wider circle of issues and questions. As for the participants, to improve their participation and interaction, the form of the reports as it was done in the last session, should be encouraged more.

To keep the same number of participants would be good.

This type of seminars should be repeated. It was very well organized in terms of number of the participants and length of the seminar. It was very important to include judges.
The timing and organization were adequate.

This type of organization should be kept in the following seminars too. But in my opinion, perhaps, the number of participants should be decreased and one session (topic) should be extended, so that more information can be obtained in shorter time.

It would be useful to keep the same format in the future workshops. The number, lesson duration etc were very appropriate.

5. How do you intend to use what you have learned during the workshop when you return to your regular work? Please give specific examples.

After the Civil Code is passed, there are about 20 law drafts following it, in which somehow I will take part. That is why the information I obtained at this seminar will be very useful.

I will work within the framework of the Mongolian laws. But in some cases I would consider using the examples learned at the seminar.

In the process of resolving the disputes I will use the lessons learned at the seminar on the comparative basis.

Specifically, I will use some theoretical grounds in the issues
related to contract and property rights. Especially, contract.

There were issues to reflect in the future work.

I will use the knowledge obtained at the seminar in economic and property contracts in a creative way.

I will try to use some issues which would suit our legal regulations in our conditions as much as possible.

I will consider the seminar lessons:
- -when drafting laws
- -teaching seminars to the students on the issues discussed at the seminar, also giving information to the teachers

I will use the lessons, information and ideas learned at the seminar in my own work, especially concerning contract issues.

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As a judge I will use the examples of the seminar in my practice on the comparative basis. International examples. I will also submit my opinion on improving the contract law drafting.

I will reflect the issues on business organization forms in the drafts of the company and partnership laws.

When drafting laws, I will have to not only research foreign laws, but also make legal and economic analysis considering specifics of my own country.

I will use the issues learned at the seminar, considering benefits of Mongolia.

1) I will always support business activities. 2) I will pursue a policy of returning payments and losses in the market economy conditions.

I will try to implement the lessons of the workshop in the general principles of the law drafting process and also in the regulations of the new Civil Code and the laws which will follow it.

It will influence my teaching, first of all. Also I have learned about methodology of teaching, e.g. case studies were a very good experience.

I will use the lessons of the seminar in contract cases, especially paying attention to the issue of fulfilling responsibilities by the parties.

The fact that the lessons were taught approaching Mongolian laws and within their framework will be used as an example in the court resolving activities.

I will implement the court policies of the contract law in resolving credit disputes.

I will use the lessons of the seminar in the court resolving activities and in implementation of the laws.

6. Were there particular issues during the workshop on which you would like more information?

I'm interested in the issues of regulating intellectual property and transferring rights

I was interested in contract and family laws.

No

Though we discussed the bankruptcy of an economic entity, I would have liked to have more information.

In my opinion, I have received sufficient information.

I obtained sufficient information.

We need a manual to use in the further work.

In general, the information was sufficient. But if in the future it would be possible to discuss a certain topic in more detail, from all aspects and angles with more disputes, the knowledge could be deeper. E.g. only contract law or only property law.

I didn't obtain enough information on responsibilities of an advocate and representative side in the relationship caused by a contract dispute. I would be very grateful if you could help me on this matter.

I would like to have more information or assistance on the difference between a partnership and cooperative

I got additional assistance during the seminar.

There were many such issues, but I tried to get the answers immediately.

Issues of the intellectual property, rights of its privatization and its evaluation/assessment.

Company management, rights and responsibilities of shareholders.

The seminar was held very well, all the answers to the questions I was interested in, I was able to get in the process of the seminar.

I'm specifically interested in contract law and property rights.

I'm interested in the American court structure, its activities, guarantees of the rights of the judges etc.

Let me express my gratitude to all the teachers who came and taught the lessons. Using this opportunity I'd like to say that there is a lack of the manuals on laws and procedures to be used by judges.

Please write any other comments below. Thank you for helping us.

Goes without translation in English:
It was very useful for me. Thank you very much.

I'm very grateful to those who took their time and energy to organize a seminar and taught us.

No

Thank you very much for organizing this seminar for us. I wish you success in your life and work.

I would like to participate in the future seminars of this type.

I would like to express my deep gratitude to all of you and I wish success in your work.

His English : There is not for ask from you thank you very very much. I hope see you soon. You were very generous and very kind.

I hope there will be more seminars in the future. Thank you.

It would be good to have 10-14 day seminars like this in the future. In general, economic knowledge oi our lawyers is very poor. Thus, a combination of law and economics seems to be very useful in the current situation. Thank you very much.

Thank to all the teachers for teaching very interesting sessions to us. Wish you success and all the best.

I'm happy for participation in the seminar and obtaining a certain level of knowledge.

I'm learning English now. In the future I would like to visit thc USA. I would also like to participate in all the following IRIS seminars.

Attachment 4
Trip Report: James Anderson
June 1994

IRIS-Mongolia Field Coordinator James Anderson travelled to College Park following the second workshop in June 1994. The purpose of the trip was to participate in discussions with the entire IRIS-Mongolia team about the workshops held to date, with the goal of improving workshop methodology, and streamlining logistical procedures. The key areas of discussion included (1) an evaluation of the first two workshops' curricula design and exercises to promote the application of classroom materials; (2) evaluation of participants and IRIS' role in participant selection process; (3) proposals for streamlining the logistical preparations necessary for undertaking workshops based in Ulaanbaatar; (4) preliminary discussions about the next workshop on insurance; and (5) outlining a draft schedule of activities necessary to complete six workshops before the close of the current contract.

1. First two workshops

All agreed that the curriculum for each of the first two workshops was appropriate and effectively addressed the most crucial issues facing Mongolia's policy makers. The most effective sessions are those in which the instructors engage the participants in active discussions about the existing institutional arrangements in Mongolia and make liberal use of case studies to illustrate their points. The importance of having well-informed instructors was evident in both workshops. The participants appreciated the ability to discuss classroom material in the context of Mongolia's current situation, rather simply listening to a generic lecture that might have been presented anywhere.

One of the most difficult tasks in the design of good workshops is to create an environment in which the participants are encouraged to apply the lessons of the workshop to their policy-making pursuits. Different models were used for this purpose during the first two workshops. The first workshop concluded with a full-day session in which the participants were guided by workshop faculty in a debate on reforms to the current system of intergovernmental transfers, in preparation for the drafting of a policy paper on this topic. This exercise proved to be very effective at stimulating discussion among the participants about how to implement the lessons of the workshop, and a workable plan for carrying out the policy paper was adopted by the Mongolians. However the busy work schedules of the participants in the weeks after the workshop made coordination of activities difficult, and the policy paper has not yet been completed. During the second workshop, the participants were broken down into four groups, led by an instructor, for a discussion of how they might apply lessons learned in the workshop to particular policy areas that interested them. The four groups then reconvened and presented their reports to the entire congress of participants. This approach was very well-received by the Mongolians, and the subsequent discussions helped to point out areas of the curriculum that needed further clarification. IRIS-Mongolia staff concluded that these two models yielded different benefits and drawbacks and that a choice between them (or their combined use) should depend on the objectives of each workshop and the particulars of. the workshop subject.

2. Participants

Project staff expressed a high degree of satisfaction with the participants selected for each of the two workshops while recognizing that the process of participant selection, as experienced to date, is extremely taxing on the field coordinator. Therefore, discussion focused not on the specific qualities of individual participants, but on the ways that IRIS can work to make the participant selection process less time consuming. Although the participating members of the Advisory Council have done an admirable job of pointing the field coordinator in the direction of valuable potential participants, they usually don't have sufficient information to suggest a full enumeration of participant names necessary for a Mongolia-based workshop. The result is that the field coordinator must invest a excessive amounts of time in identifying thirty or forty appropriate individuals for the workshops. This use of the field coordinator's time is unavoidable — indeed, it is terribly important to ensuring an effective workshop. However, combined with the time necessary for conducting the background research on the workshop topic and making logistical arrangements (discussed below), it is difficult to properly conduct all of the necessary activities within the allotted time between workshops. Project staff concluded that the time investment is unavoidable given the current structure of participant selection and the importance attached to having good participants. One method for making the task more manageable is to identify early-on an appropriate Mongolian counterpart organization for each workshop that will provide the majority of participants for any given Mongolia-based workshop. This system was ultimately used for both of the first two workshops, but was not viewed as an ongoing part of the participant selection process.[1] We agreed that it would be beneficial to formalize this process, with the consent of the AID Representative and the Advisory Council. In addition to easing the burden on the field office in participant selection, the use of a counterpart would streamline logistical arrangements by having the counterpart assume some of those responsibilities, as discussed below.[2]

3. Logistical preparations

A short-list of the logistical preparations necessary for running an effective Mongolia-based workshop includes translating, delivering, and tracking invitations; hiring interpreters; finding an adequate facility; arranging for mid-day meals for participants and instructors; arranging for lodging and transportation for instructors; and arranging for a reception at the close of the workshop. Three proposals were advanced for making the task of logistical preparations more manageable. The first proposal was to have one member of the College Park staff travel to Mongolia several weeks prior to the workshop to assist the field office. This person could also assist with the tasks necessary for proper participant selection and background research on the topic. A second proposal was to hire an additional Mongolian to work in the field office, easing

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[1]For the first workshop, this counterpart organization was the Government which suggested names for aimag and soum governors to attend. For the second workshop, the counterpart organization was the Supreme Court which suggested judges from all level courts.

[2]This arrangement was ultimately settled upon during the second workshop, for which the Supreme Court provided workshop facilities. Again, we see benefits in making this arrangement a formal part of workshop preparation.

the burden on the project assistant. A third proposal was to enlist the support of a different Mongolian counterpart organization for each workshop.

The proposal to hire an additional Mongolian was accepted by all in light of the small cost relative to large potential benefits. It was also agreed that having a member of the College Park staff travel to Mongolia to assist in the weeks prior to the workshop would be reserved as an option to be evaluated for each workshop. The third proposal was agreed to be a good solution to a difficult problem. Arranging for workshop facilities in a manner affordable to Mongolian organizations has been difficult. Allowing a Mongolian counterpart organization to provide facilities not only eases the workload of the field office, but allows Mongolians to make a contribution "in kind" to the workshop. If this proposal is to be implemented, it will be crucial to identify the appropriate counterpart organization for each workshop.

4. Third workshop

Soon after arrival in College Park, we received notice from the AID Representative in Mongolia that our third workshop would be on the topic of insurance. This was one of the eight topics suggested by the Advisory Council and one of four supported by IRIS in its recommendations to AID. We took the opportunity to discuss as a group our early thoughts about this workshop. Since substantive discussion of workshop curriculum requires some background research in Mongolia, most of the discussion centered on logistical arrangements. It was decided that the workshop would be held in late September or early October and would be held in College Park.

5. Outline for the remainder of the contract

IRIS is currently in the process of obtaining a six month no-cost extension on its Mongolia contract. We discussed how best to space the remaining four workshops in order to finish all six by May 19, 1995. It was agreed that if the fourth workshop topic is approved soon enough, it could be planned concurrently with the third workshop, since the third workshop will require less logistical preparation from the field office. Our tentative plan, therefore, is to present the fourth workshop in November, 1994, leaving ample time for the remaining two workshops.

Trip Report--IRIS/Nepal Project (Nepal III, Delivery Order 14)

Thierry van Bastelaer and Philip Keefer
May 20 - June 1

Purpose: We travelled to Nepal to assist the IRIS/Nepal project on and review the following activities: contract law, company law, consumer protection, regulatory reforms to reduce pollution by the carpet industry in Kathmandu Valley, stock exchange development, fertilizer price deregulation, and the Policy Analysis Wing.

Activities: We participated in two symposia: Contract Law, organized by the Nepal Law Society, and Consumer Protection, organized by Integrated Development Managers, Associate. These groups have worked on the drafting of the respective reforms. The symposia formed a crucial part of the public awareness and feedback campaign that IRIS encourages in all of its reform activity. The symposia, and statements of the IRIS representatives, were reported in many local newspapers, magazines, and in the evening news.

Work will continue on contract law and consumer protection. We discussed with both groups our preferences, on the implementation side, for continued heavy involvement of the private sector, and on the substantive side, for continued emphasis in legal reform proposals on the practical problems confronting economic activity in Nepal.

We met with the research groups for the Carpet Study (on the extent of remedies for the negative environmental impact of the industry on the Kathmandu Valley) and Fertilizer Price Deregulation and suggested wide-ranging revisions to their draft studies. The revisions mainly focused on sharpening the policy recommendations, and imposing stricter economic rationality on them. For example, the carpet group (NPEDC) was focusing on regulating the pollution from the carpet industry differently than pollution from other industrial sources. We suggested that this sort of regulatory approach exacerbated costly distortions and was not consistent with the liberal economic policy line that the Government of Nepal has taken.

We met with Prithvi Raj Ligal, member of the Planning Commission, and discussed with him the work of the Policy Analysis Wing, particularly their study on the elimination of the octroi (interdistrict) tax.

Ravi Peiris, the IRIS expert advising the Nepal Stock Exchange, visited Nepal at this time to work with the Exchange. We discussed with the Exchange, public officials and Mr. Peiris the status of the stock exchange and market regulation mechanisms. We worked with Mr. Peiris in designing a strategy to encourage

more rapid movement on the regulatory front, and prepared a memo for the Secretary of Finance to stimulate such movement.

We did some of the preparatory groundwork for the visit by Clara Lipson, the IRIS expert on Credit Rating Agencies, including meetings with the Deputy Governor of the Central Bank (S.P. Shrestha) and a representative of a local joint-venture bank. In addition, we briefed Anuja Rajbhandari, who is assisting Ms. Lipson during her visit.

Meetings Held (not including Symposia discussions)

Neal Cohen, AID

Damber Dhungel, Chairman, Nepal Security Exchange Board

Anil Gyawali, Manager-Planning, Nabil Bank (Credit Rating Agency)

Peter Gadzinski, First Secretary, U.S. Embassy

Trilocham Gautam, Krishna Man Pradhan, and others, the Nepal Law Society (Contract Law and Company Law)

Prakash Ghimire and Ramesh Dhungel, Integrated Development Managers Associated (Consumer Protection)

Madan Raj Joshi, Exec. Director, Nepal Stock Exchange

Bimal Koirala, Joint Secretary, Ministry of Industry

Prithvi Raj Ligal, Member, National Planning Commission

Govinda Pandey and Associates, Nepal Productivity and Economic Development Centre, Ltd (formerly ESEC) (Carpet Study)

Thakur Nath Pant, Secretary, Ministry of Finance

Bishwambher Pyakuryel and Praveen Shrestha, Center for Integrated Economic Development (the Fertilizer Study)

Anuja Rajbhandari (Credit Rating Agency)

Tirtha Man Sakya, Secretary, Nepal Legal Reform Commission (Contract Law and Consumer Protection)

Satyendra P. Shrestha, Deputy Governor, Nepal Rastra Bank

CRACOW REAL ESTATE INSTITUTE

with the Honorary Sponsorship of the
Ministry of Justice, Republic of Poland

welcomes you to the conference on the

DEVELOPMENT OF THE LEGAL INFORMATION SYSTEM
AND THE FUTURE OF THE REAL PROPERTY MARKET IN POLAND.

Computerization,
integration and open access to the system,
in particular to title register and other data bases.

Conference is sponsored by

EASTERN EUROPEAN REAL PROPERTY FOUNDATION
and IRIS-POLAND PROJECT
from the resources provided by the
UNITED STATES AGENCY
FOR INTERNATIONAL DEVELOPMENT

and
NORWAY GROUP A/S and TINGLYSINGSDATA A/S

Cracow, Poland
June 10-11, 1994

FRIDAY, JUNE 10

"Development of real property market in legal and information environment"

Facilitator: *Władysław Jan Brzeski*

9:00-9:45 Registration

10:00 Welcome of participants
Tadeusz Piekarz,
Governor of Cracow Region

Words from sponsors
Nicholas Rey,
Ambassador of the United States of America

Inauguraton of the conference
Bohdan Zdziennicki, Deputy Minister of Justice

10:20 Reforms and development of real property market in the period of transformation
Władysław Jan Brzeski

10:50 Coffee break

11:20 The Małopolska Spatial Information System and the infrastructure of the real property market
Kazimierz Bujakowski

11:40 Land and building inventories in the light of the existing legal regulations
Stanisław Marczyk

12:10 Computerization of registers under the jurisdiction of the Ministry of Justice
Bohdan Zdziennicki

12:30 Panel discussion and questions:
Market development and information

13:00 Lunch

14:00 The Norwegian Land Information System.
An overview of the system,
the infrastructure, and distribution of information
to the market
Kristian Stronen, Oslo-Bergen

14:40 Strategy of the real property information system
development in Slovakia
Juraj Valis, Bratislava

15:20 Access to real property information in Hungary:
legal regulations
Geza Kleber, Andras Ossko, Budapest

15:50 Panel discussion and questions:
Development of the information system for the real property in the changing economic and political environment

16:20 Computer presentation of GIS system
for the City of Cracow and its links
to sources of data
Tadeusz Chrobak

17:00 Coffee Break

17:20 Summary and open discussion
Computer workshops

18:30 Cocktail (*Polonia Studies College, courtyard*)

19:30 Dinner

SATURDAY, JUNE 11
"Open access to the system and the free flow
and exchange of information"
Facilitator: *Judge Henryk Walczewski*

9:30 Computerized title register system in Austria
Prof.Dr.iur. Herbert Hofmeister, Vienna

10:10 Access to sources of legal information
in the light of legal regulations in Poland
Henryk Walczewski

10:50 Coffee break

11:10 Panel discussion and questions:
Experience of information users

12:00 Access to the title and company registers
by the integrated computer system
Henryk Walczewski

13:30 Lunch
Computer workshops

14:30 Panel discussion and conclusion:
Possibilities of further development of the legal information system

15:30 Coffee break

16:00 - 18:00 Summary and closing of the conference
Władysław Jan Brzeski
and Henryk Walczewski

The organizers of the present seminar hold a deep conviction that for the development of the legal information system in the Polish Republic occur, much depends on mutual, well-considered co-operation amongst various institutions and the representatives of all legal professions.

The prospects for improving the circulation and accessibility of legal information depend not only on the resources that the Minister of Justice or other institutions can allocate to necessary investments.

The Kraków conference provides a unique opportunity for a multifaceted approach to the problem and an exchange of experiences with guests and experts from abroad.

We have witnessed the arrival of the revolutionary changes in the field of information in Poland.
Are we really certain that we utilize all the possibilities that it provides for us?

In the process of selecting systemic solutions we have the opportunity to use satisfactory solutions tested elsewhere by trial and error.
In a way our task is easier. However, the institutions face the task of adjusting and reconciling computerization plans to the standards established by the European Union and global plans for "informational highways".

As envisaged by the organizers, the main aim of the seminar is to discuss and find solutions with a view to reconciling two principles - the old and the new ones. **The old principle** - unrestricted access to information - has yet to find its proper manifestation. **The new principle** - the integration of the information systems enables users to gain easy access to the data collected and allows those who create and maintain the records it can contribute to diminishing their costs and effort.

Your active participation in our seminar shall most certainly contribute to implementing both principles in the process of formation and organization of an appropriate modern legal information system in Poland.

Cracow Real Estate Institute acknowledges
support of
Martha Sickles (EERPF)
and
Ronald A.Dwight (IRIS-Poland Project, Director).

Without their contribution and stimulating consultancy during the process of preparation of the conference we would not be able to offer as much to participants.

Krakowski Instytut Nieruchomości
IRIS-Poland Project
Eastern European Real Property Foundation

Konferencja pt.
ROZWÓJ SYSTEMU INFORMACJI PRAWNEJ A PRZESZŁOŚĆ RYNKU NIERUCHOMOŚCI W POLSCE
Kraków, 10 11 czerwca 1994

Informacja na temat obecności wydarzenia w mediach

A. Relacje radiowe

W dniu 10 czerwca
Radio Kraków - wzmianka w serwisie wydarzeń lokalnych (8^{00}, 9^{00}, 10^{00}, 13^{00} [wiadomość poszerzona o kilka zdań z przemówienia ambasadora USA N.Geya na otwarcie konferencji] oraz o 19^{00}.
Radio Mariackie - w serwisie wydarzeń krakowskich w serwisach od 6 do 14, wieczorem odtworzenie fragmentów rozmowy telefonicznej z z-ca dyr. KIN nt. celów konferencji, przeprowadzonej we czwartek po południu.
Radio RMF - wzmianka trzykrotnie w serwisie lokalnym, w godzinach przedpołudniowych. Wieczorem w bloku informacyjnym informacja opracowana na podstawie dostarczonych materiałów, ok. 90 sek. (ok.20^{20}).

W dniu 11 czerwca
Radio Kraków
nadało ok. 8^{35} ok.2,5 min. wypowiedź prof.W.Modzelewskiego, uzyskaną w trakcie konferencji, a odnoszącą się do debaty nt. planów wprowadzenia podatku od wartości nieruchomości. W zapowiedzi podano tytuł konferencji.

B. Relacje telewizyjne

W dniu 10 czerwca
TVP Kraków (TVP SA)
Relacja z konferencji w *Kronice* o godz.23^{55}
TV Krater (Polonia 1)
Informacja o otwarciu konferencji odczytana przez spikera w *Wiadomościach* o godz.17^{30}

W dniu 11 czerwca
TV Kraków
Wypowiedź Prof.W.Modzelewskiego nt. podatku od wartości nieruchomości, *Kronika* o godz.18. W zapowiedzi podana nazwa konferencji.

C. Publikacje prasowe

Gazety lokalne:

1. "Gazeta Wyborcza"
   [sekcja "Gazeta w Krakowie"]
   9 czerwca
   strona 3
   artykuł wprowadzający w tematykę konferencji p.Grażyny Lubińskiej pt.
   " Sądy nie lubią komputerów: Wieczysty problem z księgami".
   (na podst. rozmowy z sędzią H.Walczewskim i wizyty w SR)

   11 czerwca 1994
   strona 3
   notatka p.Bogumiła Kuryłczyka pt.
   "Kaleckie nieruchomości"
   (wymienione nazwiska: ambasador N.Rey, W.Brzeski, B.Zdziennicki i W.Cimoszewicz)

2. "Gazeta Krakowska"
   Nr 132
   11-12 czerwca
   strona 2
   "Komputery i rynek nieruchomości"
   (wymienione nazwiska: amb. Nicholas Rey i W.Modzelewski)

3. "Echo Krakowa"
   Nr 111
   13 czerwca
   strona 3
   "Sądy bez kolejek"
   [illegible] o konferencji)

4. "Czas Krakowski"
   14 czerwca
   strona 9
   "Podatek katastralny"
   wzmianka o konferencji, relacja z wypowiedzi W.Modzelewskiego

5. "Dziennik Polski"
   Nr 134
   13 czerwca
   strona 17 i 21
   "Nie taki podatek straszny, jak go malują"
   Rozmowa z Prof. W.J.Brzeskim, wzmianka o konferencji
   i opis jej celów

Cracow, June 16, 1994

Mr Ronald A. DWIGHT

Director
IRIS Poland Project

Warsaw

Sir,

on behalf of the team closely cooperating with the CRACOW REAL ESTATE INSTITUTE, which prepared the Conference "Development of the Legal Information System and the Future of the Real Property Market in Poland", we would like to thank you very much for the oustanding contribution You have brought to the organization of the event.

The moral and material support that we have received from You and from IRIS Poland Project became a main pillar of our Conference. Your hard work and diplomatic efforts will not be forgotten, either. They enabled us to overcome quickly the problems and threatening difficulties that accompanied the preparation of the Conference.

The impressions and immediate comments of the participants of the Conference indicate that its important goals have been achieved, and that it was successful. It is our sincere conviction that it should be considered Your personal achievement as well.

Sincerely yours,

Władysław BRZESKI

Henryk WALCZEWSKI

"Development of the Legal Information System;
and the Future of the Real Property Market in Poland"
Cracow Conference
June 10, 1994

From left to right: Dr. Tomasc Stawecki, IRIS consultant and attorney at Dickinson, Wright, Moon, Van Dusen and Freeman; The Honorable Nicholas Rey, U.S. Ambassador to Poland; Ronald A. Dwight, IRIS-Poland Director; Jan Winters, ICMA; Adam Polanowski, Warsaw real estate broker

4th Eastern European Regional Conference

Privatisation in Central and Eastern Europe: 5 Years On

Hotel Vitosha, Sofia, Bulgaria
19-22 June 1994

WORKING PROGRAMME

SUNDAY 19 JUNE

1000 – 1800 **Registration and check-in at the Hotel Vitosha**

1930 – 2200 **Welcome Reception**

MONDAY 20 JUNE

0800 – 1800 **Registration and check-in at the Hotel Vitosha**

0900 – 1000 **Opening Ceremony**

Introductory words by
Todor Bourilkov *President, Bulgarian Bar Association*
Peter Kornajev *Minister of Justice of the Republic of Bulgaria*
Yordan Shkolagerski *Vice-Chairman, National Assembly of the Republic of Bulgaria*
Blaise Pasztory *Chairman, IBA Eastern European Forum*
Professor J Ross Harper CBE *Vice-President, IBA*

1000 – 1030 Coffee

1030 – 1230 **The Case Study**

Co-Chairmen
Stephen Denyer *Allen & Overy, London, England; member of Law Society of England and Wales' Working Party on Central and Eastern Europe*
Valentin Braykov *Braykov's Legal Office, Sofia, Bulgaria*

The first day of the Conference will be devoted to a case study which will allow panellists drawn from a broad range of IBA Section on Business Law Committees to comment on privatisation in practice in Central and Eastern Europe based on the example of a hypothetical Bulgarian privatisation. Bulgarian panellists will comment on the Bulgarian aspects. This session is intended to have a very practical bias, and has been designed to bring the realities of privatisation in the region to life. Audience participation will be encouraged and appropriate materials will be supplied. The full text of the case study is set out (below), but the key points are as follows:

A Bulgarian state enterprise which manufactures office equipment is to be privatised and Western advisers have been appointed consisting of an international investment bank, one of the big six accountancy firms and a combined legal team of Western and Bulgarian lawyers. The advisers undertake a due diligence investigation on behalf of the Bulgarian Government and produce an information memorandum for prospective bidders.

Participants will review the key potential problems identified in the memorandum, review the

Panellists
Borislav Boyanov *Borislav Boyanov Attorneys at Law, Sofia, Bulgaria*
Rudolf Coelle *Boden Oppenhoff Rasor Raue, Berlin, Germany; Vice-Chairman, SBL Committee P (Employment and Industrial Relations Law)*
Geert Glas *Loeff Claeys Verbeke, Brussels, Belgium; representing SBL Committees L (Intellectual Property and Entertainment) and R (International Computer and Technology Law)*
Kristian Krastev *Sofia, Bulgaria*
Heinz Löber *Heller Löber Bahn & Partners, Vienna, Austria; Vice-Chairman, IBA Eastern European Forum; representing SBL Committee M (International Sales and Related Commercial Transactions)*
Philippe Nouel *Gide Loyrette Nouel, Paris, France; Co-Chairman, SBL Committee D (Procedures for Settling Disputes)*
Professor Ioannis K Rokas *Ioannis K Rokas Law Offices, Athens, Greece; representing SBL Committee G (Business Organisations)*
Birgit Spiesshofer *Hengeler Müller Weitzel Wirtz, Frankfurt, Germany; representing SBL Committee F (International Environmental Law)*
Dr Martin Wernli *Lenz & Staehelin, Zürich, Switzerland; representing SBL Committee E (Banking Law)*

1230 – 1400 Lunch

1400 – 1530 **The Case Study continues**

1530 – 1600 Coffee

1600 – 1730 **The Case Study concludes**

TUESDAY 21 JUNE

0800 – 1800 **Registration and check-in at the Hotel Vitosha**

0900 – 1030 **The Role of Competition in Privatisation**

Co-Chairmen
Michael J Reynolds *Allen & Overy, Brussels, Belgium; Chairman, SBL Committee C (Antitrust and Trade Law)*
Anna Fornalczyk *President, Anti-Monopoly Office, Warsaw, Poland*

Panellists
Péter Pogácsás *Office of Economic Competition, Budapest, Hungary*
Stefan Neshev *President, Bulgarian Competition Authority, Sofia, Bulgaria*
Olivier D'Ormesson *Gide Loyrette Nouel, Brussels, Belgium*

1030 – 1100 Coffee

1100 – 1230 **The Emerging Securities Markets of Central and Eastern Europe**

Co-Chairmen
Stephen Denyer *SBL Capital Markets Forum representative on the IBA Eastern European Forum*
Gerhard Wegen *Gleiss Lutz Hootz Hirsch & Partner, Stuttgart, Germany; Vice-Chairman, SBL Committee Q (Issues and Trading in Securities)*

Panellists
János Tóth *Head of International Affairs, State Securities Supervision of Hungary, Budapest, Hungary*
Jacek Jonak *Secretary, Polish Securities Commission, Warsaw, Poland*
Jörg Franke *Chief Executive Officer, DTB Deutsche Terminbörse, member of the Executive Board, Deutsche Börse AG*

This session will look at the rapidly developing securities markets of Central and Eastern Europe and review the laws being enacted to regulate these markets.

1400 – 1600 **Insolvency Laws in Eastern Europe**

Co-Chairmen
Blaise Pasztory *Seward & Kissel, New York, USA*
Ian Gaunt *Sinclair Roche and Temperley, London, England; SBL Committee J (Insolvency and Creditors' Rights) representative on the IBA Eastern European Forum*

Panellists
Vladimira Glatzova *Glatzova & Co, Prague, Czech Republic*
Peter Köves *Köves & Partners, Budapest, Hungary; Vice-Chairman, IBA Eastern European Forum*
Ksenia Orlova *Moscow, Russian Federation (currently with Sinclair Roche & Temperley, London, England)*
Pavlina Todorova *Interadvocat Bar Association, Sofia, Bulgaria*
Wojciech Wadolowski *Allen & Overy, Warsaw, Poland*

This session will review topical subjects relating to insolvency laws in Central and Eastern Europe and try to identify problems common to the development of the Central and Eastern European market economies

1600 – 1630 Coffee

1630 – 1800 **Practice of the Law**

Consideration of new rules affecting legal practice, and activities by foreign law firms in the countries of Central and Eastern Europe

Chairman
Professor J Ross Harper CBE *Harper Macleod, Glasgow, Scotland*

Panellists from the countries of Central and Eastern Europe

WEDNESDAY 22 JUNE

0800 – 1300 **Registration and check-in at the Hotel Vitosha**

This session is free and all lawyers are invited to attend, whether Conference delegates or not

0900 – 1200 **Law Office Organisation, Development and Technology**

Organised by the IBA's General Professional Programme (GPP) Committee

A Simple Two Page Description of the Law of Secured Transactions

Example: the tractor and the farmer

A farmer wishes to purchase a tractor but has only enough cash to pay 20% of the purchase price. The farmer could borrow most of the money he needs from a local bank, if the bank knew it could easily and inexpensively take the tractor away from the farmer if the farmer fails to repay to the bank the amount he owes when he promised he would. Before making a loan to the farmer, the bank will check the loan registry to make sure the tractor has not already been used to secure another loan (either by the farmer or the current owner of the tractor). After the loan is made, the bank will make an entry into the loan registry giving notice to the world that it has first claim on the tractor if the farmer's loan is not paid.

Assume the harvest fails and the farmer cannot pay the bank. The bank has the right to collect its debt from the farmer by taking the tractor. If the value of the tractor is greater than the amount of the outstanding loan balance, the bank must give the balance back to the farmer. If the farmer has other creditors, they will not be able to touch the tractor until the bank's claim is satisfied to the extent of the value of the tractor. If the tractor was not valuable enough to satisfy the farmer's debt, the bank has no greater rights to the rest of the farmer's property than any other lender.

What if the farmer was dishonest and took another loan from a second bank, again giving the tractor as collateral? Assume the second bank did not follow the established procedures and failed to check the loan registry, made the second loan to the farmer and failed to make an entry in the loan registry giving notice of its interest in the tractor. After the first bank takes the farmer's tractor away, the second bank has no protected interest in the tractor and is in the same position as other general unsecured creditors.

Asset-based or secured lending:

The secured lending system described in the example above is a way for businesses (of whatever size) to finance their enterprises. The system's central concept is the "security interest," given by the borrower to the lender, in the property or assets, of the borrower (often referred to as "asset-based lending). The borrower's specifically identified property which is the subject of the security interest is generally referred to as the "collateral." The security interest is recorded in a public registry, sometimes referred to as a loan registry. This registry is open and available to anyone. The date and time of the registration of the security interest determine the priority of creditors' claims to the collateral.

If it is otherwise cost effective, the benefit of a law governing asset-based lending is that lenders are more willing to extend credit and to charge lower interest rates on secured loans than on unsecured loans because there is less risk of loss to the lender. The underlying thought is that in the event of the borrower's default the lender can take the collateral.

In order to be effective:

1. The lender must be **protected from the claims of third parties,** secured and unsecured creditors (including governmental taxing authorities), the trustee in bankruptcy and purchasers of the collateral from the borrower. The priority of the lender's claim to the

collateral must be absolute. Taxing authorities should have a priority only if they register their tax claims, giving lenders notice that they are not first in line.

2. The lender must be able to **determine, with certainty and at little cost, before the loan is made, if any other lender has claims** to the collateral. This is the purpose of a **central public registry** where all secured transaction for a defined region are recorded.

3. It must **cost only a little to create a security interest.** Large fees to register the security interest discourage its use. In the United States the charge is under $5.00. Notaries do not collect fees based on the value of the transaction, only a small fee to certify the identity of the parties.

4. It must **cost only a little to enforce the security interest** fin the event of the borrower's failure to repay the loan. No complicated and expensive legal proceedings are necessary. The borrower agrees that the lender, after notice in the case of nonpayment, may drive up and take the collateral away.

5. The collateral must **produce real commercial value for the lender** when it is taken away. The lender is permitted to keep the collateral or sell it as it sees fit.

Legal framework;

A collateral law has **three essential elements:**

1. A **material section** describing how to create a security interest and register it, who may take a security interest, and what kinds of property can be used as collateral.

2. A **procedural section** that describes how a **central public registry** operates and what legal consequences attach to its use.

3. An **execution section** defining the **relationship as between the parties to the collateral.** This section regulates what actions the lender may take with respect to the collateral if the borrower fails to repay the loan. This section also outlines the **hierarchy of rights in the collateral** as between, or among, the lender and anyone else who may assert claims to the collateral.

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Collateral Law:

Buying Equipment With Assistance From Your Local Bank

Example: the tractor and the farmer:

A farmer wishes to purchase a tractor but does not have enough money to pay the entire purchase price. If the farmer lives in a country with a "collateral" law providing for "secured lending,"[1] the tractor could be financed by a loan from a local bank using the tractor as collateral.

Before the bank gives the farmer the loan, it must determine that the person selling the tractor to the farmer can sell it free and clear of any other security interests. The bank checks on this by checking the central lien registry to see if anyone else has registered a security interest in the tractor. Then, after it makes the loan to the farmer, the bank will give official notice to everyone else in the community that the tractor is subject to its claim. It does this by making an entry into the central lien registry. This will cost the bank a very small fee. Now, ahead of any other creditor including the tax collector, the bank has the right to come and take the tractor away if the loan is not paid back.

"Asset-based" or "Secured" lending:

The secured lending system described in the example of the farmer and the tractor describes a way for small and medium sized businesses ("SMEs") to finance their enterprises. The central concept of a system of secured lending is called "secured lending" and its central concept is the "security interest"[2] taken by the lender in the property ("collateral") of the borrower. (There are generally two systems for collateral in the West, one for real estate and one for non-real estate or movables. This paper describes the system for movables, but its principle could be adjusted to apply to real estate.) The security interest is recorded in a public registry that is open and available to anyone. The date and time of the registration of the security interest in the central public registry constitute official legal proof upon which courts rely in determining the priority of claims to the collateral.

When a business or person borrows money, the repayment of the loan may be ensured if the borrower gives the lender certain specified rights in property of the borrower. This is referred to as a "secured loan" and the borrower's property is referred to as "collateral." In the event the borrower is unable to meet its repayment obligations ("is in default"), and the loan is secured by collateral, there is less risk to the lender that it will lose money. If the borrower has merely given the lender a promise

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[1]Or "asset based lending" or "collateralized loans" or "secured financing."

[2]A 'security interest" is known by different names in various countries. In France, this is a "gage;" in the United Kingdom, a "charge;" in the United States, a "lien" or "security interest;" and, in Germany, a "pledge." The concept is not the same as the classical possessory pledge of civil law, where the object pledged must be delivered to the creditor.

to repay (an "unsecured loan"), the lender faces a greater risk of loss. Lenders are willing to extend credit and to charge lower interest rates on secured loans than on unsecured loans because there is less risk of loss to the lender. However, if a scheme for collateralized (secured) loans is to be accepted as a useful business tool, it must be **cost effective.**

In order to be cost effective:

1. It must **cost only a little to create** an enforceable security interest. Large fees to register the security interest discourage its use. In the United States the charge is under $5.00. Notaries do not collect fees based on the value of the transaction, only a small fee to certify the identity of the parties.

2. It must **cost only a little to enforce** the security interest in the event of the borrower's failure to repay the loan ("default"). No complicated and expensive legal proceedings are necessary. The borrower agrees that the lender may drive up and take the collateral after notice in case of non-payment.

3. The collateral must **produce real commercial value for the lender** when it is "enforced" (in other words, seized and sold). The lender is permitted to sell or auction the collateral as it sees fit.

4. The lender must be able to **determine, with certainty and at little cost, before the loan is made, if any other lender has better claims** to the collateral. This is the purpose of a **central public registry** where all secured transactions for a county or region are registered.

5. The lender must be **protected from the claims of third parties**, secured and unsecured creditors (including governmental taxing authorities), the trustee in bankruptcy and purchasers of the collateral or charged property from the borrower. The lender's priority to the collateral must be absolute. Taxing authorities have priority only if they register their tax claims, giving lenders notice that they are not first.

An asset-based loan transaction:

Secured financing can be illustrated by describing a loan transaction. A lender loans money to an SME. The borrower promises to repay it to the lender. The borrower also grants to the lender an enforceable security interest in certain described property (the collateral) to secure the repayment of the loan. The enforceable security interest arises out of a contract (called a "security agreement") between the parties (borrower and lender). Although the entire contract is not made public, the parties are required to make the essential terms of their transaction public by filing a document both at the borrower's place of business (in a "collateral or lien register") and in a court or other designated registry in a public office (such as a commercial registry or land registry) (the "central public registry"). The value of this scheme is apparent if one assumes that before making a loan to the borrower, a potential lender will want to know if the borrower has already given any other lender an enforceable security interest in the property offered by the borrower as collateral. If a secured lending scheme incorporating

a registry is in place such information is available either in the borrower's registry or in the public registry

Legal Framework:

A collateral law has **three essential elements:**

1. A <u>material section</u> describing **how to create a security interest** and register it, who may take a security interest, and what can be used as collateral-which includes stocks, and intangibles such as book royalties.

2. A <u>procedural section</u> that describes how a **central registry** operates and what legal consequences attach to its use.

3. An <u>execution section</u> defining the **relationship as between the parties to the collateral.** This section regulates what actions the lender may take with respect to the collateral if the borrower fails to repay the loan secured by the security interest. This section also outlines the **hierarchy of rights in the collateral** as between, or among, the lender and anyone else who may assert claims to the collateral in the event the borrower defaults.

Discussion:

The purpose of the **material section** is to define who may make a collateral agreement[3], what kinds of property may be given as collateral, and what formalities are required to create a secured loan. In Poland, the proposed law provides that any movable or property right which is transferable (with the exception of sea-going ships) may be used as collateral. More particularly, the collateral may be: one or more specifically identified things; things identified as to type; a collection of movable things constituting an economic entity; claims; intellectual property rights; and rights arising from stocks and bonds. The amount of the claim may be expressed in Polish zlotys or in another currency. There must be an agreement in writing that describes the transaction and must include: the date of the agreement; the names and addresses of the borrower and lender; a description of the collateral; and the amount of the claim and the legal relationship giving rise to the claim

One of the requirements of the **procedural section** is that the borrower must establish and maintain a **register of security interests** relating to its property. Since it is not safe to assume that all borrowers are completely trustworthy, provision for a second form of public notice is made. The lender gives public notice of the existence of the borrower's obligation by registering it with a governmental registering authority in a **central public registry**. The risk to the lender who does not give public notice, is that other lenders who do give public notice will have greater rights to the collateral in the event of the borrower's default. This section would also describe how the registering

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[3]In the West nearly anyone can be a creditor; in Poland only certain banks will be allowed to use the special procedures under the proposed revisions to the Civil Code.

authority is to handle, process and dispense information to anyone making an inquiry.

