# COMMERCIAL LAW IN EGYPT
# DIAGNOSTIC REVIEW

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**U.S. Agency for International Development**

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# EXECUTIVE SUMMARY

Commercial laws and their underlying infrastructure should promote private sector development. This often does not happen in many transitional and developing economies, including Egypt. Counterproductive legal provisions and confused legislation are two of the causes.

For Egypt to improve its economy it should:

(1) revamp its commercial law regime,
(2) increase government efficiency, and
(3) boost legal education and training.

Businesses in Egypt contend with more government involvement than in developed market economies. This involvement takes two forms: excessive legal requirements and government intervention/bureaucracy. Governmental intrusion is a disincentive to entering the formal business sector and for investment from abroad.

The reduced level of corporate formation in Egypt could represent a large cost to the Egyptian economy. Moreover, a developed private sector could draw workers from Egypt's bloated and underproductive public sector with a resulting savings to the public treasury.

Certain obstacles to private sector development run thematically through Egypt's laws. These include the imposition by the government of legal provisions that instead should be decided and agreed by parties to a transaction under the widely-accepted principle of "freedom of contract," and excessive governmental involvement, bureaucracy, and delay in certain procedures. Legal and practical inefficiencies create high transaction costs which discourage foreign businesses from participation in Egypt.

The problems to correct are wide and deep. Therefore, the first steps to be taken should be fundamental and strategic. We believe that in a sense this is a bottom-to-top endeavor; and that something as basic as encouraging businesses to join the formal sector is of greater moment for Egypt, than for example, some of the more technical requirements for WTO compliance.

The first goal should be attracting more Egyptian businesses into the formal system - and making Egypt's laws friendlier to foreign investment. (In fact, there is no foreign investment law in Egypt.) Toward this end we recommend the enactment of a new, comprehensive (and comprehensible) set of commercial laws.

This Report is written for both an American and Egyptian readership, as well as for future analysts and drafters of Egypt's commercial laws.

Part I of this Report demonstrates the need for commercial law reform in Egypt. It does this by identifying some but not all the faults of four major commercial laws.

To give the reader a flavor for the seriousness of the problem, we list here some of the more notable provisions which likely create a disincentive to doing business in Egypt: [1]

- companies must distribute 10% of their net profits to employees including employees of branch offices of foreign investors

- workers must participate in the management of the company [2]

- representative offices of foreign investors cannot undertake actual commercial activities and are limited to market studies

- corporate officials can have unlimited personal liability arising from good faith mistakes made within the scope of their duties

- corporations are required to file their internal and external correspondence with a government agency

- disputes with foreigners over technology contracts can only be heard in an Egyptian forum applying Egyptian law (*i.e*, no third party arbitration in a neutral country)

- foreign principals must pay a penalty to local agents for not renewing expired, fixed term contracts.

Much also needs to be done with respect to the institutional capacity building; again from the bottom up. We address this in Part II of the Report.

There is a need to move away from so-called "law faculties" and create real, postgraduate law schools with high admission and academic standards.[3] Too, there should be a post law school examination the passage of which is necessary for obtaining a license to practice law; akin to the bar examination in the United States.

Training of law professors and judges in commercial law is also necessary, as is the establishment of courts (or at least judges) specialized in commercial law, bankruptcy, and small claims.

Training will not only make the courts more knowledgeable in their fields but should lessen their load and quicken the pace of litigation.

Moreover, it should be recognized that a judiciary that is not independent of political influence is one that will not rule fairly; and therefore attention should be given to increasing judicial independence in Egypt.

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[1] The absence of a free press in Egypt with the concomitant lack of information is a deterrent to foreigners to conduct business in Egypt. There are strict government controls on who can publish a newspaper.
[2] Workers' rights appear in the Constitution of Egypt created during Egypt's socialist era.
[3] The case for legal education reform in Egypt is profoundly supported by the present system which, for example, does not require classroom attendance.

Training of government regulators and members of parliament would be a useful step toward helping them understand the commercial laws and principles.

Extrajudicial means for commercial dispute resolution should also be improved. This includes arbitration, mediation, and conciliation. Governmental restrictions on the choice by parties of neutral arbitration in a third country should be removed.

This Report presents ample evidence for the need for reform in Egypt both of the commercial laws and the governmental and educational infrastructure that are meant to implement and enforce those laws.

These findings will likely come as no surprise and indeed were confirmed by Egyptian businesspeople, government officials, lawyers and law professors, both at the Consultative Workshop we held on July 9, 2003 and in direct interviews.

The finding that the laws and system need reform leads to the question of how those reforms should be achieved. Toward this end, we recommend the creation of a unified, interdisciplinary commercial law commission empowered not merely to comment on but also to initiate legislation.