Example: The farmer and the tractor, revisited

Assume the harvest fails and the farmer cannot pay the bank. The bank may take the tractor in order to collect its debt from the farmer. If the value of the tractor is greater than the outstanding loan balance, the bank must pay what remains to the farmer. If the farmer has other creditors, they will not be able to touch the tractor until the bank's secured claim has been satisfied to the extent of the value of the tractor. If the tractor wasn't worth enough to satisfy the farmer's debt to the bank, the bank has no greater rights to the rest of the farmer's property, in which it had no security interest, than any other unsecured lender

What if the farmer was not completely honest and, needing money, took another loan from a different bank again giving the tractor as collateral. Assume the second bank did not check the central registry and did not file a notice in the registry of it interest in the tractor. After the first bank takes the farmer's tractor away the second bank is out of luck. It should have checked the register.

The **execution section** of a collateral law concerns collection procedures and defines the priority of parties with claims to the collateral. This section of a collateral law permits inexpensive enforcement of a security interest after the borrower's default. There is a provision for the seizure and sale of the collateral after suitable notice of non-payment. The lender may take possession of the collateral after first taking steps detailed in the law giving notice to the borrower. The lender may not use force. In some jurisdictions, the lender may not retain possession of the property. It must be sold in a commercially reasonable fashion. That is to say, this sale must be conducted expeditiously and fairly so as to discharge as much of the obligation as possible and to pay the remainder of the proceeds, if any, to the borrower. The borrower may recover possession of the property, only if he or she discharges the obligation and pays associated costs before the sale takes place.

"**Priority**" describes the order in which competing claims are to be satisfied and to what extent. The lender is protected from most claims to the collateral against claims of persons who are not parties to the security agreement. The lender is also protected from the claims of unsecured creditors (including taxing authorities that have not registered their claims in the registry). The priority of claims of different lenders holding security interests is based on the time of their registration with the registering authority. After its disposition by the borrower, the lender is protected against subsequent purchasers of the collateral if he or she takes prescribed steps to continue the security interest. However, this is not the case where the lender consented to a disposition or where he or she should have expected the collateral to be disposed of, such as when the collateral is inventory of a kind usually sold by the borrower. Thus a person who buys a refrigerator from an appliance store which has borrowed money to finance its inventory, gets free title to the refrigerator. In such cases, the lender should look

only to the proceeds of the sale, and the buyer gets clear title to the property. On the other hand, a person starting a restaurant who buys a refrigerator from the owner of the building where the restaurant is to be located, will own the refrigerator subject to any security interests encumbering the refrigerator at the time of the sale. The lender's security interest will survive the sale and the lender will have better title to the refrigerator than the person opening the restaurant.

In the event of a forced sale, the purchaser of property subject to a security interest takes the property free from all security interests, not just those of the lender who forced the sale. However, a lender taking possession is required to surrender the collateral to any other lender which has a security interest with better priority and demands such a surrender.

Additional sections of a law on secured lending concern the relationship between the lender and the borrower's trustee in bankruptcy. If the borrower still has possession of the collateral, the lender may exercise his or her right of enforcement against it without interference from the trustee. There are two exceptions: security interests given after the borrower declares bankruptcy; and security interests given by the borrower for no new value at the last minute before a declaration of bankruptcy. This usually occurs on the eve of bankruptcy when a previously unsecured creditor attempts to gain priority over other unsecured creditors.

Cornell Law School

Arvilla and Leo Berger
International Legal Studies Program

PANEL PRESENTATION

BERGER INTERNATIONAL LEGAL STUDIES PROGRAM
BRIGGS INTERNATIONAL LAW SOCIETY

TOPIC: "LEGAL REFORM IN RUSSIA: A WORK IN PROGRESS"

SPEAKERS: LANE H. BLUMENFELD, ESQ.
DIRECTOR OF THE IRIS CENTER'S RUSSIA PROJECT
AND ITS COMMERCIAL LAW REFORM INITIATIVE

PROFESSOR ALEXANDER N. DOMRIN
VISITING PROFESSOR OF LAW, CORNELL LAW SCHOOL;
CHIEF SPECIALIST, COMMITTEE ON FOREIGN AFFAIRS
AND FOREIGN ECONOMIC RELATIONS, SUPREME SOVIET
OF THE RUSSIAN FEDERATION.

PROFESSOR OLGA DYUZHEVA
VISITING PROFESSOR OF LAW, COLUMBIA LAW SCHOOL;
FORMER PROFESSOR OF LAW, MOSCOW STATE UNIVERSITY

PROFESSOR ALEXANDER L'VOVICH MAKOVSKY
DEPUTY CHAIRMAN OF THE PRIVATE LAW RESEARCH CENTER;
DEPUTY HEAD OF THE IRIS-RUSSIA DELEGATION

DATE: MONDAY, APRIL 18, 1994

TIME: 4:00-5:30 P.M.

PLACE: ROOM 390 - MACDONALD MOOT COURT ROOM
MYRON TAYLOR HALL

Refreshments will be served following the panel. You are cordially invited to attend.

John J. Barceló
Director, Berger International
Legal Studies Program

Myron Taylor Hall, Ithaca, New York 14853-4901 - Fax: (607)255-7193 / Phone: (607)255-2362

Cornell Law School

Arvilla and Leo Berger
International Legal Studies Program

LUNCHEON

BERGER INTERNATIONAL LEGAL STUDIES PROGRAM
BRIGGS INTERNATIONAL LAW SOCIETY

TOPICS: "MAKING A CONSTITUTION IN THE LATE TWENTIETH CENTURY--THE COLOMBIAN 1991 EXPERIENCE"
AND
"CIVIL LAW REFORM IN RUSSIA"

SPEAKERS: JUAN CARLOS ESGUERRA
DEANCO ACADEMICO, PONTIFICIA UNIVERSIDAD JAVERIANA

PROFESSOR ALEXANDER L'VOVICH MAKOVSKY
DEPUTY HEAD, IRIS-RUSSIA DELEGATION

DATE: THURSDAY, APRIL 21, 1994

TIME: 11:45 A.M. - 1:00 P.M.

PLACE: ATRIUM, MYRON TAYLOR HALL

Dean Esguerra is Dean of the Javeriana University Law Faculty, in Bogotá, Colombia. After receiving his LL.M. degree from Cornell Law School in 1973, he practiced law in Bogatá and served for two years as Vice-Minister of Communications in the Colombian government. He has been on the faculty of the Javeriana University since 1974. In 1990 he was elected to the National Constituent Assembly charged with drafting a new constitution for Colombia. The new constitution was adopted on July 4, 1991. Dean Esguerra was recently appointed Associate Judge of the Constitutional Court of Columbia.

A graduate of Leningrad State University, Professor Makovsky is a specialist in the field of civil and international private law. He has served as Chairman of the department at the University and also as Deputy Director of the Institute of Legislation and Comparative Law. He is a member of the International Commercial Arbitration Court and of the Scientific Committee of the Supreme Arbitration Court.

A buffet luncheon will precede the talk. So that we may plan accordingly, please reserve a place with Judy Oltz, room 315, 5-2362, by noon on Friday, April 15.

You are cordially invited to attend.

John J. Barçelo
Director, Berger International Legal Studies Program

Myron Taylor Hall, Ithaca, New York 14853-4901 ~ Fax: (607)255-7193 / Phone: (607)255-2362

15

WAFER

The Washington Area Forum on Economic Reform

invites you to a speech by

Sergei Alexeev

Chairman of the President's Civil Code Drafting Commission of the Russian Federation

The Politics & Economics of Russian Legal Reform

Wednesday, April 27
2:30 - 4:00
The Carnegie Endowment For International Peace
2400 N St, N.W.
Washington, DC 20037

WAFER is a Washington area meeting series aimed at facilitating the exchange and dissemination of ideas regarding economic development. It provides an opportunity, through events such as this, for exchanges between leading researchers and policymakers who would not ordinarily find themselves at events sponsored by a single organization. The co-convenors of WAFER are Mario Blejer (IMF/World Bank), Max Corden (Johns Hopkins/SAIS), Robert Litan (Department of Justice), Mancur Olson (Institutional Reform and the Informal Sector, IRIS/University of Maryland at College Park), Lawrence Summers (Treasury Department), Vito Tanzi (IMF) and John Williamson (Institute for International Economics). WAFER is partially supported by the United States Agency for International Development.

INTER VOLGA

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INTERVOLGA INTERNATIONAL BUSINESS CONFERENCE '94

Togliatti, Russia
May 23-26, 1994

Organized By:

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The United States Peace Corps Western Russia
The International Centre of Culture "Volga", City of Samara

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E mail: root@foreign.admg.togliatti.su

PROGRAM OF EVENTS

May 23, 1994

Arrival of Participants, Hotel Check-In

11:00 am----	Conference Registration, Zhiguli Hotel
7:30 pm----	Cocktail Party, Zhiguli Hotel

May 24, 1994

7:30-9:00 am	Breakfast; Registration, Conference Hall
9:00-9:40 am	Welcome and Opening Remarks, *Nikolai Dmitrievich Utkin, Mayor of Togliatti*
9:40-11:30 am	Practical Applications of International Business Contracts *Marian Hagler, Coudert Brothers, Moscow*
11:30 am-12:00 noon	Tea Break
12:00 noon-1:45 pm	Customs and Regulations of International Trade Activities *A..G. Vasilev, Customs Control Department, State Customs Committee, Moscow*
2:00-3:00 pm	Lunch
3:00-5:30 pm	River Cruise
7:30 pm----	Banquet for Participants Hosted by Conference Organizers and Sponsors, Zhiguli Hotel

Concurrent Session

9:45 am-2:00 pm	Company Interviews (by appointment)

May 25, 1994

7:30-9:00 am	Breakfast
9:00-11:00 am	Russian Taxation Overview *Natasha Milchinkova, Phil Tremonti, Price Waterhouse, Moscow*
11:00-11:30 am	Tea Break
11:30 am-12:15 pm	Protecting Your Investment--Security Before and After Investment *Michael Brockert, RCMI Inc., Moscow*
12:15-1:30 pm	The International Experience in Russia--Panel Discussion by Major Businesses *Laurence Eubank, Russian-American Enterprise Fund, Moscow* *John H. Pratt, EEC Food Distribution Project, Togliatti* *Victor Smirnow, General Motors, Moscow*
1:30-2:00 pm	Sponsor Presentation, *Representative of Avtovazbank*
2:00-3:15 pm	Lunch
3:15-5:30 pm	Meetings with Togliatti Businesses (by invitation)
7:30 pm--	Banquet and Cultural Entertainment, Palace of Culture and Technology

Concurrent Session

9:00 am-2:00 pm	Company Interviews (by appointment)

May 26, 1994

7:30-9:00 am	Breakfast
9:00-10:15 am	The Efficiency of Ethics and Law in Business Transactions *Lane Blumenfeld, The IRIS-Russia Project, Moscow*
10:15-10:45 am	Tea Break
10:45 am-12:30 pm	The Relationship of Business and Culture--Roundtable Discussion *Nikolai Aleksandrov, International Academy of Banking & Business, Togliatti* *Robert McCarthy, United States Embassy, Moscow* *Boris Lvovich Rudnik, Ministry of Culture, Moscow*
12:30-2:00 pm	Press Conference and Closing Remarks
2:00-3:30 pm	Lunch

Departure of Participants

12:30 Panel discussion and questions:
Market development and information

13:00 Lunch

14:00 The Norwegian Land Information System.
An overview of the system,
the infrastructure, and distribution of information
to the market
Kristian Stronen, Oslo-Bergen

14:40 Strategy of the real property information system
development in Slovakia
Juraj Valis, Bratislava

15:20 Access to real property information in Hungary:
legal regulations
Geza Kleber, Andras Ossko, Budapest

15:50 Panel discussion and questions:
Development of the information system for the real property in the changing economic and political environment

16:20 Computer presentation of GIS system
for the City of Cracow and its links
to sources of data
Tadeusz Chrobak

17:00 Coffee Break

17:20 Summary and open discussion
Computer workshops

18:00 Cocktail (*Polonia Studies College, courtyard*)

19:30 Dinner

SATURDAY, JUNE 11
"Open access to the system and the free flow
and exchange of information"
Facilitator: *Judge Henryk Walczewski*

9:30 Computerized title register system in Austria
Prof.Dr.iur. Herbert Hofmeister, Vienna

10:10 Access to sources of legal information
in the light of legal regulations in Poland
Henryk Walczewski

*

10:50 Coffee break

11:10 Panel discussion and questions:
Experience of information users

12:00 Access to the title and company registers
by the integrated computer system
Henryk Walczewski

13:30 Lunch
Computer workshops

14:30 Panel discussion and conclusion:
Possibilities of further development of the legal information system

15:30 Coffee break

16:00 - 18:00 Summary and closing of the conference
Władysław Jan Brzeski
and Henryk Walczewski

*10:30 Some observations on Collateral Law and Institutions in Russia Today!

Lane Blumenfeld, Moscow

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"COMMERCIAL LAW IN THE NEW RUSSIA -- AN AMERICAN PERSPECTIVE ON THE RUSSIAN CIVIL CODE"

Lecture By

PROFESSOR ROBERT SUMMERS, CORNELL UNIVERSITY LAW SCHOOL

and

PROFESSOR JAMES WHITE, UNIVERSITY OF MICHIGAN LAW SCHOOL

THE IRIS CENTER,

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UNDER THE PRESIDENT OF THE RUSSIAN FEDERATION, AND

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Invite you to a lecture by two of America's foremost experts on commercial law and the U.S. Uniform Commercial Code.

WHERE: The Supreme Arbitration Court of the RF
Ulitsa Griboedova 12
Plenum Room, 5th Floor
(near Turgenevskaya metro station)

WHEN: Tuesday, June 14th, 15:00 - 16:30

RSVP: To IRIS-Russia by Phone or Fax

Please show this invitation at the door.

Supported by funding from the U.S. Agency for International Development

IN THE UNITED STATES CONTACT:
DR. DAVID FAGELSON, THE IRIS CENTER, 2105 MORRILL HALL, COLLEGE PARK, MARYLAND 20742
Phone: (301) 405-3021/3110; Fax: (301) 405-3020; E-Mail: David@IRIS.ECON.UMD.EDU

A hole in the bucket

The unavailability of financial credit due to the lack of a registry in Russian collateral law

Lane H Blumenfeld, Resident Director of the IRIS-Russia Project

In May 1992 the Russian Federation adopted the Law on Pledge. This legislation was designed to guarantee that, in the event that a debtor defaults on a loan or other obligation, the creditor could recover by acquiring the property the debtor had pledged to secure the loan.[1] The Law is broad in scope, allowing virtually any form of property to be pledged in all types of contractual situations.[2] Furthermore, the Law provides that, in the case of a debtor's non-performance, prior creditors can obtain satisfaction from the pledge before subsequent lenders.[3] With the adoption of the Pledge Law, Russia seemingly took a major step toward bringing its commercial lending practice in line with that of other industrial countries.

Collateral registry

In market economies, commercial lending institutions ensure repayment of loans by taking an interest in collateral put up by the debtor. This collateral, also referred to in various countries as a security interest, charge, lien, or pledge, can come in many forms: real property (including land and fixtures), movables, and intangibles (such as inventory or accounts receivable). For a bank to be willing to extend financial credit based on collateral, it must be able to assure itself that the debtor has not previously pledged the property to another bank to obtain a prior loan. Likewise, the bank wants a guarantee that if the debtor uses the same property as collateral to obtain a future loan from a second lender, it gets paid before the subsequent lender in case the debtor defaults.

The institutional device that provides this protection to lending institutions is called a collateral registry. Through a registry, a bank conducts a title search to determine who actually owns, not merely possesses, the property in question; furthermore, by recording that it is using the said property as collateral, the bank provides notice to future lenders. The existence of a reliable, accessible, and efficient registry is a prerequisite for a functioning system of financial credit.

Pledge Law ineffective

Although the Law on Pledge mentions registration of pledged property,[4] Russia has yet to introduce a mechanism for recording and thereby securing all forms of real and personal property that can be used as collateral. As a result, the Pledge Law is completely ineffective. Needless to say, this hole in the legal structure deters commercial lending institutions from making credit and capital available to potential investors. Without a registry, it is difficult – if not impossible – to trace the ownership of property and determine the extent of encumbrances attached to it. If a lender cannot determine who owns the collateral or has an interest in it, the lender cannot be assured it will get repaid.

Because of this uncertainty, commercial banks are unwilling to use property as security for loans. Hence, Russian businesses are unable to obtain credit domestically to finance new entrepreneurial activity. The only avenue open to the new class of entrepreneurs is to seek a foreign partner to provide the capital. The foreign investor is able to acquire financial credit elsewhere precisely because in market economies commercial lenders can secure collateral through a registry and are therefore willing to make loans.

1 Russian Federation Law on Pledge, 29 May 1992, Article 1.
2 RF Pledge Law, Art. 4.
3 RF Pledge Law, Art. 22.
4 RF Pledge Law, Arts 11-17.

Commercial failure

Despite the lack of a registry, some commercial lending in Russia takes place. What lending does occur, however, is inadequate, inefficient, and expensive. A Russian entrepreneur may be able to receive a loan, but local commercial banks' borrowing requirements, due to the risks involved, are generally very restrictive. First, banks refuse to extend credit beyond three months. Second, banks charge exorbitant short-term interest rates of between 15 and 30 per cent. Third, the debtor must deposit hard currency as collateral - that is, to get the money, he must first have it. Lastly, assuming the borrower can meet all these arduous conditions, he must nevertheless cultivate a close, long-term relationship with the lender, the development of which can frequently be facilitated through "unrecorded payments".

Given this country's current state of financial lending, Russians cannot obtain credit for long-term projects, such as construction. This commercial failure presents a clear impediment to the advancement of Russian economic reform: without the creation of a collateral registry, Russians will have limited access to financial credit. In such an environment, there will be no new entrepreneurial activity, production facilities, or investment, beyond what can be accomplished in three-month blocks.

Commercial law reform

To date, most of the Russians and Western advisers participating in the reform process have focused on the financial and economic aspects of the transition, emphasising steps such as privatisation, the introduction of tight fiscal and monetary policies, and the end of state price controls. These are critical components of any functioning market system. Perhaps the most important aspect of reform, however, has until now been largely overlooked: the creation of a legal framework of commercial laws and institutions to define and ensure the rights and obligations of all participants in the economy.[5]

Without commercial law reform, including the development of effective adjudicatory and enforcement mechanisms, Russia's economic reforms cannot succeed. The creation of a collateral registry is a critical component of this commercial law regime and thus an integral part of Russia's transition to a market economy.

Author

Lane H Blumenfeld, Resident Director of the IRIS-Russia Project and its Commercial Law Reform initiative (see page 12), is a Russian-speaking American lawyer. He earned his JD at the Yale Law School, his MA from the Johns Hopkins University School of Advanced International Studies, and his BA from Cornell University. Mr Blumenfeld has also worked on legal reform in Kiev, assisting Ukrainian policy makers on commercial legislation.

5 For a good discussion of this point, see report by the Commission of the European Communities, "Shaping a Market-Economy Legal System", April 1993, Preface and Summary.

26 June 1994

R E P O R T

WORKSHOP ON ISSUES OF COMMERCIAL LAW IN THE RUSSIAN CIVIL CODE

Ithaca, New York
April 18 - 24, 1994

Washington, D.C.
April 25 - May 6, 1994

Organized by the IRIS Center
and the Research Center for Private Law
under the President of the Russian Federation

With the support of the
United States Agency for International Development

OVERVIEW

This report summarizes the Workshop on Issues of Commercial Law in the Russian Civil Code organized jointly by the IRIS Center and the Research Center for Private Law under the President of the Russian Federation, with the support of the United States Agency for International Development. The Workshop, held in Ithaca, N.Y. and Washington, D.C. between April 18 and May 6, 1994, enabled the key members of the Presidential Civil Code Drafting Commission of the Russian Federation to consult with some of America's foremost commercial law experts. The three objectives were to:

1) *Study the principles underlying an effective commercial law regime in a market economy;*
2) *Review Parts I and II of the Draft Civil Code developed by the Russian law makers;* and
3) *Address questions posed by them on specific issues of law and economics governed by the Code.*

The Workshop included seminars, lectures, and meetings covering a wide range of legal, commercial, and economic topics. As the Drafters themselves emphasized, the Workshop made an important contribution to the enhancement of the Russians' indigenous capacity to draft their Civil Code. The Workshop accomplished this goal by providing them with a better understanding of the interrelationship between law and economics, the underpinnings of a market-based commercial law system, as well as the American approach to commercial law, legislative codification, and commercial practice.

The western specialists with whom the Commission met acknowledged the sophistication of the Russian draft Code. They confirmed that it is market-oriented, drawing upon the best models available in the civil law tradition. They noted, however, that a more thorough review of American law would greatly benefit certain sections of the draft, particularly those on pledge or personal property security interests. Most importantly, those expert in Russian law agreed that the draft version, if enacted, would clearly improve and clarify the current state of Russian legislation. Therefore, the task for these specialists was neither to suggest whole-scale revisions nor a redrafting of the Code. Rather, it was to highlight issues in the draft for the Russians to consider reexamining in light of how countries such as the United States deal with similar problems.

As a result of the Workshop, the members of the Presidential Drafting Commission now share a better understanding of how commercial law functions in a market economy. The Drafters expressed their gratitude to USAID and IRIS for providing the opportunity to review the draft Code and examine the U.S. approach to commercial law and market economics with American's leading commercial lawyers and academics. Moreover, they acknowledged that upon returning to Moscow they would revisit issues discussed during the Workshop, with an eye to improving the draft in light of the

new lessons learned.

ITHACA SESSIONS

The sessions in Ithaca, N.Y. took place between April 18-24 at the Cornell University Law School. The Workshop at Cornell focused on commercial law issues such as sales, secured transactions, lease, and credit and the application of these issues to draft articles of the Russian Code.

The Workshop was chaired jointly by Professors Robert Summers of Cornell, James White of Michigan, and Alexander Makovsky, the deputy chairman of the Research Center for Private Law--the institute coordinating the Code's development. Professors Summers and White are the authors of the most widely cited treatise on commercial law and the Uniform Commercial Code in the United States. Ten members of the Presidential Commission attended, drawn from all spheres of the Russian government. The team included representatives from the Executive Branch, the Government, the Judiciary, and private practice. Additionally, IRIS invited Professors W. Simons and F. Feldbrugge from Leiden University in the Netherlands to participate in the sessions. They are not only experts in Russian law and European civil law, but also have been working closely with the Russians on the development of the Civil Code. Through their knowledge and prior experience, they provided a critical bridge between the Russian Drafters and American experts. Their participation ensured cooperation among the principal western advisors to the Presidential Drafting Commission. Cornell Law Professor G. Alexander also led a session on real property issues. Additionally, Dr. David Fagelson and Lane Blumenfeld from the IRIS Center coordinated and participated in all phases of the Workshop.

The Ithaca program was designed to focus intensively on the draft articles prepared by the Commission. Both Part I, in its entirety, and sections of Part II were translated into English. The drafters also provided detailed questions on each article, which formed the basis for the Workshop sessions. During the Ithaca sessions, Summers and White reviewed the Russian drafts, addressed the questions presented to them, and discussed the American legal approach to similar issues.

Ithaca Workshop Topics

The following commercial law topics were covered during the Workshop sessions in Ithaca:

I. Law of Sales
   A. Concept of Contract of Sale of Goods
      1. Agreement
      2. Contract Terms
         a. Express versus Implied

3. Course of Dealing
4. Usage of Trade
5. Course of Performance

B. Contract Formation
1. Sale of Goods Form Contract
2. Contracts of Adhesion

C. Defective Seller Performance
1. Breach of Warranties
2. Remedies
3. Good Faith

D. Damages

II. Secured Transactions

A. Pledge and Personal Property Security Interests
1. Perfection
2. Pledge Registration
3. Notification

B. Priorities between Conflicting Interests
1. Buyer in Ordinary Course
2. Super-priority

C. Foreclosure

III. Negotiable Instruments

A. System of Payments

IV. Bankruptcy

B. Liquidation v. Reorganization
C. Voluntary v. Involuntary
D. Role of Trustee
1. Trustee's Powers
E. Priorities
F. Discharge of Debtor

V. Sale and Security Matters related to Real Property Leases

Ithaca Public Events and Lectures

Members of IRIS and the Drafting Commission gave a series of public presentations to the Cornell Law School community, including the following:

1) Russian Law Reform Panel Discussion, with Professor A. Makovsky and Lane Blumenfeld, as well as Olga Diuzheva, a visiting Russian professor at Columbia Law, and Alexander Domrin, a visiting Russian professor at Cornell Law and a member of the Committee on Foreign Affairs and Foreign Economic Affairs of the RF. The panelists addressed various aspects of Russian law reform before a group of Cornell law students and faculty sponsored by the Berger International Legal Studies Program. Professor Makovsky discussed the draft Civil Code; Blumenfeld, the relationship between law reform and economic reform; Diuzheva, family law; and Domrin, the

new Russian Constitution.

2) Civil Law Reform in Russia, talk by Professor Makovsky on the creation of a new Russian Civil Code to a group of law faculty and students. Also, sponsored by the International Legal Studies Program.

3) Advisory Council Dinner. Professor Makovsky and Mr. Blumenfeld were invited by the Dean of the Law School to address guests at the annual dinner of the Law School's Advisory Council, a group composed of prominent lawyers, judges, and professors who have graduated from Cornell. They both discussed legal, political, and economic issues associated with the transition in Russia.

WASHINGTON SESSIONS

The two-week Washington program was designed to accomplish the Workshop's objectives in a different way than the Ithaca program. In Ithaca, IRIS organized an intensive, week-long seminar to study commercial law and the draft Russian Code. In Washington, IRIS arranged a series of sessions with a variety of groups on issues of commercial law, economics, and uniform legislation, with each group focusing on its particular area of expertise. During the first week in Washington, the Drafters focused on Code implementation issues; the second week provided members of the Commission the opportunity to conduct research in preparation for drafting articles in Part II of the Code. IRIS also arranged for the Drafting Commission to meet with a number of donor organizations and other technical assistance programs. Additionally, IRIS sponsored two public forums to enable members of the Presidential Commission to address the broad Washington audience interested in Russian legal reform.

Washington Seminars, Workshops, Meetings and Speeches

Following is a summary of the seminars, workshops, meetings, and public forums held in Washington, D.C.

ARD/Checchi Rule of Law Program Meeting. Discussion with Professor P. Maggs of the Rule of Law Program on ARD/Checchi's commercial law activities in the NIS. Explored Russian priorities for technical assistance, including the introduction of computerized communication systems through the Internet.

Workshop on Corporate Law. Professor J. Bauman of the Georgetown University Law Center, co-author of a widely used law school text book on Business Law and Organizations, addressed various corporate law issues, including: Corporate Forms, Governance Structures, Closed and Public Corporations, Fiduciary Duties, Minority Rights, and Reorganization Transactions such as Mergers and Take-Overs.

Economics Seminar. Peter Murrell, Professor of Economics at the University of Maryland at College Park and a member of the IRIS Center, spoke about the economic foundations of the transition process and their relationship to law reform. Professor Murrell has written widely about economic reform and privatization in Russia and other transitional economies.

Central European Russian Area (CERA) Forum. Victor Dozortsev, a member of the Drafting Commission, addressed the CERA Forum, sponsored by the University of Maryland. He discussed the importance of legal codification to the reform process and the problems of corruption present in Russian society.

World Bank Legal Department Meeting. Meeting with Andrew Vorkink, the Chief Counsel for Europe and Central Asia, seven other members of his legal department, and representatives from the Financial Department. The Bank officials and the members of the Drafting Commission discussed opportunities for collaboration with the Russian Government on the effective implementation of the Civil Code. The Bank praised the Research Center for its role in the development of the Code and also expressed its support for the Research Center's work on coordinating the drafting of civil codes throughout the CIS.

Federal Reserve Seminar. Seminar with Oliver Ireland, Associate General Counsel for Reserve Bank and Monetary Affairs. Mr. Ireland ran a seminar focused on banking issues, particularly the system of payments.

Department of Justice, Civil Division Seminar. The Civil Division conducted a full day workshop on issues of enforcement and litigation in US commercial law, with special reference to government contracts and remedies, bankruptcy, bank failures, tort liability, and the American legal and judicial process.

Washington Area Forum for Economic Reform (WAFER): *The Politics & Economics of Russian Legal Reform,* talk by Dr. Sergei Alekseev. Dr. Alekseev is the Chairman of the Research Center for Private Law, a member of President Yeltsin's Advisory Council, a member of the Russian Academy of Sciences, and Head of the Presidential Civil Code Drafting Commission. He delivered a lecture to an audience that included representatives from USAID, the State Department, foreign embassies, IMF, University of Maryland, Carnegie Endowment for International Peace, World Bank, American Bar Association, U.S. General Accounting Office, National Democratic Institute, ACLU, Brookings Institute, Treasury Department, Georgetown University, ARD/Checchi, Johns Hopkins University, Institute for International Economics (IIE), and IRIS. (This list refers to those that responded positively to the invitation and may not accurately reflect actual attenders.) The talk, held at the Carnegie Endowment for International Peace, was sponsored by WAFER, a lecture series on issues of economic

development co-sponsored by IRIS, the World Bank, SAIS, the Justice and Treasury Departments, IMF, IIE, and USAID.

Dr. Alekseev's lecture covered the three foundations of legal reform: personal liberty--as guaranteed by the new Constitution, private law--as embodied in the draft Civil Code, and an independent judiciary. He emphasized that the development of functioning institutions, such as the Code and Courts created to interpret it, is the key to the success of Russia's democratic reforms.

His talk elicited almost a dozen questions from the audience including ones pertaining to the following: problems of Code implementation; private sector input into the drafting process; political outlook on the Code and the parliament's role; supplemental legislation called for by the Code; process for Code amendments; relationship of Code to privatization; the Russian Constitution; and system of notice and comment.

Office of the Maryland Attorney General Seminar. This seminar, held at the Office of the Attorney General for the State of Maryland in Baltimore, dealt with commercial law issues such as government contracts, procurement, and loans, franchising, and insurance.

Semmes, Bowen & Semmes Workshop. One of Baltimore's largest and oldest private law firms ran a workshop on real estate, leasing, and secured transactions. Both private lawyers and business leaders participated, including the firm's managing partner and the owner of a major automobile dealership. This workshop focused on practical applications of law as seen from the perspective of private attorneys and entrepreneurs.

Conference on Uniform Legislation Meeting. Professor Frederick Miller, the Executive Director of the Conference on Uniform Legislation, conducted a seminar on the theory and practice of uniform legislation in the United States and its applicability to the development of civil codes in the CIS. Professor Miller also discussed legal education and translating the UCC into Russian with the drafters.

US Agency for International Development. Representatives from USAID, the State Department, and the Department of Commerce held a briefing session with the Presidential Civil Code Drafting Commission. The briefing covered three topics: a progress report on the Civil Code; an analysis of the important players and institutes involved in Russian law reform; and Russian priorities for future legal assistance. Both sides made presentations on the status, strategy, and objectives in the area of Russian legal reform.

American Bar Association's Central and East European Law

Initiative (CEELI) Meeting. The Drafters met with the ABA's CEELI project to discuss commercial law issues addressed in Part I of the draft Civil Code. Professor S. Symeonides from Louisiana State University, an expert in both civil and common law and a member of CEELI's civil code review team, conducted this session.

Washington Program of Research on Issues of Commercial Law.

During the third week of the Workshop, two members of the Presidential Commission conducted research on leasing and franchising. The met with specialists in this area, visited a title registry, and were provided unlimited access to the Georgetown University Law Library. The meetings were arranged in the beginning of the week to create a context for the independent research, scheduled for the later part. The Research part of the program included the following activities:

Brownstein, Zeidman & Lore Meeting. The research associates met one of this private law firm's lawyers who is a specialist in franchising and has experience working for the World Bank on Eastern Europe. They discussed issues of franchise law and its operation in practice.

World Bank and Lathan & Watkins Meeting. The Researchers met with a representative of the Bank's Financial Department and a member of the private law firm of Lathan & Watkins to addressing leasing and commercial real estate.

National Law Center, George Washington University, Workshop. The Researchers worked with Professor John Spanogle, a collateral law expert who has worked with IRIS in Poland and Russia. They focused on issues of secured transactions, collateral registration, leasing, franchising, and insurance.

Montgomery County Land Registry, Tour. On of the Researchers toured the land registry at the County Court Clerk' Office, examining how the registry operates.

ABA Conference, Session on Leasing and Construction. One of the Researchers attended this Conference to study the specific issue of construction lease contracts.

Georgetown University Law Center, Research. The Researchers were provided unlimited access to the Georgetown Law library during the week and were assisted by the staff. They conducted independent research on issues of leasing and franchising.

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Annex IB

6 July 1994

R E P O R T

WORKSHOP ON COMMERCIAL LAW ISSUES IN THE RUSSIAN CIVIL CODE: SALES AND BANKING LAW

WITH PROFESSOR ROBERT SUMMNERS
OF CORNELL LAW SCHOOL,
PROFESSOR JAMES WHITE
OF THE UNIVERSITY OF MICHIGAN LAW SCHOOL,
AND THE
RUSSIAN CIVIL CODE DRAFTING COMMISSION

**Organized by the IRIS Center
and the Research Center for Private Law
under the President of the Russian Federation**

**With the support of the
United States Agency for International Development**

Overview:

This is the final report on the "IRIS Workshop on Commercial Law and the Russian Civil Code: Sales and Banking Law," held in Moscow, June 13-17, 1994, at the High Arbitration Court of the Russian Federation. All sessions were chaired jointly by Professors Alexander Makovsky, Robert Summers and James White. The workshop was organized by the IRIS Center and the Research Center for Private Law under the President of the RF, with the support of U.S. AID.

Sunday, June 12:

1. Summers arrives.

Monday, June 13:

1. White arrives.

2. IRIS Meeting.

Blumenfeld and Summers met at IRIS-Russia office to discuss itinerary for work sessions, Tuesday's speech, logistics, and current status of the Code.

3. Foreign Advisors Meeting

IRIS, including Summers, White, and Blumenfeld, met at the Aerostar with Jonathan Hay of HIID and the Dutch lawyers he has working on alternate versions of the Code. The meeting was informal and cordial. The HIID/Dutch group stressed that it accepts the draft prepared by the Presidential Commission and coordinated by the Research Center as the framework. However, they have a number of problems with certain parts, which they believe can be fixed fairly easily. We asked for a specific list of those problems, because, most likely, the problems they have with the December draft are ones we addressed in Ithaca. That turned out largely, although not always, to be the case. They did raise some new and important issues.

We told them we have not yet seen the revised versions of articles in Part I or Part II that we discussed during the Ithaca and Washington Workshop. Thus, we could not comment on how much of what was discussed or suggested has been integrated into the draft Code. We will ascertain that over the course of the week.

They listed three problems with Part I:

1) Over-reliance on Courts to enforce a pledge execution;

2) No provision permitting contract suspension in case of breach by other party;

3) Too much formalism, in general.

They shared with us a short memo on the specific problems they found with the pledge sections and we discussed those at length.

Tuesday, June 14:

1. Work Session, Introductory Meeting.

Greetings and introduction of new faces. Reviewed and revised work session itinerary. Added Thursday session to reexamine issues in Part I on Corporate Liability, Contract Execution, and State Liability.

2. Work Session, Sale of Goods: Warranties

The morning session centered on the seller's breach of contract with respect to the quality of goods. Warranties were examined from two viewpoints: how they are addressed in the UCC and in the Russian draft Code. Occasionally, participants discussed ow the Vienna Convention on International Sale of Goods (CISG) or European countries approached the problem. Topics included:

1) Length of Warranty under the UCC and draft Russian Code;

2) Starting point from which the Warranty runs (time of manufacturing, delivery, inspection, or discovery);

3) What constitutes breach: perfect vs. substantial performance; US-European distinction;

4) Exceptions to Warranty Period (tolling: product liability and mass torts);

5) Notification to Seller. What constitutes proper notification? Timer period for notification. Promissory estoppel if failure to modify.

6) Express vs. Implied Warranties;

3. Yakovlev Meeting. Chairman of Supreme Arbitration Court.

Summers, White, Blumenfeld, and Russian Drafters met with Veniamen Yakovlev to discuss progress on code drafting and US-Russian collaboration. Also discussed work of the Court, including how it functions, its jurisdiction, and problems it encounters.

4. Summers and White Speech on "Commercial Law in the New Russia: An American Perspective on the Russian Civil Code."

Professors Summers and White each addressed a mostly Russian audience of almost one-hundred persons in the Plenum Room of the Supreme Arbitration Court. Chairman Yakovlev introduced them.

Professor Summers discussed his impressions on the high quality of both the members of the Presidential Civil Code commission and the draft itself, drawing from his experience in reviewing the text and working closely with its authors. He also highlighted the specific articles in the UCC most worthy of consideration by the Russians, with special reference to Article 9 on Personal Property Security Interests. He further noted the important contributions that Articles 3, 4 and 4a, all of which cover banking transactions (Negotiable Instruments, Bank and Electronic Funds Transfers), can make. He observed that European countries have very advanced laws on Sales (Article 2 in the UCC) and that the CISG offers an excellent model in this area. Finally, he stressed the critical importance of educating lawyers and judges to implement the Code after its adoption, and not simply focusing on legislative drafting.

Professor White addressed the dilemma of wanting to introduce the most advanced law with the necessity of introducing something geared to the local country's legal tradition and economic condition. In this light, he stated that often attempts to transplant inappropriate models from one country to another fail. Furthermore, he observed that in most situations law does, and should, follow practice, not the other way around. This provides an important lesson for law makers and cautions them against assuming or ensuring that a body of law will not change frequently or significantly to keep pace with business usage.

White then discussed the three major principles of American commercial law:

1) Uniformity of Law between the States. The efficiency and economic rationale behind uniformity offers an important lesson to both the Russian Federation and the CIS. Code harmonization will be critical as these countries each develop new civil codes.

2) Freedom of Contract. US courts respect this freedom, assuming that both parties are sophisticated commercial entities or that there is no overreaching, unsconscionabililty, or unfairness by one side. White distinguished the American principle of permitting anything except for that specifically proscribed, versus the Soviet legal principle of prohibiting anything not explicitly permitted.

3) Form versus Substance. The UCC emphasizes the importance of substance over form.

Finally, White also recommended specific provisions of the UCC to use as a model for drafting, focusing on the uniqueness and sophistication of Article 9. He noted that Article 2 on Sales and 3 on Negotiable Instruments are older and similar to English law.

The two speeches attracted a range of questions on the following topics:

1) Business Usage and its effect on law;

2) The limitation on Freedom of Contract;

3) Limitations on same in the area of Antitrust;

4) Effect of International Treaties on US law in the commercial context; and

5) Electronic Funds Transfers and UCC Article 4a

5. Tchaikovsky Concert

In honor of Professor Summers and his wife, who is accompanying him to Moscow, on the occasion of their 39th wedding anniversary.

Wednesday, June 15:

1. Work Session, Sale of Goods: Warranties and Early Delivery of Goods, Improper Tender.

The morning session centered on UCC 2-508 and cure by the seller of improper delivery. Summers began by pointing out that 2-508 presupposes that the time for making a complying contract performance has not yet expired and the seller may thus seasonably inform the buyer of his intent to cure and then tender or deliver a conforming good. Questions arose whether the buyer was required to wait for the delivery of a conforming good or whether this was simply the buyer's option. The Russian participants pointed out that early delivery was forbidden unless specifically allowed due to the command economy's emphasis on precise delivery dates and the general lack of storage space in Soviet industrial plants. Topics also covered included:

1) Distinguishing between express and implied warranties.

2) Express warranties resulting from descriptions of goods.

3) Distinguishing between consumer and commercial contexts in regard to warranties.

4) Businesses limiting liability for consequential damages and repair and replacement.

5) Examining differences between loan contracts and bank credit contracts.

6) Why usury laws have generally been overturned in the U.S. and why they are harmful.

7) Lender controls on debtor's use of money.

2. Work Session, Banking Transactions:

The afternoon session focused on banking law, especially bank liability for processing transactions. Prof. White emphasized that except for filing a 1099 form for the IRS and reporting any cash deposits over $10,000, a bank has no responsibility to supervise or otherwise get information about its accounts. The accounts are not privileged and if there is litigation involving the depositor, the accounts can be seized either by the IRS or by another party. Other points covered included:

1) Certificates of Deposits; penalties for early withdrawal.

2) Possibilities of using banks to prevent illegitimate transactions such as bribes.

3) Problems associated with non-sufficient funds.

4) Use of Federal Reserve Bank to clear checks.

5) Minimal use of checks in Russia.

6) Inefficiencies in Russian check clearing system: faulty or non-existent electronic equipment; Central Bank interference; general graft.

Thursday, June 16;

1. Work Session, Law of Contracts: Hardship, Frustration of Purpose, Impracticability:

The first morning session dealt to a large extent on the poor translation of the Code sections dealing with impracticability of contract fulfillment. Several terms were poorly translated leading to a great deal of confusion. Prof. Summers was also concerned that the drafters were attempting to fold impracticability and frustration of purpose into one article. Prof. Rosenburg explained that they were not so doing and that this article was based on a series of British courts decisions on concerning oil shipments following the Suez War of 1956. Other topics included:

1) Means of allocating risk.