# COMMERCIAL LAW IN EGYPT
# DIAGNOSTIC REVIEW

# PART I

## INTRODUCTION

Laws should be tailor-made to fit the political, economic, historical, cultural, and legal elements of a country. Nonetheless, to improve economic development there are “dos and don’ts” which are suggestive of best practices.

In Egypt, many of the above elements combine to make commercial law reform uniquely challenging.

For example, most businesses in Egypt, even the large ones, are family owned, creating less of an incentive to establish formal business organizations [4] and to follow corporate governance principles.

Major corporate decisions not made by management but instead by a patriarchal figure called the *Haj*. This has major implications both for such topics as corporate governance, agency, and liability.

Another unique aspect: the law of Egypt was earlier handed down by the *Khedive* whose pronouncements were taken as divinely-inspired. The influence of the Khedive remains in some way, and he is cited in at least one provision of a current commercial law. [5]

Moreover, the socialist past of Egypt, with its central command involvement in business, and paternalistic tendencies, lingers in some forms.

On a more tangible level, ambiguity and controversy even exist in Egypt as to the legal nature of a check. [6]

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4 The incentives to form a business organization that do exist are taking of loans from banks and tax exemption under the overly-benevolent Investment Incentives Law.

5 Article 40 of The Companies Law.

6 The check provisions in the 1999 Commercial Code have not yet been put into effect. The effective date of the provisions was postponed until 2001 and then again until 2005. The government’s reported reason for postponement is the current state of the economy. Debate exists in Egypt over whether a check is cash or credit. Egypt’s Commercial Law forbids the use of checks as an instrument of credit, yet checks are virtually the closest thing to security used in Egypt. Historically, checks in Egypt have been used for credit and the writing of a check meant the payor was in debt. Banks required a check in order to issue a loan. Even a good faith inability to repay a debt is considered theft of public funds as the government owns an interest in the commercial banks in Egypt. Article 723 makes a “crime” the writing a check where there are insufficient funds. The Article should be changed to include intent or maybe recklessness as an element of the crime as negligence should not suffice.
For the information of readers, in the United States a check is a type of commercial paper. In particular it is (i) a draft, other than a documentary draft, payable on demand and drawn on a bank or (ii) a cashier’s check or teller’s check. If certain conditions regarding the check are satisfied, then it is a negotiable instrument. The law governing this in the United States is Article 3 of the Uniform Commercial Code (UCC). In the U.S., to be a negotiable instrument a check must be: (a) unconditional for payment (b) in the form of "order to pay" (c) for a fixed amount (d) payable to order (e) on demand (f) at a definite time (g) not subject to unauthorized promise.

Reportedly, discrepancies often exist between a law and its implementing ("Executive") regulations. Note should also be taken of the "super law" enacted annually, called the Socio-Economic Law, which reportedly supercedes any inconsistent provisions of existing laws.

The oppressive weight on an overburdened judiciary has caused the high court itself to compromise the importance of time-effective litigation. The court has ruled that the time periods prescribed in the Civil Procedure law are merely advisory; apparently because it is impossible for the burdened judiciary to make those times.

This dovetails with another fundamental issue: the extent to which the rule of law is followed in Egypt.

The independence of the judiciary is a key component of a legal system based on due (fair) process.

The value of even perfect laws would be greatly discounted if misapplied for political reasons by a non-independent judiciary. The inability on the part of the populace and foreign investors to rely on the judicial system would be yet another reason to not establish formal business organizations or invest in Egypt.

The laws considered herein are:

1. The Commercial Law (*aka* The Trade Law)(includes the Bankruptcy provisions);

2. The Companies Law;

3. The Investment Guarantees and Incentives Law;

4. The Recently-Proposed Capital Markets Law; and

recommended provisions for foreign investment and business registration laws.

## LEGISLATIVE DRAFTING

### General Principles of Legislative Drafting

Laws should be:

1. understandable,
2. unambiguous,
3. concise,
4. as easy as possible to comply with,
5. not effective until properly promulgated,
6. non-discriminatory,
7. non-partisan,
8. enforced,
9. consistent with other laws,

10. separated by subject matter, and
11. organized by articles which are identified not only by number but by subject matter.

## Recommended Sections and Order of a Law

A logical and comprehensible structure for writing a law is as follows:

- Title
- Short Title (for ease of reference)
- Purpose
- Scope
- Definitions
- Substantive provisions in a well-organized, logically consistent order
- Penalties section (largely civil or administrative)
- Repeal all prior laws on same topic or certain provisions and all inconsistent existing laws.
- Effective Date – Entry into Force (specifying either the day the bill becomes law or a certain date thereafter)

## Promulgation of Laws

"Promulgation" means informing people about the existence and content of a law. The notion of "ignorance of the law is no excuse" only should be applied where the people have a real way of knowing the law. Reportedly there have been instances in Egypt in which the government has sought to enforce laws after enactment but before promulgation.