2) Use of the price term as a method of risk allocation.

3) Defeat of all but one of the parties in the Suez Canal cases who asserted their freedom of contract on the grounds of impracticability of fulfillment.

4) Limited recognition of the impracticability defense in the United States (Mineral Park Land); permissible but severely restricted.

2. Work Session, Banking Law, Conclusion:

Prof. White was concerned about the failure to acknowledge oral contracts or accept parol

2. Work Session, Banking Law, Conclusion:

Prof. White was concerned about the failure to acknowledge oral contracts or accept parol evidence as valid in determining the parties' intent. Prof. Dozortsev pointed out that there is a basic requirement that a contract be written. Prof. Komarov seconded this, likening the Russian requirements to a more rigid variant of the American statute of frauds. Other points raised included:

1) Article 8 of Chapter 35 saying that a bank cannot refuse a bank deposit.

2) Article 7. subjecting loans between completely private parties to the regulations of the central bank.

3) Flaws in considering banks to be the equivalent of public utilities; monopolistic behavior, general inefficiencies.

4) Article 13(2) provisions for bank set-offs.

5) The lack of specifics in Chapter 36 (17) and (19) in regard to open account payments.

3. Work Session, Pledge Agreements:

This late afternoon session focused on pledge agreements and Russian reticence about adopting an article which placed less judicial interference in the way of secured credit transactions. Prof. Makovsky argued that the Russian "market" is still not in reality a market, but that in any case a less complicated mechanism for secured credit transactions should be adopted. Other points included the following:

1) 9-504 of the UCC gives the creditor the right to sell the goods in a private or public sell as long as he does it in a commercially reasonable way. This means that in many cases there is a foreclosure of a security interest without any court intervention.

2) The importance of summary proceedings to ensure the efficient foreclosure of collateral.

3) A more streamlined approach is required when dealing with commercial personal property.

4) The provision in 9-505 that allows the creditor to take the goods in full satisfaction of the debt.

5) State laws outside of the UCC which protect against wrongful repossession.

Friday, June 17:

(Legal Advisor, USAID/Moscow), W. Richter (Privatization Section, USAID), J. Horowitz (Economic Section at Embassy) and T. Rishoi (Private Sector Office, USAID.) The major law reform players were there, except T. Niblock, who leaves Moscow in a week . Good turn out. Summers and White were fairly honest about the strengths and weaknesses of the drafters. The question is are the drafters taking our input and redrafting? We have not yet seen new texts that show they have incorporated ideas from our Ithaca Workshop. But, at the same time, there is clear evidence that they are listening and thinking deeply about what we are saying, they just don't seem to have reworked the technical language yet.

The issue we posed is how to work with a process where one group consists of the authors of the framework while the other is composed of those posing amendments, some helpful. To spend all the resources on the amenders is clearly worthless without putting resources into the drafters. Moreover, it is very unclear to us that the GPU folk have the political clout to amend it without the Research Center's support.

2. GPU Meeting with Orechov (GPU Head), HIID, Summers, White and Blumenfeld.

The Dutch lawyers were also there. About 15 of us were at this meeting. Orechov asked for the opinions of the foreign advisors on Part I. The Dutch went first. They talked about the issues discussed with Summers earlier in the week.

One of the things they said was problematic was that if there are problems in Part I, you can fix them in Part II. Of course, to do that undermines the entire point of the Code, whose purpose is to be a cohesive document. You must either fix it now or amend it later or leave it as it is, but you cannot put contradictory provisions in it. White and Blumenfeld both made this point.

White made the points that the pledge section clearly needs improvement, (although picking the Dutch model is probably a little odd because it is antiquated); that changes need to be made in Part I, not Part II; that some problems are political, not legal, and therefore, thought needs to be given to what the Duma will accept; and that the real course to follow is negotiation between the Russians (GPU and the Research Center).

Bottom line. Orechov has asked IRIS and Summers and White to review the GPU drafts. We agreed on the following conditions. First, he write a letter to Makovsky stating that he has made the request. Second, that any responses will be shared equally with the Drafters, which means texts, too. Finally, we stated that we need to discuss first the issue with the Drafting Commission.

29 June 1994

R E P O R T

WORKSHOP ON THE RUSSIAN CIVIL CODE:

PROPERTY -- PROVISIONS, IMPLEMENTATION AND IMPACT

WITH PROFESSORS R. ELLICKSON AND C. ROSE
OF THE YALE LAW SCHOOL
AND THE
RUSSIAN CIVIL CODE DRAFTING COMMISSION

Organized by the IRIS Center
and the Research Center for Private Law
under the President of the Russian Federation

With the support of the
United States Agency for International Development

Overview

With the support of the United States Agency for International Development, the IRIS Center's Russia Project sponsored a Workshop on Property issues in the draft Civil Code of the Russian Federation. This Property Workshop, held on June 22, 1994, was another in the series of sessions IRIS has organized between the Civil Code Drafting Commission and western commercial law experts to review the official draft Code. The Workshops have also focused on the legal and economics principles that lie at the foundation of a commercial law system in a market economy.

In addition to the Property Workshop, IRIS organized a series of meetings on June 23 between Ellickson and Rose and representatives of the Ministry of Justice, the World Bank, PADCO, and the Urban Institute. The purpose of these meetings was to explore the potential impact of the property sections in the Civil Code on the land and housing sectors.

I. *Property Workshop*

The IRIS Center organized a full day Workshop between the Drafting Commission and Professors Robert Ellickson and Carol Rose of the Yale Law School. These two Professors are preeminent scholars in the field of property law. Professor Ellickson specializes in real property and housing law; Professor Rose is an expert on land use controls and environmental law.

The Workshop focused on the wide range of real property issues covered in Parts I and II of the draft Civil Code. In addition to providing the two Professors with the text of Part I and select articles in Part II, members of the Commission had also prepared questions on property for the western experts to answer. IRIS has previously had these materials translated into English.

In preparation for their visit to Moscow, Professors Ellickson and Rose wrote commentaries on the property provisions in Part I of the Code. IRIS has provided these analyses, which included the Professors' suggestions for revision, to the Drafting Commission. Additionally, IRIS is currently translating them into Russian in anticipation of wider distribution.

Although the Workshop lasted for only one day, the participants covered a broad spectrum of real property issues found in the Code. Specifically, the session covered the following eight topics (questions and major issues discussed are also noted):

1. *Land Registration and the Classification of Rights*

   Are rights created by contract during the transaction or through the registration process?

   Parties to the contract are bound by the transaction.

Third parties are bound only by notice.

2. *Limitations on Property Rights*

The Code's response to attempts by certain political factions to establish upper limits on the size of private land holdings permitted? Possible solutions.

3. *Federal verses State Control over Land*

Land is uniquely local.

Federalist issues.

How to address local governmental corruption and anti-market measures.

4. *Land Use Controls and Regulation*

Zoning.

Purposeful use and affirmative use of land.

The danger of the breath of land confiscation provisions for general crimes.

5. *Eminent Domain*

Application, restraints on its use, and compensation.

Ensuring fair treatment by the institution responsible for awarding compensation.

Public purpose defined.

Land warehousing: governmental purchase of land for future use.

Power of eminent domain in Russia belongs to oblasts, not smaller localities. Benefits and drawbacks to such a policy.

6. *Public Lands*

Land that should be exempt from private ownership.

Public Trusts: park lands and historic sites; public use spaces.

Mineral Rights: deep minerals verses surface minerals.

7. *Leasing: Commercial and Residential Leases*

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Ministry is the governmental agency authorized to ensure that the development of supplemental legislation called for in the Code is coordinated so that it complies with the Code's provisions. He also enumerated the laws and codes the Ministry is currently helping to draft, which include laws on joint stock companies, state-owned enterprises, consumer protection, and condominiums; codes on land and housing; and the land registration system.

He was particularly interested in Ellickson and Rose's advice on land registration. This part of the discussion focused on setting up a registration agency, how to administer a registry, the amount of discretion that should be afforded to that agency, and issues of federal versus local control over such a system.

Mr. Krashenninkov also addressed the implementing legislation that will accompany the Code. This law will repeal any and all laws that conflict with the Code, listing specific laws subject to rescission by name.

In addition, Ellickson and Rose offered their observations on the strength and weaknesses of the property sections in the Code.

2. World Bank and PADCO Housing Construction and Reform Project. Ellickson and Rose met with representatives of the World Bank/PADCO Housing Construction and Reform Project. Discussion topics included title registry, guaranteeing architectures right to construct buildings on land, new housing construction, and the legal vacuum caused by the absence of laws on housing, lease, mortgage, land, and condominiums.

3. Urban Institute Housing Project. Finally, Ellickson and Rose met with Ray Struyk of the Urban Institute. Discussion centered on the Urban Institute's work in the housing sector, land and housing registration, and relevant property provisions of the Civil Code.

Attachment:

Memorandum by Ellickson and Rose on Property Workshop with Civil Code Drafters.

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MEMORANDUM

TO: Lane Blumenfeld, Director, IRIS Russia Project

FROM: Robert Ellickson and Carol Rose

DATE: June 29, 1994

RE: Meeting with Committee of Drafters of Russian Civil Code, June 22, 1994

The following persons were present during our discussions (though for varying periods and lengths of time): Gainan E. Avilov, Michael I. Braginsky, Victor A. Dozortsev, Georgiy D. Goloubov, Stanislav A. Khokhlov, Alexander S. Komarov, Alexander L. Makovsky, and, at the end, a professor named Sirodsev (?), whose specialty is land law. The organizing person appeared to be Khokhlov, who was present for the longest time overall.

Registration--legal effect. At the Committee's request, during the morning we primarily discussed issues of land registration. Some of this discussion was devoted to the legal effect of registration, and specifically whether property rights have to be registered to count as genuine "rights." We urged ~~that the problem be treated~~ in a bifurcated way (as most European and American legal systems treat it): that is, rights are set by the transaction as between the transacting parties, but are only binding upon third parties upon registration or some other notice-giving event. The drafters generally seemed to grasp this distinction, and indeed a crude version of it already appears in the draft Code at Article 165(2).

that the problem be treated

Registration--mechanics. We also discussed the mechanics of registration. We urged that any registration or recording process be kept as simple, mechanical, and transparent as possible, so as to reduce opportunities for graft and other bureaucratic obstacles to real estate transactions. We also urged that the registration bureaucracy play as small a role as possible in defining the rights registered, particularly since these rights may well have to derive from informal criteria, notably long actual possession.

Limits on landownership quantities. Toward the end of the morning (and spilling over to lunch), we moved to questions of the limitations on property, and specifically to the Agrarian Party's effort to limit overall quantities of land that may be owned by any individual. The drafters appeared to oppose any such limits, but were worried that the Agrarian Party might carry

the day. Bob suggested a compromise that would authorize each oblast to set an ceiling on each individual's private acreage at an amount equal to not less than 25% (or even 10%) of the average area, in 1994, of the state and collective farms in that oblast; this might allay fears of monopolization and latifundia (by a formula embarrassing to the collective farm Agrarians) without posing genuine obstacles to private land ownership.

Public land use restraints; confiscation. In the afternoon, we discussed legal restraints on land use, including private servitudes and general nuisance law, but more particularly public measures such as zoning and environmental laws. The subject of confiscation came up immediately, since several Code sections appear to contemplate this remedy for "irrational" land uses or uses not in accord with specific public directives. We urged the incompatibility of such confiscations with general principles of private control over property. Our sense was that the drafters agreed, but may have felt constrained by political considerations. We also urged that confiscation could be alleviated by requiring just compensation, as well as by "public use" criteria that impede governmental transfer of property from one private user to another.

Public property. The drafters were interested in the kinds of property that might appropriately remain in the hands of the public. We gave the standard typologies: public trust properties like waterways and beaches that are not alienable by government; property used by the public (roads and transportation ways, public buildings, parks, areas especially sensitive to environmental degradation); and properties whose successful exploitation requires large landholding (deep subsurface minerals, though with private ownership of the surface). We pointed out that the United States sometimes gave away too much property in its early years, but noted that eminent domain can be used to correct such mistakes after the fact, as occurred during the creation of some national parks.

Leases; divided property; mortgages. Particularly after the arrival of Makovsky, the afternoon questions focused on leasing and mortgage finance. We discussed the possible strengthening of eviction proceedings to encourage private land rentals; some drafters raised the countervailing concern that tenants currently have nowhere to go. We also discussed ways in which property might be divided by lease, e.g. lease of timber rights. On mortgages, we discussed foreclosures and a variety of legal efforts to protect borrowers (e.g. statutory redemption periods after foreclosure sales). We pointed out that these measures may backfire, in the sense that they may make lenders charge higher interest rates or limit the funding available to borrowers. Makovsky was particularly interested in privately run foreclosure sales, leasehold mortgages, and deficiency judgments.

Sale of public property. At the close of tha day, we turned briefly to the abuses that may result from the transfer of public property to political cronies at below-market prices. This subject appeared to arouse very considerable interest, but we had too little time to pursue it.

Important issues not discussed. We thought that we did not have adequate time or occasion to discuss several important problems. One was the issue, mentioned above, of restraints on the transfer of public property. A second was the Civil Code draft's excessively paternalistic treatment of tenants in existing housing, which we thought could well discourage transfers and investments in housing. A third was the extremely limited scope of servitude law in the Civil Code draft. A fourth was adverse possession and prescription.

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June 20, 1994

COMMENTARY ON THE DRAFT CIVIL CODE OF THE RUSSIAN FEDERATION

The IRIS Center has been assisting the Presidential Civil Code Drafting Commission as they develop a new Civil Code for the Russian Federation. IRIS has organized workshops between the drafters and Western legal experts, both to examine the principles underlying a commercial law regime and to review the draft Code. Additionally, IRIS has solicited comments from Western specialists with expertise in American, European, and Russian law to assist the Russian law makers. IRIS is now making the first compendium of these comments available, in both English and Russian.

Attached are comments on Part I of the Civil Code prepared by five distinguished legal experts from the United States. These individuals are:

* Professor John A. Spanogle -- Professor of Law at the George Washington University National Law Center and Member of the Drafting Committee to Revise Article 2 -- Sales -- of the UCC. He is an expert in Secured Transactions and Collateral Law, and has consulted for the World Bank and the IRIS Center's Poland office extensively. His has prepared both general comments and comments focused on the pledge sections.

* Stephen Butler, Esquire -- Private attorney practicing in Connecticut. He has considerable experience working on land reform in Moscow as a consultant for the World Bank and the Urban Institute. He has also assisted the drafters of the Land Code and Mortgage Law. His comments cover Part I in its entirety, but have a particular emphasis on land issues. Mr. Butler's comments, both in English and Russian, are provided courtesy of the Urban Institute.

* Professor Carol Rose -- Professor of Law at Yale Law School. She is an expert in Land Use Controls, Property Law, and Environmental Law. Her comments concentrate on those articles

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dealing with property.

* Professor Patricia McCoy -- Professor of Law at Cleveland-Marshall College of Law of Cleveland State University. She is an expert in Banking Law, Securities Law, and Secured Transactions. She has been a visiting law professor at law schools in St. Petersburg and Volgograd, and a guest lecturer in Moscow. Her comments address banking and securities regulation.

* Professor Robert Ellickson -- Professor of Law at Yale Law School. He is an expert in Real Property Law and Housing Law. His comments concern property issues, particularly land.

* Official commentary prepared by the members of the Presidential Civil Code Drafting Commission. This commentary is provided by the Research Center for Private Law, in Russian only.

IRIS will receive additional commentaries from other Western commercial law experts in the near future, which will be translated and distributed as soon as possible.

#1 C:\WP51\IRIS\STEVE\620COLET.LET

TO: Lane Blumenfeld
FROM: J.A. Spanogle
RE: Russian Civil Code - Part I

A quick reading of the Dec. '93 draft raises a few detailed problems outside the "pledge" provisions.

Article 23. Why is this power to engage in entrepreneurial activity limited to citizens only? Most countries allow all permanent residents to engage in such activity, especially if they register with the State. There could be a list of prohibited activities for non-citizens. See Article 49.

Should some citizens not have this power? *E.g.*, persons in bankruptcy proceedings, and those subject to disabling orders of a court.

Article 66.4. (Second paragraph) Same observation as for Article 23.

Article 239.1. This article allows the State to take property whenever it wants to. That power should be limited so that a land plot or other immovable property may be alienated only for important State or municipal needs which cannot be met by other means.

The purchase by the State should be "at a market price," which should be provable by any means. Sale at public auction is one way to prove that market price, but it is not the only way, and such a price should not be conclusive.

Article 242.1. Same observation as in Article 239. Add "market" before value. The date for measuring the market price should be the date of requisition, not later.

Article 280.1. Same observation as in Article 239. Add "important" State or municipal needs "which cannot be met by other means."

Article 282.2. The value should be determined as of the date of the acquisition by the State.

Article 283. A sentence should be added allowing judicial review both as to the grounds of alienation and as to evaluation.

I will get the comments on the "Pledge" section to you later.

#1 C:\WP51\IRIS\STEVE\620SP.LET

To: Lane Bloomenfeld, IRIS

From: John A. Spanogle, Consultant

Re: Russian Civil Code

I enclose comments on Civil Code Articles 330-338.

Comments on Russian Civil Code

A. Pledge law provisions:

1. Article 334(1). There are two types of secured transa[illegible] laws. One type gives the secured creditor only a procedur[illegible] to share in the distribution of the proceeds of sale of t[illegible] collateral. The other type gives the secured creditor a "[illegible] rem," or a property interest in the collateral. The latte[illegible] protects the creditor better, and therefore allows the deb[illegible] obtain better credit terms. The former type usually allows [illegible], non-secured creditors to share and to take priority over t[illegible] secured creditor. Thus, he may take his share only after the tax

man, employees, alimony and child support, etc.

The current language of Article 334(1) suggests a procedural right only. Pledges would be more effective in lowering credit costs if they were made into a "right in rem." If the drafters worry about the secured creditor taking the collateral and keeping it, that property interest can always be made subject to a condition subsequent. The condition subsequent, which should be in the Code, would be that, upon obtaining the collateral, the creditor must sell it, and obtains title only for the purposes of resale and passing title onto a third party.

2. Article 334(2). You have made provision for a Russian Law on Mortgage, which is good. However, there are likely to be other secured transactions laws in the future (e.g., factoring, financial leasing, etc.). Could the reference to the Mortgage law be made more generic to allow such future developments? A reference generally to laws on secured transactions would obviate the necessity to amend the Code each time there is a new development, or discovery of a new security device.

3. Article 334(3). Pledges usually arise by virtue of a contract, either express or implied in law. A similar, but non-consensual property interest, which arises solely by operation of law, is usually called a "lien." You may want to treat consensual and non-consensual interests differently. Thus, you may wish to limit your definition of "pledge."

4. Article 335(3). Should there be language which limits to "lease or other right" to the duration or extent of the pledgor's actual interest? As it reads now, I think I can rent a car from Avis for the weekend and then pledge the entire car to my local finance company, unless there is something contrary in the contract. Avis will put a clause in the contract, but a Russian citizen making a casual weekend arrangement is not likely to do so.

5. Article 336(1). Does this provision also cover real estate, or only movables and intangibles? Real estate presents separate problems from movables and intangibles, and most experts who have studied the problem believe that laws on each should be separately drafted.

6. Article 338(1). There is no substantive problem here. But there may be a linguistic one. For centuries, "pledge" has meant only a possessory security interest. Other words ("mortgage," "charge," "security interest," etc.) have designated non-possessory interests. Can some word other than "pledge" be chosen in the Russian Code?

7. Article 338(1). As it reads now, the debtor is not permitted to deliver the mortgaged collateral to the secured creditor. That may be a translation problem. I assume you wish to say only that the debtor is not required to deliver the mortgaged collateral to the secured creditor.

8. Article 338(2). If the pledged collateral is under lock and seal, it is not commercially useful to the debtor. If it is marked, and it is inventory, it may not be saleable. I would suggest deleting this provision and allowing these concepts to be dealt with by contract between the parties.

9. Article 338(4). I need to know the definition of "security." If it includes chattel paper, accounts or contract rights, or any other intangible, this will create problems in using them as collateral. If it includes bills of lading or warehouse receipts (documents of title) the provision is contrary to current commercial usage, which allows these documents (securities?) to be controlled by endorsements.

B. Other Provisions

Articles 330-334: Although penalties were the normative way of enforcing contractual obligations under a command economy system, they have many drawbacks when used as part of a market economy system. In particular, they can inhibit the entrepreneurial activity of borrowers. Lenders always draft the loan forms. Lenders, under this legislation, can put in any provision they want to--and may have a single penalty provision which is fine for some defaults and disproportionate for other defaults.

Thus, a business may be penalized too much for missing a single installment payment, or even for being a single day too late in such a payment. The Commission should consider limiting the penalties applicable. If actual damages are too difficult a limit, then perhaps 5% of a missed installment payment, or a minimum amount of penalty, or use a statutory interest rate to measure the penalty.

Also, do these provisions apply to obligations in the loan contract other than those to repay money? For example, promises to insure assets, to maintain assets, to maintain the value of pledged collateral, to maintain sales or rental revenue at a certain level? All these provisions routinely appear in current commercial contracts, including loan contracts. I unlimited penalties can be applied to such non-monetary promises, the debtor is in a truly dangerous situation.

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COMMENTS ON THE DRAFT CIVIL CODE OF THE RUSSIAN FEDERATION DATED DECEMBER 12, 1993*

Stephen B. Butler**

The Urban Institute
12/5 Furkasovsky per.
Moscow 101819

March 25, 1994

The Russian Civil Code of 1964 is undergoing a comprehensive restatement under the direction of the Research Center of Private Law of the Office of the Russian President. Part One of the restated Code has been made available for comment.

The Urban Institute/USAID Russian Program for Technical Cooperation in Reform of the Shelter Sector focuses on issues of housing development and finance, including fundamental issues of property rights and urban land development. The following comments therefore address elements of the draft Civil Code that potentially affect rights in land and housing or the process of urban land and housing reform and development.

I. General Comments

(1) These comments are based upon a translation from the Russian, which may at times have led to a misunderstanding of the intention of the law.

(2) Only a portion of the provisions on lease, an essential part of real estate law, were available at the date of this writing.

(3) The draft thus far is a good, comprehensive approach to restatement of the civil law of property on the basis of civil law models from established market economies. However, the provisions reflected in the draft are in some instances not necessarily the most progressive or flexible available. It might be possible to improve upon some aspects of the draft by looking at some additional models and codifications of property laws, including some from common law states.

(4) The draft might be improved in some cases by distinguishing between transitional legal concepts and concepts suitable for an established market or mixed economy. Some property concepts may be useful or necessary in the short run only to protect existing rights during a period of transition, but should not necessarily be permanent parts of the law. The clearest example of this idea is the perpetuation of Soviet-era forms of property tenure, for example inheritable possession, permanent use and economic or operational management, that have no real counterparts in the law of other developed nations and which may be consolidated or converted to better defined forms of tenure.

(5) There is sometimes too much detail where less is needed. Considering the rapidly changing legal concepts in Russia today and the role of the Civil Code as a law of fundamental principles, perhaps some detailed concepts should be better left to other civil laws that may be amended and modified

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* Translated from the Russian by W. E. Butler, dated December 12, 1993.

** The author is the legal advisor to the USAID/Urban Institute Program in Technical Cooperation for Reform of the Russian Housing Sector.

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more easily. At the same time, there is not enough detail where additional development of concepts might be useful. An example would be in the definition of property rights such as servitudes. Generally, the different property rights in land and real estate are not precisely defined or distinguished from each other.

(6) Further consideration should be given to the relationship between the Civil Code and the recent drafts of the Land Code of the Russian Federation. Both laws are attempting to define fundamental property rights in land and there is the potential for conflict and confusion. The stronger argument is that the definition of property rights to land should be found in the Civil Code, and that the Land Code should simply adopt those definitions by reference. Instead, this draft appears to delegate to the Land Code the role of defining important aspects of fundamental property rights. At some point a question must be raised about the function of, or necessity for, a separate land code, when most issues affecting land will be defined in separate laws, including the Civil Code (property rights), the urban planning law (urban land use), agricultural codes, laws of cadastre, title registration, mortgage and environmental protection. (Relevant also is the argument that the new Constitution abolishes the use of laws of fundamental principles.) In one sense, the land code should perhaps be viewed only as a law of transition, governing relationships with respect to publicly owned land and the process of land privatization.

II. Specific Comments

Article 131

What is meant by property registration will be accomplished by justice agencies? Most proposed drafts of the registration law place this responsibility in other agencies, most notably the land committees. Moreover, the present draft states that rights to real estate will become effective upon registration. Since the term "juridical agencies" might include state notaries, will the rights arise upon notarization by a state notary or upon registration with some other registry?

Under paragraph (2) it is unclear whether this is meant to be a closed list. The second paragraph refers to special registration of individual types of immovable property, but the real issue will be registration of intangible rights to immovables, for example, options, contracts, preferential rights of purchase, etc. Compare this article with the language of Article 164, which is more broadly written.

Article 157

The definitions of conditions subsequent and conditions precedent are reversed.

Article 186

The two paragraphs of section (1) are contradictory.

Article 210

What is meant by the "burden of maintenance"? The prior draft, in Article 199, referred to "taxes, duties and charges connected with the property," but this language has been deleted from the present draft. The question is pertinent because the draft suggests that burdens connected with land will be the responsibility of the owner "unless the owner has provided otherwise by contract." Depending upon its interpretation, this language could have implications for public policy.

Obligations connected with land -- including without limitation the obligation for taxes and compliance with planning, building, environmental, and nuisance or personal injury laws -- invariably should be the responsibility of the owner. The government or injured parties should not be concerned with the owner's contractual relationships with others. Placing absolute responsibility on owners establishes a simple and effective rule that requires parties with interests in land to organize their relationships contractually (for example, through insurance contracts), while at the same time efficiently locating ultimate responsibility.

If the "burden of maintenance" is meant to apply to all obligations that may arise from land ownership, it might be better to place absolute liability on the owner, but provide that contracts between the owner and others with an interest in the property for cost sharing, contribution or indemnification will be enforceable between the parties to the contract.

Article 212

Paragraph 2 provides that the specific aspects of acquiring or terminating rights in property "and the possession, use and disposition of it" may be established only by a law. This appears to establish a restrictive principle, that is, use and disposition only as specifically permitted by law. At the same time, Article 209 allows owners to perform with respect to their property anything that is not prohibited by law or does not violate other protected rights, which is a permissive principle. These are two different approaches to rights; is this a real or apparent contradiction?

Article 216

Conspicuously absent from the enumerated rights of non-owners is the right of lease, which may eventually be among the most important landed property rights in Russia. Rights of lease are true real property rights. and not simple contract rights; they attach to ("run with") the land, are registered, can be terminated only by order of court and as a general rule are specifically enforceable against the owner. The apparent intention of the draft is to discuss lease in connection with rights of contract, which is not unusual in civil law systems. But the failure to include lease among real property rights simply perpetuates a fiction. If this reflects an intention to view leasehold simply as a contractual right there may be serious implications for the development of market relationships in land.

Is this a closed list, or are there other possibilities allowed? For example, the interest of the beneficiary of a trust or other legal arrangement in which legal ownership is held by a trustee or guardian. The entire concept of beneficial ownership, that is, rights to property legal ownership of which is held by another subject to contractual limitation, is not addressed in the code.

Paragraph 3 states that the transfer of ownership shall not be grounds for the termination of the property rights in a thing described in Article 216 (1). Is this provision limited to the rights described in Article 216 (1)? Also, is the intention that transfer alone will not terminate the described rights? In fact, the transfer of ownership through foreclosure of mortgage or lien may under some circumstances result in termination of some interests in property, including overlying liens or mortgages and some leases, and it is difficult to distinguish between the act of terminating the mortgagor's rights and the act of transferring the rights to another. (In Article 237 (2) of the present draft it is established that the mortgagor's rights terminate upon completion of the transfer to another person.)

Is it the intention of paragraph (3) that the rights to a thing not specifically identified in paragraph (1) may be terminated by sale of immovable property to another party? What about contract rights that are registered, for example, options and rights of preferential purchase?

Article 218

Under paragraph 4 the members of consumer cooperative with fully paid shares are entitled to "ownership" of the real property granted to them for their use. What does this mean?

In a true cooperative individuals do not own any portion of the property, but rather own a participatory share in the ownership entity, which is established as a legal entity. This article of the draft confuses the concepts of cooperative ownership, in which the individual owns a right of occupancy and a share in the legal entity, and condominium ownership, in which the individual holds title to a divisible piece of property. With respect to real estate, the effect of this provision will be to create a form of condominium ownership for some occupants, i.e. those who have fully paid shares, and continue a cooperative form of ownership for other occupants, all in the same building. The ultimate legal implications of this are unclear.

It seems clear that once there are individual owners as well as ownership of some units by the cooperative association as a legal entity, the entire building or property would have to be registered under the condominium law (two or more owners). Moreover, as financing becomes generally available for purchase of houses, even in cooperatives all new purchasers will likely have paid up shares from the date of occupancy, that is, the cooperative organizations need no longer serve as financiers of cooperative members. Ultimately, then, it is likely that all cooperatives will become condominiums. Is it the intention to phase out the cooperatives law as it relates to real estate and to replace it with the condominium law?

This confusion suggests ambiguities of the existing laws of cooperatives, which should perhaps be reviewed also at this time. If the cooperative laws were properly structured, providing secure and well defined property rights, this provision would be unnecessary.

Article 219

At what point can rights to a structure be registered and ownership certified? This article suggests only upon completion ("newly created"). The legal implications of this concept are unclear. For example, consider the following situation: The owner of land seeks to obtain a loan for construction of improvements to the land. The mortgage lender requires a mortgage on the construction works in progress so that it can recapture and complete the construction if necessary. If the landowner is not considered to own the constructed building until completion and registration, how can he mortgage what he does not own?

This provision perpetuates the artificial distinction between ownership of land and constructed improvements to the land that arose as a response to Soviet-era land law, and also confuses the right of ownership of a structure with the right to use or occupy the structure. Constructed improvements to land, regardless of the stage of development, should be presumed to belong to the owner of the land from their inception (the principle of accession), subject to any contractual obligations regarding use of or payment for the improvements.

The basic unit of registration is the land itself; separate registration of ownership rights in constructed improvements and immovables should be necessary only if private parties wish to show separate rights to land and constructed improvements, and then it should be the responsibility of private parties to look out for their own interests. The lawfulness of the constructed improvement should be considered in the issuance of a building permit, as part of the building and planning process, and not determined upon registration after it is completed.

Article 222

Is the concept of "arbitrary structure" a useful one? In the first instance, denial of ownership rights should not be the penalty for building or planning code violations. There is probably not a building in existence that cannot be found to be in violation of planning or building codes. While it is true that the law refers to "material" violations of codes, property rights should not be subject to the varying interpretations placed on the term "material" by courts and administrative agencies in various locations and over various periods of time. The appropriate penalties for those violations are fines and other financial penalties, denial of occupancy permits, orders of demolition (after appropriate periods for cure and rights of appeal) or criminal penalties. The penalties should attach to ownership of the land, creating incentive for the private parties to act responsibly and practically preventing the sale of the land to another.

With respect to structures deemed "arbitrary" because they are located on land not owned or in the lawful use of the creator of the structure, this concept gradually would become unnecessary if the principle were to be established that all structures place on the land were legally presumed to be in the ownership of the land owner, thereby placing the creator of the unauthorized structure at risk of losing his investment to the landowner if he builds without permission. In fact, rather than penalizing unauthorized construction, this provision protects the interloper by requiring that the landowner pay him for the improvements; trespass should not be so encouraged. This article also fails to make a distinction, found in some civil codes, between mistaken and willful use of another's land.

There appears to be a conflict here between what is good policy for the present transitional period and what would be good policy for an established system. The provisions of this article may be necessary to deal with the many ambiguous or unregistered rights to structures that have arisen over the years in Russia when land was not privately owned -- for example, squatters on public lands. But the question should be asked whether these principles are useful or appropriate in the context of private rights of land ownership. If the proposed principles are not appropriate for an established systems, perhaps consideration should be given to dealing with the issues of existing , ambiguous rights to property under laws directly related to the problems of transition. The land code could serve that purpose.

Article 234

While prescription is not necessarily incompatible with a registered land system, it certainly raises more issues. Not the least of these is the nature of the government's guarantee of registered land rights. None of the drafts of the title registration law now in circulation consider an exception to the government's guarantee of title for prescriptive rights not shown in the register. An essential point here is that the rules of prescription should be brought to the attention of those persons responsible for creating the law of title registration.

Other issues include, for example, the concept of possession in good faith, which means essentially without knowledge of the defect of one's claim. The concept of good faith should be irrelevant in a registered land system, where each owner is legally deemed to be on notice of the extent of property rights by virtue of registration, except in the situation of registered but incorrect property descriptions. In addressing this issue some systems require not only that the prescriptive rights be based on use, but also on actual registration for the required term of years; that is, prescription is only good as between two registered but conflicting titles.

Other issues not clearly addressed in the law include, for example, the concept of hostility, that is, that prescription cannot occur under grant of right from the landowner, or whether prescription is

effective against the government, which for some time may be the largest landowner and victim of prescriptive rights.

Article 235

Paragraph 2 (8) raises the issue of termination of property rights ("compulsory alienation") for violation of use restrictions or limitations on land (See Articles 285 and 286). As a general principle, use restrictions on land are better enforced through other means, including fines and criminal penalties, than through termination of property rights.

The law of land use appears gradually to be moving toward relaxing controls, particularly with respect to urban land, and also toward greater emphasis on private market decisions on the best uses to be made of land. Issues of use should be left to laws of urban planning or other laws of land use, which would be more flexible and adaptable than the Civil Code, and it should be sufficient for the Civil Code to state simply that land must be used in compliance all applicable laws. The withdrawal of land ownership for violations of use restrictions or on the basis of issues of "productivity" is of questionable validity under the Russian Constitution, and the Civil Code should specifically renounce the dependence of rights of ownership on the types or quality of uses made of the land.

With respect to the issue of serious ecological damage, an alternative approach could be to place a statutory mortgage on the land in favor of the government to secure the financial obligation of the owner to cure the ecological problem.

Article 242

While requisition is an established civil law concept, what distinction is drawn in the law between requisition and withdrawal? Requisition clearly must be based on an emergency need. In that case, the withdrawal is temporary, and there also may be insufficient time to calculate and pay for the value of the property. Would the law be more precise if it stated explicitly that requisition did not result in termination of the rights of ownership (See paragraph 3) and that under emergency circumstances payment may be made within a reasonable period of time after the emergency arose?

If there are no clear distinctions between requisition and withdrawal, why create two concepts when one will do?

Article 243

Confiscation of land as punishment for a crime is a troubling concept. It has largely been abandoned in common law countries. Where it does exist, as in the United States' anti-racketeering laws, it is limited to property directly involved in the commission of a crime, and is coming under increasing constitutional scrutiny because of widespread abuse in enforcement.

Confiscation of property as a general penalty for crime is frequently a penalty against other innocent parties as well as those engaged in the commission of a crime.

Chapter 16, Generally

The laws of condominium ownership of real property are still in development and may be refined over several years. Some provisions on common ownership found in Chapter 16 are not compatible with condominium ownership, including, for example, divisibility, the right of partition and requirements of unanimity for disposition. These incompatibilities are specifically recognized under Article 254, which

states that issues of partition of specific types of property my be dealt with under separate laws. However, it is not clear whether the intention of Articles 254 and 292 is to exempt condominium ownership of real estate from the general provisions of Chapter 16, or are limited only to the provisions on partition.

Similarly, Article 292 of Chapter 18 specifies that partnerships of housing owners will be created and operated according to a separate law. However, condominium ownership of real estate is a useful form of ownership for all types of real estate, not simply housing, and Article 292 deals specifically with housing.

It might be advisable to begin the chapter on common ownership with a general provision, similar to paragraph 4 of article 254, which would state that the provisions of the present chapter apply to common ownership unless established otherwise elsewhere in the civil code or in other law.

Of particular concern is the right of preferential purchase. Rights of preferential purchase ("rights of first refusal") are often cumbersome and frequently impose delay and higher transactions costs on the seller; they sometimes result in lower prices for the property. As a general principle, rights of preferential purchase should be a matter for private agreement and should not be imposed by law. There is especially no need for such a right in a common interest housing community, in which each owner is subject to the same rules, and these rights should be made inapplicable to housing communities unless specifically agreed by the owners.

Article 260

This article again implies the dependence of rights of ownership upon the "purposeful use" made of the land. This concept should be rejected. The Civil Code should state simply that land will be used in compliance with all applicable law, but renounce the dependent relationship of rights and use. See also Articles 235, 285 and 286.

Article 262

The actual physical scope of ownership of land is not defined. The right of ownership may extend not only to the surface of the land, but to the air and subsurface spaces as well. Air and subsurface spaces are important parts of fundamental property rights and should be included in the definition of ownership rights in the civil code, not left to the land code. If it is intended to reserve rights to air and subsurface spaces to the state, this should be included in the basic definition of ownership.

Generally, the code does not address the possibility of restricted or limited ownership, but defines ownership in terms of absolutes of use and disposal. There are several concepts relevant to ownership that may be helpful, including ownership in trust (legal ownership subject to the beneficial ownership of another) or ownership subject to rights of termination or reentry for violation of a condition. For example, the concept of trust may be an appropriate substitution for "economic jurisdiction." Similarly, the concept of ownership subject to a condition may be helpful during the period of transition in which the government wants to privatize land subject to enforceable rights of reentry or termination in the even that the land is not developed within a reasonable period of time. Rights of ownership subject to a condition could be subject to appropriate limitations, both in terms of time and the purposes for which termination would be enforceable.

The territorial boundaries of land are not determined by "documents issued by the state," but rather by agreements for the sale of land between private landowners or between the state and private persons. Those boundaries are simply reflected or memorialized in the documents (certificates of title)

issued by the state. A more accurate statement would be that territorial boundaries are determined by reference to the laws of contract, cadastre and title registration.

In paragraph 2, what is the significance of the limiting language "created by him for himself"? To organize private property relationships a stronger principle should be established. That principle should be based on the right of accession of immovable objects, and establish a legal presumption that any immovable objects (not just objects "created by him for himself") placed on land belong to the owner of the land. This strong principle serves to organize the law and encourage the owners or users of land and immovables located on the land to properly document and register their contractual relationships.

Article 265

Paragraph (1) would more accurately reflect the full range of possibilities by stating that "all or any portion of land plots, or rights to use land plots, may be granted by their owners to other persons in perpetuity or for a defined term, in accordance with the provisions of this law."

The entire concept of "permanent use" of land is of questionable utility. Moreover, the concept of permanent use found in this draft is vaguely defined. The essential purpose of the Civil Code is to define fundamental property rights; if the concept of "permanent use" is to be retained, the precise definition of these rights should be made in the Civil Code and not be left to some further legislation.

It appears that under Article 269 the only way a right of permanent use to land can be acquired is in (1) a grant of land from a government, or (2) if a person "owns" a building or structure located on the land, or (3) by juridical persons through the process of legal succession. It is not made clear whether rights of permanent use may be inherited, whether they are limited to the life of a natural person, whether they may be granted by private landowners by contract, and whether the grantor of a right to permanent use may charge a price or rent for the use of the land.

The right of permanent use is clearly a legal device invented to provide some security of rights in a legal system that did not recognize the right to own land, while at the same time maintaining government control over use and disposition of land. Now that the right to own land has been enacted, along with the lesser right of lease, it must be questioned whether it is useful to perpetuate the concept of "permanent use." Permanent use results in a potentially permanent division of property rights, particularly in the case of rights of use held by juridical entities, and may adversely affect the efficiency of markets. In effect, at any given time there are two owners of the land, and neither can sell, lease or change the use of the property without the consent of the other. While this same situation arguably exists under leasehold, at least the leasehold is for a defined term of years, at the close of which there is again a unity of rights.

Most of the objectives of the permanent right of use can be achieved through the use of other forms of property rights, including ownership, lease and servitude. (Why, for example, in the case of the rights granted to the owners of structures, why is it necessary to grant a right of permanent use instead of a servitude of support and access?) Because of the availability of these other forms of rights, it is arguably not necessary to perpetuate the permanent right of use as a form of property right except as a transitional matter to deal with such rights existing at this time. Elimination of the permanent right of use would consolidate and simplify legal concepts of land rights and bring the Russia law more into line with legal concepts in other systems.

The grant of new rights of permanent use should be terminated with enactment of the Civil Code, and the treatment of existing rights of permanent use should be assigned to the land code, one of the primary purpose of which should be as a law of land privatization. Any attempt to convey a right of

permanent use after the enactment of the Civil Code should be deemed legally to be a conveyance of ownership of the land.

If the concept of permanent right of use is to be retained, it might be modeled more closely on rights of usufruct found in other civil law states, which it now only vaguely resembles.