*The fundamental legal and fairness principle*
*of due process would be sorely violated*
*by a government that enforced a law*
*without sufficient promulgation.*

It should be determined whether there is often a large time gap between a law's enactment and its publication in the *Gazette*. (We have heard conflicting reports on this.) "Official Promulgations or Publishment" in Egypt is very limited. An insufficient number of each law is made available to judges and lawyers- let alone the general population.

Another problem is that finding the new laws in the *Gazette* is a cryptic process. The volumes of the *Gazette* do not have a table of contents or index by law name. There are only law numbers.

## The Legislative Process

Attached to this Report is a publication of the United State Congress called: *How Our Laws Are Made*. This publication provides a clear and detailed account of the legislative process of the U. S. Government. Its potential utility to Egypt was illustrated at our Consultative Workshop when a Ministry of Justice official expressed keen interest in the translation of that publication into Arabic.

## Translation and Terminology

Foreign investors and commercial law reform projects worldwide are often plagued by poorly translated laws. This is clearly true with the laws we have worked with in this project (although the proposed Capital Markets Law marks a vast improvement in translation.)

Poor translations and anachronistic terminology will certainly impede non-Arabic language speakers from understanding the laws and indeed might discourage them from even trying to read an entire law. This will decrease the chances of their involvement in business in Egypt. A thorough review of these laws requires a professional translation as well.

## Rulemaking – Executive Regulations

Regulations are the measures by which the executive branch of a government implements legislation. In the United States the process of developing these regulations is called "rulemaking."

<u>It is vital that the Egypt's "Executive Statutes"[7] that are created to implement the laws are exactly true to both the spirit and the letter of those laws</u>. Reportedly this is not always so in Egypt. Moreover, the key elements of a governance framework should be in the law itself and not in the implementing regulations. Deferring to a subsequent regulation is often a case of legislative laziness.

A brief description of the rulemaking process in the United States is attached. Also attached is a recent rule of the US Securities and Exchange Commission. This rule is attached for two reasons: it shows the form of a rule in the United States and the rule itself is on a very current topic; namely, the activities of auditors in public corporations.

[7] It is recommended that the term "Executive Statute" or at least its translation into English should be changed because it is confusing. "Statute" in the US means a law while in some other countries "statute" means corporate bylaws.

# BANKING LAW

A banking law was adopted by Parliament in June, 2003 but at the time of this writing was not available in English. It should be determined whether the new law solves the "public money" problem. The underlying problem is that because the major commercial banks in Egypt are state-funded, the Criminal Code [8] provides that a fraud upon the bank is a fraud upon the state. [9]

It should also be determined if the new law includes the errant banking provisions that currently appear in the Commercial Law or if those provisions are still improperly placed in the Commercial Law.

*Lending*

Lending to businesses should be a major priority and activity of commercial banks. In Egypt however the penalties for even honest failures to timely repay would thwart businesses from formal sector borrowing.

The Prosecuting Attorney often claims that criminal intent existed *ab initio* in the borrowing of the money, *i.e*, the borrower never intended to repay the loan. Prosecuting Attorneys have charged that the failure to timely repay a loan is a theft of public money even though this is not provided for in the law. These practices give rise to unwarranted prosecutions and commercially unrealistic penalties.

The 30 June 2003 *Egyptian Gazette* [10] reported: "Unfortunately, the new law offers no solution. Nor does it cancel out clauses in previous laws that penalized faltering investors."

Although we do not have the benefit of seeing the recently-adopted Banking Law, we set forth here some of the essential topics that should be covered in a modern banking law:

## 1. Definitions Section

Amongst the terms this section should include are: currency, cash and cash equivalents, business day, financial institutions, board of directors, and officers.

As to the definition of "bank" the following should be helpful. This is not a technical definition but instead describes some of the functions of a bank.

> A bank is a type of financial institution that at a minimum accepts deposits from the public and makes loans. In addition, a bank may handle financial transactions such as issuing letters of credit, handling settlements and clearing operations between branches of its own bank and other banks, both domestic and foreign. Banks may do foreign exchange activities, may pay interest on deposits, may act as a trustee, may issue securities, may provide insurance of various sorts, may provide safekeeping services, and other activities.

[8] Criminal Code Article 119
[9] Bank privatization should have a place in the legal and market reform agenda.
[10] *The Egyptian Gazette*, June 30, 2003

Note: due to the increased risks in the securities sector it should be carefully considered whether commercial banks in Egypt should be involved in securities.

## 2. Foreign Involvement

This section would discuss if and how foreigners are permitted to open domestic banks, or branches of foreign banks.

## 3. Licensing and Permitting

Fundamental issues for this section are who can apply for a banking license and how. Which type of business organization can operate as a bank? For example, a joint stock company, a limited liability company, or a partnership.

The assumption in most jurisdictions is that a bank will be a joint stock company. According to the Egyptian Companies Law joint stock companies "with shares" and Limited liability Companies are prohibited from owning banks. (The Companies Law Article 5). One can extrapolate that only corporations can own banks. However this is probably a translation/terminology problem as the term "joint stock company" in the Egyptian law apparently erroneously means a partnership. This shows the danger of improper translation and terminology.

There are two schools of thought amongst developed economies on whether the licensing authority should be able to approve an entity as a business organization simultaneously with allowing the organization to be a bank. In the United States, the Office of the Comptroller of the Currency licenses a bank and it becomes a business entity at the same moment.

However, in Egypt, it might be preferable to first require the business organization to registered like any other business. The reason for this suggestion is the general need to centralize business registration in Egypt. That need would not be well-served by carving out exceptions except under compelling circumstances.

## 4. Pre-existing Banks

For banks that are already in existence in Egypt when the law goes into effect there should be a re-licensing requirement within six months following the entry into force of the banking law.

## 5. Permits for Branches of Foreign and Local Banks

The law should have a permitting section for the procedures needed to allow branches to be formed, to allow operations by representative offices of foreign banks and as well as branches of foreign banks. Typically there is a requirement that there be agreements between the host country and the country where the foreign bank is headquartered regarding appropriate supervision of the local branch or representative office.

## 6. Bank Registry

The law should require the existence of a register of approved banks which is located typically at the offices of the licensing authority.

## 7. Revocations

Provisions for the procedures for revoking licenses and permits should appear in this part of the law.

## 8. Ownership

Another key area involves who can own capital in a bank and who may be restricted from having a qualifying holding in a bank.

## 9. Standards for Individuals

Individuals involved with bank management and ownership control must be "fit and proper persons." This term should be defined with as much detail as possible in the law, otherwise it will be meaningless. The titles and qualifications of bank management are usually spelled out in the law. Some jurisdictions require the establishment of a bank code of ethics and the appointment of an inspector general.

## 10. Changes in Control

Change in control provisions will address what notices are required and what approvals must be obtained when there is a change in control of a bank.

## 11. Bank Structure

The law often covers the structure of a bank, sometimes by specifying what has to be in the by-laws. There is often a requirement for a board of directors to be elected by the general meeting of shareholders.

*Board of Directors*

Sometimes there is a dual board system – one board is the policy making board of supervisors, the other is the board in charge of management and operations. In the US, there is only a board of directors that handles policy and management oversight.

*Independent Audit Committee*

There is always an independent audit committee, usually approved by the shareholders. An outside auditor is required to be appointed and an annual audit is specified at a minimum (some jurisdictions require more frequent audits by the outside auditor).

## 12. Secrecy

Bank secrecy is always part of the law. These provisions can be complex or simple. Anti-money laundering requirements appear here, and today, also antiterrorism provisions.

## 13. Reorganization (not bankruptcy reorganization)

Most banking laws provide for how the owners of a bank can reorganize their institution, typically by the infusion of additional capital and adding new shareholders.

## 14. Banking Principles

In this section appear both allowed and prohibited banking items such as:

- "prudential requirements" which address capital reserves, risk management standards, loan classifications, and more.

- record keeping requirements, usually now tied to adherence to International Accounting Standards (IAS).

- the requirements on dealing with secured debt of the bank and secured debt for loans made by the bank to its customers.

- the restrictions on loaning to "related parties." Related parties mean not only family members but also persons who have a controlling direct or indirect interest in the bank or in entities controlling the bank. These provisions are often highly technical and complex.

## 15. Accounting and Auditing

Provisions on international accounting standards appear as well in this section. The requirement for publication of the audit report is specified. Also, there will be a requirement that the audit be certified and sent to the supervisory authority. There will be included a provision giving the supervisory authority the right to inspect the bank and do its own audit.

The actual authority and procedures that the supervisor will use are spelled out in the other major law that runs along with the banking law; namely the Central Bank law.

This section also gives the supervisor the power to issue preventive orders to the bank to cease certain imprudent practices. Other kinds of orders may be corrective or terminal (usually the last step). Procedures for issuance, effect of orders and appeals from orders are covered in these sections.

## 16. Rehabilitation, Conservatorship, Receivership and Liquidation

These provisions are often the most complex in a banking law.

*Rehabilitation*

Rehabilitation ought to be the least-used provision since it involves committing public monies into shoring up a failing bank.

This is where the notion of "too big to allow failure" comes into play. That is, the political head of government has to personally approve the use of government funds to increase reserves so the bank does not continue down the road to insolvency. To justify this, the prospective collapse of the bank in question must be a real threat to the systemic integrity of the country's banking system.

*Conservatorship*

A conservator would be appointed if there was a belief that the bank, with proper management, can be brought back from the edge of failure. During the savings and loan crisis in the United States The Resolution Trust Corporation (RTC) was involved in this.