As to paragraph 3, it is perhaps inviting title problems to allow conveyance of land by non-owners under power of a contractual right. As a general rule it should be established that one cannot convey greater title than one holds. Exceptions to the rule are acts through power of attorney (which under most systems must be registered along with the documents of conveyance), sale of property by trustees under the terms of trust agreements, and sale of property by receivers or juridical entities pursuant to legal process.

Article 266 & 268

The right of inheritable possession should be abolished, and has been by Presidential Decree. It serves no useful purpose, and should be limited to life estates granted under testamentary grants, with full ownership established after the life estate. All earlier possessions of inheritable possession should be a matter for transitional provisions in the land code.

Inheritable possession in effect establishes a potentially perpetual succession of life estates, with no current possessor having the power to alienate the land. Historically, much of the common law of property was devoted to avoiding just this situation. This form of tenure serves only to take the land out of the market indefinitely, and results in escheat to state ownership in the event that families are without heirs.

Existing rights of inheritable possession should be deal with as a transitional matter in the land code or other appropriate law, as was attempted by Presidential Decree in October and December, 1993. For example, the law of transition could provide that existing rights of inheritable possession are deemed to be ownership once inherited. In testamentary law the rule could be established that life estates must convert to ownership upon the death of the life tenant.

Articles 269-271

See generally the comments under Article 265, above.

It is not clear that the enumerated means of acquiring right of permanent use are exclusive. If so, this limitation might be made more explicit in Article 265, which allows owners generally to grants rights of permanent use to any other persons. For example, may a private landowner grant a right of permanent use by contract, as implied by Article 265 (2)? Is right of permanent use inheritable?

Article 270 (1) no longer refers to use rights being defined within the terms of a contract, as provided in Article 265 (2), but only to the "act on granting the plot for use," suggesting that the grant of permanent use by private contract is not contemplated.

Articles 272-274

Serious consideration should be given to abolishing the concept of "ownership" of structures without ownership of the underlying land. The concept of "ownership" of structures without ownership of the land raises the same problems as the concept of permanent use -- it potentially prevents unity of rights, and therefore unity of power of decision on land use or sale, in perpetuity. It should be contrary to

policy to perpetually divide the ownership of land in such a way that may hinder decisions on use and alienation of land or to raise the possibility of rights of access and support terminating prior to rights to the structure. Again also, there is no reason why in the future the rights to use and occupy structures cannot be determined under the laws of lease or servitude, making the concept of "ownership" of structures apart from ownership of land unnecessary.

Abolition of the concept could be accomplished by stating that upon enactment of the Civil Code the right to use and occupy structures may exist only together with ownership of the land underneath the structures and equivalent servitudes of support and access over land, or by lease agreement with the owner of the land. In the absence of a contrary written agreement, agreements purporting to convey ownership of structures alone would be deemed to convey both ownership of the land directly under the structure plus whatever other rights of land use, access and support as may be necessary to service the structure. (This in fact may be the intention of Article 274, but in translation the meaning is unclear.)

Existing rights to ownership of structures could be treated as transitional matters to be dealt with under the land code.

The corollary principle should be that upon expiration of the term of a grant of land for a fixed term or under lease, in the absence of a contrary agreement the improvements to the land revert to the ownership of the landowner without compensation. The provisions of the first and third paragraphs of section (2) of Article 273 should be applicable only in instances where rights to structures arose prior to enactment of the Civil Code.

It is unclear in the draft whether the rights of use to land granted under Article 272 survive the destruction or demolition of a structure, in which case the rights granted are the same as a permanent right to use vacant land, or whether they terminate upon destruction or demolition of the structure. Article 272 (3) states that the possessor of the right may demolish a structure in his discretion, but does not sate whether he may rebuild. If rebuilding is possible, what are the limitations? Can the use be intensified?

Article 275

In many market oriented economies the concept of servitude, covenant or easement is at the heart of modern land transactions, particularly urban transactions. The concept of servitude described in this code has the following limitations, for example:

1. It appears to be limited to transactions between owners of neighboring land plots, or at least to owners of land (appurtenant easements). Paragraph (1) speaks of the "owner of other land plots," but then proceeds to define these plots as ""neighboring plots." Limiting servitudes to appurtenance is not unusual in code systems, but it is not necessarily the most flexible approach.

2. It does not provide for the creation of land servitudes by the owner of the land alone (quasi servitudes, for example, in the French code).

3. It does not provide for affirmative servitudes or covenants, which are the basis of modern laws of common property ownership.

4. It does not address the issue of easements in gross for the benefit of the public at large.

In addition, some consideration should be given to whether court ordered servitudes should be permitted. Despite the assertion of Article 275 (2), this is essentially a withdrawal of land from the owner for private benefit, not for state or municipal needs, and is not identified as a permitted withdrawal elsewhere in this code (See Article 235). Despite the statement of 275 (2), imposition of a servitude invariably deprives the owner of a potential possession, use or disposition of a portion of his land. Involvement of the judiciary in the decision to grant servitudes may distort the economic rationale and pricing of servitudes and the development of the land. As an alternative, servitudes could be imposed by law in limited, well defined circumstances ("statutory servitudes"), for example when the owner of land sells a portion of the land without reserving rights of access or utility service over the remainder. There are many examples of statutory servitudes in other civil codes.

Particularly vague in this code is the language of the second paragraph of section (1) which refers to "other needs of the owner of the immovable property." This language is very broad; for example, is a good view a "need" of an adjoining property? What about access to a nearby body of water for recreation? If servitudes are to be established by courts, they should perhaps be more closely tied to the concept of absolute necessity, such as pedestrian and vehicular access and utilities.

Without too much additional effort, significant gains could be made by more attention to many uses of servitudes, easements and covenants affecting land an attempt to develop some of these concepts in the law. Numerous models are available in the civil codes of other countries.

Article 277

Paragraph 2 apparently allows courts to terminate servitudes on demand because of an adverse effect on use of the servient land. What is meant by "cannot be used?" This language is very vague. Again, servitudes are property rights, not mere contract rights, so this would result in the withdrawal of property without compensation. Under what circumstances can this be done? What is the extent of the adverse effect on servient land that would allow non-compensated withdrawal? What if the effect of the grant of the servitude was foreseeable at the time it was granted by the owner of the servient land or his predecessor? Can the owner still ask that it be removed? Wouldn't that result in unjust enrichment of the grantor, particularly if he was paid for the servitude?

Either servitudes are to be treated as property rights, or they are not. This provision creates ambiguity in the law.

Article 280

If after registering a notice to withdraw the land the government, for any reason, fails to complete the withdrawal, would the government be liable for any losses incurred by the owner because of the notice to withdraw? For example, frequently a notice to withdraw may result in tenants declining to renew leases during the pendency of the withdrawal, resulting in empty space and losses to the owner.

It might be considered that if the government has not completed the withdrawal within a reasonable period of time, say 2 years, the withdrawal will be prohibited and the government will be liable for damages. The purpose of placing an outside limit on the completion of the withdrawal is that loss of tenancies could cause the owner significant cash flow problems during the pendency of the withdrawal; as a matter of public policy it would limit the government's (and taxpayers') potential liability for losses incurred by the property owner.

Article 283

Withdrawal of land should not be viewed as a normal tool of land allocation or planning. It is an extraordinary infringement on private property rights. As such, it should by law be limited to situations in which

1. it is necessary; that is, there is no alternative land in the market available for purchase by the government in a negotiated transaction; and

2. it is for a public purpose, that is, not for the benefit solely of private individuals; it might be provided that withdrawal for later sale to private persons pursuant to an overall plan or program of urban redevelopment should be considered a public purpose.

Article 284

Why is the right to make a claim not extended to any person with a valid, registered interest in the land, including lessees and holders of easements, servitudes and other rights? These are all important interests the loss of which could have serious financial consequences.

Articles 285 and 286

How these articles will be implemented is unclear. It may be worthwhile to distinguish between initial privatization transactions in which land is first transferred from public to private ownership, and secondary transactions in privately owned land. In transactions where land is initially transferred from public to private ownership it may be possible to reserve a right of termination to the state if the land is not used within a stated time period for the designated purposes, and in fact this is done by municipalities in many countries. As a matter of practice, however the right of termination is generally applied only to those significant parcels of urban land in which the city specifically negotiates for a types of project or use to be constructed. (If not properly structured, reservation of this right will put a cloud on the title and adversely affect the ability to finance development of the property.)

More importantly, how does this article apply to transactions in privately owned land? For example, a person purchases privately owned farm land but decides not to farm it for 4 years. Similarly, if a person purchases a piece of land designated for housing, the structure is destroyed by casualty, and he decides to not rebuild? Can the state terminate rights of ownership originating in a private transaction?

Curiously, it is in these types of provisions that the Russian land law tends to resemble the laws of feudal economies rather than modern market economies, insofar as the right to possess land is subject to the continued obligation to provide service to the state in the form of actively using the land for purposes designated by the state. This is quite similar to the dependent land relations of feudal societies, in which rights of possession were often dependent upon obligations of service to the king. The concept has no place in market land relationships, as the rights of ownership include the right not to use the land, or to determine the time at which it will be used. There are better ways to assure highest and best use of land, primarily the economic forces of markets and real estate taxes.

Article 286-288

See the general comments on termination of land rights for use violations under Article 235, above.

It is not clear whether the owner is compensated for the land upon withdrawal. Article 287 (2) calls for public sale, but does not address the disposition of the proceeds.

Chapter 18

Apartments are real estate and are subject to the general law of real estate; is the level of detail contained in Chapter 18 necessary? A better approach may be to state simply that the rights to possess, use and dispose of residential apartments may be subject to the housing code and to the law of condominiums or housing partnerships. Housing relationships are changing rapidly and may change over some extended period of time, and relegation of these issues to housing codes would prevent frequent amendment of the civil code.

For example, paragraph 3 of Article 289 is an issue of land use. Issues of land use should be left to the laws of urban planning. The Civil Code need only say that land and other real property will be used in accordance with applicable law. In effect, this article attempts to address in a law of general principles a current social issue that may perhaps be dealt with through more flexible local approaches, or may change over time.

Article 292

Article 292 (2) provides that partnerships for the ownership of housing will be created as consumer cooperatives under the Law on Partnerships of Owners of Housing. In fact, the direction of the Russian law appears to be toward creation of the condominium form of ownership, which is based not simply on juridical form but also on a specific form of property right called condominium. The property right of condominium is based primarily upon servitude, and not primarily partnership or contract. One of the problems with the articles on servitude is that they fail to accommodate the condominium form of ownership because they do not provided for affirmative servitudes. Care should be taken that the civil code concept of partnerships of housing owners and the law on condominium, of which there is now a preliminary regulation, are creating the same legal rights.

There is also some question of the extent to which the general law of consumer cooperatives applies to the housing partnerships. The law of housing partnerships may have significant differences with the general law of consumer cooperatives (for example, the liability of members and the rights of creditors) that should be reviewed and necessary exceptions made.

Article 293

In practical effect, this article defeats the primary right of real property ownership, which is the right to dispose of the property in a market transaction. Realistically, who would purchase an apartment subject to the continuing right, vaguely defined, of the owner's family to occupy the apartment?

Even if the policy itself were acceptable, this article seriously clouds the title to apartments by failing to define the scope of the family rights, the time limitations on rights, or the procedure for relinquishing the rights ; it throws the title to all apartment properties, and consequently the ability to dispose of the properties, into total disarray. In effect, state approval becomes necessary to sell any apartment in which minor children live. This is not only an invitation to corruption, but in the vast majority of cases the best judge of the interests of the children is the parent, not a state agency. The attempt to deal with a perceived social issue through limitations on property rights will have serious adverse affects on the development of apartment markets.

A better way to deal with this issue would be to establish a rule that the primary residence of a married couple with children is deemed to be held in joint ownership by the couple regardless of the actual legal rights, thereby throwing the issue of disposition of the property into the divorce and family laws, where it belongs.

Article 294

Forced sale of residential premises for violations of building codes is an extreme policy. (What are the "rights and interests" of the neighbors? Do they need to be defined in local building codes? What if there is a building code violation that has no damaging affect on neighboring properties?) In the first instance, the enforcement of building codes should be left to fines and penalties and in appropriate circumstances, criminal offenses. Building codes can also provide for mandatory demolition of unsafe and dangerous structures.

Secondly, most urban housing should be multifamily housing subject to either the rules of social housing established by the local municipality, or the rules of a private housing partnership. In either case, the methods of enforcement should be left to the appropriate entity and to the laws of civil contracts.

Finally, an owner is subject to civil financial liability for damages to neighbors from the use of his property.

The drafters might look at the law of Sweden, where the remedy for serious building code violations which the owner fails to correct is to place the property in temporary receivership for the purpose of implementing the corrections, for which the owner is financially liable.

Chapter 19

Of what continuing use are the concepts of "economic jurisdiction" and "operative management?" Do they complicate the property laws unnecessarily? Are these true property rights or merely accounting conventions? (For example, isn't the right of economic jurisdiction over land and real estate actually grounded in the property right of permanent use (though this is nowhere clearly defined)? If not, how is it distinguished from the right of permanent use?) They seem to classify of property rights on the basis of the characteristics of the owner, rather than on the characteristics of the rights, and are difficult to distinguish even from each other except on that basis. Is there any policy reflected in economic jurisdiction and operational management that could not be achieved through lease, or even the traditional civil code concept of usufruct? If other forms of property rights can serve the same function, why not focus effort on defining those forms of property rights, thereby simplifying the law?

To the extent that there are existing rights of economic jurisdiction and operational management, the law could provide for treatment of those rights under transitional provisions of a land code. The options are to allow then to continue and expire by their terms or to provide an opportunity for ownership or lease at the decision of the enterprise, and on financial terms to be set by the privatization authorities. Earlier Presidential acts attempted to establish this principle.

Article 303 & 304

Purchasers of real property at court ordered public auction sales of property in foreclosure or execution of liens should be deemed as a matter of law to be good faith possessors. If the laws of real estate mortgage are to be truly effective, the rights of those good faith possessors should be considerably stronger than those described in this section. For example, they should be entitled to repayment of the amount expended to purchase the property at the auction sale. It might be better to state that the rights of

a good faith possessors of real property acquired in a court ordered auction sale are governed by the law of mortgage.

Actions for possession of real property which the former owner fails to vacate after a forced sale through execution of levy or foreclosure are likely to become more commonplace. The right to evict someone from real property, particularly residential property, is ambiguous at this time in Russian law, leading , by many reports, to self-help and violence. The civil code should recognize as a fundamental protection of the right to property the right of a purchaser in foreclosure sale or levy of execution of seek an order vacating the property either under this Chapter or under specified laws of eviction. The actual process of eviction could be dealt with in the housing code.

Article 314

In paragraph 2 an interested third party is given the right to cure violations that may endanger title to the property, but this right is practically of limited value unless there is also the right to notice. Because of the difficulties of reestablishing ownership rights after they have been terminated by legal action, it may be necessary to say that termination of an interest in real property is ineffective against any holder of a duly registered interest in the property until that person has been notified of the termination in writing and provided with a 30 day period for cure. This provision would by its terms be applicable against the state as well as private parties. In the event that termination has occurred without the proper notice, the third party should have the right to cure the violation and obtain title to the property.

Article 329

Paragraph 3 is probably meant to read "The invalidity of the principal obligation shall entail the invalidity of the obligation by which it is secured."

Chapter 23, Section 3 (Pledge)

With respect to its potential effect on mortgage of real estate, the provisions on pledge raise several issues. Since 1992 the author has provided various comments on proposed drafts of mortgage laws which are available on request.

Because the concepts of real estate mortgage are so new and will develop over time in response to experience, as a general principle it might be better to see what detailed provisions of this code might be eliminated and delegated to a law of real estate mortgage. In the event that the Federation's law of mortgage follows the basic principles established in this draft civil code, the following are only a few examples of issues that might arise:

1. Article 338, paragraph 5. Mortgagees should not be subject to the rights of those whose interests in the property arose and were registered after the registration of the mortgage, unless the mortgagee specifically agrees to subordinate to the rights of such persons. Moreover, mortgagees should not be subject to rights arising before the mortgage but which were not properly registered. This provision potentially undermines the purpose of the registration system and the concept of priority of rights.

2. Article 349. Many modern mortgage systems allow foreclosure and execution on personal real estate without court participation. This also may be useful in the Russian system as it grows in volume. The principle expressed in this paragraph might be better left to a law on real estate mortgage, which may be amended more easily as changing practice may require.

3. Article 345 (2). The right of substitution of damaged or destroyed collateral is not appropriate to real property, where questions of valuation can be complex. These issues are better left to private contractual agreement of the parties.

4. Article 350 (2). The unconstrained right of a court to delay execution of judgment for up to a year will impose greater borrowing costs on all borrowers; there is no clear policy underlying this right of deferral, though in effect it resembles the "period of redemption" laws of some American jurisdictions, which can be for as long as one year. Ultimately, it is an indirect subsidy to owners from lenders, and imposes much higher risks of loss on lenders.

5. Article 350 (4). The relationship between the starting price and the mortgagee's right of acquisition and set off is unclear; must the mortgagee forego the right to a judgment in the event that the value of the property is less than the outstanding balance of the debt?

6. Article 350 (7). This provision practically prevents the right of acceleration (demanding payment of entire debts prior to maturity) on installment debts; acceleration is one of the most important protections for residential mortgage lenders. Lenders should be able to place reasonable limitations on the right of redemption, particularly for habitual abusers of the right. In addition, there is no relationship drawn between payment of overdue installments along with all costs and losses to the lender incurred to date on account of the late payments.

7. Article 354 (2). Termination of mortgagee rights by confiscation of property for commission of a crime potentially punishes an innocent party for the criminal acts of another and unjustly enriches the state.

8. Article 356. This should be stated in just the opposite fashion; upon the assumption of a debt by another party, the pledge should remain in effect unless specifically released by the lender. Otherwise, the power of approving the security for a loan, or whether security for a loan is released, is in the hands of the debtor, which makes no commercial sense.

Article 384

As a general principle, this runs contrary to concepts of negotiable instruments found in many modern codes. It could have affect on secondary markets for residential mortgages.

Article 388

The recourse liability of assigning creditors should be a matter of private agreement, with the code principle applying in the absence of such agreement. Again, the principle stated in this article is contrary to the approach of some modern commercial codes.

Articles 396 and 427

The relationship among articles 396 (specific performance), 427 (preliminary contracts), and the laws of real estate registration is unclear.

The code states that a contract for sale of real estate must be registered but it is unclear whether preliminary contracts for the sale of real estate must be registered as well. Article 427 seems to address only the form of the contract, not the requirement for registration. In fact, it is likely to develop that the

preliminary contract will be the rule rather than the exception in real estate transactions. In light of the principles of Article 396 (enforcement of contracts for transfer of specifically identified property), it would be necessary to register a preliminary contract to put others on notice of the interest, otherwise the right of specific performance or real estate contracts, essential to the real estate market, would be defeated by the transfer of the property into anther's ownership or use. This same point applies to options and rights of first refusal (preferential purchase) or real estate as well. (The matter of whether preliminary contracts and options for the sale of real estate may be registered must also be taken up in the context of a law on real estate registration.)

It is unclear from Article 396 what the result would be if a purchaser of real estate registered a preliminary contract or option for the purchase of real estate, yet the seller of the real estate proceeded to convey the property to another. Would the right of specific performance be denied despite the fact that the possessor was legally on notice of the registered adverse interest, that is, he was not bona fide? It would be a simple matter to say that specific performance of contracts will remain available for holders of registered contract rights.

Subsection II. Leasing; Chapter 32. General Provisions

It is unclear whether further chapters of Subsection II will deal specifically with issues of real estate leasing, in which event many of the following comments might be addressed.

Articles 1 & 2

An initial question with respect to real estate leasing is the relationship to the Russian concept of "naym," which can be viewed as a category of lease as defined in this law. Is the naym contract, which may be the predominant form of lease contract in social housing, excluded from the concept of lease covered by this law? Various aspects of the lease relationship described in this chapter, in particular he rights of tenant "self-help" and rent set-off, might raise serious issues for the social housing sector if applied to naym contracts.

Similarly, the concept of residential lease generally may be governed by an entirely separate housing code or code of residential landlord-tenant relationships, as it is in practically every other western legal system. Those codes frequently provide significantly different rules and procedures than those found in this code. The point is that it may be necessary to specifically address the relationship between this code and naym or other leases of residential property.

With respect to the definition of lease generally, what does the distinction between "possession and use" and simply "use" imply with respect to real estate leases? Is it intended that the lease will be used as a profit (profit a prendre) is used in other systems, that is, as a right to enter upon and remove materials from the land, as in mineral or timber rights? If this is intended, then what is being leased is not possession of property or a physical thing, as suggested in Article 1, but the right to use property. Similarly, the definition of objects of lease in Article 2 seems also to speak only of physical property. If leases are to be used to grant rights of use without possession, which is often the essence of a mineral rights lease (or grazing or timber), for example, should the definition of lease and objects of lease be broadened to include the lease of rights to use real estate for specified purposes?

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* Translation of Chapter 32 provided by Institutional Reform in the Informal Sector (IRIS); undated.

Article 4

Should all leases to real estate be registered? Even the typical residential lease, which will likely be governed under a law of landlord-tenant relations? Many systems do not require registration of leases for terms of less than 2 or 3 years, simply to avoid overwhelming the registration system, and because the rights of residential tenants are usually fully protected under very stringent laws.

The final paragraph deals with options to purchase. Options to purchase should in fact be registered even if the lease itself does not need to be registered. However, this paragraph requires that the lease/option to purchase be executed as a contract for purchase and sale of real estate. An option to purchase is actually a preliminary contract for purchase and sale of real estate under Article 427. If it were a final contract for purchase and sale of real estate, under existing Russian law and this code, upon registration it would constitute a present transfer of title, which it is not intended to be. It would probably be better to say that leases containing options must be registered both as leases if required by law and as preliminary contracts for the purchase of real estate. The law of title registration should reflect this requirement as well.

Article 5

How will a lease for a term "in perpetuity" be distinguished from a right of permanent use, particularly if the documents fail to specifically identify the term or type of tenure? A lease in perpetuity can be terminated upon giving the notice required in the code. A right of use granted by the government can be terminated only upon completion of withdrawal procedures, particularly if associated with economic jurisdiction or operational management. (It is not clear whether rights of use can be granted in private transactions, or how they may be terminated between private parties.)

In paragraph (3), why is it necessary to establish maximum terms by law? Why not let the market establish the appropriate terms? If this language is put in the law, someone will consider it necessary to make use of it.

Article 6

There seem to be some ambiguities in concepts. Article 306 defines the holder of the right of enforcement as a "possessor" of the property. Article 302 speaks only of the "owner" of the property. A lessee not yet in possession is neither the possessor nor owner of property, but the possessor of a contractual right to possess property. Will this cause a problem in interpretation? Why doesn't the law refer to Article 396, the right to specifically enforce a contract for delivery of a defined thing.

Article 7

The relationship of tenant's rights to social housing has already been noted above.

Another relationship that should be considered is the commercial leasing arrangement. Article 7 seems to grant to the tenant the rights of self help or rent set off without regard o the terms of the lease contract. This denies to the parties the ability to enter negotiate a lease for the property "as is," that is, in its current condition, without liability to the landlord. Moreover, the rights of a tenant to exercise self-help remedies, particularly rent set-off, may affect the ability of a landlord to obtain mortgage financing for a property, which depends upon a secure and uninterrupted flow of rental income. In short, this article seems to allocate risk and liability, which influences pricing, and which is a market function that should

be left to the agreement of the parties. All of the provisions of Article 7 should be made applicable only if the parties have not agreed otherwise in their contract.

Article 8

Claims of lessees should be based on actual damages, not merely on failure to disclose. The purpose of the civil law is to compensate for damages, not punish.

Article 10

The rights of mortgage and sublease are perhaps the most important issues for landlords and tenants and a clear rule should be established. In the civil code this rule should favor the landlords as the code will probably have most relevance to commercial leasing transactions and landlords have the most at risk; the rights of residential tenants will probably be covered in a housing or landlord-tenant code. The rule should state that there is no right to mortgage or sublease a lease unless otherwise specifically provided in the lease contract.

The relationship of sublease may need further definition. For example, does the lessee have the right to collect the rent from the sublessee? Does the sublessee have any claim of contractual rights against the landlord unless specifically agreed by the landlord? For example, what if the lessee collects a deposit fro the sublessee and then files for bankruptcy? Does the landlord have the right to enforce a sublease against the sublessee in the event of a default by the lessee? Can the landlord demand payment of rent under the sublease? Does it make a difference if the sublease is for less than the remaining term of the lease or for the entire remaining term (sublease or assignment). Article 13 (1) seems to suggest that there is a contractual relationship between the landlord and subtenant, because it prevents the landlord from terminating a sublease contract.

Should the law distinguish between sublease and outright transfer or assignment of a tenant's rights under a lease. Paragraph (2) seems to allow transfer of rights and obligations but calls all transferees "subtenants." Are there any contractual implications of characterization as a subtenant or an assignee, as described above? · For example, shouldn't the tenant and the landlord be permitted to negotiate to release the tenant from further liability if all of the rights under the lease are assigned by the tenant to another tenant for the entire remaining term? The second sentence of paragraph (2) seems to make the tenant's continuing liability non-negotiable.

Article 11

In paragraph (3), the tenant's rights of self help and rent set-off should be negotiable in the lease contract.

Article 12

Presumably, a lease contract that is not registered in accordance with law is considered a nullity from inception, and therefore not binding upon any subsequent owner or user of the real estate; that is, the concept of termination of lease is not relevant in such a case.

Article 13

Should paragraph (1) distinguish between a sublease authorized by the lessor (if required by contract) and other subleases made without the landlord's consent? For example, if the lessor has not authorized a sublease, why should he be bound by it? Moreover, the article establishes the terms of the sublease as legally controlling, while it is likely that unauthorized subleases will not protect the rights of the landlord. It might be better to establish the terms of the main lease as legally controlling with respect to the rights of sublessees in the event of a termination of the main lease. This would give subtenants the incentive to properly investigate and arrange his contractual relationship with the landlord.

Article 18

What is the implication of paragraph (4)? All constructed improvements on land are generally subject to amortization by either a landlord or tenant. Does paragraph (4) mean that all constructed improvements on leased land legally belong to the lessor? While this is a good principle, it might be more clearly stated.

Is paragraph (2) meant to say damage "to the leased property" or damage to the "improvements"? The latter would be closer to the definition of immovable property found in the draft. For example, the demolition of a structure arguably does not cause damage to the underlying land, which may be the leased property on which improvements are constructed by a lessee.

Couldn't the entire article be expressed in the simple concept that all movable improvements to leased property are the property of the lessee, unless otherwise specified by contract, and all immovable improvements to leased property are owned by the lessor subject to such compensation to the lessee as is specifically provided in the lease or other agreement?

C. Rose
Comments to Russian Draft Civil Code
4/23/94

In general: I read most specifically the code provisions relating to property. I did not understand all the terms of the code on that subject. No doubt this is due to some degree to translation, and also to the fact that these sections relates the legal forms that are unfamiliar to me.

In general, however, most sections seemed to me a matter of the normal civil law of property.

I did think there were a few things to look out for:

1) Some matters are stated as a matter of immutable legal obligation, even though it seemed to me that there would be little problem in allowing private parties to alter the legal terms by agreement between themselves. The Code authors might want to consider more carefully whether some restrictions need be immutable and universal, or whether they might instead merely act as "default rules," to guide the courts when parties make no specific agreement on an issue.

2) Some matters, notably those concerning residential property, seemed to me to reflect a great concern for problems of unfairness that might arise during a transition period to private property. It may be important to avoid putting transition rules in the form of a permanent code. Even if these rules do avoid unfairness in the short run, if made permanent, they may make property transactions too rigid, and discourage investment in the future.

3) I thought that some sections, concerning various kinds of involuntary transfers of property, were not sufficiently attentive to issues of compensation for the owner.

4) A few sections (especially 285-87) seemed to rest on the presumption that public authorities will intervene heavily in real estate transactions, and will direct private owners in some detail what to do with their properties. If so, this suggests that the code contemplates only a limited privatization of land. If the code authors contemplate a more thoroughgoing transition to private land ownership, however, they might want to reconsider some of these sections.

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The following are specific comments about particular articles and paragraphs.

There are several matters that I do not quite understand, that

appear to reflect policy decision concerning state ownership of property.

Art. 216 is one of these: when read together with the articles in parentheses (266 & 269), this article appears to contemplate that public property may be handed over to private persons or organizations for a sequence of life possessions. I am not certain whether this reflects (a) a contemplated lag in privatization, or (b) whether it is something like our own leasing system for lands in the National Forests and under Bureau of Land Management control.

If the former, the authors of this Code might consider whether they want to codify such possessory rights in anything more than a transitional way. If the latter (that is, public property continues to be held for leasing, e.g. for mineral development, timber, etc) the law might need to add include considerably more complex contractual schemes.

Article 224, Transfer of a thing.

The two subparagraphs within paragraph 1 seem slightly uncoordinated. The first subparagraph contemplates transfer at delivery to a transporter; the second contemplates transfer only at actual receipt.

In any event, it might be wise to signal that this is a default rule, and may be altered by contract.

Article 234, Prescriptive Limitation.

This looks like what Americans would call adverse possession, applied to both movable & immovable property. This kind of acquisition presents some problems.

First, with respect to <u>immovable</u> property (land), adverse possession is an unrecorded form of ownership. Some systems of land recording or land registry (e.g. the Torrens systems) do not permit adverse possession, precisely because it does not appear in the registry, and hence undermines the registry as a complete record of land transactions. The Code authors should therefore make certain that this Article 234 is compatible with the contemplated land record or registration system. To some degree this is done insofar as Para. 1 requires "good faith," which presumably requires a search of the land registry. Fraud and especially mistake are still possibilities, though, and the Code authors may wish to consider how they wish to deal with these.

Second, with respect to prescriptive rights in <u>movable</u> property: there has been some controversy about whether there should be any prescriptive rights in immovables, given the possibilities of theft and concealment. This has been especially important with respect to art works. Here too, the "good faith" requirement should help, and so should Articles 302, 304, and 306, respecting an owner's right to demand back an article initially acquired by theft, even if the property is given over to an innocent third party.

The problem here is, when should the period of prescription begin to run? Running from the time of acquisition is not normally a problem for land, since land is not easily concealed, and claims by a non-owner should be noticeable. But this beginning point can be a major problem for thefts or mistaken removals of artwork, especially if stolen from warehouses or storage areas, where their absence may not be noticed. If these works can be stolen and then handed over to third parties, who are ultimately protected by prescription, the true owner may never have reason to find out about the loss or the artworks' whereabouts until too late. I believe that Article 303 (on an owner's right to demand the return of lost or stolen items) is an effort to deal with this problem, but it may not help if the prescriptive period has already run.

Article 202 (on suspension of limitations periods for extraordinary circumstances) may help here. Some states in the US have made the prescriptive period for immovables run not from the acquisition, but from the time that the true owner may reasonably have been expected to know of the loss. However, some commentators think that even this is too much an invitation to fraud. For a review of the considerations, a comment will appear shortly by Steven Bibas in the Yale Law Journal.

One other small point: I believe there may be a typo in the first line of new para. 4, which refers to "acquisitive limitation." Should this be "prescriptive limitation"?

Article 243, Confiscation.

I presume that the criminal code spells out in more detail the circumstances and limitations on the confiscation of property as a sanction for commission of a crime. This is of course an extremely significant power and needs to be exercised with great caution.

Chap. 16, arts. 244-59

This section looks like partnership property, tenancy in common, and jointly held property.

I am not entirely certain what all the sections are attempting to accomplish. The authors should consider whether they wish to make all these provisions simply default rules--that is, subject to alteration by agreement. Some sections do mention agreement of the parties, but others do not, and I see no obvious reason why all these rules might not be alterable by agreement, at least in the absence of fraud or overreaching by other partners.

Art. 263, para 2.

This paragraph concerns the ability of persons to pass through unenclosed and unmarked land. The authors may wish to state that this pass-through does not give rise to prescriptive rights in those that cross the land. Otherwise, owners of the land may be encouraged to mark and enclose the land simply to avoid losing it by prescription.

Art. 275

The first paragraph gives the owner of a plot the right to demand a servitude (easement) over the neighboring plot. No mention is made in this paragraph of compensation, although copmpensation is mentioned later, in Art. 277. The authors may wish to decide whether they wish to require some more explicit form of just compensation for the neighboring owner, at the time of the initial demand. Otherwise, owners may find themselves subjected to unreasonable demands from neighboring owners.

Art. 277, Termination of servitudes

Paragraph 1 seems to be about the termination of servitudes on grounds of obsolescence, and seems relatively unproblematic.

Paragraph 2 appears to give an owner a right to be free of servitudes that severely restrict the use of the underlying land.

This is more problematic. Sometimes the whole point of servitudes is to prevent the use of a piece of land, as for example in conservation servitudes for environmental purposes. Here the owner of the land agrees to a servitude that restricts the land to its wild state, for the sake of preserving wild plants and animals. Such servitudes may make the land unusable for other purposes. But they are extremely useful for environmental preservation, and allow private groups to transact for environmental purposes without the intervention of state agencies.

If such servitudes can be easily removed, these transactions will not be entered into in the first place. At a minimum, removing such servitudes might also entail compensation to the holder of the servitude right.

Article 285-87, and also Article 294, concerning withdrawal of land from an owner for failure to use the land in accordance with a designated purpose.

Removal of an owner from his land is a draconian punishment, and reflects what seems to be a continuation of close governmental planning of land use. A state directive to use the land for specific purposes might undermine the goal of privatization--that is, privatization generally would allow owners to decide how best to use their property, so long as other peoples' property is not damaged.

The authors of the code might want to consider whether land use controls might be more permissive than a designation of private land for specific uses. A common pattern in the United States is to "zone" property for certain uses, but to allow less intensive uses than that for which the property is "zoned." For example, property zoned for commercial uses may also be used for residences, which is less intensive, but not for manufacturing, which is more intensive.

Article 289: I do not understand paragraph 3.

Article 291, concerning common property of apartments. I am not sure I understand paragraph 2. I believe it means that an

apartment owner may not sell rights in the common property independently of the apartment unit. This is quite ordinary, and not problematic. An owner should, however, be able to sell the entire "bundle of rights" of apartment ownership (apartment, common areas, right of participation).

Article 293, Rights of family members of owners of dwelling premises

I do not quite understand all the provisions of this article, but it appears to put serious constraints on the alienability of dwelling units, particularly by allowing former users of an apartment to remain. The authors of the code might want to consider making these issues a subject of contract among the various parties, rather than fixing them immutably by code. They might also want to consider whether such protections are really simply transitional, and less important after privatization occurs more widely. Once more real estate is in private hands, existing tenants can rely on the market to provide more housing opportunities, and are less likely to face extortion by owners.

Chapter 19. I am uncertain about the meaning of the phrase "economic jurisdiction," and cannot comment on this chapter.

April 7, 1994
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COMMENTS ON THE DRAFT RUSSIAN CIVIL CODE

I am leaving for a long trip to Russia [illegible] to confine my comments to one particular section of the draft, Chapter 7 on Securities, which appears on page 51 of my English language draft.

Before I begin, let me describe my background. At Cleveland-Marshall College of Law, I specialize in banking regulation and securities regulation. Before I came to the law school, I was a partner at the Washington, D.C. law offices of Mayer, Brown & Platt, where I litigated numerous complex commercial law cases, including banking, securities fraud, and antitrust claims. This spring, I will be a lecturer at the law schools in St. Petersburg and Volgagrad on securities regulation and bank payment systems.

Overall Comments on Chapter 7

As I understand it, this chapter seeks to set forth the legal rights surrounding two rather different groups of financial instruments. One group of instruments that this chapter would govern would be stocks, bonds, state bonds, and privatization securities. In the United States, these are deemed to be securities because third parties who own stocks and bonds are free to sell them without being subject to liability if the stock or bond falls in value after they come into the new owner's hands. This freedom from liability is considered crucial to encouraging ordinary citizens to invest their personal savings in securities. Thus, an important attribute of a security is the legal assurance that private, third party citizens who sell their securities cannot be held liable for a subsequent drop in value. Otherwise, far less money will be available in the form of stocks and bonds to finance companies and government entities because citizens who otherwise would invest will refrain from doing so due to fears of potential liability. Their fears would be heightened because most individual investors do not participate in management and cannot control the profitability of the companies or government entities they invest in, yet any liability would penalize them for unprofitable performances they cannot control.

Another second, separate group that this chapter would govern would be instruments giving the right to payment in full on demand or on a specified date (such cheques, deposit and savings certificates, bank bearer savings books, and bills of lading). In the United States, traditionally we have not treated this second group of instruments as securities because they primarily [illegible]

vehicles and thus we want to hold the maker or endorser liable under certain circumstances if the instrument is not good.

Particularly in its treatment of "order securities," Chapter 7 would hold all who endorse such securities "liable to the legal possessor thereof jointly and severally." Article 147, Section 1. This language is broadly drafted and conceivably could include the very stocks, bonds, and privatisation vouchers for which it is essential to insure that <u>no</u> liability accrue. Thus, the traditional notion of a "security" is fundamentally at odds with what this section is trying to do. Accordingly, I would do the following:

(1) delete all references to "securities" and instead call the instruments this section applies to something like "payment instruments" and

(2) make it clear that classic securities such as stocks, bonds, state bonds, and privatisation vouchers are <u>not</u> governed by this section.

I also would recommend the following changes.

<u>Article 142</u>

<u>Section 1</u> -- This section says that "effectuation and transfer shall be possible only when presenting" the instrument. The drafters might want to consider expanding this to also recognize transfer by operation of law, i.e., pursuant to a will, a court order, the laws of intestacy, etc.

<u>Section 2</u> -- If Section 1 is expanded to include transfers by operation of law, then there will be instances where the person in whose name the securities appear cannot make an entry on the special register, for example, because he has died. This would need to be changed accordingly.

<u>Article 143</u>

I would eliminate this section and replace it with a definition of the <u>payment instruments</u> Chapter 7 covers.

<u>Article 145</u>

Under this article, it is definitely possible that stocks, bonds, and privatisation vouchers could take the form of an order security. Note under Section 2 that unless another law is enacted that prohibits the issuance of stocks, bonds, and privatisation vouchers as an order security, they can be issued in that form.

<u>Article 146</u>

This is one of the two provisions that could impose liability on sellers of stocks, bonds, and privatisation vouchers for a later

drop-off in value if they were issued as order securities. Section 3 states that anyone who endorses an order security -- including a stock, bond, or privatization voucher -- "shall bear responsibility not only for the existence of the right, but also for the effectuation thereof."

Article 147

Section 1 of this article is the other provision that could impose such liability: "The person who has issued a security and all the persons who have endorsed it shall be liable to the legal possessor thereof jointly and severally." Thus, under this provision, if I sell you my Lada stock in the form of an order security and later it drops in value, you could hold me jointly and severally liable with Lada for the drop in value. That is inconsistent with the notion of a stock, in which each purchaser assumes the risk of a decline in value in return for the corresponding potential for profit.

I hope these comments will assist the drafters of the Civil Code.

COMMENTS ON THE DRAFT RUSSIAN CIVIL CODE, PART 1

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June 17, 1994

These comments, completed just prior to my departure to Moscow, evaluate Part 1 (Sections 1-3) of the draft Civil Code of the Russian Federation, translated by W.E. Butler from the redaction of 12 December 1993. I mainly focus on provisions dealing with property in land and housing, two of my legal specialties. I decline to offer suggestions about the general organization of the code. The United States is a common law country. Scholars from code nations are much more qualified to comment on code architecture.

I start by stressing the importance of land law, turn next to pervasive legal issues that cut across several articles of the draft Code, and conclude with suggestions on relatively confined legal topics.

I. LAND LAW IS MOMENTOUSLY IMPORTANT

How a nation allocates the land within its borders vitally effects the freedom, economic prosperity, political stability, and social organization of its citizens. In "Property in Land," 102 Yale L.J. 1315 (1993), I identify the advantages of legal recognition of (1) private property in lands that are used for housing, commerce, agriculture, and other productive uses, and (2) public property for the circulation network in which those private parcels are embedded. That article provides a fuller and more historically grounded justification of many of the bald assertions that follow. I can provide a copy of the article to anyone who writes to me at my Yale University address.

Compared to other developed nations Russia lacks a tradition of private property in land. The Communist regime of 1917-1991 was obviously hostile to private land ownership. Prior to 1917 institutions such as serfdom and the redistributive commune (miri) proved relatively invulnerable to efforts such as the Stolypin reforms. The drafters of the new Civil Code and Land Legislation have a momentous opportunity to contribute to a better future for their nation. Russia is rich in land. By

moving dramatically in support of private property in land, the Civil Code can unloose much of the energy that has been caged within the Russian people.

II. GENERAL OBSERVATIONS ON THE DRAFT CIVIL CODE

The current draft would do much to move Russia from a state-controlled economy to a market economy. Nevertheless, the draft can be much improved. To oversimplify, it appears that market-oriented reformers have prevailed in the debates over the general articles in the Code, but have lost many of the battles over narrower issues. The narrow provisions that presuppose continuing state controls are certain to hamper Russia's evolution to a freer, more prosperous society.