In other countries, there is often little expectation that a conservator will be able to save a failing bank. Instead, the conservator is put into place to preserve the *status quo* until the bank regulator can decide on what to do next. A conservatorship is usually limited in time, for example three years, with the right to extend for another year.

*Receivorship*

Assuming the bank cannot be brought back to health, the next step is usually receivership.

This is the Federal Deposit Insurance Corporation (FDIC) function in the U.S. Receivership is analogous to bankruptcy and is often called bank bankruptcy proceedings. A receiver is appointed to marshal the assets of the bank, receive the claims of creditors, and (barring deposit insurance) establish the amounts and priority of customers' deposits.

The law establishes priorities of claims for paying off creditors of the failed bank. The system resembles in some respects the priority system used by a trustee in bankruptcy. The last priority of claims is usually the shareholders.

Receivership provisions in banking laws are extensive and cover applications for bankruptcy, proofs of claim, powers of the receiver, set off and netting of claims, termination of executory contracts in whole or in part, how to handle secured claims, filing of reports, distribution and timing of assets to settle claims, appeal rights, cross border receiverships, and more.

*Liquidation*

At the end of the process is liquidation. Once all claims are settled, all distributions made, final accounting and reports filed, the bank is stricken from the register of banks and ceases to exist.

*Regulatory Lenience*

A typical addition to the foregoing basics is a provision that allows the regulator the power to exercise discretion in holding banks accountable for compliance with the banking law. For example, the central bank may overlook strict compliance if it determines that its regulators are too inexperienced to provide proper regulation and guidance to banks. Likewise, banks may be given a bit more discretion in the early stages of their existence as they learn the practical realities of banking, especially in those jurisdictions just emerging from some disaster or crisis or civil unrest.

# BANKRUPTCY LAW

The current bankruptcy provisions are found in Articles 550 - 772 of the Commercial Law. [11] Many of these provisions should be changed. Moreover, other provisions, consistent with the purposes of a modern bankruptcy law should be added.

The bankruptcy provisions should be codified as a separate law in order for businesses to locate it more easily.

It is suggested that the law have a more descriptive name such as: "The Law on Liquidation and Reorganization in Bankruptcy."

The purpose of a bankruptcy law must be kept in mind by its drafters; namely, to achieve the social good of invigorating the economy. This is achieved by liquidating those businesses that are beyond repair and giving other debtors a fresh start through reorganization.

*A modern and efficient bankruptcy law*
*will adequately provide for reorganization/rehabilitation.*
*The current Egyptian bankruptcy law provisions have*
*been characterized by one lawyer as a*
*"death sentence for companies."*

*Balancing the Rights of Both Debtors and Creditors*

A bankruptcy law covers rights both of debtors and creditors and therefore should represent a compromise of the interests of both. This is the case in the United States. The Egyptian law does recognize the rights of both debtors and creditors but should have a stronger reorganization section. A law that favors liquidation over reorganization is one that favors creditors over debtors. A more balanced law will lead quicker to a developed market economy.

[11] The Commercial Law No. 17 of 1999 is also in Egypt referred to as the Trade Law. We will use the term "Commercial Law."

*No Stigma Should Attach to Bankruptcy*

There is no moral breach in being an "honest debtor." The relief offered in the law should encourage entrepreneurial risk-taking, and that will not be the case if, as in Egypt, being a bankrupt is viewed by the law as being shameful.

Businesspeople typically devote their best efforts to make their businesses succeed. Should they fail, it is often due to matters beyond their control, such as the nation's or world's economy, and decisions or changes in positions of third parties, such as suppliers or buyers.

*Loss of Civil Rights*

Certain of the current Egyptian bankruptcy provisions place bankrupts in a second class citizen status. Article 561 2 of the law allows the debtor to be taken into custody "in case of necessity." This type of provision then reappears in Artcle 586. Stigma is also suggested in Article 587 which bars a bankrupt from leaving his "domicile" without informing the trustee in writing of his whereabouts and prevents him from changing his domicile without the consent of the judge.

Similarly, Article 586 disqualifies a bankrupt from being a "voter or member of the parliamentary councils, local councils, the chambers of commerce or industry of the professional unions" as well as a corporate board member, banker, securities broker, in the import or export business.

Attention should be given to the second clause of Article 588 as it seems onerous although the current translation makes it difficult to understand.

*Reduce the Criminal Aspect*

The negative characterization of bankruptcy is further displayed by certain criminal provisions in the law. "Bankruptcy Crimes and Compositions Bankruptcy" appear in Article 768 through Article 772. This prospect of criminal prosecution is ominous to a business person. Even more ominous is Article 768 which simply states: "The provisions prescribed in the Criminal Law shall apply to criminal bankruptcy cases." This matter is sufficiently important that whatever specific provisions are obliquely alluded to in Article 768 should at least be identified in the Bankruptcy Law; though, the question would remain as to whether such provisions should exist at all.

*Proper Organization of a Bankruptcy Law*

It is important for the bankruptcy law to be drafted in a logical order as it will then make clear which classes of debtors can obtain relief, the rights of all parties, and the role of the court and trustee. In many jurisdictions, including the United States, the procedural rules are not in the actual Bankruptcy law but appear in another measure. (Procedure is discussed later.)

Borrowing somewhat from the U.S. Bankruptcy Code, a recommended order of the Egyptian bankruptcy law would be:

- Short Title of Law
- Purpose
- Definitions
- General Provisions
  Including role of court and trustee in general
- Creditors, the Debtor, and the Estate
- Liquidation
- Reorganization
- Adjustment of Debts of an Individual With Regular Income

*What Types of Debtors are Covered?*

The Egyptian law should clearly identify the types of debtors for which relief is provided. Instead, it is ambiguous and possibly incomplete. The bulk of the law covers "traders" [12] but the term "trader" is not defined in the bankruptcy provisions. Instead, the reader of the law must find A 10 of the Commercial Law which defines trader as: "every one who practices a commercial act in a professional way in his name and on his behalf, 2) every company established under any company law regardless [of] its purpose." We take it that a trader in Egypt is anyone who conducts business. [13] This goes to the importance for all laws to have a definitions section.

"Bankruptcy of Companies" is apparently only covered in Article 698 to Article 724. It is not clear how a company differs from a trader other than being a subclass of a trader.

The law does not appear to offer relief to non-business, individual consumers. Such relief is provided in Chapter 13 of the U.S. Bankruptcy Code. Whether such relief should be in Egypt's law is an open question. Many countries do not provide (non-business) individuals with the bankruptcy mechanism. This may be because of potential abuses and because bankruptcy proceedings involve significant fixed costs that are best absorbed through larger cases.

Moreover, many countries' citizens do not have much consumer credit making such a provision less necessary. <u>Conversely, the availability of consumer relief would likely be a factor contributing to the development of consumer credit, and therefore increased consumer demand, in Egypt</u>.

*What Triggers Involuntary Bankruptcy?*

<u>The Egyptian law rather vaguely provides that bankruptcy exists when the trader "stops paying his commercial debts following disturbance of his financial affairs</u>." (This is the same language used for corporations.) The vagueness and lack of details in this provision brings no level of certainty over when a businessperson might find himself declared a bankrupt.

This differs from the notion of bankruptcy in the U.S., for example, which is based on liabilities exceeding assets.

[12] Articles 550 to 697 of the Commercial Law.
[13] The use of the term "trader" may derive from the differentiation in the French Civil Code system between commercial and professional activities.

The law in Egypt will recognize a forced bankruptcy petition of just one of the debtor's creditors.

*Under the Egyptian system one could be deemed bankrupt*
*even if he has paid nine of his ten creditors*
*and his assets exceed his liabilities.*

*Voluntary Bankruptcy*

Voluntary bankruptcy is provided for in Article 552. The timing of the declaration is insufficient. Article 553 provides for bankruptcy within only 15 days from the failure to pay the debts. Fifteen days is likely too soon to ascertain whether the bankruptcy mechanism would truly be necessary.

*Who can Petition for Involuntary Bankruptcy?*

This is another troublesome provision for someone seeking to do formal business in Egypt. Article 552 allows for a petition to be filed by "one" of the creditors, the Public Prosecutor, or the court apparently on its own volition and without a hearing (see also Art 556). The topic is then resumed in Article 554 whereas instead it should follow from 552.

The court should not have power to declare a bankruptcy without the debtor being heard on the matter. Moreover, preferred practice is not to vest the Public Prosecutor with the power to initiate a bankruptcy proceeding.

*Unless the government is a creditor*
*it should not have "standing" to advocate*
*the bankruptcy of a debtor.*

This power raises the question of whether a political motive is involved. Allowing a Prosecutor to bring a bankruptcy action is a disincentive for foreigners to invest or do business in Egypt as well as a problem for nationals.

Involuntary bankruptcy forced by creditors should only be on sufficient grounds set forth specifically in the law. Bankruptcy should not be forced where the debtor is only 30 or even 60 days in arrears as there may simply be a cash flow problem. (Of course, the debtor should also be trying during this period to explain his situation to his creditors and thereby bring them comfort.)

*Rights and Status of Parties in General*

The power to object with cause to judicial rulings rightfully belongs to the parties directly affected by such ruling; namely the debtor and creditors. Unfortunately, it seems that debtors and creditors in Egypt are barred from contesting a range of important court rulings [14]. Again in abrogation of a debtor's rights Article 644 3 seems to allow the trustee to waive the rights of the debtor in certain circumstances.

*Impact on Foreign Investors*

[14] Articles 567 and 580 of the Commercial Law.