A. Avoiding Excessive Restraints on Owners' Choices

A system of private property decentralizes the control of resources to owners--mostly individuals, households, and business firms. The history of the Twentieth Century unmistakably shows that decentralized owners, acting on their own initiative, can vastly outperform state-administered economies. Although some regulation of private owners is undeniably appropriate--for example, to ensure environmental protection--a market economy cannot function unless private owners of resources have broad freedoms to decide when and how to use their assets.

1. Presuming Freedom. It follows that the Code should emphatically assert a property owner's presumed freedom to act, and then list prohibited acts as exceptions. The Code should reject the statist approach, which presumes a landowner's lack of freedom to act, and then lists permitted acts as exceptions. An illustration:

> Article 129(2), which presumes alienability unless there is a specific legal prohibition, is superior to Article 129(3), which presumes inalienability unless there is legal authorization.

2. A Private Owner's Freedom to Decide Land Uses. Two of the broadest articles, 1 and 209, rightly declare the freedom of citizens. On the other hand, a number of narrower articles restrict an owner's decisions as a matter of national policy:

> Article 260 restricts the use of designated agricultural lands, a doubtful policy in a nation with much farmland and a shortage of housing.
>
> Articles 269-274 deal with the right of permanent use, an unfamiliar concept for U.S. lawyers. This right appears to be based on the conception that the State is best able to

decide the use of land, and therefore should place tight restrictions on private land owners. This is entirely contrary to the logic of a market economy, which assumes that private land owners are generally more capable than the State at determining how to use land. By legitimating obsolete rights of permanent use, the Code perpetuates overly statist practices.

The same criticism applies to the articles that keep alive the "right of operative management."

3. A Private Owner's Freedom to Transfer. The drafters rightly have included broad endorsements of an owner's freedom of alienation. See Articles 129(1), 218(2), and 261. Narrower articles, however, unduly limit alienability in some contexts. For example, Article 250 should be amended to entitle common owners to agree by contract to allow one of them to make a unilateral sale of a participatory interest. Article 268 should not flatly prohibit the sale or pledge of a life interest. Article 299 overly limits enterprises' powers to transfer rights of operative management.

B. The Risks of Listing Permissible Arrangements

People are endlessly creative. Drafters of Civil Codes should refrain from trying to fit all the things that people invent into tidy classification schemes. Most of the Code's many lists of legal rights and forms should include a phrase stating that the items on the list should be construed as illustrative, not exhaustive. To illustrate, the second draft of the Code improved upon its predecessor by adding the phrase "and other forms of" to Article 212(1).

Some suggestions for improving lists in the current draft:

Article 131(2)'s list of the rights of ownership subject to registration might end with the phrase, "and other significant rights of ownership."

The first line of Article 216 ("The rights to a thing . . . are, in particular:") could be amended to read: "The rights to a thing . . . include, among others:".

The first sentence in Article 264 could read, "The owner of a land plot has rights, among others, to erect buildings . . . ."

C. Avoiding Forfeitures of Land Interests

In Anglo-American law, the owner of a "defeasible fee" in land must honor certain legal obligations or suffer the forfeiture of his ownership interest. Anglo-American attorneys

have learned through painful experience that it is almost always unwise to create these interests. Forfeiture provisions impose unnecessary risks on owners and, more importantly, scare off potential mortgage lenders and lessees. It is better to enforce a landowner's obligations through fines, mandatory court orders, and criminal prosecutions, and not through forfeitures.

Several provisions of the draft Code authorize forfeitures. These include Article 243 (on Confiscation) and Articles 285-288 (on loss for improper use). The drafters should reconsider them.

Relatedly, Anglo-American experience teaches that interests for life (Articles 266-268) are awkward and to be avoided. When an owner for life is 60 years old, will a bank lend him money? Will a tenant want to enter into a ten-year lease? It is better to measure time-limited interests by specified numbers of years, for example, ownership for a 50-year term.

D. Avoiding the Separation of Land Ownership from Building Ownership

Article 262(2) states the sound principle that a land owner who builds should own what he has built. Unifying ownership of a building with the immediately surrounding land has many advantages. The unified owner can install landscaping, recreation facilities, parking, and other site improvements to enhance the usefulness of the building. The Soviet tradition of separating land ownership from building ownership led to underinvestment in urban land improvements in Russian cities.

Articles 239, 272, and 340(4) hark back to this obsolete Soviet tradition. The Code should discourage, not warmly accommodate, the separation of land and building ownership. For example, when a state or municipality auctions off or otherwise transfers a parcel of land into private ownership, the Code should create a rebuttable presumption that the transfer includes all buildings, improvements, and fixtures on the land.

E. Land Registration

I applaud the drafters' efforts to establish a reliable information system about land ownership. (See Articles 131, 164-165, 180.) Uncertainty about land titles threatens to slow the work of entrepreneurs and investors whose efforts are vital to Russia's future.

Articles 165(1), 219, and 339(3) state that a transaction is not effective until registered. In the U.S., it has been found that a rule of this sort may enable a legally sophisticated person to evade a promise made to an unsophisticated person. A better approach, hinted at in Article 165(2), is to hold that an unregistered but otherwise complete transaction is binding upon

the parties to the transaction, but not upon third parties. This approach would maintain incentives for registration, but lessen risks of exploitation of the unsophisticated. Consider an example based on Article 275(3), which deals with the registration of servitudes (easements). If an unsophisticated farmer were to acquire a right-of-way across a neighbor's property but were to neglect to register it, the servitude should be binding upon the neighbor, but not upon a third party, such as that neighbor's innocent successor in ownership.

This example inspires an idea: To aid in its transition from the Soviet regime, Russia should consider establishing Land Courts that specialize in adjudicating land-title disputes. (These courts could be created as a division within the existing Arbitration Tribunals.) Because these special courts would be justifiable only during the transition period (roughly the next decade), the Civil Code is probably not the proper place for creating them. Because clearing land titles is an urgent priority, these courts might be created in other statutes.

III. DISCRETE LEGAL ISSUES

A. Defining a Land Owner's Default Set of Entitlements

Article 209 does not adequately address the following issues involving the scope of an owner's rights in land:

1. Partial Transfers. To respond to changing events, land owners must have the right to subdivide, to combine parcels of land, and to alienate partial interests. The Code should be clear on these points.

2. The Right to Exclude. An essential attribute of private land ownership is the right to exclude unconsented entrants (trespassers). The Code should explicitly articulate this right. Articles 221 and 263 allow casual entries onto unenclosed lands. The states of the United States adhere to a similar approach; most authorize hunters, fishermen, and other recreationists to enter private lands unless the lands are either (1) enclosed; (2) cultivated; or (3) posted with "no trespassing" signs.

3. Retaining State Ownership of Oil and Gas. The United States wasted much of its natural resources by including oil, gas, and other deep minerals in the rights of private surface owners. These minerals are usually best exploited in parcels with a territorial area much larger than the parcels suitable for private owners of the land surface. To illustrate, an oil field is naturally larger than a family farm. In Article 209 or elsewhere, the Civil Code should state that a landowner's rights do not include ownership of deep minerals, particularly oil and gas.

B. Adverse Possession (Prescription, Arbitrary Structures)

During the past turbulent decade, Russia has witnessed much looting and grabbing of state and collective property, including land and buildings. This history portends that the issue of adverse possession will be central in Russian law during the coming years. Articles 222 (Arbitrary Structure), 225 (Masterless Things) and 234 (Prescriptive Limitation) bear upon these issues. Given the difficulty of the transition now underway, the drafters should give these articles their closest attention. A specialized Land Court, if created, could become adept at resolving fact-sensitive disputes of this sort.

Although many commentators are reluctant to permit ownership to be acquired through illegal possession, it is significant that virtually all societies honor the rights of longtime squatters. During the Russian transition period the issue of prescription requires balancing the efficiency advantages of rapidly establishing private titles in current possessors against the unfairness of enabling the unscrupulous to benefit from having grabbed public assets. Although the issue is difficult, I generally favor rapid settlement of titles. Looters who prevail in title claims should still be subject to criminal prosecution for their past thefts. The law's object is not to exonerate them, but to clear titles. When marketable private land titles start proliferating in Russia, an economic boom will follow.

I suggest several specific amendments to Article 234 (Prescriptive Limitation):

§1 should be amended to add the requirement that the claimant be "adverse" to the owner; otherwise a long-term tenant, for example, could acquire ownership.

In light of Russia's need to reduce investors' title risks, the draft's limitation periods are too lengthy. (I don't understand the purpose of §4, which seems to add further length.) I suggest a 5-year statute of limitations for good-faith possessors and a 10-year period for bad-faith possessors. Alternatively, the Code could employ a 5-year period for a bad-faith possessor, but obligate him to provide cash compensation to the dispossessed owner.)

Article 4 makes the Code exclusively prospective, unless an article states otherwise. The drafters might allow the prescriptive period to begin to run prior to the date of the enactment of the Code, particularly if prescriptive rights had been recognized under preexisting Russian law.

C. Ownership of Peasant (or Farmer's) Economy

I assume that Articles 257-259 deal with the ownership interests of the members of the successor organizations to Collective Farms and State Farms. For rural Russians, these provisions may be the most important in the Code. One hears that certain agrarian political interests oppose entitling a peasant to set out on his own. To be consistent with Stolypin's efforts and Article 1's endorsement of individual self-determination, these Articles must enable a member of an agricultural economy to withdraw his share, either in cash or in kind, through some fair, swift, and realistically enforceable procedure. Properly drafted, these articles can help bring prosperity to the Russian countryside. When facing opposition on this issue, reformers should point to the glorious results China achieved by converting its rural communes to family farms in the late 1970's.

D. Duties to Protect the Environment

Article 260(3), echoing Article 36 of the Russian Constitution, states that land activities "must not cause damage." Although Russians rightly view environmental protection as a high priority, this rule is too sweeping. For example, officious state officials could invoke this provision to hassle any landowner with a fireplace, any farmer who cleared brush, any dumper of waste into a sewer. This article should be amended to read "must not cause unreasonable damage." The article should also provide that in appropriate cases the remedy for "damage" is a monetary fee, not the cessation of the activity. Russia should avoid creating insurmountable legal barriers to building new power plants and factories.

E. Servitudes

Articles 275-278 deal in summary fashion with the complex topic of servitudes. The drafters are probably wise not to include too much detail on this topic in the Civil Code. However, the articles should be amended to mention additional varieties of servitudes that later legislation can flesh out in detail. These include prescriptive easements, promises to pay money to a neighborhood association, and negative servitudes such as promises not to block a view from a window. The articles certainly should not imply that the types of servitudes mentioned are the only ones permitted.

Articles 275(1) and 277(2) make it too easy for a land owner to create or terminate a servitude by unilateral demand. Servitudes work best when neighbors have expressly agreed to them after bilateral negotiation.

F. Withdrawal (Eminent Domain)

Government's compulsory acquisitions pose two key legal issues: the appropriate constraints on government's use of this power, and the rules for measuring compensation. Article 280(3) appears to require the State to give a year's notice before taking land. This rule might unduly delay progress on urgent public projects. The Code should allow quick government takings, but assure that owners receive full and just compensation. This is the practice in the U.S.

Article 35 of the Russian Constitution and Article 282 of the draft Civil Code deal with the measure of compensation. Since 1970, U.S. law has increasingly provided compensation for incidental losses such as moving expenses and loss of business goodwill. Because being uprooted from land is upsetting, the Code should promise just compensation not only for owners, but also for tenants and other occupiers.

G. Chapter 18: Rights in Dwelling Premises

A number of provisions in Articles 289-293 restrict freedom of land use and restrain transferability. These are contrary to the spirit of Article 1 of the Code. Article 292 dictates how apartment buildings are to be owned, a provision too specific for a Civil Code. Particularly worrisome is Article 293, which threatens to slow the transfer of dwellings by giving veto power to guardians and other nonowners. The drafters should not grant children ownership interests, but instead assume that parents almost always have the interests of their children at heart. The entire chapter is unnecessary and should be deleted.

Annex IIIA

CONFIDENTIAL - FOR INTERNAL USE ONLY

June 28, 1994

MINUTES

FROM WORKSHOP ON ISSUES OF COMMERCIAL LAW IN THE RUSSIAN CIVIL CODE

CORNELL UNIVERSITY LAW SCHOOL SESSIONS

PROFESSORS SUMMERS AND WHITE AND THE RUSSIAN CIVIL CODE DRAFTING COMMISSION

Ithaca, New York USA
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THE IRIS-RUSSIA PROJECT

MINUTES FROM ITHACA DRAFTING SESSION WITH PROFESSORS SUMMERS AND WHITE

INTRODUCTION

Summers:

We have focussed on your draft and on the questions you submitted paying particular attention to the areas in which we have expertise. There are many topics that either White or I will have comments on. There are also topics you have addressed in your questions in which we are not experts because they are only peripheral to commercial law. For example, we will not be able to provide an in-depth analysis into the areas of transactions in land and securities in land. We have alerted a member of our faculty at Cornell, Gregory Alexander, who is a specialist in land questions, so that he can fill this gap. He will lecture on these issues on Saturday morning.

Our major areas of study are the Uniform Commercial Code (UCC) and general contract law. We are aware that you are interested in the sale of goods and security interests. We will begin, today, with material from Article 2 of UCC.

Article 2 is far from perfect. In fact, Professor White is a member of the committee which is revising Article 2 of the UCC.

White:

Let us briefly discuss how we want to proceed with our agenda. Should we divide the group in two? You should also take the liberty to make proposals about deletions or additions to the program we have designed. We will cover the issues which you want covered.

Makovski:

Let's work as a single group. The program looks fine, there is no need for any changes. What is your opinion on Part I of the draft? We were not going to discuss that at all, but it has yet to go to the parliament. There still is time to amend it. We are very interested in your reaction. We should start with this.

Komarov:

Professor White, could you describe your role in the drafting of the UCC?

White:

I am on the committee that proposed changes in the UCC, but I have done no drafting myself. That is the task of a separate committee.

COURSE OF DEALING, USAGE OF TRADE, AND COURSE OF PERFORMANCE

Summers:

Let's focus on Article 5 of Part I of the Russian Civil Code.
We will take Questions 1 & 2 which you prepared regarding the purchase and sale of goods. (Page 3 of list of questions.):

Q1. The conceptual approach to the structure of the "purchase/sale" chapter in the Draft Civil Code; the assessment of the general provisions by U.S. specialists; standards governing specific types of purchase/sale and the procedure for their classification (retail purchase/sale; purchase/sale of dwellings; purchase/sale of enterprises; delivery, etc.

Q2. Essential terms of the purchase/sale contract. What is understood to be the subject of a purchase/sale contract in the US? Is it sufficient for the descriptions and quantities of goods to be stipulated by the contract? Are the terms governing the assortment and the quantity of goods sold recognized to be the characteristics of the subject of the purchase/sale contract?

The conceptual approach to the structure and the assessment to the general provisions.

A: You might wish to consider expanding and defining the concept of AGREEMENT. The most fundamental concept in commercial law, according to Llewellyn, is that of agreement. He believed that there should be a definition of agreement which includes the notions of COURSE OF DEALING, USAGE OF TRADE, COURSE OF PERFORMANCE.

You already have in Article 5 language dealing with USAGE OF TRADE. Butler translated the Russian wording as "customs of business turnover".

The exact definition of course of dealing is found in 1-205(1) of the UCC:

> (1) A course of dealing is a sequence of previous conduct between the parties to a particular transaction which is fairly to be regarded as establishing a common basis of understanding for interpreting their expressions and other conduct.

The exact definition of usage of trade is found in 1-205(2):

> A usage of trade is any practice or method of dealing having regularity of observance in a place, vocation or trade as to justify an expectation that it will be observed with respect to the transaction in question.

Course of performance is defined in 2-208(1):

> Where the contract for sale involves repeated occasions for performance by either party with knowledge of the nature of the performance and opportunity for objection to it by the other, any course of performance accepted or acquiesced in without objection shall be relevant to determine the meaning of agreement.

Llewellyn incorporates these three concepts in 1-201(3). 1-201(3) defines "agreement" to mean "the bargain of the parties in fact as found in their language or by implication from other circumstances including course of dealing or usage of trade or course of performance as provided in this Act".

Dozortsev:

Are all of these three concepts the TERM of the agreement, or are they the rule that can be disposed in the agreement? I would object including USAGE OF TRADE in the agreement.

Khokhlov:

The point is not only to give the definition of all the elements of the commercial agreement, but to also provide a general definition for "agreement". We must include articles 418 and 419 in our discussion. The notion of contract should be a general notion, not just a notion of commercial law.

Makovski:

There is a slight misunderstanding owing to differences between in the basic concepts of our respective commercial codes. The aim in defining "agreement" should be to include these three elements in the definition.

Summers:

The definition of "agreement" includes these concepts which are defined in 1-205. The word agreement appears throughout the code and each time it includes these three concepts. If you wish to take an approach similar to Llewellyn's, you should think of a number of issues.

1- How to define these three concepts. In the UCC experience, the definitions of course of dealing, usage of trade and course of performance have served their purpose well.

2- Whether the parties can, by express agreement, change the effect of these concepts.

3- What the relationship is between these concepts and the express terms.

I came across two of these concepts as I read over your draft. Article 5 alludes to the idea of usage of trade. Its definition is broader in Art 5 than that of the UCC, and may incorporate the notion of course of dealing as defined by Llewellyn. Article 429 includes an expression that touches upon Llewellyn's concept of course of performance: "The subsequent contact of the business parties".

You should consider providing more separate and clearer definitions for each of these notions. We have separate definitions for each one and an elaborate description of their interrelationship in 1-205.

To summarize, the following are some of the issues to consider regarding Article 5:

1- precise, separate definition of Llewellyn's terms,
2- their legal effect,
3- relation to expressed terms, and
4- procedurally, 1-205(6).

Makovski:

Is the notion of trade usage an objective one that does not depend on parties' intentions, or is it more subjective?

Summers:

The theory is that it is objective, that the usage of trade goes beyond the interaction of just the two parties. The objective proof is provided by expert witnesses. It also has to be objective in that it satisfies the definition set forth in 1-205 (2): REGULARITY OF OBSERVANCE. However, according to 1-205(6), you cannot offer at trial any relevant evidence of usage of trade without prior notice to the other party. Also, an expressed term may exist in the agreement. For example, if the controversy is over an issue in which "B" is the usage of trade, it would be considered an unfair surprise if the other party thought they were dealing with meaning "A" which is an expressed term in the agreement.

Makovski:

This is a procedural question, and therefore, it is of less importance.

Summers:

If it is of less importance, then we can remove the procedural question from the issues which I suggested that you consider. One must remember, however, that on the time line, course of dealing is prior to transaction. Course of performance is during the transaction. How parties perform is strong evidence of what they understood the terms to be when they signed the contract.

Komarov:

Therefore, course of dealing is much more concrete than course of performance.

Khokhlov:

With regard to the need of a definition of course of performance in our draft, it is important to consider the following: If we are speaking of the elements of agreement, course of performance should not be included in Article 5 because it concerns matters which come into existence after actual signing of the contract.

Summers:

Was Llewellyn wrong to think of course of performance as part of the agreement because it occurs after actual signing of the contract? Llewellyn's answer would have stressed the view that parties perform according to what they thought the agreement meant. This is clearly stated in the comments to 2-208.

Makovski:

The problem we have with usage of trade is that our economy is in transition from a centrally planned system to a free market economy. Hence, usage of trade is essentially nonexistent in our experience.

Summers:

If we have a gap in the agreement, we can fill it by going to either:

1- a statutory gap filler, or
2- usage of trade, course of dealing, and course of performance.

Makovski:

Given our situation, I would suggest the statutory gap filler.

Summers:

If that is what you prefer, you would need a specific clause in your code which would direct you

to the statutory gap filler. In U.S. law, we go to course of dealing and course of performance first, because it is closer to the understanding of the parties than a statutory gap filler would be.

Makovski:

Is this a general approach for all agreements, or is it just applicable to trade law?

Summers:

For all contracts, not just sale contracts.

Khokhlov:

What is the hierarchy between these three concepts?

Summers:

Let us take the example of a seller selling goods to the buyer. After the goods have been dispatched, there is controversy over whether or not the buyer is entitled to 30 days of credit. The statute may say that no credit should be provided to the buyer. However, the statute can be displaced by the trade usage. The trade usage would give the buyer the 30 days of credit if the contract is silent on this issue.

When does trade usage have priority in Russian law? You have indicated that the statute would control in some cases and that the trade usage would control in other instances. When each has priority over the other needs to be defined clearly in your draft.

Makovski:

This question always provokes discussion among us. You are right, this is a fundamental issue in our law which needs to be addressed. Generally, statutes control trade usage and course of dealing in Russian law. However, if we look at Article 429, trade usages and course of dealing are given greater importance. Hence, the law is contradictory and needs to be clarified.

Feldbrugge:

The hierarchy in European commercial law is the following:

1- will of power,
2- statutory gap filler,
3- trade usages.

In the European theoretical tradition, course of dealing and course of performance are not linked with the agreement. However, in the net result of practice, the relationship may be less clear.

As a general correction, however, there is the concept of good faith.

Komarov:

In the Classical legal tradition, commercial law is a subsection of civil law. In the German commercial code, trade usages also have priority over statutes.

There is a difference in philosophy between common and civil law traditions. In the civil law tradition, the agreement comes before the transaction. In the common law tradition, first there is the case which then translates into the law. We are trying to incorporate the common law philosophy into our commercial subsection of the civil code. We need to adopt one definite philosophy for the entire civil code so as to reduce the probability of contradictions in the law.

Summers:

In our case of 30 day credit, if the statute says that there should be no credit, and trade usage says that there should, what happens then? The statute needs to be amended so that it makes a provision for trade usage. A clause for 30 day credit should not have to be inserted into every contract. In American business practice such a clause is not included in every transaction agreement for reasons of efficiency. The point of the code is to facilitate transactions, not to hamper them.

TERMS OF ADHESION

Questions:

* How is the problem of standardized contract forms and contracts of adhesion solved in US law, legal practice and legal doctrine?
* What is the source of standardized terms of contracts (regulations of state agencies, documents developed by the parties or associations in which they are constituent elements; customs, etc?

Summers:

We do not need to spend too much time on this because what you have in your draft is an improvement on our law.

White:

The terms of adhesion are rarely applied in daily business practice. They do come up, however, in the context of consumers against large firms which provide their clientele with forms. You are generally bound by a standardized form. But if writing on the form contains wording of which the receiving party was not aware, and hence the prescription of the wording is

unjustifiable, it will be removed from the original writing of the contract.

Under 2-301, the general obligations of parties, the unjustified language is removed and the general obligations of the contracts withstand.

Avilov:

In the Russian tradition, if there is an unfair term included in the wording, the entire contract becomes void.

Summers:

I suggest that, generally, you include a provision in your code to void only a single term of the contract in order to preserve the transaction.

Dozortsev:

We need to cross reference between the articles so as to allow for voiding of a single term. Otherwise, the entire contract should become void.

OFFER AND ACCEPTANCE

Summers:

There exists a big problem in US law regarding the notion of OFFER and ACCEPTANCE. In the profession, it is commonly referred to as the BATTLE OF THE FORMS: contracting through forms.

In 436 and 431, you make no provision for contracting through forms. To what extent do you want to do this in your draft?

There are two things which you must keep in mind:

> 1-Forms are everywhere. Buyers and sellers will have forms. They are convenient in a market economy; and
> 2-They will not have the same forms. They will vary in their terms.

Example 1:

The seller (A) sends a form to the buyer (B). The form has a given provision "X". The buyer returns a form to seller which does not include provision "X".

Then let us assume that the market price of the goods shifts. Since the buyer did not include provision "X" in his form, he claims he has no contract with the seller and then goes to (C) to buy the goods at a lower price. The seller claims that the contract should hold.

Example 2:

There are three steps in this transaction:

1- The seller sends a form to the buyer with a "no consequential damages" provision.
2- The buyer sends a form to the seller with a "consequential damages" provision.
3- Then there is the performance of the contract. Damages are caused and the goods do not perform as contracted.

Which form controls in this scenario?

1- the first form?
2- the second form?, or
3- a gap filler law?

Example 3:

The buyer (Boeing) makes an oral deal over the phone with the seller (wheel manufacturer). Since the deal is oral, it is not binding. Who sends first form in this case? Let us assume that the buyer sends a Purchase Order which act as an acceptance of the deal. The seller then sends back an acknowledgement which includes a provision for no consequential damages after one year. The plane crashes because of faulty wheels after one year. The seller wants to sue.

Does the acknowledgement redefine the terms of the contract?

In 2-207, the acknowledgement, the last form, contains the final terms of the contract. The seller will not be liable for the accident which occurred after one year, as stated by its no consequential damage provision.

> 2-207: Additional Terms in Acceptance or Confirmation
>
> (1) A definite and seasonable expression of acceptance or a written confirmation which is sent within a reasonable time operates as an acceptance even though it states terms additional to or different from those offered or agreed upon, unless

acceptance is expressly made conditional on assent to the additional or different terms.

(2) The additional terms are to be constructed as proposals for addition to the contract. Between merchants such terms become part of the contract unless:

(a) the offer expressly limits acceptance to the terms of the offer.

(b) they materially alter it; or

(c) notification of objection to them has already been given or is given within reasonable time after the notice of them is received.

(3) Conduct by both parties which recognizes the existence of a contract is sufficient to establish a contract of sale although the writings of the parties do not otherwise establish the contract. In such case the terms of the particular contract consist of those terms on which the writings of the parties agree, together with any supplementary terms incorporated under any other provisions of this Act.

In common law and traditional doctrine, the seller's one year provision falls out of the contract and the seller must provide full warranties. You need to consider whether you should have something like 2-207. Our provision is not perfect. The current reviewers of Article 2 are changing it too.

SECURED TRANSACTIONS AND REGISTRY SYSTEMS

White:

A car dealer buys 500 cars. The dealer borrows from a bank to purchase the cars from the manufacturer. The security agreement will cover financing for these cars plus any increase in the loan resulting from any additional purchases.

Articles 9-401 and 9-402 deal directly with the issue of the perfection of security interests.

The process for perfecting a loan is as follows: The dealer signs the loan agreement. The bank then files it electronically with the state agency. As stipulated by 9-301, the filing must occur because the bank would otherwise be subordinate in bankruptcy, to the trustee, the lien creditor, or the later secured creditor in the case of default. The legal effect of filing is that if the dealer defaults on the loan, the bank can seize the cars. Filing this document makes the debtor accountable rather than third parties.

Let us make the assumption that the car dealer is dishonest. He goes to a second bank and denies the existence of prior security interests. The second bank searches the electronic file under the dealer's name. He will find the previous filing and will know that it is unadvisable to issue another loan to the dealer. If the first bank does not file properly, causing the filing not to appear in the registry, then second bank's claim to the defaulted loan money would have priority over that of the first bank.

Then let us assume that individual buyers buy the cars from the dealer. Each individual buyer signs a security agreement with the dealer. The bank is also automatically attached to this promise because it lent the money for the cars. Although the dealer has a separate security with the bank, 9-306 on "proceeds" guarantees the right of repossession to bank. Hence, the promise to pay by the buyers becomes very valuable. If the buyer pays cash for his car, he is freed of the security interest even though it is perfected. This appears in 9-307 of the UCC. The bank has no power to reclaim this individual's car even if the dealer has defaulted on his loan to the bank.

If the dealer defaults on the debt, but an individual buyer does not, the bank has the right to the payments made by the individual. The individual has the right to keep the car as long as he is making his payments. The bank receives the remainder of the installments under the same term of sale contracted between the dealer and the individual. Any previous payments made by the individual to the dealer, which are not retrieved by the bank, are written off by the bank. The individual is in the clear.

If the dealer defaults, but is not bankrupt, he has the immediate obligation to give up the collateral to the secured creditor as stipulated by 9-503. Your draft law does not provide for this. This may be a serious omission.

> 9-503. Secured Party's Right to Take Possession After Default.
> Unless otherwise agreed a secured party has on default the right to take possession of the collateral. In taking possession a secured party may proceed without judicial process if this can be done without breach of the peace or may proceed by action. If the security agreement so provides, the secured party may require the debtor to assemble the collateral and make it available to the secured party at a place to be designated by the secured party which is reasonably convenient to both parties. Without removal a secured party may render equipment unusable, and may dispose of collateral on the debtor's premises under 9-504.

The creditor takes physical possession of the property. If the dealer refuses to return the cars on its own accord, the bank can come and seize cars as long as there is no breach of the peace, as is stated above. If the car dealer resists the seizure, the bank will get a court order forcing the dealer to return the vehicles.

Once the bank has seized the cars, it has two possible courses of action:

> 1- It may sell the cars and sue the dealer for the difference between the amount of debt and what it gets from the sale; or
> 2- It may take the cars in full satisfaction of the debt and agree not to sue the dealer for the difference.

Again, your draft law requires court action in this instance.

If both the dealer and the individual buyer default on their debt, under 9-306, the bank steps into the shoes of the dealer and may repossess the car from the individual. Unlike European law, the bank may do this without the interference from the court if the debtor agrees.

There is always conflict when goods are repossessed. The debtor always claims that the repossessed goods are sold below the market price by the creditor. In the 1930s, this was a big political issue with respect to farm land in the midwest. The outcome was a lot of legislation serving farmers' interests. The point is, you should expect controversy and conflict in the practical application of repossession clauses.

(N.B.: There exists a division between real property and personal property in the American legal tradition. These rules are personal property rules and do not necessarily apply to real property. With respect to land in foreclosure law, the court is much more involved in the process of repossession and the process is considerably more time consuming.)

Russia does not yet have a system of registry. The current U.S. registry system has been in existence since WWII. In the case of automobiles, the creditors are listed in their order of claim to the collateral on the certificate of ownership of the car. The reason for this is political. Car companies, which hold considerable political clout, see it as more efficient in satisfying their interests.

Summers:

Does the scope of your authority granted for the drafting of the code permit you to recommend a particular registry system?

Makovski:

We can propose any system of registry. However, we do not know which system will be accepted by our parliament. It is connected not only to political criteria, but also to the technical legal aspects of designing the system from scratch. We had a registry system for some types of personal property, but it did not serve as a registry of civil transactions. It only served for administrative transactions. We have this framework upon which to build a system that will serve civil interests as well. Real property was registered by a different authority using a different procedure. Therefore, the difficulty lies in designing a comprehensive system.

Is it more profitable for the seller to retain the title of ownership or to use a lien system?

[DISCUSSION OMMITTED]

White:

It is treated the same way. Section 9-102 forces you into the system regardless of the form of the purchase, whether it is a lease or a complete turnover of ownership.

Makovski:

If there is a default on the loan, is there anyone who has priority to claim the collateral over the pledge? For example, can the state retrieve lost taxes?

White:

The state has its own lien mechanism. However, under its own rules, it agrees to behave as a secured creditor. However, in a real transaction, the local property tax lies above the mortgage in the lien. The secured creditors have priority over employees of the defaulter and over individuals with tort claims against the defaulter. Employees have very few claims because they are laid of when bankruptcy occurs. There is not a question of retroactive wages.

However, although federal bankruptcy law does not change the lien order in theory, it may do so in practice. In the case of bankruptcy, the secured creditor's repossession rights as stipulated in 9-501, 9-503, 9-504, are frozen. While the freeze is on, wages to employees may continue to be paid. Property and capital may also devalue.

So yes, there are exceptions, but in general, the secured creditors have priority to proceeds.

Summers:

In the past, chattel mortgages, conditional sales, factor lien acts, and trust receipt financing were separate and diverse concepts. Dunharn & Gilmour, as subdrafters, drew all these concepts together into one unified statutory scheme: Article 9.
The pledge is also incorporated into Article 9.

White:

Now, regarding the logistics of instituting a system of perfection:

How would one go about establishing and financing a registry system in Russia? Is there another way of giving public notice on disbursed credit. In the U.S., there used to be a system of "field warehouses". This system consisted essentially of warehouses where goods were kept while they were still "owned" by the creditor. This system was abolished with the institution of the present registry system.

Makovski:

In Russia, the Pledge Act requires every pledger to have a book registry wherein he inscribes

all liens that affect his property. This book is open to the public. In theory, all creditors have access to this book. However, this does not work in practice. Also, this assumes that all debtors will report all their pledges. There is no system of enforcing inscription and, hence, no method for the prevention of fraud through exclusion.

What percentage of transactions use credit in U.S.? In Russia, most transactions are conducted with cash.

White:

Most transactions involve credit in the U.S. You want to establish rules for credit in business. Credit is necessary for the stimulation of economic growth.

Here is a brief list of things which need to be dealt with in the Russian code:

1- What system to use for public notice?
2- There is nothing in your pledge law that establishes priority between the trustees in bankruptcy and lien creditors. In 9-301 of the UCC, the lien creditor is superior to the unsecured creditor and subordinate to the secured creditor. You need a rule to establish this hierarchy.

Makovski:

Article 64 covers this partially.

NEGOTIABLE INSTRUMENTS

Summers:

A Siberian drilling company sells oil to Chevron. Chevron gives the Siberian Co. a negotiable instrument in exchange for the oil. The Siberian company goes to a bank and takes a loan out with the negotiable instrument as collateral.

Question: How does the Siberian company conduct the transaction with the bank? It has two options:

1- It could sell the negotiable instrument to the bank for cash, or
2- It could sell the account. 9-102 treats this as a sale.

The perfection works differently in each of these cases. If there is a sale of the account, the perfection procedure is the standard one. With a negotiable instrument, however, there is no way to perfect. The creditor must take physical possession of the negotiable instrument. The theory is based on the assumption that people dealing with negotiable instruments are not expected to deal with registry files.

Komarov:

There is not a concept of negotiable instruments that exists in the Russian commercial or legal tradition. Is the negotiable instrument separate from the contract of purchase?

White:

Yes, the contract states that the debtor will pay in receipt of the goods. The negotiable instrument is payable to the order of the creditor and is strictly a promise to pay.

9-318, explains how the transfer of collecting rights from the previous creditor to the new holder of the negotiable instrument occurs. In our example, the account debtor (Chevron) may request proof of transfer of creditor status from the Siberian Co. to the new holder of the negotiable instrument -- the bank. The bank must provide reasonable proof of the change in assignment. The Miller Act defines this transfer in more depth. This is an area where the UCC is not perfect.

BANKRUPTCY

White:

There are three chapters in bankruptcy law:

> Chapter 7: Covers the conventional liquidation of a company. The debtor is freed from debt with exception to obligations of alimony, liability of tort, student loans, etc.
>
> Chapter 13: Sets the rules for the financial reorganization of an individual.
>
> Chapter 11: Deals with the reorganization of bankrupt corporations. Chapter 11 is mostly applied to cases which involve larger businesses.

Case Study Example:

We have a manufacturer with security interests on inventory, accounts receivable and equipment. The manufacturer owes money to U.S. and state governments for taxes as well as to trade creditors -- i.e. people who supplied goods to the debtor without secured credit.

When the debtor business is in trouble, it will negotiate with creditors before it files for bankruptcy. If the negotiations are unsuccessful, the course of filing bankruptcy is as follows:

(1) The company files Chapter 11.

(2) Having filed bankruptcy, the company enjoys an automatic stay -- i.e. any act by a creditor to seize or sell property is stayed. In addition, trade creditors and secured creditors stop receiving interest payments. In inflationary times, such as those being experienced in Russia, this has serious repercussions for the debtor because the relative size of the debt shrinks at the rate of inflation.

(3) Under Chapter 11, there is no trustee and the bankrupt company can pay its post petition creditors, such as employees, lawyers, etc, and its post petition trade creditors. The company may borrow money with court approval.

This is one area in which the theory deviates from practice concerning the secured creditor. In theory, the secured creditor can go to court and have the stay lifted, but this is not very common in practice.

In general, cases of bankruptcy can be divided in two classes according to the size of the company in question. Small firms tend to end up liquidating by filing Chapter 7. Most large bankrupt firms are reorganized through Chapter 11 and remain in business. Whether to file either Chapter 7 or Chapter 11 is generally the free choice of the bankrupt entity. On some occasions, the creditor to the bankrupt entity can get the court to force filing of Chapter 7. The courts are sometimes sympathetic to allowing the debtor to file Chapter 11 in the interest of saving jobs.

Let's assume there exists a company which has the capacity to reorganize.
According to Section 1-129, the conditions under which filing of Chapter 11 is permitted are the following:

- Reorganization must be feasible (the debtor must convince the court that it will be able to pay off its debts).
- The debtor has the exclusive right to propose a plan for reorganization for the first 120 days after the filing. After that, if specified by court, the debtor's creditors may submit proposals. However, creditors seldom do because they lack the necessary detailed information about the financial situation of the debtor, and the court usually extends the 120 day allowance for the debtor to submit its plan.
- The debtor must promise to give each creditor as much as it would receive under Chapter 11, plus interest. This is imposed by the court.
- at least one class of creditors must vote for the plan (for example: trade creditors or secured creditors). The secured creditors and the tax creditors get priority of claim over remainder of creditors in the plan of reorganization.

The DEBTOR IN POSSESSION (DIP) (in Chapter 11) is in charge of the daily administration of the business. For the most part, the DIP is the same person as the original debtor, but

simply wears a different hat. He has the power to avoid payment of interest charges on debt that is not perfected. The trustee in Chapter 7 has the same right.

[Handing out of exemplary Security Agreement and Financial Statement.]

9-402 specifies the terms which need to be included in Financial Statements. Therefore, the forms issued by different states are very similar.

The security agreement is prepared by the creditor. Many creditors will have different forms for different types of secured lending. Generally, the debtor is expected to adhere to the form, but the debtor may have some negotiating strength and may be in a position to force the creditor into making some modifications. Part 5 of Article 9 prohibits certain terms from being included in these agreements.

If there exists a definition for a specific term in Article 9, this definition will control in the interpretation of the form. However, frequently the drafter of the form will include material in addition to what lies in Article 9. The drafter is required to keep the material on the form in accordance with the terms stipulated in the Federal Tax Lien Act, bankruptcy law, and in Article 9. 9-501(3) specifies the terms which may not be included.

SHAREHOLDING

Question: If one is a preferred shareholder in a bankrupt company, does he have a good claim?

There are three kinds of stock:

1- Common stock - The shareholder has the right to dividends only if they are declared. The shareholder has no legal right to claim money from a bankrupt company if the dividends are not declared.

2- Preferred stock- The shareholder has the right to dividends only if they are declared, but receives the declared dividends before common stock shareholders in the case of bankruptcy. Again, the shareholder does not have a legal claim to dividends if the are not declared.

3- [DISCUSSION OMMITTED]

Summers:

The following is a list of the basic questions which should be addressed when drafting the bankruptcy law:

1- Who can be made Bankrupt?

a) forced to liquidate
b) reorganize

2- How can a party be made bankrupt?
a) voluntarily
b involuntarily

3- Should a trustee be appointed?
a) to gather assets of debtor (what powers?)
b) to reorganize and operate
4- Claim priorities on the distribution of recovered debt where there is liquidation
5- Administrative powers on reorganization
6- Discharge of debtor on liquidation (pre-conditions). Under section 1-141, the debtor discharges any debt before the confirmation of the plan of reorganization.

Makovski:

When does the government assume liability for certain banks? What is the legal foundation in such a case of bankruptcy?

White:

It is illegal for banks to file bankruptcy. In the 1930s, banks used to just close their doors. In the mid 1950s, the Federal Deposit Insurance Corporation (FDIC) was set up to act as the guarantor of the bank. With the FDIC, the Federal Government will step in if the bank goes bankrupt and may sell off the bank's assets if it sees fit.

Komarov:

Is any record kept of the companies or individuals that have filed bankruptcy?

White:

Typically no record is kept of small companies because the company usually ceases to exist. A record is kept for individuals who have gone bankrupt. The credit reporting industry is very thorough on maintaining reports on individuals with bad credit history.

GAP FILLERS

Summers:

Assessment of the Russian Gap Filler Provision on Damages.

In your draft law, you do not make a clear distinction between DIRECT and CONSEQUENTIAL damages. .The notion of direct damages appears in Article 39. You also make some reference to consequential damages in Article 39-(6).

Problems With the Current Version of Article 39:

1- How to distinguish between direct and consequential damages. You must clearly define the conditions under which consequential damages are recoverable. In our law, we have many cases related to this issue. The problem is enormous and important in our law. Two important points which need to be looked at are:

(1) how to measure consequential damages, and
(2) how you can exclude consequential damages through contract.

An Example to Demonstrate the Difference Between Direct and Consequential Damages:

Assume that a company which mills grain has to stop its mill because a shaft in the machinery is broken. Also assume that the miller takes the shaft to a carrier and tells the carrier to take the shaft to a distant town to have it repaired and then to ship the shaft back. The carrier agrees to complete the task, but does not get the shaft back on time. It arrives one week late. The miller might have two claims, **direct** and **consequential**:

Direct: With one week of delay, simply the shaft was unavailable for a week. The direct damage equals the rental value of the shaft for one week.