A foreign investor would find many of the bankruptcy articles troubling. Moreover, he would be puzzled and troubled by Article 559 2 which in summary fashion speaks about the declaration of bankruptcy of a trader having a branch or agency in Egypt. This appears to refer to foreign businesses. The rules should be spelled out with greater specificity and would need to provide for appropriate notice to such foreign entities and a hearing.

*Reorganization: Management of the Business*

A major issue is who will run the company during its reorganization. Consistent with the understanding that bankruptcy does not carry a stigma, the view in the United States is that the debtor should in general be recognized as the best party to carry on the business during reorganization. Moreover, the debtor has the most knowledge of the business including third parties such as suppliers and customers. If the debtor is barred from running his business he will have less of an incentive to file for reorganization.

This understanding seems to appear in Article 573 where the trustee "deputizes" the bankrupt in the management of the business. However, this notion becomes murky in the provision that the trustee "shall record, day by day, all works related to the management of the bankruptcy."

The law seems to provide too large a role for the trustee, who should have more of an oversight than operational role.

The position on management in the Egyptian law becomes even more questionable in Article 589 which states: "[t]he mere issue of the bankruptcy declaration ruling shall fetter the hands of the bankrupt from managing and disposing of his property." (emphasis added.) While the handing down of a bankruptcy ruling should limit the disposition of assets it should not unduly bind the bankrupt's hands in running the company.

The premise of rehabilitation is that a business will continue to operate. However, Article 645 seems to presume that this is not so, as it is conditional. The preferred method would be to say that the business will remain ongoing unless there is a showing why it should not.

*Type and Role of Court*

The specialized nature of bankruptcy proceedings prompts some countries, like the United States, to have specialized bankruptcy courts. As bankruptcy proceedings are in way emergency measures they should be expeditiously handled.

*There would be value to establishing*
*specialized bankruptcy courts in Egypt.*

The preferred practice is to establish a system that allows the courts to make judicial rulings independent of administrative decisions. (See Role of the Trustee below)

*Role of the Trustee*

The practice in the United States is to limit the role of the judge to judicial (rather than also administrative) functions.

Thus, in liquidation proceedings, the bankruptcy judge in the U.S. delegates the administrative functions to a division of the Department (Ministry) of Justice called the Office of the United States Trustee. (Although in reorganization proceedings a trustee may be appointed where there is fraud, mismanagement, or incompetence of the debtor.)

The Trustee, not the court, appoints and supervises the Administrator and holds the first meeting of the creditors. This helps eliminate any conflicts of interest and undue influence on the judge, and it reduces the workload on an already-burdened judge.

This seems to be the case, too with the Egyptian law as Article 561 provides for the court to appoint a trustee. However, this preferred approach seems contradicted by Article 578 which then allows the judge to "assume control of the management of the bankruptcy . . . . " There should be consistency in this regard.

At least until the establishment of specialized bankruptcy courts this management role for a judge would be another major burden on the judiciary and also present the potential conflicts of interest of having a judge rule on matters when he is actually managing the business of the bankrupt.

Article 561 calls for promulgation of a decree by the "competent minister" regulating trustees. Standards and qualification for trustees should be set forth. Article 572 properly disqualifies a trustee candidate for certain, but not all or enough, ties with the bankrupt. <u>Such a safety net against conflicts of interest should also apply to a trustee's relationships with creditors.</u>

The grounds for personal liability of a trustee should be expressly stated and limited; otherwise good trustees may be hard to find. A trustee should only be personally liable for malfeasance, such as taking personal gains from the estate, incurring unjustifiable expenses and gross negligence/recklessness. (Ideally, there would be insurance to cover him for this.)

The law should clearly indicate how the compensation of the trustee will be calculated. Article 577 provides for the court to decide the remuneration and reimbursable expenses of the trustee.

*Role of the Controller*

Controller is a different term for Administrator.

The law or its implementing regulations should set forth educational and professional qualifications for the Controller. They should have no conflict of interest and thus should not be related in family or business to the debtor or the creditors.

It is possible to go farther. In Canada, Administrators are licensed. The court should be authorized to dismiss a Controller under appropriate grounds. Compensation should be easily discernable, for example, in the United States it is a percentage of the distributed funds. The liability of the Administrator, as with the trustee, should be limited.

*Role of Specialists and Experts*

The Administrator should be entitled to retain specialists and experts. The law or its implementing regulations should establish the qualifications for specialists and experts and indicate that they too must be free of any conflicts of interest. Further, the Court should be able to dismiss them under appropriate circumstances.

*Procedure*

In the United States and many other jurisdictions, the procedural rules for bankruptcy are not contained in the bankruptcy law itself. Instead, they are issued separately, although they should also be issued contemporaneously.

Such procedures would include the contents of petitions and other filings to the court, notice provisions, the scheduling of the number of days for events such as judicial rulings and objections thereto to take place, grounds for dismissal of bankruptcy proceedings, and qualification requirements for the trustee and administrator.