Consequential: The consequential damage is the lost profit for one week. Without more facts, in our law, the plaintiff would only get the rental value of the shaft.

The diminished value of the performance is a direct damage. It flows from the breach. The lost profits do not flow from the ordinary course of the breach. The miller might have had a substitute shaft. If so, he could have used the substitute. Based on these facts, the lost profit is not recoverable.

If at the time when the miller sent the shaft, he claimed that the mill had stopped due to his inability to find a substitute shaft, and it was true, then he would receive consequential damages. This problem of distinction between direct and consequential damages appears throughout the law.

I am concerned that your draft lacks an important rule. I looked at Articles 9, 39 (6) and Section 15 of Part I, and in none of these articles did I find a provision that would have prevented the miller from receiving consequential damages if he had been able to replace the

shaft.

Dozortzev:

It appears in the Russian version. The translation into English of our draft is poor.

Summers:

Regardless of the quality of the translation, you need to cross reference it in different articles.

Makovski:

If the miller claims these damages, the court would make the miller prove that he has truly suffered these damages. Then the miller would have to provide a figure for a week's average profit. Should we solve the problem of damages that are foreseen?

Summers:

If the miller proves lost profit for the week, and as a result of losing that profit, he was prevented from buying equipment which would allow him to earn a higher profit in a future transaction, how would the court rule on this?

Makovski:

Under certain circumstances, he would be able to recover this additional loss of profit. He would have to show a contract or proof of negotiations for the purchase of this equipment. I, personally, would rule in his favor.

Komarov:

It is all based on the rule of causation.

Summers:

At what point does causation end? Why would you cut it off?

> 1- because there is not enough proof of causation, or
> 2- or because the claim of causation does not lie fairly within the risks of the original contract?

These reasons are very different.

Makovski:

You can require the carrier to predict certain losses.

Summers:

My assessment is to consider being more explicit about several things:

1- Foreseeability as a limit on consequential damage claims.
2- Avoidance by self-help on the part of the miller. This should be drafted directly into these provisions and/or be cross referenced into the provisions you were talking about.
3- Make explicit the provision about the extent to which the parties can, by contract, exclude all consequential damages.

There are two approaches to distinguish between direct and consequential damages:

I. First Approach:
Direct damages are those that flow from the direct course of the breach of contract. As a result, they are obviously foreseeable.
Consequential damages are those resulting from the breach which are not foreseeable when the breach occurs.

II. Second Approach:
In Dobbs' Treatise in Remedies: Direct damages should be conceptualized as the loss of value from the breach of the performance itself. All else is consequential. The non-performance of the promise generates a loss in value of the promise itself. The difference between the shaft being delivered on time and being delivered late is the rent due. All else is consequential according to Dobbs.

Suggestions/Issues:

1- Make an explicit differentiation between direct and consequential damages.
2- With the differentiation, how do you define the circumstances in which damages could or could not be claimed?
3- Assuming causation of damages, what limitation do you want on causation?
a) foreseeability limitation,
b) remoteness, or
c) excludability of damage claim in original contract.

Makovski:

The concept of foreseeability is central to Civil law in general. We can only demand the party to have reasonably foreseeable liabilities.

Summers:

Can you exclude liability in your system?

Komarov:

No, explicit provisions for exclusion or limitation of liability in Russian law only exists for international trade.

Summers:

Defective Seller performance:
- law of warranty
- law of rejection

Gap filling problems: (Art. 13) The issue of quality of the goods delivered is dealt with in 2-313, 2-314, and 2-315.

Goods delivered should be in the condition suitable for their common uses:
Merchantability: 2-314
Expressed Warranty: 2-313

After comparing your Article 13 with our law of warranty, I have some suggestions which you should consider:

(1) Warranty of merchantability: In your draft, the warranty of merchantability covers the goods for purposes of which such goods are commonly used. Llewellyn believed it to be more useful to define the warranty of merchantability in a gap filler. 2-314(2) does give this concept more definition.

For example, according to Llewellyn, fungible goods have to be of fair average quality (cases are settled with language of this kind more readily than with more general language).

To what extent can the seller disclaim the warranty?
According to 2-314(2) of the UCC, the seller must mention explicitly that he is disclaiming merchantability.

Makovski:

Do these warranties cover non-commercial transactions in the U.S. -- *i.e.* between consumers?

White:

2-314 applies strictly to merchants. Hence, transactions between consumers do not have to

involve these warranties.

In the event that the contract should contain no terms for the quality of the goods, the supplier is expected to supply the buyer with goods of adequate quality for the purpose of the goods.

> *Example*:
> A bank buys a computer from a seller. The computer does not work because it did not fulfill the buyer's specific needs. Under American law, the warranty does not apply because the transaction was relying on the seller's judgement of the buyer's needs. A clause should be included to show that the buyer is relying on the seller's judgement regarding the suitability of the goods for a SPECIAL USE -- freeing the seller of warranty obligations. This feature is included in 2-315 of the UCC.

Summary of Issues to be Considered:

1- Give more definition to merchantability (common uses to goods).
2- Include a procedure for negating warranty of merchantability.
3- Make the liability of the warranting party for any goods of special purpose depend upon whether or not the seller is made aware that he is being relied upon by the buyer to know the exact suitability of the goods for the buyer's specific purpose.

Makovski:

2-314 will be considered. However, most transactions occurring in Russia are between individuals, not consumers. These contracts do not provide any warranty. How are these transactions treated under US law?

Summers:

In our law there would be no liability for a non-merchant seller if he does not make special claims about the item he is selling. If he does make such claims, and if the item sold did not live up to these claims, this would constitute a breach of expressed warranty. If the seller had kept his mouth shut, there would be no liability.

White:

When are the statements made by a seller substantial enough to be warranties? There is a lot of litigation on the distinction between the warranty in 2-313 and mere "puffing" or seller's talk. A special section of 2-313 deals specifically with this issue.

EXPRESSED WARRANTY GAP FILLERS

Summers:

Some of these gap fillers have significance beyond immediate parties involved in the transaction. The case of cigarettes illustrates this well.

> *Example*:
> The manufacturer of cigarettes advertises goods and sells them to a retailer who, in turn, sells them to the consumer. The end user buys them after reading the advertisement put out by the manufacturer. Assume the consumer get cancer. What are his rights against the retailer and the manufacturer? There is a lot of litigation over such an issue, and not just about cigarettes. The UCC does not say in 2-313 that any warranties described in the advertisement are guaranteed to the end user of the product. There is a section, 2-318, which extends then manufacturer's warranty a little bit, but it is very narrow in its scope.

A new draft proposal for this section of the UCC states that any affirmation made by the manufacturer is presumed to constitute an expressed warranty. Under 2-318, the buyer may claim an expressed warranty whether or not the claim is made against its immediate seller. The manufacturer has the opportunity to prove that the buyer was not aware of the advertising, or that the buyer did not believe the advertising (cigarette case). This is a very controversial area and still remains to be passed on by legislators. Consumers want it, manufacturers do not.

QUANTITY GAP FILLERS/OUTPUT AND REQUIREMENT CONTRACTS

Summers:

I'd like to go over three or four possible drafting ideas arising out of a comparison of your draft article and the UCC as it was generally adopted. Now, you have in your draft Article 11 of which we have a translation here. It says the quantity of goods shall be defined in the contract in units of measurement. This section, as I read it, does not explicitly include any provisions which purport to provide a quantity gap filler. Now, the UCC also does not have a general provision which purports to state just what the quantity will be in the absence of contract stipulation. However, there are three provisions which I should call your attention to. One of which is quite important and does function similarly to a gap filler. The section I have in mind is 2-306, and that section is addressed mainly to what we call output and requirements contracts. Before the UCC, many states took the position that contracts which measured quantity by the output of the seller or by the requirements of the buyer were too indefinite to be valid.

Avilov:

They were valid.

White:

No, invalid.

Summers:

Yes, invalid because they were so indefinite. This was thought to be very unsatisfactory because these are very common kinds of contracts in our economy and in many Western economies. Here is an example of an output contract: Suppose the buyer wishes to buy all of the seller's output of flour for making bread. The contract might only say that the buyer and seller agree that the seller will provide all of his output of flour to the buyer. Now, today, that is called an output contract.

An example of a requirements contract would be as follows: The seller agrees to supply all of the buyer's requirements for oil to be used in the buyer's electricity generating plant. Karl Lewellyn and others who worked with him concluded that it was very important to put these agreements on a good legal foundation. So they did a number of things. One of the things that they did was draft a general provision, 2-204, which makes it clear that the kind of indefiniteness inherent in an output contract and in a requirement contract does not constitute the kind of indefiniteness that makes contracts invalid. And in 2-204(3), we have the general principle, and perhaps Professor Avilov or Professor Komarov could read this in Russian. Even though one or more terms are left open, a contract for sale does not fail for indefiniteness if the parties intended to make a contract and there is a reasonably certain basis for giving an appropriate remedy.

If you apply that to an output contract or to a requirement contract, you can easily see that in a sense, they are both contracts which leave quantity indefinite to a certain degree. Output just says output; requirements just say requirements. They do not say how many units in the language of Article 11-1. Yet, Lewellyn intended that the output and requirement contracts be valid and their validity is consistent with 2-204(3) because these parties have clearly intended to make a contract and, secondly, there is a reasonably certain basis for a remedy. If, for example, the seller does not provide all of the buyer's requirements, then to the extent of the shortfall, the buyer is entitled to damages in the amount of the difference between the contract and the market price. So there is a reasonably certain basis for remedy, no doubt about that. Lewellyn wanted to put these functionally very important kinds of contracts on a firm legal foundation. And the first thing that he did was draft 2-204(3). Now, Professor Lewellyn was not only interested in the problem of validity, but he was also very much aware, because he was a good legal historian, of what historically had been a major source of difficulty. Namely, the abuse of these agreements, especially in the agreements having a fixed price, and the market shifts. Here's an example of a common pattern of abuse. Let's take my example of the requirements contract buyer who is buying at a fixed price the oil for his generating plant, he

is buying 200,000 units a year and has been buying between 185,000 to 210,000 for the preceding three years, the market price has been fairly stable, and the contract price set at the beginning has been fairly close to the market price. The market price goes quite high, so what does our buyer do, he says I will now become a broker and will start selling this oil to third parties, demanding 400,000 units of oil. He just can't resist the urge to make a great big profit. Lewellyn knew this and he knew that this was one reason these contracts weren't regarded as valid at all in a number of states since they were susceptible to such abuse. So he drafted 2-306. I will read it and then we will discuss it after Professor Avilov has translated it. A term which measures the quantity by the output of the seller or the requirements of the buyer means such actual or requirements as may occur in good faith except that no quantity unreasonably disproportionate to any stated estimate or to the absence of the stated estimate to any normal or otherwise comparable prior output or requirements may be tendered or demanded. Now in the official comments to 2-306(10), Lewellyn tells us how he would approach the solution to my example where the buyer is trying to take advantage of the seller. The language appears as follows: A sudden expansion of the plant by which requirements are to be measured would not even be included within the scope of the contract as made by a normal expansion undertaken in good faith would be within the scope of this section.

One of the factors in an expansion situation would be whether the market price had risen greatly in a case in which the requirements contract contained a fixed price. Now we still need to draw a very important distinction between requirements and output contracts on the one hand and other contracts regarding quantity on the other hand. This is an important distinction. Let's look now at 2-201. This is what we call a statute of frauds in our system. It says in the last sentence of subsection 1 that a writing is not insufficient because it omits or incorrectly states a term agreed upon but the contract is not enforceable beyond the quantity of goods showed in such writing. So if the price is above five hundred dollars and the quantity of the goods is not shown in the writing, under our law the promise is not enforceable. The promise is generally not enforceable. There are some qualifications. But before we get to those, let's ask, does that apply to this? The answer is no. The word quantity here has been interpreted to be satisfied by the use of outputs or requirements language.

Our law follows through Lewellyn's draft consistently with 2-201, 2-204, and 2-306. And the idea is that although there is indefiniteness, this indefiniteness is not fatal under 2-201 and is not fatal under 2-204 in regard to output and requirements contracts given their inherent nature. The fact remains that in regard to other types of contract, not requirements and output contracts, that without such specification of quantity under 2-201, these are invalid unless the case falls within the exceptions within 2-201.

Now, before we turn to price, perhaps we could have questions that Professor White and I might attempt to answer.

Zvekov:

Can you have an output or supply contract with a consumer?

Summers:

I've not seen any case that looks like that. Normally, what's involved in requirements and output contracts is the provision of more or less fungible goods as distinguished from the provision or supply of roofing material or concrete material for basements or linoleum for a kitchen. Maybe, you have something to add to that, Jim.

White:

No, I've never seen an output or supply contract with a consumer.

Avilov:

An individual makes a contract with a coal supplier that the supplier will supply a certain quantity of coal.

Summers:

Again, I think the language here is broad enough, but our courts have not so broadly conceptualized these kind of consumer arrangements as output or requirement agreements.

White:

But they could. I suspect that there are some contracts that consumers have with fuel oil suppliers that might have this quality. They are usually informal contracts and are rarely sued upon since they are for modest amounts.

Summers:

And 2-306 is not confined just to merchants, but both of us are quite clear that the other type of case involves a variety of provisions concerning what goes into a house is entirely outside of 2-306(1).

Zvekov:

We have a question which is perhaps a bit outside our discussion, but it is important to us. To what extent are output and requirement contracts binding on the other party? Is the seller obliged to sell all his products to the buyer or can the buyer find some other seller? It is very difficult for us.

Summers:

Very good question. The general requirement becomes applicable here not because of a specific provision, but because of 1-103 (General principles of law). What we have required is that the

relationship be exclusive. However, it can be qualified. The general principle is that, for example, in a requirements contract, the buyer must agree to buy exclusively from the seller. Many cases state that it is important to focus on the general requirement of consideration. Many cases hold the same from the other perspective in regard to output. The qualification is that it is enough if the buyer agrees to buy a certain minimum exclusively from the seller and the seller agrees to provide a certain maximum exclusively to the buyer in the output contract. That would satisfy the requirement for consideration and that requirement must be met.

White:

Most of them are exclusive, would be construed to be so and would require the output to be sold to that person and that he take the output. Neither is free.

Avilov:

Is the problem addressed in your code?

Summers:

No, it is not. And if I were redrafting our code, I would give consideration to stating it all together as part of the validity requirements. I would probably add something in 2-204 about this. This is a very good question that you've asked. A very good question. An excellent question.

White:

Subsection 2 is aimed at a slightly different problem: I agree to buy all my requirements from you, but all of a sudden I don't have any requirements, the price is too high all of a sudden.

Dozortzev:

If you have a gap in a contract, if there is no term dealing with quantity in a contract that is not an output, or how do you say it, a requirements contract, can the gap be filled?

Summers:

2-201 is what you need to look at. If the contract is lacking a term of quantity, then the contract is not enforceable.

White:

Quality can be left out, but not quantity.

Summers:

Except for certain exceptions, the contract is unenforceable if no term of quantity is mentioned, except as to output and requirements contract for which you do not need a specific quantity.

White:

But 2-201 is going to be withdrawn from the new revision. 2-201 deals with the sale of goods. The current version is going to be withdrawn.

Summers:

I've made copies of this draft revision, but it is only a revision. The final version has yet to be prepared. You know there is much to be said for form and formality in the law.

White:

The U.S. still retains a great deal of law that is no longer in use in England. I remember the story about an Englishman who came to a law class and said that it gave him great joy to come to America and study outdated English law.

Dozortzev:

When another party in an unenforceable contract performs its obligations, is the performing party allowed to regain what it had given?

Summers:

Yes, this is covered by the doctrine of unjust enrichment. 1-103 covers the general principles of law and equity. This is applicable widely throughout contract law.

White:

Yes, and this principle will also be enforced in oral contracts.

Summers:

Now, if you will look at 2-201. There are three exceptions to 2-201. Look at 2-201(c). There should be a fourth. *Expression Unio Alteris* does not apply here. However, it should apply. It should be the fourth exception to 2-201.

White:

The fourth exception should be as follows. If the other party has acted in reliance on an oral

promise, then the oral promise should be enforced, despite 2-201.

Summers:

One half of the states now accept this through the development of case law.

Avilov:

Under Soviet law which concerned the qauntity in a contract of sale, we had two types: definite contracts and definable contracts. Both are concerned with the quantity and whether the gap can be filled. I believe your example concerned definite contracts.

White:

The output and requirement portion is the gap filler. For example, consider a contract for the sale of natural gas that escalates over a 20 year time period along with the expansion of the gross domestic product (GDP). The quantity is definable and there is no gap in the formula. 2-306 is really different from 2-304.

Summers:

Well yes, there's a difference, but it is only a difference of degree. This lack of specificity, this degree of gap will not prevent the contract from being valid as to quantity. The difference between a complete gap and one that is bridgeable is a question of degree. If you have an open price, well, there are many variations when it comes to open prices. The price could be completely open or perhaps there could be a procedure to agree on a price or some criterion to help determine the price of the contract. Again, it is a wide spectrum depending on what is actually in the contract.

Avilov:

Is it possible to place a provision in a contract that the price will be determined by a third party at a later date?

Summers:

2-204 would mean that this sort of contract would be open for indefiniteness, but that it would probably by upheld.

White:

I agree.

Summers:

There are two other gaps concerning price and risk of loss. 2-305 deals with price and is very important. 2-509, however, is much more important. I will deal with 2-305 for a bit, then deal with 2-509 in greater detail depending on your questions. Please translate this and I will then move on. Do you agree, Jim?

White:

Yes.

Summers:

I do not see in your draft any provision which is closely similar to our 2-305 Lewellyn provision on open prices. You will see that it envisions a wide range of open and closed prices. You will notice that it is unmistakable that a contract is not invalid simply because it fails to include a specific price.

The example that I am going to give is illustrative of a wide range of circumstances when the price is left open. Agricultural contracts often involve many small farmers entering into agreements with one large canner. First, the buyers say that they will take all of the output of the seller, then the buyer refuses to take any. Thus, we have a lawsuit. For that, we would look to 2-305 and 2-204. Under 2-305(1), the parties, if they so intend, can include a provision in the contract whereby the price is not included. In the example that I've given, where the parties intended to have a contract, this is a very serious matter. 2-305 says that the price to be enforced is the price at "the time of delivery" if (1) nothing is said; (2) the parties failed to agree; and (3) the price is to be set by a third party according to a reasonable market demand formula. Now, in this example I have given, the farmer sued the canner for breach of contract. The defendant said that no contract existed since they never agreed on a price. The court held that there was no price in the contract, but that the court was going to read a reasonable market price into the contract -- the difference between what the farmer sold the goods for to a third party and the market price at the time the transaction was to take place. No consequential damages were received. In many other cases, a judge might say that there is a contract here and though the contract does not state a price, the past course of dealing that the parties engaged in shows that they usually determined the price to be set by an agency of the federal government. Past dealings can be used to fill the gap. Do you have any other questions?

I will say just a little about the risk of loss. Goods may explode, burn or spoil. Who has the risk of loss? Typically our agreements say nothing about this. In our law, 2-509 is the basic point of departure. 2-509 provides for a risk of loss in absence of a breach. It is very different from your Article 6. Now, whether ours is better or worse, frankly I don't know. But, in any case, I want to explain the theory behind 2-509. Under your draft Article 6, the risk of loss generally jumps to the buyer when the contract is made. The general approach of 2-509 beginning with subsection 3 is that the risk of loss does not jump to the buyer at the time the contract was made, instead it jumps to the buyer only when the buyer receives the goods. I do not judge one as better or worse than the other. I just want to explain Lewellyn's theory for

keeping the risk on the seller until the buyer gets the goods.

The general principle which we operate under is that **Risk Follows Possession.** Why? If Karl Lewellyn were sitting here and he often came here to Cornell for the New York Law Revision Commission, he would say that we do so for two reasons:

> (1) the Possessor is the party more likely to have an insurance policy that covers the goods; and
> (2) the Possessor is in control of the goods and is in a position to protect them. So he will have incentive to protect them.

Posner and others have added another reason to Lewellyn's. Posner looks at how the law can maximize wealth. He says that the Possessor is also the one to whose goods are subject to risk and thus, he can bargain for a lower price from the insurance companies. A most complicated situation would occur when the goods are in the hands of a supplier. Look at 2-503, 2-504 and 2-509. You should differentiate between a shipment contract and a destination contract. In a shipment contract, the seller passes the risk over to the buyer when he gives the goods to the shipper unless it is otherwise stated in the contract. In a destination contract, on the other hand, the risk of loss does not pass to the buyer until the goods are tendered to the buyer. Thus, the seller retains the risk until the buyer actually receives the goods. This is covered by 2-509(b). Also, very often, the concept of shipment and destination does not apply when there is no third party transporter. Then the general law applies that risk of loss follows possession.

AMERICAN LEASING LAW

Summers:

First, I'd like to introduce to you Professor Alexander. I'd like to thank Professor Alexander for cooperating with us on such short notice. Professor Alexander received his B.A. in 1970 from the University of Illinois, Urbana-Champaign. He then received his J.D. in 1973 from Northwestern University. He did graduate study in philosophy at the University of Chicago. He clerked for Judge George Edwards, 6th Circuit Court of Appeals. He was a Bigelow Fellow at the University of Chicago. Prior to coming to Cornell, he taught at the University of Georgia, the University of Virginia, the University of Michigan and UCLA. He has contributed substantially to the world of scholarship. He has recently co-authored a new work entitled A Fourth Way: Privatization, Property and the Emergence of New Market Economics.

Professor Alexander:

It is a great privilege and honor. I have to be honest. There are many aspects of American real property law. It is very complex and it is unusual to be an expert in all facets about it. My focus tends to be on inheritance law, trusts and estates, and theories of property. I will be honest about what I don't know which, as you will see, is a great deal. I understand that the

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primary subject that I am to address is Leasing Law, especially for mineral interests, oil and gas leases. Let me structure my remarks in terms of a list of questions I was given concerning American Leasing Law. It's a big list, and we do not have much time. Feel free to ask any questions. Unfortunately, there is no counterpart to the UCC that applies to the leasing of real property in the U.S. The leasing of real property varies from state to state. The law is generally far more complicated in the area of Real Property Leases. Let me begin with what types of property can be leased and what type of restrictions the law places on them. No restrictions are imposed on what sort of property can be leased be it agricultural, mineral, oil & gas, timber, commercial purposes (extraction contracts) and submerged land. There are, however, different durational limits imposed on land by different states. Well, question number one asks what limits are placed on subsurface leases. How much of the subsurface does the surface owner control? To the center of the earth? For air rights, I can sever the air rights and transfer or lease the rights so that someone can develop the area above my land. This is very common in cities. In New York City, the city imposes limits on how high I can build. If I decide to build a building only one half as high as the limit, then I can sell or lease my air space in NYC or other major cities due to the density of urban space. Well, you might ask, do these restrictions in New York City mean that I don't own the air space above my building or that I can't use it? It means that you can use the land, but can't place a permanent structure there. You can have an airplane fly over it. An easement would give you a right to possession or use, but not to ownership. I can exclude others from the space. Here federal law serves as a limit on the states.

In regard to subsurface property, all fixed mineral resources that do not move, I own. For example, I buy a piece of land simply to build a house. I find gold. I bring a geologist to check. It turns out that there is a huge vein of gold under my property. Thus, I own all the gold on my property. If the vein of gold crosses onto my neighbor's property, then he owns the gold on his property. With respect to movable resources such as oil, gas and water, everyone owns the oil. It is not my oil until I take the oil and gain physical possession. The oil is simply part of our common heritage. But anyone who wants to obtain the oil has to get the permission of the surface owner to drill. Since I own the surface over part of the deposit, I can build a well and extract. What I extract, I physically possess. Can I drill onto someone else's land? No, that would be trespass. How much oil can I take? In common law, I could take it all. By state statutory regulation, I am limited to what I can take. In order to prevent the rate of expropriation from being too much, the state will place limits on the rate of expropriation. The state doesn't want a destructive race between the surface owners for the oil beneath the surface. It doesn't want the rate of extraction to exceed the market's capacity to absorb the excess oil. At the same time, I will not be conserving oil which is a depletable resource. We want to maximize the value of oil since it is a depletable resource.

Avilov:

Who determines the rate of extraction?

Alexander:

A federal agency, but the owner can extract without permission as long as his extraction is within reasonable limits.

Makovski:

Can the state force two property owners over one pool of oil to unitize?

Alexander:

Yes. The state can simply limit the number of barrels which may be extracted; it may proportionately divide the oil among the multiple surface owners; or it may unitize with a maximum limit of barrels which may be extracted. This maximum limit is set from time to time by a state regulatory agency. The underlying principle of the concept of unitization is to reduce the number of people who can act individually to take the oil out. This requires surface owners above a single deposit to coordinate their efforts in the extraction. If the surface owners were allowed to take as much as they wanted from the deposit as they were under the common law, then the deposit would be depleted and we would have failed to maximize the value of the oil over time. What is the principle behind the distribution of the levels of extraction, you might ask. One factor is the size of the property and another is the amount of the oil already extracted. If Owner A owns 70% of the land, then he will get more oil than Owner B who has 30% of the land. It doesn't mean, however, that A automatically gets 70% of the oil. The amount taken is proportion to the amount there and to the amount set by the state regulatory agency from time to time. So the amount taken depends on the amount of oil left in the deposit. In Alaska's Prudhoe Bay, the right to take the oil that is below the land is interesting. The Federal Government owns the land, a tremendous amount of land out west and in Alaska. The Federal Government does not itself want to become an oil producer, but it does not want to give the right completely away. Alaska Oil and Exxon bid for a leasehold interest to the rights to drill for oil in the bay, but the leasehold is expressly limited to a certain number of years.

Golubov:

What precisely is the subject matter of such a lease?

Alexander:

The right to take whatever mineral you have negotiated for the right to drill. Here, it is the right to take oil from beneath Prudhoe Bay for whatever period of years. Suppose we have four lease interests in the same pool. But here the auctioned leases will give percentages for each under the terms of the lease. Now let's look at a different topic. Suppose Ithaca decides to build a sewer under my land. Ithaca has the right to do so. It does not get the ownership of my subsurface land. It does, however, get an easement. Permission is required, but usually if the city thinks that there is any possibility in the future that it may put in a sewer, it will put a servitude on this land, thus giving the City the right to use the land below the surface. The city, nevertheless, must pay compensation for use of the land. When the government takes private

land for public use, it does so through the use of eminent domain. The state has the power to take any land, air, or subsurface land as long as it uses the land for a public purpose. Eminent domain is a forced sale, but the government must pay a fair market value for the land. This is embedded in the United States Constitution. Even if the land is 90 feet below the surface and the owner will never use it, the state must still pay. Depth and lack of potential use by the owner do not affect the need for reasonable compensation, but it most certainly will affect the amount of the compensation. The owner retains the right to appeal in court if the amount given is too low. This could be either an easement for 50 years or forever, or the state could say that it is not buying an easement, but the land itself.

Golubov:

What are the rights of the landowner in court?

Alexander:

The owner may challenge not just the amount of compensation, but the legality of the taking itself. He could argue that the taking is not truly for public purposes. The reasonableness, however, is irrelevant. The decision and its rationality is purely for the state to determine. The taking need only be for public policy, not a reasonable public policy. There's another restriction on the state. The state has a police power. This police power allows the state to enact regulations to limit how landowners will use their buildings and land. Zoning is an example of a state's police power. For example, in a residential zone, the state will prevent the construction of a factory. The state does not have to pay for zoning. A decrease in value due to zoning is not compensable, but there is a limit to how far the state can exercise the police power without paying compensation. In South Carolina, off the coast, there are small, fragile barrier islands between the land and the open ocean. Hurricanes always destroy the buildings on these islands. South Carolina made a regulation stating that the owners on these islands were prohibited from putting up any permanent structures. The economic effect of the regulation is to reduce the market value of the land to zero. Even though passed for legitimate public purposes such as health and safety, the state must either pay compensation or rid itself of the regulations. This is a constitutional requirement. There need be no compensation for rezoning, though. A landowner can appeal in court arguing that the zoning was a misuse of the state's police powers. The zoning regulation will be declared invalid, rather than declaring that the zoning was valid and compensation must be paid. If the land is zoned for agricultural or residential or industrial uses, what if the land lays fallow and is not used for the purpose for which it was zoned? There is no public law that requires that you develop your land. There are, however, several sources of private law that may require you to develop it. For example, the law of adverse possession. Or if I buy undeveloped land, and the deed requires that I use the land for residential purposes, then the person who retains the right of reversion can come in and take the land. This is the result of a private agreement, not of public law. In some cities, there is no zoning at all. You can build whatever you want wherever you want. An example of this would be Houston.

Oh, shall I go back to leases? Okay. Leases of land can be for any period of time. But the law

can impose limitations on the duration of these periods. As for agricultural leases, many states limit them from 10-50 years. Generally, it is not possible to have an agricultural lease for 100 years. Oil and gas leases are also limited from as short as 10 years to as long as 99 years in California. Mining leases are treated the same as oil and gas leases in most states. Submerged land leases usually have a 10 year limit. There are limits to leases within a city, usually less than 100 years. Leases of land actually owned by a municipality can range from 20 to 99 years.

Avilov:

In regard to ground leases, is it possible for the lessor to own the land and the lessee to own the building?

Alexander:

You could have an option to review that takes into account the increase in value due to the building. There could be a right of preemption. Theoretically, it could be possible that the owner of the land will force the lessee to move the house, but it is highly unlikely.

Now, I want to discuss agricultural leases. Agricultural leases are very common here. This is an area of considerable complexity. There is a wide variety of types of agricultural leases. In general, there are three types of leases: share leases; cash leases; and standing rent leases. With share leases, there are a number of variations. The first variation was the crop and share system. The basic idea is that the major crops are divided between the landlord and the tenant. The tenant keeps the income from livestock and some of the crops while the rest goes to the landlord. The expenses of the shared crop is then divided between the landlord and the tenant. In stock share leases, the landlord provides the land, permanent improvements and part of the livestock as well as paying for insurance and taxes. The tenant provides for the requirement and repairs. The landlord and tenant share the crops and any increase in the livestock.

Next, we have a cash lease. Here the tenant pays a fixed amount of money rent. The tenant pays and supplies everything like livestock, fertilizer and seed, except the land and the buildings. The landlord pays the taxes and insurance. If the value of the crops and livestock is greater than the amount of the rent, then the landlord does not get the increase in value. If there is a decrease, the tenant still has to pay the same amount of rent. The major difference between a cash lease and a share lease is that they have different methods of allocating risk.

Then we have a standing rent lease. Here the tenant pays no money and no percentage of the crops, but a fixed number of bales of hay, bushels of wheat, or pounds of tobacco. And again, the requirement of rent doesn't change due to the amount of the crop grown. Let's look at the leasing of timber.

Avilov:

Excuse me. Can we first ask a question? The legislation of which state is most sophisticated in regard to the leasing of real estate?

Alexander:

I think that would most likely be California. California has massive amounts of all types of land. It has mountains, beaches, lakes, mines, caverns and huge metropolitan areas. It also has a permanent Law Revision Commission which is considered to be the best by far in the United States. Well, to continue, the rights that the lessee has in timberland are limited in two ways. First, they're limited by public law; next, by the lease agreement itself. First, leases of timberland are privately owned, not by the government. The limitation that public law imposes on how much timber a lessee can take is vague. A lessee cannot commit waste. If a lessee enters upon a parcel of timberland and cuts down all the trees, that is a premier example of waste. Public law sets up very broad parameters. You can take a certain amount, but not so much that it unreasonably diminishes the value of the lessor's land. Public law generally leaves it to the parties to determine the extent of the lessee's rights. The federal government owns a lot of timberland. It sells its lease interest to the timber companies through a federal agency, actually through several federal agencies. It's a big problem getting all the federal agencies to agree with one another since they often have conflicting policies. The United States Forest Service will give to Georgia Pacific a lease to clear-cut a large area of federally owned land. The Interior Department will then find an endangered species right in the middle of the land. Georgia Pacific and the United States Forest Service will then be informed that Georgia Pacific cannot use its lease in the way it intended at the signing of the lease. Major timber companies like Georgia Pacific have found in the past fifteen years that the major problem that they have involves dealings with environmental controversies. They absorb a great deal of time for everyone involved.

Avilov:

What is the right of the lessee in the land itself?

Alexander:

Simply to take the timber, not to use the land. Both in leases from private landowners and the government, the rate of the rent depends on the amount of land, not the number of trees. Typically, the lessee has an estimate of the number.

LEASING/SECURITY AGREEMENTS

White:

Many states have now adopted some version of Article 2A. And not among them is New York

which is either the most important or the second most important commercial state in the U.S. So this is an area in which we have very little experience. When the 1987 version was proposed to California, the Californians opposed a number of sections and refused to adopt it in its proposed form. In consequence, the Uniform drafters agreed to adopt the California proposals and, thus we have the 1990 amendments. A case of Mohammed coming to the mountain, not the other way around. I am not sure how to explain how we view Californians. I am not sure if it would be like the relationship between Georgians and Russians or between Moscow and St. Petersburg. Californians are a different breed.

Translator:

Californians are more independent and different.

White:

Yes. In any case, we now have Article 2A, but as I say, you are at the same level as we are, for while leasing is a widespread business practice here, we have had no uniform law here until very recently. I am going to talk about only two or three different things and then we can take questions. First, I want to talk about the distinction between leases on the one hand and various subsets such as security agreements or financing leases on the other hand. One of the characteristics of American law and American lawyers is that they will take a provision in a statute apparently designed for one thing and apply it to something else or argue that a different part applies to their transaction. And one of the things I have observed about all your drafts is that they presume that there will be agreement about which transactions fit in what areas of the law. Whereas we proceed on the assumption, because of our history, that lawyers will bend the rules to fit their transactions in order to avoid certain prohibitions. So we have an important distinction here between leases and security agreements. There is a section in Article 1-201(37) that defines security agreements and is principally for distinguishing between leases and security agreements. And this section was redrafted as part of the adoption of Article 2A. So there is new language in it.

It is common in American practice for a lender to write a document that is in fact a security agreement and to label it a lease. And they'll do that for various reasons. First, as a way to avoid having to make a public registration. Second, it allows the lessor somewhat greater rights if the lessee/debtor goes into bankruptcy. Third, it may make the debtor/lessee's financial statements look better since it will not show on the financial statement as a debt but only show as a footnote to the financial statement.

Another reason is that there will be restrictions on interest rates that can be charged under state law, but these will not apply to lease payments because the quote "interest payment" will be hidden within the monthly lease payments. So I am not sure that these same problems will arise in your economy, but they have been a continuing source of trouble and litigation in our economy, whether it is a lease or a security agreement.

Let us assume that Aerospatiale is going to sell or lease an airbus to Aeroflot.

Translator:

This transaction would be called a security agreement?

White:

Yes. A sale and a security agreement back or a lease. Let's take that example. Aerospatiale is producing an airbus and let us assume that they are going to sell it to Aeroflot. Presumably they are not going to let the child of the pilot fly it. How are we going to characterize the transaction? As a lease or as a sale and a security agreement back. These two options might have quite different consequences, for example, in terms of what you could do in default. If Aeroflot defaulted, then what it could do under a lease would be quite different from what it could do under a security agreement. So they might draft this document and put the word "Lease" at the top, but as you read through you discover that it has all the qualities of a security agreement. The way 1-201(37) would deal with this is by not looking at the label but at the economic consequences of the underlying transaction.

The principal thing we would look at for this to be a lease is that Aerospatiale must get something back, they must have a reversionary interest, an interest in Aerospatiale getting something back at the end of the lease. They must have an ownership interest. Is there a Russian word for "reversion?" If the lease provided that Aeroflot would lease the plane for ten years and at the end of the ten years, Aeroflot has the right to purchase the airplane for 1000 rubles because the option price is so small, what they've really done is a sale. Despite what the agreement says, we have a security agreement, not a lease. So what 1-201(37) says is that where the lessee has an option to pay for only nominal value, it is to be treated as a security agreement, not a lease. So despite how you label the agreement, it would be dealt with under Article 9, not under Article 2A. This has big consequences in cases of bankruptcy and maybe tax liability.

Another way in which something labelled a lease is considered to be a sale is when the entire economic life is used up by the lease. Assume, for example, that an airbus would last for 30 years. If you sign a 30 year lease for it, that would be treated as a sale and security agreement under our law. So it seems to me interesting whether you need Article 1- 201(37) which is similar to 9-102 which says that transactions which have the economic consequence of one particular form should be treated that way.

Even though some leases are forced into security agreements by 1-201(37), we have the same idea that you have in your draft document about finance agreements, too. For example, let's assume that there was a ten year lease for the aircraft and at the end of this time, Aeroflot had an option to purchase the aircraft but only at the fair market value. The fair market value option would not be regarded as a security agreement, but as a lease. Then we have to determine whether it would be regarded as a financing lease or as a regular lease. And section 1031(g)

of Article 2A, I think it is, defines finance lease.

A finance lease exists if the lessor does not select, manufacture or supply the goods and the lessor acquires the right to use the goods through the lease. If Aerospatiale went to Citibank and they would sell the aircraft to Citibank who would lease it to Aeroflot, then this would be a finance lease. And it would be assumed that there would be negotiations directly between the lessee, Aeroflot, and the seller/manufacturer, Aerospatiale. And Aeroflot would give Aerospatiale its requirements for seating, electronics, engines and so on. Then, of course, the terms of the lease would say to Citibank, "you don't have responsibility for complaints about the aircraft." If Aeroflot has complaints concerning quality, then they must go to Aerospatiale, not Citibank.

I believe your draft code is the same. The only question I have about your code is whether you need a provision like 2(A) 1031(g) to distinguish between finance leases and other leases. We have also cut consumer leases out of the treatment as a financing lease. The way we have defined consumer leases is by establishing a dollar limit. If the total payments under a lease are under a certain number, then they are regarded as a consumer lease, not as a financial lease, so that certain terms in a regular financing lease could not be included in a consumer lease. Now let met talk about a **Hell or High Water clause.** Do you have this concept? No matter what happens, come hell or high water, you must do this. Section 2(A) 407 authorizes hell or high water clauses in finance leases.

Now the significance of this is the following. Citibank has a lease for 20 million in payments between the two of them. Let us assume, because of a computer failure in the aircraft, it crashes. Aerospatiale was at fault. The Hell or High Water clause says that Aeroflot must continue to pay Citibank for the plane. Essentially, what we have done is split the liability in two. We have said, if you want to go recover from Aerospatiale for breach of contract since they have a warranty which runs to you at Aeroflot, fine. However, you can't stop paying Citibank. You can't assert your defense against Aerospatiale against Citibank as well. That's the main meaning of 2(A) 407. And the warranty provision means that Aeroflot must get warranties from Aerospatiale even though it doesn't have a contract with Aerospatiale. And let me see if I can identify the warranty provision that says that, and then we can talk about your draft of the finance leases. Look at section 2(A) 212. It says that except in a finance lease, a warranty of the goods is implied in the finance contract.

I assume that in a commercially contracted finance lease, there is no warranty from the lessor to the lessee, is that your intention?

Avilov:

Yes.

White:

And Chapter 33 does not say that there is not, it simply does not deal with it one way or the other. There is no reference to that. And presumably you could disclaim them although there might be an argument. That, of course, is one of the reasons why you want to keep people from claiming that their leases are finance leases when they are not because it is a way of avoiding warranty liability if you are a lessor. For example, is it common now to lease automobiles in Russia.

Avilov:

No, this is only now just beginning in Russia.

White:

That is an area where you would want to say that the lessor could not get rid of his liability. The lessor should have liability to his consumer lessee.

Makovski:

Can purchasing contracts exclude the effect of article 4-107 which says that the promise becomes revocable upon the failure to accept the goods?

White:

Yes, the promise would become revocable, but they won't revoke. That is because in this situation, the clause is for the benefit of the lessor, since here the lessor is the one in the powerful position. Although, if you have a customer like Aeroflot which is going to buy a lot of airplanes, they are going to have a lot of bargaining power. But I assume then that what would happen is that Citibank would go to Boeing or Aerospatiale and say that you make a contract with them to satisfy their interests in this respect.

Translator:

In our discussions yesterday with Professor Alexander, we came to understand that it was possible to lease a right to something. Does this possibility extend to other transactions outside of real estate? Our draft is based upon the notion that the subject matter of a lease should be a tangible object, a thing.

White:

I suppose, well I don't know the answer to that. You're talking about a lease for something intangible, a trademark or a patent. I've never seen one, but I don't see why you could not have one. In intangibles, you would normally not call it a lease, but a license. Article 2A only applies to leases of goods, not to licenses. But if you wanted to give someone a right to use an intangible, you'd call it a license and you can certainly do that.

Avilov:

Can the term "good," under U.S. law, incorporate only tangible products or can it also include intangible items as well?

White:

Normally, the term "good" is taken to encompass only tangible items. There are, however, borderline situations. For example, software. Is software tangible or intangible? I can have it on a disk, right? So it is tangible. But it also can be transported. We have had trouble with that. For example, in Article 2, we have had cases about whether warranties which only go to goods apply to software sales. The re-draft of Article 2 will deal with these problems, but as of now, those are problems. In general, goods would not include patent, copyright, or something like that, but if it could assume a tangible form such as software on a disk, there are some cases which say that those are goods. Electricity is another example. There are some cases which say that electricity in some settings is a good.

Avilov:

Electricity is a good?

White:

Yes, in some cases, electricity has been considered as a good, but it depends on the context; it is not always considered to be one. Some courts have said that software is a good. Let's assume that I sell you a computer program and that there is an error in the program itself, in the intellect of the person who created it. I would say that there has been no breach of warranty since the defect is in the immaterial portion of the program. Some courts, however, have held differently.

LEASING/SUBLEASING

White:

I have two other points. What are the consequences for terminating a lease for a sublease contract? Do the rights of the sublessor automatically transfer to the lessor? First, you must understand that to the extent that I am going to answer this question will be limited only to movables. In the United States, for reasons of history, the leases of real estate are in the real estate sphere of Professor Alexander. He knows nothing about movable leases and I know nothing about real estate leases.

Summers:

This is known as specialized ignorance.

White:

I am not sure I can answer this question but let met start by looking at 2(A) 305 which will have something to do with it. In general, under 2(A) 305, a sublessee has the right of the lessee. Your question is really, "If the lease is terminated, what are the rights of the sublessee?" And that is . . . I don't know the answer to this. I don't think that Article 2A deals with that; at least, I can't find the provision. Why don't you read 2(A) 305 and that will give you some of the idea.

Okay. The language you ought to emphasize says, "and take subject to the lease contract," and I read that to say that if this lease is cancelled, for example, the lessee does not pay and the lease is cancelled, then the sublease is cancelled as well. So the burden is on the sublessee to ask the lessee what the terms of the contract are. The sublessee also has the burden of ensuring that the lessee remits the sublessee's payments to the lessor because the sublessee can be cut off if the lessee fails to meet the terms of the contract agreed upon between the lessee and the lessor.

Makovski:

Our legal system operates upon a different assumption. Our assumption is based upon the following: In a case where both the sublease and the lease are valid, and if the sublessee did not breach any provisions of the sublease, then his rights are not terminated even if the lease between the original lessor and lessee was terminated. If the original lease, however, was invalid from its beginnings, then the sublease would also be held invalid, since there was not a valid lease to begin with.

White:

Okay, and that presumably means that if the original lease was cancelled, then the sublessee would have to pay the lessor in order to continue to hold the goods.

Translator:

Why would the lessor be entitled to higher rent from the sublessee?

White:

Well, how about the case where the lessor specifically prohibits the lessee from subleasing?

Makovski:

According to our law, it is not allowed unless it is specifically provided for in the lease. But, it can be provided for in the lease terms. So we have a presumption against subleasing unless the lessor and lessee have clearly agreed to allow it.

White:

But the lease can provide it?

Translator:

Yes.

White:

Let me raise two other questions, then we will go on. In our law, there has been an argument about damages in case of a breach of a lease. Let's assume the lessor is leasing to the lessee an airbus for, let's say, twenty years. Let's assume that the lessee hangars the airbus because he has no further use for it. The lessee says to lessor, "I have hangared the airbus at Moscow's airport because I don't need it and am not going to use it anymore." Can the lessor collect all the rent? That is the first possibility. The other possibility is to say that he only gets the difference between rent under the lease and fair market value rental. And it is these different possibilities that have created a big problem in American law concerning which remedy you get. Let's assume that the lease calls for $3000 per month. Let's also assume, because the market is bad, that the FMV would be $2000 per month. Under this theory, the lessor would get $3000 per month multiplied by the number of months left in the contract, but reduced to present value. In an inflationary economy, you better know about present value.

Let's assume that I owe you a million dollars five years from now. And you sue me to get a judgment today since I breached the contract. If I am supposed to pay you one million dollars today, then that would be unfair because then you could take the one million dollars now and invest it today. Thus, over the next five years, you could end up with considerably more than $1,000,000. So under American law, we would award you much less than a million under the theory that you could take and invest the money. Article 2A recognizes that idea and these numbers would be reduced to present value, but the difference here is whether you collect $3000 multiplied by the number of months remaining on the contract reduced to present value or if you collect only the difference between $3000 and $2000 multiplied by the number of months. If you use the second formula, it means that the lessor must go to Moscow airport and lease the airbus. It really is the question of who has the burden of releasing the airplane and mitigating damages.

Makovski:

In the first situation, does that mean that the lessee can do whatever he wants with the airplane?

White:

Yes, it does. But I'm assuming that the lessee's business has gone bad and he has no need for the airplane. It's really a question of upon whom does the burden rests. Now, let me answer some of the questions you've given me and then we will finish up.

Avilov:

One more question concerning this point. Does the lessee have an option to renew?

White:

No, not unless it is in the lease. Question #1 was answered yesterday by Professor Alexander since it concerned real property. Can forest, water, and mineral rights be leased? Yes. Does the law prescribe certain types of leases? Generally not. For example, things that that could not be leased would be liquor licenses or an authorization of an airline to operate since the authorization would be based on that specific airline's safety record. The law does not stipulate maximum terms for leases. We've already answered questions 3, 4, and 5. I don't understand question 6. What is it supposed to mean?

Translator:

This question has already been answered.

White:

Oh, okay. With respect to question 7, regarding existing law for residential and commercial real estate, what provisions are there for reviewing lease rates? There are so-called rent controls in some cities such as New York. The rent may not be raised without authority of a rental board. These are the exceptions and the normal rule is that when the lease ends, any rate may be established between the parties.

Avilov:

There is no way that the rent can be increased or changed before the term of the lease is over?

White:

No, not normally, unless there is a term in the agreement allowing for this. And in the rent controls in NYC, our children will go there in order to understand what the system was like under the Soviets. The last outpost of common ownership.

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Minutes

From Workshop on Issues of Commercial Law

In the Russian Civil Code:

Sales and Banking Law

with

Professors Summers & White and

The Russian Civil Code Drafting Commission

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THE IRIS-RUSSIA PROJECT

MINUTES FROM MOSCOW CIVIL CODE WORKSHOP WITH PROFESSORS SUMMERS AND WHITE

INTRODUCTION

Makovsky:

First, I want to thank Prof. Summers and White for coming here. It is good to have his wife and daughter here with us and I hope that they have been enjoying themselves. This has been a very difficult and intense time for us. The first draft of the revisions has passed its reading in the Duma. This has been a very, very busy time and you must forgive us if some of our participants have to get up and leave during the meetings. Prof. Sukhanov, Prof. Komarov, Prof. Khokhlov, Prof. Dorzortsev, Dr. Gorbounov, Prof. Vitryansky, Dr. Goloubov and Prof. Zvekov, you already know I would also like to introduce Dr. Kozir' and Cilia Vladimirovna Aviina. First, let's change our opinions on the order and then begin working.

The first question concerns the liability of managers, directors and other officials of companies and their liabilities for the creditors of the company for the debt which they have incurred. The second question concerns the execution of the contract in the context of changed circumstances. The third question focuses on the means of the state. Dr. Goloubov also has some questions and maybe my colleagues will have some questions to discuss. Does any one have any further suggestions? Today we will discuss the sale of goods. Tomorrow sales and banking. Thursday, morning electronic transactions. Thursday after lunch we will discuss questions concerning the first part of the civil code. After our return from Ithaca, we continued our work on the sale of goods and we already have many questions on this. Most of these questions have been put forward by Prof. Komarov to Prof. Summers.

SALE OF GOODS: WARRANTIES

Summers:

Hello, first I want to say what a pleasure it is to be working with you on this scientific project. Prof. Komarov says that a matter of great interest is for how long does this responsibility for the quality of goods last after the goods have been delivered to the buyers? As I read your draft, Art. 15 on the lifetime of the goods is your section that deals with this and it is Art. 16 (2) in which it is provided that if the warranty period is not otherwise stipulated by the contract, the lifetime will be calculated on the date of the goods manufacture certifying the quality of the goods or by other means so certifying. Now, we have in the UCC no section which purports conceptually to address the general question of how long the warranty lasts. The issue is not framed in those terms. The issue is framed in terms of statutes of limitations. And there are basically two main things about this statute of limitations in 2-275. First, a general rule that says that an action for any breach of contract for sale must occur within four years after the cause of action accrues and the cause of action accrues when the breach occurs and the breach occurs at the time of delivery. In the ordinary, standard case, you would normally have a four year period after the delivery of the goods to bring a lawsuit concerning the discrepancy between the legally required quality of the goods as we would find in a gap-filler and the actual quality of the goods. Thus, generally there is a four year period after the delivery of the goods to bring a lawsuit. This is the approach of the UCC. There is an exception to this which I will discuss after the translation.

Makovsky:
First of all maybe we could clarify a point and address those situations in which there are no contractual warranties.

Summers:
Assuming an implied warranty of merchantability. That the goods are suitable for ordinary purchasers. Again, the rule would be that breach occurs at the time of delivery.

White:
Those of you who are smokers will be happy to know that two large class actions have been filed in the US within the last month. I think the class is limited to US citizens so you might not be able to join. The actions claim that the sellers of cigarettes breached the implied warranties of merchantability and the actual warranties as well. And when you have someone who has smoked for 20 or 40 years, the timing difficulties become very interesting as to when delivery occurred and as to when to bring the law suit.

Summers:
Perhaps a very simple, perhaps too simple, way of analyzing this problem is to say that the breach occurred with the first cigarette. But surely one cigarette would not be enough to cause the ultimate harm. So do you get four years from the first cigarette or four years from the final cigarette that triggered the illness? These questions are not settled.

Komarov:
A very interesting question. The moment of breach in the UCC is the moment of delivery Here we have the fiction that the moment of delivery is the moment of tender. We need to have explained why this is moment when the breach is said to have occurred. Why in the UCC is the time when warranty is considered to be broken is at the moment of delivery instead of using our approach?

Summers:
That's the buyer's first opportunity to inspect the goods and determine nonconformity.

White:
What is the time under the current draft of your civil code?

Komarov:
It is not so clear so cut and dried, yes, as your approach?

Summers:
The approach of the code in Art. 16 is this: That the lifetime is to be calculated effective on the date of manufacture of the goods. This raises the question of who calculates and how is it to be calculated. We avoid this by simply saying the breach occurs at the moment of tender. Thus, we indirectly avoid this problem.

White:
May I ask a question about Art. 16. Would liability for personal injury arising out of the use of goods come under this or under some other law?

Makovsky:
This liability arises from, is regulated by, the tort rules in the civil code, by the protection of consumer rights.

Summers:
I think we now see the differences in our two approaches. In order to understand our thinking, we should try to understand why this draft imagines the calculation of a specific time period. Can you give something to help explain this point? It is an extremely important question. I agree with Prof. Komarov when he wrote that this is vital, but we should try to get the reasons behind the differing approaches.

Komarov:
I will try to explain. Our approach is based on the approach that there are two different things. If you sell something, you have an implied warranty. In our terms, there is not an implied warranty, you have to look to the code itself. On top of that, they should be durable and should be capable of use within their period. You buy shoes, you can use them not only the next day, but for the next two years? Are the sellers liable for the defects for the shoes which you discover only after two years?

White:
First of all on the question whether this is a warranty of duration. Our warranty of merchantability covers this. Thus if after one month you discover that the shoes are defective, then you the moment of accrual begins at the moment of delivery. Under Art. 2, there are two limitations: (1) there is the four year period as Bob mentioned that after which you can no longer sue; and (2) 2-607 where a tender has been accepted the buyer must within a reasonable time the buyer must notify the seller of the defect. If I buy the shoes and the laces break the next day and I don't notify the seller for two years then I am at fault for not notifying the seller. A better example would be a commercial one concerning steel. If I discover that the steel is weak or defective, I can't wait for several years before notifying you.

Summers:
There is this general point that is like our merchantability concept. The argument can be made that if you fold this concept into that concept then you avoid any problems like having to calculate the lifetime of the product. This is in Art. 13-2 we look at the purposes for which goods are commonly used.

White:
A second point about the limitation. 2-725 is that it specifically allows you to shorten the period for one year. If I am selling parts to you and find a defect within one year, no matter what, then I shouldn't be held liable. If you can't find a problem with the locomotive within one year, then tough, that's your problem.

Makovsky:
Is it possible to ask a question? 2-725(2) holds what implications in the shoe hypo? I buy shoes and put them in my closet for 3-4 years and then when I try them on, they break. When does the statute of limitations begin?

White:
That section of 2-725 does not apply here. A case where an express warranty given for future performance is dealt with elsewhere.

Summers:
These shoes will last for ten years.

White:
A very limited number of cases on this topic here. For example, you buy a heater in the summer but will not use it until the winter. The courts have had a great deal of trouble interpreting this. But there are very few cases on this, very few.

Makovsky:
This provision concerns only contractual warranties. So it is an explicit warranty of duration.

Summers:
Otherwise a duration is either a party of a warranty of merchantability or it is folded into the warranty of merchantability or it is again implied and 2-725 general rule will apply only upon delivery and that's the basic approach. An argument could be made that this could be simplified by putting in a definite time period here It could be simplified.

Makovsky:
Is it true in cases where there are no specific contractual warranties that it doesn't matter that a buyer had no opportunities to discover defects?

Summers:
That's true and you could argue that it is unfair. But you can see that if the buyer doesn't discover anything in four years, then the seller could be placed in a difficult position. It goes both ways. It is a compromise between conflicting interests and it could be decided a little bit differently. But I think that question is intended from the question of whether there should be a warranty of merchantability.

Khokhlov:
Art. 275 applied only to commercial parties or it is also applied to consumers?

Summers:
It is applied to both.

White:
Yes but that actions would accrue at different times. The consumers would begin from the time when the consumers . . .

Blumenfeld:
Jim, can you have a situation where the consumer can recover from the retailer within the four years, but the retailer cannot recover since his purchase occurred more than four years?

White:
Yes, but I want to emphasize that these sort of things are extremely rare in our experience Usually a defect can be discovered within four years. Almost always it will be discovered. The only type of case that gives problems would be in the case of drugs which have side effects which are long delayed. For example, birth control drugs or nausea control drugs which women taken during pregnancy. Often, the effects of these drugs will only be seen in their offspring, several years after the woman has taken the drugs.

Makovsky:
If a contract is made between two parties who are not commercial parties, does this still apply?

White:
First, there is no implied warranty if the seller is not a merchant and that is a big difference. To the extent that the contract between the two parties had an express warranty, then there is liability If there is no express warranty, then there is no liability.

Summers:
If I were redrafting now, I would make a change. Suppose a seller sells a furnace to a buyer. It works pretty well the first winter. It works pretty well, but not perfectly the second winter. The third winter, it breaks down a little. The seller sends his repairman and says "We will make it work." The fourth winter it really breaks down and they come again to repair it. The repairman again says, " We will make it work. It will be OK." You all as lawyers know how this hypothetical will end. The fifth winter it completely breaks down and the buyer, in this case me, wants to sue and knows about 2-275. It is now in the fifth year and this has now technically run its course. There is the question now of whether there is a judicial exception for promissory estoppel here because they have said "We will make it work." Under promissory estoppel notions, we should be able to get an extension of time but this varies form state to state. If I were rewriting the statute then I would explicitly put in that an extension will be granted in cases where the buyers justifiably relies on the seller's false promises.

White:
Some sections of Art. 16, in effect, cover that.

Summers:
The problem is an important one with respect to large durable goods. Especially for consumers who buy furnaces and other large durable goods. Some parts of Art. 16 seem to cover this, but I am not sure that it was drafted with this sort of case explicitly in mind.

SALE OF GOODS: TIMELY NOTICE AND DISCOVERY OF DEFECT

White:
There is a federal warranty law which overrides state law It is the Magnuson-Moss Warranty-Federal Trade Commission Act. In the case of consumers, it puts some disclaimers on purchase of goods.

Summers:
In our law, the UCC has provisions which do require 2 quite different things: timely notice, and particularization of defect (depending on type of remedy sought). In 2-607, timeliness requires that buyer must notify the seller of a breach within reasonable time after finding the breach. Cases show that general notice is all that is necessary. This is a very common situation -- something wrong with goods but buyer will keep them and repair then repair himself. In order to get damages, the buyer must notify the seller of the breach. There are three basic policies that US law seeks to implement:

(1) Facilitating discussion of the problem.
(2) Preparation for litigation -- opportunity to investigate.
(3) Similar to a statute of limitations -- it is called repose.

These are the three policies. Is it wise to set up time limits for notice of defects? Yes, and in my opinion these are policies are worthy of consideration. There is ambiguity in the timeliness requirement in the draft Code, but that may just be because of the translation.

Dozortsev:
Is the notification necessary?

Summers:
It is necessary. It is an element of the claim. If notice isn't given, then the claim fails. It is because of the three policies.

White:
I have a question on the draft Code? How does Art. 27 (4) coincide with 27 (1)?

Summers:
That is where the ambiguity is. [He reads the two subsections].

Khokhlov:
This is the core of the problem, because in Russian law, there are two types of terms. First, the duration of the period of discovery of defect. Second, the duration for notification, which runs from discovery of the defect, not the delivery of the goods.

Makovsky:
This question is connected to the purposes behind this rule. [Hypothetical posed]

Summers:
Some cases state that filing a claim is not sufficient notice because it defeats the policy of settlement. But I have a question about the 6 month time period.

Avilov:
If today is the last day for notification and I a notice defect, can I fax a letter to the manufacturer and file a claim at same time?

Summers:
Some courts in US may say that in these rare circumstances, then filing complaint is sufficient.

Khokhlov:
This is an extreme example. [further questioning]

Summers:
The cases are not uniform, but many say that filing a law suit is not sufficient notice because it defeats the policy of settlement.

Avilov:
After notification of the seller, can you then go to court? There is no time period for the seller to respond?

Summers:
There is no official time period in the UCC, but I could see many courts frowning on attempts to circumvent an opportunity for non-judicial settlement. Now about the 6 month period in Section 21 (7) -- [quotes section]. Suppose there a case where goods are perishable and the buyer does not notify until towards the end of the period (value lost). Does the buyer have responsibility of any of the deterioration? The issue is raised here and you may want to consider this issue further. It would be interesting to here your reactions to this.

Khokhlov:
Do you understand this "identification of defects" as "discovery of defects." Misunderstanding is due to the translation.

Summers:
[repeats hypothetical re: perishable goods] Does this section address this issue?

Khokhlov:
[requests clarification of question]

Summers:
Is damage less because goods could have been refrigerated by buyer?

Khokhlov:
But 6 months is just for discovery of defect.

Summers:
I just put this to you for consideration. I now want to discuss particularization of notice. Language so far has read "notify the seller." But, if the buyer wants to reject the goods, under the UCC, the buyer is precluded from relying on the unstated defect if it could have been cured seasonably if notice was given. [2-605] This is similar to your Art. 21 (4).

Khokhlov:
I want to turn your attention to the draft where there is a 2 step mechanism: a time period for discovery of defect, and time period for notification. You, in your law have only 1 period for both. My question is, in our system, when you have first time period, is second period necessary?

Summers:
It strikes me as a rational approach to have both time periods. The UCC is not a Bible that has to be followed exactly by you--it is not necessarily perfect. Now, 2-605 requires that the defect be stated, and if not, it cannot be relied upon later to establish breach or justify rejection. I am wondering if you want to address these aspects in your Art. 21 (4)? It is just a question that I pose. It is an issue of not mentioning a defect. We have a large number of cases decided on this point. It is important in our system. This is why I raise it. You need not necessarily address it. It is just a question I pose. Jim wants to add something here.

White:
One thing that may not be clear from what was said, we have 2-605 notice, the higher level of notice [the case of rejection] which is different from notice required when buyer keeps the defective goods.

Summers:
There is an additional point to be made here. 2-605 says that in conjunction to an attempt to reject, defect that is not noticed but should have reasonably been noticed, you can not reject on those grounds nor does the defect establish grounds for a breach. This may be too strong. You may want to consider this fact. It is a branch of the law of waivers. You can say failure to particularize defect is waiver of right to reject based on that defect. This is what American law does.

White:
One other point is that both of our notice requirements apply to those who discover AND those who reasonably should have discovered. Now the draft appears to apply only to those who do discover.

Summers:
That is a major feature of my perishable goods hypothetical case. Now there is a third notice requirement. [recap of 2 forms of notice already discussed -- acceptance does not require particularization of defect. rejection does] This third form is in 2-608. Revocation of Acceptance. The buyer may change his mind after acceptance. Acceptance carries liability for price minus any offsetting damages. But 2-608(2) says revocation of acceptance is not effective until seller is made aware of revocation by buyer.

Avilov:
[question asked]

Summers:
UCC has general responsibility that buyer may reject goods if the goods are defective in any manner. But there are exceptions to this. In regard to minor defects, we would look to see if these exceptions apply. 2-601: Perfect Tender. 2-504 deals with delay. Another exception appears in 2-608, which requires a significant impairment. It is a goods remedy. Another exception for installment contracts -- requirement of substantial impairment. But the exception that I love is the exception for bad faith.

White:
If you cannot define good faith, you are in the same situation as all American lawyers, except Bob. [Laughter]

Khokhlov:
[asked for clarification of bad faith]

Summers:
Rejection of the buyer is in bad faith -- this is what I mean.

Khokhlov:
[asked a question]

Summers:
2-601 says any defect allows for rejection. Therefore substantial impairment is not always needed. In your draft, you require "significant" impairment. This is not something that worlds fall apart over. Either side is a reasonable basis for a legal system. There is a deep question here about which way to go.

Avilov:
Is substantial impairment based on a list of impairments, or is it based on the material quality of goods?

Summers:
There is no materiality requirement. There are several grounds for rejection [grounds reiterated]. This is the way US law works. I think we should look at 2-106.

Avilov:
Can the remedies be modified by the parties?

Summers:
Yes, the parties can often modify requirements. Now, 2-106 [read again] covers all forms of breach.

Khokhlov:
Do these provisions apply to consumers?

White:
Yes. In fact, the consumers requested that the Perfect Tender Rule be kept.

Summer:
You have not heard Prof. White's definition of consumer's remorse.

White:
Consumer's remorse is when a consumer finds an identical product at a lower price.

BREAK FOR LUNCH

SALE OF GOODS: WARRANTIES AND IMPROPER TENDER

Summers:
One thing that we were discussing at the very end of the hour yesterday remains of interest. It was one thing that Prof. Llewellyn and Prof. Menschikoff put forward and I think that it should be discussed. Prof. Llewellyn and Prof. Menschikoff introduced a section called 2-508 "cure by the seller of improper tender or delivery." I will read the general rule first.

Now, If I make a contract to tender these glasses to Prof. Dozortsev with delivery to be on Wednesday and on Monday I tender the glasses to him but one arm is broken and her rejects them and before Wednesday I repair the glasses and retender them, then he must, he must accept them. So the legal effect of this is to limit the options of the buyer where the seller had made a nonconforming tender and the time for contract performance has not yet expired.

This means that unless the agreement of the parties is to the contrary, the buyer must stand by the contract until the time for contract performance has expired. This is a very substantial limitation of the perfect tender rule of 2-601. Now, there is a limited modification of this rule in subsection (?) of 2-508 which under limited circumstances allows for an extension of the contract time within which the seller may cure a defective tendency. This subsection presupposes a rejection of a nonconforming tender and if the seller had reasonable grounds to believe that if the tender had been made would have been acceptable with or without money allowance, then the seller may resubmit a conforming tender.

Now, Prof.'s Llewellyn and Menschikoff thought that this was a major advance. There was much discussion in state legislatures and in academic journals on this topic. And I saw it myself in a case concerning tender of audit. I would like to know what your thinking is on this problem.

Vitryansky:
First, may I start by a clarifying question? In your example concerning your glasses, does this example presuppose that there is no problem? And what if the parties have stipulated in the contract that no delivery may take place before the date of tender included in the contract?

Summers: Yes, it does presuppose no problem in this regard and that if such a clause were included in the contract, then this provision of the Code would not apply to the example I've given.

Vitryansky:
If the contract stipulates specifically that the goods must be delivered at a specific date and the goods are nonconforming, then does the buyer have grounds for nonacceptance?

Summers:
Well, under the general provision no, but if we look at subsection two, then we can perhaps find grounds for nonacceptance.

White:
I'd like to make two points. First, the glasses example is not that good an example. Maybe I'm

shipping natural gas or a large shipment of corn to you and you want to reject it because you can buy the gas or corn more cheaply elsewhere, not because of any defect. Not because there is too much water in the corn or because the natural gas does not meet the agreed upon standards. Then here the cure would be inapplicable. Second, the cure only takes away the buyer's right to reject, it does not take away his right to seek recompense. If he so desires, he can go for damages.

Makovsky:
If the seller can try to sell the grain with more than the specific amount of water or the natural gas, does he have time to cure under subsection two?

White:
Is it the buyer or the seller who says this?

Makovsky:
Is it an obligation of the buyer to give more time or is it his option?

Summers:
It is an obligation. Let's assume that in the past these same parties have dealt with one another several times and on each occasion something similar to this has occurred, perhaps more water than was intended in the corn and the buyer has allowed the seller additional time. Under 2-208(2), the seller has reasonable grounds to believe that there will be more time. Now, if this cost the buyer money, then, as Prof. White point out, the buyer is entitled to receive this money. But the central transaction will be protected and that's the whole point.

Khokhlov:
If the parties have acted in conformity with subsection one and all the conditions of subsection one have been met, is the buyer entitled to reimbursement of the damages resulting from the acceptance and return of goods as well as other damages such as delay in the redelivery of the goods? Is he entitled to all types of damages in this case?

Summers:
First of all, let's assume that the parties have set a delivery date on Wednesday, but the preceding week they have a discussion that the delivery should instead be on Monday. And, the buyer goes to great expense preparing for delivery on Monday. As I read this provision, the buyer would be entitled to reimbursement for these damages. This is a question as to whether he could get damages concerning the two day delay. Getting ready to receive the goods on Monday, I would think that this would entitle him to receive compensation for his damages. If you are drafting a provision like this, I would encourage you to be very specific.

White:
Under subsection one, he would not get expectation damages.

Summers:
These sections are drafted very broadly. 2-507(1) does talk about the seller's breach. So if I were drafting this provision, I would make it clear that if there were this kind of fact pattern, the buyer should get some kind of damages. Incidentally, 2-701(4),(5) are drafted rather tightly and there could be a dispute as to whether you would get any kind of incidental damages. It is just that the seller and the buyer have agreed that the delivery would occur earlier and the delivery did not take place. One could argue that there had been a modification of the contract and take it from that point. Still, I don't see it as a major problem for you in regard to the drafting.

Komarov:
The exception of pure performance as reflected in the Vienna Convention is something that I would like to recommend as being very close to your UCC.

Summers:
It is possible to have just the example the Vienna Convention provision. You know that the Vienna Convention provisions comes from our own UCC though it has some minor changes. One change is that is worries about these incidental losses. Now, there is still a problem about what the word "obligation" means in regard to the right of the buyer to any costs he has incurred from getting ready early. By putting together 2-508 and sections four and five of the Vienna Convention, you would get the most modern code provisions possible.

Makovsky:
Now, could we discuss the problem connected with the type of performance?

Summers:
Before we turn to that. Article thirty two in sales is the one that I found in your own draft that comes closest to this, but it is not as expansive as 2-508. What you might want to do is put your copy and the Vienna Convention down next to one another and compare them word for word. Now you have another question.

Makovsky:
Yes, thank you. The reason I'd like to shift is that the provisions of 2-508 are based on the idea that the seller can always deliver before the time in the contract. The principles of this provision are closely based upon the principles of 2-[illegible]. The first part deals with commercial transactions. It is based on another principle.

Summers:
This is very, very tightly drafted. It is true that the word "customs" is included here. It says that the debtor shall have the right to perform the obligation before . . .

Dozortsev:
Yes, but you see that that is an exception . . .

Summers:
You have a general rule which looks like the old clause.

Dozortsev:
Yes, but you see that his is just one of many exceptions . . .

Summers:
Again, this is very, very tightly drawn and it seems to me that you might want to liberalize it. It is really quite strict. Secondly, there is no provision like subsection two which involves an extension of time and this is another example of how this provision of your is much, much more restrictive. Thirdly, I should point out that this focuses on Time while 2-508 focuses on topics more broadly. It includes topics other than time.

Makovsky:
2-508 is based on the assumption that the seller has the right to deliver before the time in the contract while the Russian provision is based on the assumption that the seller does not have the right for early delivery.

White:
Where in the world does this come from? Why is this included? Who would be unhappy about an early delivery? Does this concern the prepaymer. of debt? What are you trying to get at?

Komarov:
The problem is that in our industry early delivery was not allowed. It was not only when the creditors were concerned with prepayment of debt.

Dozortsev:
Yes, Yes.

Komarov:
Something was arranged in time so that it would not be possible to have an early delivery because that would throw everything off schedule. Thus, in our code drafts we have continued this. Early delivery is now allowed unless allowed specifically by the buyer. Another point. during this period the rule was that . . . .

Dozortsev:
Excuse me, the problem is not related to the planning system of our centrally planned economy. You know, the economy which we traditionally, which we in the past have had. The problem rather is to due with the construction of our buildings. Yes, with the construction of our buildings, there is simply no storage space. We have no way to store perishable goods. That is why we have in our draft put the idea that only when the buyer agrees to accepts is early delivery OK. If the buyer does not want to have an early delivery, then he is not obliged to accept early delivery. This relates back to what we discussed yesterday. First of all, we have to decide what is the basic presumption. Early

delivery is not acceptable is our basic presumption.

White:
That does not sound too different from what we have. Except we don't have an express term for this. If the date of delivery is July 1 and you deliver in May, I don't have to accept. Clearly if you delivery something three months ahead of time, I don't have to accept. Your example concerning construction contracts is right on point. If I don't have storage space, I as the customer do not have to accept. I don't think that is too terribly different from what we have.

Makovsky:
Perhaps, now would be a good time for a break.

SALE OF GOODS: EXPRESS AND IMPLIED WARRANTIES

Summers:
Now the American experience, here, dates back way into the nineteenth century when there was case law evolving which upheld the contract provisions which explicitly limited, or even excluded entirely, warranties of audit. Our Uniform Sales Act included in two basic sections a variety of provisions which were often referred to as disclaimer provisions, limiting provisions and/or excluding provisions and when it came time to draft the UCC forty years later, a lot of time was given to the problem of discussing these problems. The UCC has a section on this, but 2-302 on unconscionability also deals with this. Now, that's the general historical picture. Now, there is one further feature of the general historical picture. In the 60s and 70s, there were some states that adopted state consumer protection law and then there was the Magnuson-Moss Act which also dealt with this.

First, let's distinguish between express and implied warranties. Express warranties are defined in 2-313. There are several types of them. Express warranties include an affirmation of fact or promise which relate to the good. Any description of the good; any sample of the good which is made part of the basis of the bargain. Now then, it is essential to read the comments to 2-313 in order to understand that express warranties may be disclaimed or modified. There is a strong attitude in the commentary favoring language that might be construed to be express warranties. This means that, well, the drafters intended express affirmations of fact and express promises and express descriptions and specific models and examples to generate express warranties if they are part of the basis of the bargain.

There is nothing more beyond that. They clearly thought of it in that way. Take descriptions for example. Here is a very important idea. Comment four to 2-313, a clause generally disclaiming all warranties, cannot reduce the seller's obligation with respect to such descriptions and therefore cannot be given literal assent under 2-306. Now, do you want to translate.

In 2-316(1), we see the actual text backing up this point saying that negation is inoperative to the extent that it is unreasonable in light of the language. (Missed two sentences while water being poured). So, this attitude finds textual support. Preserving that has had an express warranty effect in the absence of anything further. But notice what this famous comment says in its second paragraph. This is not intended to mean that if the parties consciously desire, they cannot make their own bargain if they wish. So Prof. White's freedom of contract beliefs raise themselves up here. This attitude of preserving express language returns in the next sentence. Good.

Now, this means that when the parties sit down and agree and describe the goods, without more, a description or an affirmation of fact or a promise as to the nature of the goods will be an express warranty if it is part of the deal, part of the basis of the bargain. It will be an express warranty unless you fairly clearly make clear that there is a disclaimer or a modification of the warranty or, now comes a new section, or you provide that the remedy for anything wrong with the goods shall be a limited remedy. Notice the effect of that . . . . is substantially the same as a disclaimer warranty. If you disclaim the warranty, then you rid yourself of liability. You can achieve the same end by leaving the warranty intact under 2-719 by limiting the remedy. These

limitations can often be quite drastic, including, no consequential damages. Why don't we see if they have anything like this in their draft.

White:
Well Prof. Komarov just said that they didn't.

Summers:
Hmmm

White:
Are you saying, Prof. Komarov, that there will be other drafts more specific than Article 30?

Summers:
Well, I was under the . . . .

Makovsky:
Excuse me, but let us let him translate.

Summers:
Now what I understood from Prof. Komarov's letter is that the liability as to . . . . ., whether the liability as to goods can be excluded in regard to goods. Now even though you have something in the general part, Part I, the question is whether you want to add anything more specific in Part II.

White:
What section in Part I deals with this.

Komarov:
That would be Section 398.

Summers:
There is a specific provision with regard to consumers in subsection two disclaiming, with regard to commercial warranties, that is not treated at all. There is a question in my mind if you want, in the sale of goods section, the problem of limiting of liability warranty restriction with regard not only to consumers but also with regard to commercial transactions.

White:
Are we reading Section 398 correctly.

Makovsky:
Perhaps, we have combined several issues together. Maybe we should focus on the problem of purely implied and express warranties. After our return from Ithaca, we have been working on the sales of goods. There is one distinction between the two categories of warranties. How we label them is unimportant. Unless something else is stipulated in the contract, in order to show

you the basis of our approach. I would put the articles of the UCC in a different order. First, 2-214, then 2-215, then 2-213, and in that connection arises the question of what are the limits of such connections and thus we came to the conclusion that implied warranties can be expanded.

We also came to the conclusion that implied warranties can be limited. But we have not yet reached agreement whether this limitation can be taken down to zero, whether implied warranties can be completely eliminated. Our basic approach is based on the idea of freedom of contract. I speak in terms of the UCC in order to facilitate the discussion. Although in our draft we could change the titles and it would not affect the substance. The second problem , and we view this as a separate problem, that also concerns the freedom of contract, is whether we can limit the amount . . .

Summers:
If you have your current draft on how to deal with this terribly important problem, then we can discuss it now or we can set aside an hour for tomorrow for discussion. This is a terribly important problem and we would like to discuss it if you want to. We are here to do what you want to do.

Makovsky:
We discussed this problem less than a week ago and our conclusions still have not been reduced to writing. Still, it seems to me that this problem is very important. In principle, our work is based on this distinction between implied and express warranties.

Summers:
We have fifteen minutes to lunch and Jim and I can discuss this. I have never thought of reversing the order as you have put forth. To us, it seem that express warranties should always come first. the express warranty will set the basis for what follows. That will not be just an express counterpart of the warranty of fitness.

Makovsky:
First, an explanation. Our approach is based on our view that implied warranties occur when the parties have not agreed or stipulated any express warranties. That is when they take affect. If there are express warranties, they will take affect. They is why we begin with implied warranties.

Summers:
Well, I think that we can move away from this on to other topics.

White:
I think that the UCC looks at this problem of express and implied warranties in 2-317. Once you eliminate consumers from consideration, then it will be important to business people that they will have the right to limit their liability. For example, very sophisticated business buyers and sellers will routinely eliminate liability for consequential damages and very often limit the buyer's right to repair and replacement. Do I interpret you correctly to be saying that would be possible under your Art. 15-398?

Makovsky:
Yes, unless the law or international rule provides otherwise.

White:
Such as the international rule concerning death from airplane crashes. Can you limit liability in commercial questions? If you exclude the consumers from this by 398(2), then I would probably say that you probably don't need a section like our 2-316 because that was probably put into our law for relatively unsophisticated people and in a business setting that may not be possible.

Summers:
You must be very careful in your distinction between commercial and consumer contexts. Some examples which have been cited here in a commercial context such as limitation on repair and replacement are also very common in a consumer setting. This may allow for limitation of freedom of a contract which you may not want. I am prepared to say that under 2-719 there may be outer limits on the availability of these remedies. In regard to commercial parts, you could take a different view at least in cases where the goods are experimental or built for very special needs. The consumer setting, of course, is not one where experimental goods are a problem. But it is one where replacement or repair would be the first remedy, the frontline remedy and it would be very important to preserve the freedom of contract in regard to that. You should give very special attention to the idea of restricting the idea of automobile dealers limiting repair and replacement except in cases of lemons. You also look at cases where repair and replacement is needed due to the buyers failure to maintain through appropriate maintenance. The seller should not have to bear the burden in this case.

So one of the provisions which you may want to consider is 2-719 which incidentally does not distinguish between consumers and commercial parties in its basic section. 2-719 says that subject to some limitations that the agreement may provide for remedies in addition to or in substitution for the damages remedy as a by limiting the buyer's remedy to return the goods or as to repair and replacement of the nonperforming goods. that serves as the basis for hundreds of thousands of contracts in the USA where the basis of remedy is shaped limited by 2-719. What I would like to propose is that we take another four or five minutes that we have before lunch and

Vitryansky:
We have until 13:40 until lunch. Still much time.

White:
We've got over another hour?

Makovsky:
Perhaps then we could take a break.

Summers:
Then, I would propose that maybe after the break we can start with some questions with what is on your mind. OK? Jim and I will answer them.

BANKING: LOAN CONTRACTS. BANK CREDIT CONTRACTS

Makovsky:
I would like to apologize for spending so much time on the sale of goods, but we have been working on these questions and that is why we have been asking so many questions on this topic. Perhaps, tomorrow we could discuss them tomorrow.

Summers:
If you have specific questions on warranties and disclaimers of warranties, please write them out and then I will prepare very concise answers for our discussion tomorrow.

White:
The first question I do not understand. What do you mean by a loan contract and a bank credit contract?

Komarov:
A loan is a contract when money is given and a bank credit contract is when money is given by the bank for financing, an executory contract . . .

White:
Wait, the distinction is between when money is given and when a promise to give money is given?

Komarov:
Yes, for fifty years, there was a distinction between a loan which was made for ordinary citizens and loans which were made to state enterprises. General provisions for ordinary loans did not apply to bank credits. The ordinary loans were regulated by the code which was primitive while bank credits were regulated by special administrative instructions which were quite complicated and long.

Makovsky:
We should work out some sort of correspondence between these two types of transactions. One distinction that can be drawn is the one suggested by Prof. Komarov that a loan is one made at the moment of tender and an executory bank credit contract is one in which the loan is not actually made at the moment of tender. Another approach would be to define it in the general terms of the loan agreement.

White:
The principle difference is that one is executory and the other is executive. One is a lending of money and the other is a promise to lend. Our law would treat them as different but only in the sense that one is executory while the other is a completed contract. For example, if a debtor went into bankruptcy, the person who lent him money would have a right against the estate while

the person who had promised him money would have the right not to lend him money

Kartashkin:
Please repeat that.

White:
If a debtor went into bankruptcy, then the person who lent him money would have a right against the estate, while the person who had promised him money would have the right not to lend him money. Generally, this is a distinction which our tradition does not recognize.

Makovsky:
If you have a contract or bargain made between two private citizens, can they conclude an agreement of the executory nature and the performance could be enforced by a court?

White:
Performance? No. Damages on the contract? Yes.

Summers:
Because the remedy at law is adequate, there is no need to enforce specific performance. You could get the money elsewhere and charge the difference as damages. A general common law rule.

Khokhlov:
Another question, please. The regulation that is designed to regulate banking transactions, does this law also apply to individuals or small companies who make loans?

White:
The rules that apply to banks would not normally apply to third parties. Ordinarily, there are very few regulations on banks in this regard anyway. For example, the banking rules might say that the bank can lend only lend a certain amount of its capital without security. And loans of that sort would not be subject to any limitations for private parties.

Khokhlov:
Is a promise to give a loan and a loan agreement the same or a different type of agreement subject to a different type of regulation?

White:
A promise to loan could be a negotiable instrument or some other sort of transaction and might be different in that sense. In general, however, there is not pervasive regulation for banks or anyone else as to what types of loans they can make.

BANKING: USURY LAWS

Komarov:
But there are different rules for these two types of contracts, yes: the loan and the loan agreement?

White:
Only in the sense of different rules for executory agreements and non-executory agreements. Let me go on to the second question. I'm not sure that I've deal with the first one very well. There are usury laws or limits on interest rates in most states, but in almost all cases these limitations are on consumer loans and do not apply to business loans. This is an area where the economists' predictions have proven correct.

Summers:
For once!

White:
The prediction is that if you have usury rates below the market rate, then credit will dry up and people will try to find their way around the law through evasive means. For example, in 1979, interest rates got very high and the general rate in the economy was higher than the usury rate for mortgages. The usury rates did not apply to the seller of the house, so the seller would actually put out the loan and the banks would not have to figure directly into the transactions. The answer is that the same people in your legislature think the same as ours do in that they think they are helping the consumers, but when interest rates rise they are almost always disappointed by the result. In the US, in general, usury laws have been repealed. Not all, but many have been repealed.

Makovsky:
Usury laws only applied to consumers.

White:
Yes, while there were a few places where they applied to businesses, they usually only applied to consumers.

Makovsky:
A very interesting question since the first usury law was found in the so called twelve tables 2500 years ago and it is interesting to see that such laws were found in the US and found to be ineffective.

White:
Under Islamic law, interest is still limited, but there are multiple evasions. There are other ways to hide interest. Raise the price of the commodity to be sold and bury the interest rate within the

price. Another way we regulate interest is through disclosure laws which require that each consumer calculate his rates and disclose them on the loan documents. So that way you will get the banks actually competing with one another actually advertising their rates.

Summers:
And the rules that regulate this assure that the number is comparable to other numbers the consumer can choose from and this competition drives the level downward.

White:
In summary. US experience would say that usury laws are not very effective; they interfere with the free transfer of money and can be evaded though such evasions cost money.

Khokhlov:
A question. Art. 14(12) of Part I allows the limitation of prices in certain circumstances by law. This provision would probably allow the limitation of interest rates. Based on your experience, would you say that it is advisable to reserve the possibility of limiting interest rates or simply make it impossible.

White: My bias is to make it impossible. But if politically it is necessary, you should limit it to the smallest number of consumer cases possible.

Summers:
One modification is to limit it only to cases of monopolistic lending.

White:
The trouble with that is that lenders will want to know at the time they make the loan, what they can do and what they can't do. And in the US, the remedies in many states for issuing usurious loans are draconian. For example, a common penalty for this is that the creditor loses not only the interest on the loan, but also the right to collect the debt.

Summers:
And in some states, his big toe is cut off.

White:
So I would say that usury laws are inherently dangerous because they are likely to cause credit to be denied to people who would otherwise say that we would accept the interest rate.

Dozortsev:
But if have to have the usury law, we would have to specify the penalties.

White:
Yes. On to the third question, what does it mean?

Kartashkin:
Whether a bank control credit for a specific use is possible. Can the lender control how money is used after it is et and when it is lent?

Komarov: No, the question is does the bank have any authority to control how the bank's loan is used?

White:
The bank is free to execute almost any type of agreement it wants with the debtor. Typical loan agreements executed with the bank will often place limits on the debtor including the money may be used.

Summers:
We might mention how a bank polices a loan for an automobile.

White:
For the purchase of a house, the bank may loan the money directly to the seller and take back a mortgage from the buyer. A loan condition would require the debtor to maintain certain assets and to maintain his finances in a certain way. These agreements can often be 50 and even 100 pages long.

Dozortsev:
What are the consequences if the debtor doesn't fulfill the agreement?

White:
First, the bank will have the right to refuse to lend any more money. Second, that will be a breach of the loan contract. That in turn means that the bank will have a legal right to foreclose on the property at stake in the security or to sue to recover the debt.

Summers:
Not just foreclose in some abstract way, but to actually to get the property, to get the car.

White:
As a practical matter, when a default occurs, the power lies with the debtor, not the creditor. If you borrow ten dollars and default, that's your problem. If you borrow a million dollars and default, that's the bank's problem. We are seeing that right now in US-Russian relations in regard to the granting of credits so that Russia can buy more grain from American farmers. In general, the banks will not be deeply involved in the day to day business of the debtor as long as he is not in default.

BANKING: DEPOSITOR-CREDITOR RELATIONS

Makovsky:
Well, I think we can begin with the next question.

White:
Certificates of deposit are deposits that will be given to the depositor showing the money left there, the term and other information. For example, one might say that it is due in one year and that it bears 7 per cent interest. Usually for a term of six months, or a year or two years or three years at a fixed interest rate. That is typical for a certificate of deposit. The interest on a demand deposit account varies occasionally; my account depends on the three month treasury (. . . ? . . .) Corporate accounts are normally non-interest bearing accounts. Both bank deposits and bank account contracts I call in effect the same, so I'm not sure just what it is you're asking in this question.

Makovsky:
The question is whether if you have a deposit account, can you make any transactions from this account?

White:
If it is a timed deposit, typically there will be a penalty for early withdrawal. On the other hand if the demand deposit account is the one where typically you have transactions, uhhhm, on the last question there are some rules that prohibit corporations and businessmen from having exactly the same accounts as consumers have. Other questions on number four, kinds of accounts? No. Under current law, there is very little required. You could have any kind of account that you want.

Khokhlov:
Are the regulations that are applied to a demand deposit the same if the deposit is placed there by another person or do the rules vary according to whether the deposit placed there by other persons?

White:
No, the same rules apply. Though it would be sort of strange if you wanted to put money in my account. Please go right ahead. If you know my account number, you can wire money directly into my account.

Makovsky:
On the other hand, you can instruct the bank to send money from my account to any other?

White:
Sure. I don't see any reason why not.

Zvekov:
And what about bribes?

White:
Bribes?

Zvekov:
Bribes! What about them? How do you prevent them?

White:
What? Well . . . . Invariably when you open an account with the bank, you sign a contract.

Khokhlov:
And this contract will, if not stipulated otherwise, will be an agreement for a demand deposit?

White:
Far and away demand deposit accounts are the most common sort of accounts. In any case, the contract between the depositor and the bank will usually stipulate that it is a demand deposit. Questions? No. OK, the deposit agreement for a commercial account may be 10 or 20 pages long. The problem we face is not having money put into the account in an unauthorized way, it is having the money taken out of the account in an unauthorized way. A significant problem in the United States is embezzlement in which an employee will forge or use a fax to get the signature of the depositor and then abscond with the money. This contract between the bank and the depositor will have all sorts of agreements on what sort of interest the bank will pay, how the bank will set off and garnish the money.

Summers:
You might to explain "set off and garnish."

Zvekov:
You have two different kinds of accounts: personal and business?

White:
There are many kinds of accounts: personal, business, partnership, trust. These are not terms of art, different banks call them different things.

Zvekov:
The law does not prescribe different conditions in this setting?

White:
Generally not. the one thing it does recognize is an oral stop order in which you call the bank and say "don't make a payment on a check of this number." One other are where there is not complete freedom of contract is in the responsibility of the bank to recognize your signature. Banks will generally any responsibility to recognize your signature. Though this is not clear, generally speaking.

Summers:
There is another area related to this. The problem of non-sufficient funds. Non-sufficient fund charges or expenses may be set from time to time by the bank. There are some cases saying that this language and the general obligation of good faith applicable under transactions under the UCC combine to limit what can be charged under this language to just their cost plus a reasonable profit. There is now legislation on precisely the same topic.. Interesting how these cases would have come out if there have been no such language in the agreement.

211 of the Restatement (Contracts) says that a term in the form that would be contrary to the reasonable expectations of the party would be invalidated and if you have a term allowing an exorbitant charge, an excessive charged stated for example in some percentage form the consumer might not notice, I think that this might possibly fail under 211 of the Restatement (Contracts). I assume that these agreements are all standard form agreements.

White:
Well, the really big companies will negotiate individual contracts. So the matters of dispute are very little concerning these contracts. The law has very little influence on them and they have not caused much litigation.

Summers:
What would you say, Jim, are some of the more common special provisions which these large corporations negotiate for in these individual contracts?

White:
The ones that I am more familiar with concern electronic funds transfer and concern burden of responsibility due to a loss of funds.

Khokhlov:
In this country, historically, there was regulation and this regulation depended on the type of account being regulated. One of the more common forms we have is called a transactional account. For example, when the banks have different functions which are imposed on them connected to the control of the enterprises. One of the latest decrees of the Presidents says that corporations can only have one, yes one, transactional account. Are there any limitations on the number of accounts which a company or corporation may have? What are the limitations on this subject in American law. Are the bank accounts used for the collection of information. Do the banks have a responsibility to the IRS or to other government agencies? Do they have any obligations for example in bankruptcy in regard to these accounts? Could elaborate on the need

for taxation?

White:
A bank is obliged at the end of the year to give what is known as a 1099 form that will show the amount of interest it has paid on that account for the pas year. The bank is also obliged to report any cases in which it receives $10,000 or more in cash. And that is to make it more difficult to engage in criminal activity.

Summers:
It is also for the purpose of facilitating the IRS in its auditing of taxpayers.

White:
And beyond a couple of instances like that, the bank has no responsibility to supervise or get information about its accounts. The accounts are not privileged and if there is litigation involving the depositor, the accounts can be seized either by the IRS or by another party. As such, the accounts can be seized, but otherwise the information concerning the account is not available to third parties. there are not limitations on the number of accounts that you can open. Next question.

Makovsky:
This is a slightly more theoretical question. What is the legal nature of the money in the account?

White:
It is a debt owed by the bank to the depositor.

Makovsky:
Thank you, that is what I wanted to hear.

Summers:
Is it the same here?

Makovsky:
Even among lawyers, people here do not understand that you lose your right of ownership to the money in the account, but that you gain a contractual right to the money in the account. There were some theoretical constructions developed in the legal literature of the forties when some legal rights scholars here were developing the idea that when you deposited money into a bank you were engaging in "storage." And we used to have a lot of advertisements saying that you should store your money in the bank. And many people took it literally. They did not understand. There was a famous case during the Second World War when a great deal of money was being transported from a bank when German bombers suddenly appeared. The shipment of money was destroyed in the raid. The bank argued that the money did not belong to the bank, but to the clients. They just stored the money. The clients still owned the money in question. The Supreme Court, however, held that the money was owned by the bank, not the clients. So this

has remained a question of interest even today

White:
What are the primary

BANKING: LIABILITY FOR CLEARING TRANSACTIONS

Zvekov:
Just one more question, please. we have some bodies financed by "current" accounts or "budget" accounts. A bank account that is for institutions that are financed directly from the government. In this regard, how does the American system work?

White:
In the United States, the government draws checks on itself, not on third parties. When draws money, this not on a check; it is called a warranty. The university of a state, however, will have a regular account similar to any other depositor. Shall we go on. Next question: What are the primary kinds of clearing actions stipulated by U.S. law. Article 4 of the Uniform Commercial Code and federal regulations do not specify exactly how funds must be cleared. Clearing is done through the Federal Reserve Bank. The Federal Reserve Bank performs a country-wide clearing house function. For example, the bank in California will typically have the check move through a couple of California banks then on to the Federal Reserve Bank of San Francisco, then on to the Federal Reserve Bank in New York with the check eventually ending up in the buyer's bank in New York.

Makovsky:
Excuse me, please, I have a contract with the bank in New York, do all the banks through which my check goes have the same contract with me. Do all the banks have a con ıct or is there some sort of law?

White:
I do not know how to answer that. There is clearly law concerning the relations between the Federal Reserve Banks. There may be a deposit agreement or some sort of deposit relationship. Well, there are such regulations. Whether there are such regulations between them, I do not know.

A second mode of clearing would be through a clearing house. For example, in Chicago there will be a clearing house in which all the banks will bring there checks and clear them to the ext that one of use presents more than the other, that will be set out in our clearing account at the Federal Reserve. When you have a clearing house, the banks send to the clearing house the checks deposited with them but drawn on other banks and receive from the clearing house checks drawn on them but which were deposited with other banks.

There are also automated clearing houses run by the Federal Reserve which take care of electronic fund transfers and they take care of the clearing of accounts. It would also be possible to clear by simply presenting the check to the bank and getting the money from another bank. Finally, there is clearing through the "chip" system which is run the New York clearing house and is used mainly for international accounts.

There are some legal rules that control clearing behavior. For example, the check which the payer bank receives drawn on it must either be sent back by midnight of the next business day or the payer bank will then have personal liability on that check. And that of course is what

makes the system run quickly. Without that sort of time pressure, the bank will sit on it for a couple of weeks and not push the check through.

I take it that this interest of yours arise from the fact that the Russian Central Bank has insisted on taking part in every clearing even between different branches of the same bank. We would consider that sort of behavior unusual. clearing isn't for a big issue now. There are not a lot of problems associated with it. Though there is a great deal of litigation dealing with whether the bank has held the check past midnight of the following business day and is thus liable itself for the check, over all there are not a large number of problems. More questions about that before we talk about correspondent bank accounts.

Summers:
We might ask what sort of problems they have in clearing; what it is that they're worried about to the extent that checks are used.

Makovsky:
First problem, when we speak about clearing operations, you were talking about checks, did you mean checks literally? Checks are not often used in our country. For example, the seller delivers a product to the buyer, the seller then gives an invoice to the buyer, the buyer then gives the invoice to the bank to transfer funds to the seller, this is not a negotiable instrument. It is a standardized. It includes the central bank which is involved in all these transactions. And the problem is very often that a problem arises when the buyer's bank does not follow the instructions of follows them only after a delay. Also, the seller's bank may also have a very big delay before crediting the funds which leads to many commercial problems including fraud.

I once had a case where the seller brought suit against the buyer for failure to pay for the goods purchased. The buyer, however, brought into the court it's written instruction for the bank to pay and the bank then showed that the funds had been deposited. It turned out that it had been the seller's own bank which had been holding the money and had turned it over only after a very long delay. It had been the funds for itself.

White:
Look at 4A of the UCC. There would be liability to the buyer and most probably to the seller if the buyer's bank had done this. This is covered by 4(a) and by the rules of the Federal Reserve.

Summers:
Prof. Makovsky, could I ask what body of covered this case that you had?

Makovsky: (chuckling)
The question of the form of the clearing of the transactions was established by governmental regulations and by the instructions of the Central Bank of the former Soviet Union. These regulations, however, were not renewed.

Summers:
Will you have an opportunity to renew or review these instructions in your new Part II?

Makovsky:
We would like to include in the second part of the Civil Code special parts devoted to banking which will place banking regulations for the first time on the level of law. That will make it something like 4A for electronic funds transfer. It will also deal with the liability of banks.

White:
The next question concerns what sort of interbank transactions are used in the United States. I am not certain in what way exactly that you are using this term. Are you thinking of corespondent banks. If it is in the same sense, then it is by agreement, not by law. Typically, this would be a big bank which would do services for a small rural bank. For example, they might take their checks and collect them for t hem, write letters of credit for them and other such things. Generally, these are done by agreement, and not prescribed by law. Any questions about that?

Komarov:
You maybe know that a model law had been prepared on credit transfers, but that this law was not connected especially with electronic fund transfers. It was a general model law. A problem with this law was how to determine the point at which the it should be transferred: When it is received by the corresponding bank or only at the receipt of the message that you are credited with this money?

White:
Under 4A(2), the bank that receives the message, it is obliged to accept the order when it receives the order, not the money and when it sends the order on it, it is assumed to have accepted the order and is thus legally bound. It is a very complicated set of rules: Payment of the sender's obligation, if the sender is the bank. Payment has occurred when you get the money from the Federal Reserve. In most federal transactions, the payment will occur on the same day. If I am a bank and you're a bank, as soon as the Federal Reserve gets the order, then the recipient bank has a good claim against the Federal Reserve. Have you heard of FedWire.?

Komarov:
FedWire? What is this? We have no wire system. Sometimes it takes weeks, months to get money from one bank to the other. lack of a wire system is the main cause.

Avilov:
Hardly. The real reason is that the people there use the money for their own purposes.

Summers:
This is an extremely serious problem, especially considering the amount of inflation you have her. It should be readily solvable.

Makovsky:
The difficulty results from the collapse of our central banking structure. The government tried to somehow control and facilitate the relations of the new commercial banks. They created these clearing houses. They are a part of the central bank. It is the idea adapted from the Federal Reserve system, but it was created under the condition of a collapsing economy. The problem is worsened by the fact that the banks and the clearing houses do not have any liability. This situation has led to very bizarre legislation where the central bank has the right to use resources in transit to credit other banks.

Zvekov:
Sit on the money for two days and make money off the payment.

Avilov:
This makes the inflation progress even more rapidly.

Khokhlov:
And the other reason, of course, is the technical disability of the system. My daughter works for a clearing house and she says that the simply lack of technical skill within the system is hindering its efficiency. They have almost no electronic equipment. No computers, nothing. They have to rely on the post office.

Summers:
Jim, you're the financial system czar, what would you do?

White:
I don't know. This isn't a legal problem. It is a problem of electronics, hardware and software.

Makovsky:
What we need is liability to be placed on the banks and clearing houses and to increase competition by breaking the monopoly of the central bank. The law does not prohibit the formation of independent clearing houses. Some banks are now in the process of forming their own clearing house, but the capabilities will be limited by the number of banks participating in the clearing house.

BANKING: LENDING PRACTICE AND LAW

White:
Last question. I don't know the answer to this one, but I believe the is yes. And then the question is are tax agencies as well as other agencies allowed to obtain such records. No, unless they institute such proceedings to get them, they cannot. But if I am involved in a tax dispute with the IRS, they must initiate the proceedings, they cannot simply call the bank up and say "Hey, give us this guy's financial records." They can institute a court proceeding or they could simply get a court order. They could not, however, simply go the bank and demand my records. That is not allowed.

Komarov:
This is a very important question: Is the bank allowed to give information without the order of the court?

White:
No, as I've said, the answer to that is no.

Makovsky:
Do any governmental agencies have access, the DA for example, could the DA demand the bank records without a court order?

White:
The DA and any other governmental agencies would also need a court order.

Summers:
Creditors of the person holding the bank account cannot get access to the bank account.

White:
Well, there are many tricks, of course. You can hire investigators to bribe someone working in the bank or otherwise find out where the money is located because if you have a court order and you don't know where the money is, it's not going to do you a whole lot of good. You can't simply walk from bank to bank in Los Angeles with your court order saying "please turn over the money." There are hundreds of banks in LA these days.

Khokhlov:
I have a question about minors. Here from ages 15 to 18, minors can open their own accounts. Is it the same in the US? can parents have access to their children's accounts. It is a small question of course, but still it is not without importance. But it deals with some sections of Part I that deal with the rights of minors. It is Article 26.

Summers:
For minors to dispose of their earnings and make deposits. Hmmmm, OK well I'm not really sure about that question.

White:
Neither am I.

Makovsky:
Well perhaps we should move one. It is getting rather late in the day.

Khokhlov:
First, we have numerous cases where government agencies garnish bank accounts and remove different assets when they penalize or tax companies for violations. They do this without a court order.

Summers:
We have the leading authority on banks and banking in the United States here. Perhaps we should decide on what topics we should focus on for tomorrow.

White:
Yes, let's focus on the chapters on loans and lending, and bank accounts and on payments. Also, I think that we should return and take a look at pledge law.

Summers:
We have a lot of problems already. So maybe there's no need for further prioritization. So what would you like to do?

Makovsky:
Tomorrow, after lunch, these texts which we gave to Prof. White and to Prof. Summers, well we will reserve this time to discuss changed circumstances, liability of company officers and directors and immunity of government. Before lunch we will discuss questions concerning pledge law. And before the first break, we will also allocate time for banking transactions. May you could answer Prof. Khokhlov's question now concerning the removal of a deposit without the owner's permission.

White:
They must get a court order first. So it is common for creditors including the IRS to go to court and then come and serve it. The IRS cannot get a lien until the taxes are due. .

Makovsky:
What are the legal consequences of the lien?

White:
Normally, the taxpayer can go t o court and have the lien put off. If the lien arises, it means that the IRS has rights in that asset over the other creditors of the debtor. But I don't know what the practices of banks are when they receive the lien. I don't know if they immediately freeze the account to the debtor. They can do it, but it is quite unusual.

Khokhlov:
The cases where you have a court order are clear. Are there any other cases where a court order is not required?

White:
The IRS does not need a court order if it follows certain administrative procedures. It can simply freeze the account.

Khokhlov:
No other agencies have similar rights?

White:
No. If the bank doesn't freeze, then the bank will be liable to the IRS. Usually. you understand, the banks just freeze up. This is for the IRS.

Khokhlov:
Another question. A lien that turns out to be illegal, who is liable in this situation? Some bank transactions are licensed by the Central Bank, what happens if the Central Bank wrongfully revoked the license of the bank to do specific transactions and the bank's clients are hurt as a result, who is liable here?

White:
On the second question, I know of no cases. The little litigation that there has been has been decided in favor of the feds shutting the bank down. On the first question, the bank cannot be held liable for following a lien. The plaintiff who filed the lien which is wrongful would be the one who is usually held liable. But proving damages is usually very difficult. I know of one case where the lien seeker cam with documents with the wrong name of the bank on it. Instead of saying First American, they said First National. The bank then said, "well, yes we've got that account here, but you've got the wrong name on all your documents. You'll have to correct the documents before we can follow the lien." The lien seeker returned an hour later and bank said,"Why yes we have that account here, but there is no money in it." The bank has priority to the money before they are properly served. If they are served and they have not yet set off the money, they have to pay the money into court. Sometimes they will set off and there will be litigation between the bank and the creditors.

Khokhlov:
For tomorrow, calculation of damages arising from delay of payments and breach of monetary obligation, what is the measure of damages? Right now in our country, the measure of damages is in the law as the amount of interest.

Makovsky:
If you could specify the most typical limitation clauses used in bank agreements with their clients, but that is for tomorrow.

CONTRACTS: CHANGED CIRCUMSTANCES

Makovsky:
If possible, I would like your permission to change the order that we had planned yesterday. Prof. Rosenburg, unfortunately, will have to leave early. So can we begin with changed circumstances?

Summers:
Certainly. I think that the best way to approach this is to have the drafter of this section explain it to us first.

Rosenburg:
The essence of the article is as follows: To allow a party who is influenced by changed circumstances to alter his position. The aim of the article is to enable the party to set forth a proposal to change the contract. The party can raise this question only if there are present specific circumstances. Changed circumstances shall not be a ground for such an issue to arise. While drafting this article, I considered the provisions of the UCC as well as other treatises, provisions and cases of the United States as well as those of other countries. The essence of the article is that the occurrence of a significant change in circumstances will lead to a change in the needs of the parties which will lead to a result which is quite different from the frustration of purpose doctrine in Anglo-American law. If the parties cannot agree to change the contract, then one of the parties can bring a suit in court. And if the parties cannot reach a settlement and if the courts find that these changed circumstances did occur, the court can nullify the contract. And the last point that I'd like to make is what circumstances give rise to the possibility of changing the contract due to new circumstances.

The first group of circumstances are those that occur independently of the actions of the parties and which the parties were unable to prevent from occurring. The second element would be that when the parties were entering into the contract, they had no reason to believe that such circumstances would occur. Either they didn't foresee that such a change would occur or they could not have foreseen that such circumstances would occur. They next element is that the circumstances must be significant and so drastic that had the parties foreseen the occurrence of such changed circumstances they would not have entered into the contract or they would have provided for such a drastic alteration within the contract. The last element is that the loss is so great that the party would not care what occurred in the ordinary course of business.

So, in other words, the purpose of the contract could not be reached by the parties. The limitation on this condition is that we are speaking about the gain that the party would ordinarily expect during the ordinary course of business, but would not expect huge profits out of the ordinary. My approach is based on several decisions by British courts which were reached during the war with Egypt over the Suez Canal. During the war, the ships had to make huge detours and the transportation expenses were far higher than the parties could ever have expected. And I would like to specify that the decisions of the court varied according to the specific circumstances of the ships during the war. And I have tried to provide for objective criteria that would allow the courts to come to the right conclusion.

Summers:
My first question is that the article is not quite clear to me. It isn't clear to me whether all these "ands" should be "ands" and whether some of them should be "ors."

White:
There are four conditions and each one of them must be met.

Avilov:
Yes, the English translation is not clear. All conditions must be met.

Summers:
Do you mean different things when you are always using different words? For example, where you say in (3) that circumstances have changed so substantially that had the parties been able to see it, the contract would not have been formed or would have been formed under different terms, what do you mean by "different terms" here since when you come to (4) "formed under different terms" does not have to involve "the loss of considerable advantage." Does "formed under different terms" mean the same thing as "loss of considerable advantage." 3 and 4 could mean different things and if so they could be very inconsistent. I am not questioning the policy. I am questioning the use of terms which could lead to confusion.

Rosenburg:
Probably the better version in paragraph 3 would be to write that the terms would have been "significantly different."

Summers:
I have other questions as well. What do you mean by "unpredictable circumstances." that introduces a normative quality into the discussion. Do you really want to use the phrase "unpredictable circumstances."

Kartashkin:
In the Russian version, I see "changed circumstances" while in the English version I see "unpredictable circumstances."

Avilov:
"Unpredictable" here is used more as a term of art. I didn't want to keep repeating "changed circumstances."

White:
Changed circumstances doesn't carry a value judgment as to whether they were unpredictable. It's a big difference.

Summers:
I need to ask what in subsection (1) is meant by the word "imputable." What is the Russian

concept behind the term here?

Avilov:
That is the fault of the Russian translator. It is something for which the party is responsible, not necessarily by negligence or otherwise.

Karrashkin:
A literal translation would be that the parties are "responsible" or "liable".

Summers:
By "override" I assume that you mean that the parties would not be able to cure the defect.

Avilov:
It means both the circumstances that the parties could not have prevented and could not have cured. Or it means that the circumstances which the parties could not prevent, first, and then means the circumstances which the parties could not cure.

Summers:
Remember they can always spend money to do something about it. Money can cure most problems in contracts, if they're willing to spend enough of it. I am wondering if you are requiring that money be spent which would take care of the problem. Cost increases may be all that is involved.

Rosenburg:
Well, I think that this question should be tied with subsection (4) that . . .

Summers:
Am I understanding correctly that . . . .

Komarov:
Excuse me, is it that any condition that could overridden, is that just a question of cost. This article has the aim of "hardship." This is not about impossibility of performance or frustration of purpose.

White:
Well, do you need a fifth clause that focuses on the allocation of risk?

Summers:
That is covered in the first article.

White:
What about the argument that the price term is in and of itself an allocation of risk. I am currently involved in a case in which there are over 400,000 contracts, some tied to GNP, some tied to

MFN and other things as well. Some could argue that the persons who were stupid enough to sign fixed price contracts should be stuck with them and not be let out of them.

The other point is that on all the Suez Canal cases save one the people who asserted that they were free of their contracts lost. And in US law, this argument is always made and is almost always unsuccessful. And the question is not so much the law here which as you drafted it here is fine. It is a question of how it is applied. If you get courts applying it here to every change in circumstance, then you will frighten contracting parties. Under subsection (2), would a court be permitted to amend a contract and hold the parties to that contract. There is a famous American case involving Alcoa, a big corporate giant. This is a big industrial case that is widely disputed. They had fine lawyers. They didn't say we want out of the contract. They said we just want the contract modified. This case has not been followed in the United States.

Summers:
In fact, it has been widely criticized. Only Speidel, our distinguished colleague, likes it. Please translate that, then I have another four or five points. Now, I would classify this, as in Anglo-American terms, as an attempt to formulate a doctrine that we call the doctrine of impracticability, but there is also an element of frustration of purpose, but it is primarily about impracticability. My colleagues says that there are cases that look at the price term and say "Aha, risk was allocated." I would not do that. I think that often it is quite unclear that the price does this risk allocation function. I would not look essentially at the price term. I would look at more than that and I think that my colleague would do so as well. Sec

Secondly, you should not create an excuse for nonperformance or a basic for modification because you want to encourage the parties to negotiate about these things in the first place and, secondly, an excuse or ground for modification that is too literal will deter contracting or increase contracting costs excessively. My third point is that as I read the language, and I haven't had time to really reflect on it in detail and depth, but as I read the language it is very much more liberal than American cases. Let me just tell you about the leading American case on impracticability. In the leading American case, recognizing the defense, called Mineral Park Land, in that case the seller was a seller of sand and gravel and the buyer agreed to pay a fixed price for all the sand and gravel required for his job. And he had a separate job where he was taking this sand and gravel to be used. He had agreed to take the sand and gravel that was needed for the job from the seller's property. It turned out that much of it was under water and that it would cost eight or ten times as much to take out the underwater gravel. Now, the court in this case was very, very restrictive in recognizing this defense, very, very restrictive. And that illustrates the spirit of American law on this point. Here the defense is more liberally available. That is a policy decision for you to make. I am just not sure that you want to make the defense that liberally available.

White:
I don't agree with that. Go ahead and translate what he said and then I'll explain why he's wrong.

Summers:
Ahhh, the jocularity defense.

White:
Let me give you a slightly different view. Mineral Land Park was decided long before the UCC was written. It is not a UCC case.

Summers:
But it was cited in the most recent Restatement (Contracts).

White:
The language that you have here is if anything more restrictive than 2-615 of the UCC. And I would anticipate that at least an American court would be very restrictive using this language. Certainly, the number of successful pleadings that someone can get out of a contract through Article 2 is small. And this is every bit as restrictive as 2-615.

Summers:
You won't find anything in 2-615 like you would in Article 4. What's a "considerable part"? What's that supposed to mean, one-half the profit? In 2-615, we focus on the loss part. Here, they apparently include the profit side of the bargain as well. so I would also acre with Prof. White's view that an open ended invitation to modification is a bad idea. For long term contracts, especially, to have the courts rewrite the terms of the contracts is a very risky sort of business. There were a great many cases since then and none have followed this course. Even our judges who are economics, and we have many who are economists, trained economists or have a strong background in economics, will tell you sitting around a table that they would be very, very unsure of themselves in rewriting or modifying a contract, very, very unsure of themselves.

Makovsky:
We should have a break now and then we will decide whether we should continue discussing this question or go on. First, let met share my view of this discussion which I believe to be shared by my colleagues. This article should be used only in extremely limited, rare circumstances. It should not be in everyday use. The difference between Russian and America is that extraordinary circumstances are an almost daily event for us. I think, thus, that we need further language to limit the use of this article. And I totally agree with Prof. Summers that subsection 4 should probably be redrafted in a way that the party should be compensated only for its loss, but that it should not be compensated for its lost profit and probably we should limit the possibility of a court modifying a contract. And sometimes that we are using the old mentality when we think that a court can do anything and we forget about the principle of freedom of contract and a court should be limited by this freedom. Still, there will arise circumstances in which a revision of the contract will be necessary and these could be cases in which the party is producing something that is unique and it can only to the specific user and the user can only get the product from one producer.

Khokhlov:
This article raises a number of questions which have not yet discussed relating to liability.

Summers:
May I ask a few questions? The allocation of losses in circumstances of impracticability. US courts are all over the lot. I don't think I have anything to advise on the allocation of losses without spending a whole day on it. On the second point, I do have suggestions. If you are attempting to deal with impracticability as well as frustration in one article, then I would disagree with that and I'll explain why.

Mayakovsky:
I would agree with that entirely.

Summers:
So they're not folding the two together. I was simply going to suggest that they are conceptually different.

White:
No, it seems that they're not folding them together.

BANKING: ELECTRONIC TRANSFERS AND SET-OFFS

Makovsky:
I believe that we may now begin. First, I want to introduce Prof. Braginsky who has just arrived from Kiev where he has been working on the Ukrainian Code. I want to apologize that Prof. Khokhlov has had to leave for Magnitogorsk where a large meeting on the revision of the code is currently under way. I would suggest that we go on and discuss banking and electronic transfers and that before lunch we could go on and discuss pledge law. And after lunch, we could return to questions on the first part of the Civil Code. And then to questions that were presented to Prof. Summers.

White:
Do you want to deal with these questions on Section 65 later.

Makovsky:
Let's return to banking transactions.

White:
I had several questions on Chapter 34 - loans and lending. The first question has to do with Article 2 of Chapter 34 on loans and bank loan contracts and the writing requirement. Elsewhere there is a section on credit and bank loan contracts. So what if I sell goods to you and you are going to pay me in thirty days, that would be a loan contract subject to this section.

Makovsky:
I would think not. It is not true. Such deals as this would be treated as forming a contract and would be regulated by a special article.

White:
OK, I was concerned about that because in our law there will not be a written promise, but they will be enforced in our law since there is performance by the seller. Even if there is no writing, these transactions should be enforced.

Dozortsev:
Our situation is quite different. You can have a written term in this contract. In Russian legislation, you have a written contract and a written term. There is a requirement of written contracts.

Komarov:
It is like you statute of frauds. We have a little more rigid regulation. You can prove this contract only by written evidence, even if it is collateral and additional. Oral evidence is insufficient, definitely insufficient, you just cannot do it if you want to prove the existence of this thing, this contract of yours.

White:
OK, let's look at Article 7. Let's assume that I am a manufacturing company and I want to loan money to my subsidiary or to another company, am I subject to the regulations of the central bank? For an American that seems like a really unusual rule, that a loan between two completely private parties would be subject to the regulations of the central bank.

Makovsky:
But here, the aim of this article is to regulate slightly different types of transactions, not between banks, but between special types of lending institutions.

White:
Our banks will take any deposit from anywhere that they can get their hands on. They'll take money from thieves, from drug dealers, from anyone.

Avilov:
There's a tendency here that banks will not take small deposits. They are more, more trouble than they are worth.

White:
Why don't you just let competition take care of it.

Makovsky:
Once we have free competition, the article will fall out of use.

White:
The question I raise goes beyond a question of law.

Makovsky:
Yes it does and that is absolutely correct. We have a number of specialized banks which have their own fields of interest, for example, Imperial Bank , Alpha Bank. In this article, however, we are speaking about banks which have general licenses to do all sorts of business. If they have the license, then they must accept the deposits from all sorts of people.

Komarov:
The purpose of his provision is just to ensure that if this bank is going to be a general bank, a public utility, then it must be willing to serve anyone.

White:
We have begun to think of banks as not being public utilities. It makes the banks highly inefficient. And where banks are considered to be public utilities, then they will use this argument to engage in what are essentially anti-competitive activities; I understand that there may be political reasons for this and it is out of your hands, but I would argue against t his. Looking at Article 9(4), do I read this correctly that the government will guarantee deposits only in banks

of which it owns 50 per cent of the shares and not in other banks. As you know, in the United States we have a financial crisis arising out of the Federal Deposit Insurance Corporation (FDIC) which has cost the US government more than it spent in all of the Second World War. I assume that his is a political issue that is also out of your hands. It is very controversial in the United States about what sort of insurance should be granted to deposits.

Makovsky:
Well, again, we have a unique situation in which we had only one bank. Now, we have many banks, but the majority of the people deposit their money in the Sbegeratelny bank because the government guarantees all of their deposits. And the government is interested in guaranteeing and attracting these resources because it is interested in stabilizing the currency system.

White:
Article 13(2), does that contemplate or prohibit a bank set-off?

Makovsky:
I thank that the drafters had other goals in mind. The main purpose of this article is to prohibit banks from voluntarily stopping any transactions. For example, this article would prevent banks from refusing transactions that are allowed by law and requested by the client, for example, a transfer to another country.

White:
Do you allow set-offs?

Makovsky:
Yes, we have discussed this yesterday. Banks do this currently, yes. If I am not mistaken, the instruction published by the former USSR allowed the bank to set off all the debts which the client owed to the bank. Today, we cannot clearly state whether it can be contracted for or not and probably we should probably state that a set-off is allowed only when it is specifically allowed for in the contract between the bank and the client. Of course, banks always include this provision in the contracts automatically. Do you have general rules in regard to set-offs?

White:
There are restrictions in law about when a set-off can be made. The general rules apply to banks. The two debts which are to be set off must be owned by the same client. The same rules apply to you and to me as well as to banks.

Makovsky:
Could you please elaborate on the specific provisions which apply to banks?

White:
There are no specific provisions. The main one is that the debt must be the same one on both

sides. A debt could not be set off by me and my wife and me. In that situation, the debts would not be owned by the same client since one of them would involve my wife. The liability must be due before the debt is set off. Of course, the bank has liability for an improper set off and will do so carefully.

Komarov:
Do you think that special rules are necessary?

White:
No. It is just from looking at the translation it seemed that set-offs might be prohibited by your draft. A set-off is, of course, a common protection that banks seek and is recognized throughout our law, including in bankruptcy law.

Makovsky:
You see in the first part, in Article 408, we have general rules for set-offs. The rules are not the same as yours.

White:
The final point about these sections deal with Chapter 36 (17) and (19). Will there be a more elaborate set of rules later on in Part II dealing with open account payments and payment be check? And it is also not clear to me whether they establish the liability of the payer bank or the bank to whom the order is given.

Makovsky:
This article here does not attempt to answer that question here. We have a comparatively new law here on checks. And this law will probably be sufficient.

White:
If I write a check on my account to Bob, they don't have liability. They have a day and a half to decide whether or not to pay it, then they have liability for the check. When they fail to pay that check if I have sufficient funds, then they have breached their contract to me and Bob would have a cause of action as well if they waited for more than a day and a half. The bank would be liable to both of us.

Makovsky:
The amount of the bank's liability to Prof. Summers would be limited to the amount of the check, but what about the liability to you which could far exceed the amount in the check? What if the bank hods the check for one and a half days and then discovers that you do not have sufficient funds?

White:
The bank will be liable to Bob and have a cause of action against me. When I give you a negotiable instrument, the underlying obligation is suspended. If the check does not clear, then

you can sue me on the check or on the underlying obligation. That is not the same on a cashier's check which is the same as cash. Until the bank pays the check, I am liable on both the underlying obligation and on the check. Once the bank has paid, I am relieved of both. These matters are covered by Article 4 of the Uniform Commercial Code. I assume eventually you will need a more specific set of rules, not now, but eventually.

Makovsky:
Probably the creditor has this alternative to sue on the check or on the underlying obligation of the check bounces?

Summers:
Why not have these rules now? This might be a case where the role of the law is to constitute behavior and not to regulate behavior; not to regulate, but to constitute behavior. It might be in their interest to develop a set of rules now rather than later.

Makovsky:
It is quite possible to create an elaborate set of rules regulating checks, promissory notes and other negotiable instruments. There are many models throughout the world from which we can draw. The question is whether want to include this elaborate set of rules in the Civil Code or in a separate set of legislation. Russia is already part of an international convention on promissory notes. In addition, if we put it in the civil code, then we have a problem of proportionality in the regulation of different spheres of law. We are intending to have these very specific rules in each specific law, for example, a law on promissory notes, a law on checks, a law on other negotiable instruments and so on. What we have before us here is not final. I think that it is now time for a break

BANKING: SECURITY INTEREST PERFECTION

Makovsky:
Before we begin this next session, I would like to present a copy of the text of the code which was presented to Parliament to Prof. Summers and to Prof White.

Summers:
Why thank you very, very much.

White:
Hey, well wait, we want each of you to sign our copies.

Summers:
Perhaps after the session would be better. We will begin with some Article 9 Uniform Commercial Code material.

White:
Well, one question and an important question of perfection in a security interest. I realize that there is no filing system in Russia of the kind we have in the United States and I have two suggestions that might be considered by you. Put a provision in the law that allows in perfection by filing if and when such a system is established.

Summers:
Again, this is a case where you and constituting and arranging the law in order to guide society.

White:
A second possibility would be to recognize in the law with respect to tangible collateral some form of actual notice on the debtor's premises to allow perfection. Like a sign.

Summers:
Jim, could I give an example? Suppose you own a small business that needs money from a bank to get started. Money for furniture, equipment, inventory and so on. Just a sign on the premises making it clear that the bank has security in these assets would serve as a form of actual notice. This would substitute for a public filing system. This would be a good substitute for the commercial retailing system. In the commercial manufacturing setting, you do something different from what you would do in the retail setting. Suppose you are a manufacturer of refrigerators, at any given time you will have lots of material that will go into making the refrigerators and you will have an inventory of refrigerators waiting to be sold to wholesalers. Our experience has been that banks lending to such a manufacturer may set up enclosed areas on the premises using an employee of the debtor who is also working for the creditor - Field Warehousing. This gives the creditor a certain kind of security that doesn't interfere with the manufacturing property. Anyone coming onto the property would see this and understand the bank's role here. I am using "warehouse" metaphorically. It could be just a screened in are with a

fence around it. The point is that everyone could see it. It does not have to be a separate warehouse.

White:
Well, method of perfection must be addressed. The giving of notice is one method of perfection. And I should emphasize that when Bob and I are talking about this that we are talking about personal property not about private mortgages.

Dozortsev:
Is this considered to be a form of possession?

Summers:
Yes, but the main purpose is to give notice.

White:
Yes and to let everyone know that the lender has priority over third parties.

Summers:
And anytime third parties have notice, this confidence of the creditor is enhanced even more.

White:
The second topic that I think is important for secured creditors who would lend in a business context is 349 and 350. As I contemplate those, if I had a security example and a debtor's inventory and I wanted to repossess the debtor's collateral, I would have to go to court and get a court order and then I would have to have a court sale and the court would have the authority to hold off the sale for a period of one year.

Summers:
And that's no good.

White:
In the United States, we divide real estate transactions and mortgages very sharply from personal property security. The rules that you have in 349 and 350 are similar to our rules on real estate transactions. Our rules on personal property security 9-502, 9-502, 9-504 and 9-505 would be much quicker and the courts would have much less influence over the process.

Summers:
This is one of the very, very few places where I have seen something in your draft that really should be changed. We did raise this in Ithaca. It is in the minutes which you will receive and we should discuss it some more. It should be changed.

White:
First, assume that collateral accounts are receivable, payable by a third party. I don't see anything

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