At least some of the applicable procedures for Bankruptcy in Egypt appear in the Civil and Commercial Procedure Law per Article 565 of the Bankruptcy Law. These provisions might more properly be either in the Bankruptcy Law itself or a separate implementing measure.

*Timing*

There should be a quick turnaround between the filing and granting of the application for bankruptcy. Otherwise the debtor could become irreparably damaged and have no chance of rehabilitation.

However, for certain other matters, the Egyptian law should perhaps contain periods longer than it does. For example, Article 564 only gives the debtor and creditors ten days from publication to dispute the list of debts. Likewise, Article 656 only gives the party ten days to contest the judicial ruling on the contested debt.

*Notice*

Notice requirements are key to ensure that all creditors are aware of the proceeding. Especially for foreign creditors, notice should be by mail, as well as generally by publication through the appropriate outlets. Article 564, which appears to be the notice provision, is deficient in this respect and thus is a disincentive for local businesses to lend and foreigners to invest.

*Foreign Judicial Rulings*

Egypt's bankruptcy law should contain a provision setting forth the standard on which it will recognize the ruling of a foreign court with respect to a debtor's assets. This is because a bankruptcy proceeding against a business with assets in Egypt could be brought in another country.

Under the international law principle of "comity" courts of other countries may recognize a judicial ruling so long as it equitably affects national creditors and it resulted from due process of law. Adhering to this principle of comity would relieve the Egyptian court of hearing a bankruptcy matter against the same company and make unnecessary a governmental determination on such matters.

## Bankruptcy of Companies

*Question about Scope*

The scope of this Chapter applies to all business organizations in the Companies Law other than joint ventures. Article 699. However, the Companies chapter of the bankruptcy provisions is very short and lacks most of the relevant provisions found in the Traders' section. Article 698 gives no indication that any of the numerous trader sections apply to the bankruptcy of companies.

The one express exception to this in Article 712 which references Article 588 by which, all disqualifications from the holding of positions cited in A 588 of "the bankrupt" can be reinstated three years from the termination of bankruptcy. It should be noted that referring in this context to "the bankrupt" in a commercial sense is questionable as the bankrupt is a juridical entity and the positions held are by individuals.

The bankruptcy provisions should be amended and reorganized to:

(a) clearly incorporate both Trader and Companies where applicable;
(b) reference by incorporation the applicable Trader provisions in the Companies Chapter; or
(c) restate the applicable provisions in the Companies chapter.

The same vague provision for triggering bankruptcy is seen for companies as for traders in that it is deemed to have occurred where a company "discontinues paying its debts following confusion of its business affairs." Worse, according to this article, bankruptcy takes place by a judicial ruling without mention of a hearing.

*Problems with Individual Liability*

The unlimited liability issue arises here as in other laws as all "joint partners" appear to be personally liable according to Article 701 2. [15] There may be a linguistic or translation question here because the Companies Law includes corporations which of course have shareholders rather than partners. In the United States, the general partners of a general partnership have unlimited personal liability as do the general partners of a limited partnership. But a sacred cornerstone of corporate law is that shareholders are only liable for the amount of money they have invested in the corporation.

[15] Apparently, Article 701 2 of the Commercial Law is applied only for general partnership companies; while A2 of the Companies Law provides that the liability of the shareholder is limited to the value of his investment in the company.

Another inappropriate enlargement of the jurisdiction of the court is Article 704 which provides that "the court may also pass a judgment in bankruptcy for all person [sic] who under cover of this company carries out commercial operations for his own account . . . . " Directors of the company are also at risk. Art 704 2.

*Reorganization is Given Short Shrift*

Rehabilitation of corporations is only discussed in Chapter 8 in cursory fashion. This is a critical deficiency in the law and must be addressed.

*Crimes*

Bankruptcy crimes are referred to in Articles 723 and 724. Criminal liability should only attach to egregious, willful behavior. Of additional concern is the reference in Article 716 to the crime of "bankruptcy with negligence."

*Modern criminal codes do not include negligence as an element of a crime. Typically the legal requirement for a crime includes intent.*

<u>There is a view in Egypt that due to the difficulty in proving intent, it will simply be inferred by the court as an expedient</u>.

## EGYPT'S SEVERAL LAWS ON BUSINESS ORGANIZATIONS

The purpose of business laws is to stimulate business. Business laws should be drafted to achieve that purpose and should be tailor-made to various ownership and control structures. This will encourage people to form business organizations because each law presents different opportunities for its owners to share rewards and risks.

The level of legal risk normally depends on whether the investor/owner is involved in the management of the business. [16] Where he is, such as in a general partnership, he faces the potential of great profits and unlimited personal liability. Where he does not, such as with limited partnerships or publicly-held corporations, the investor/owners potential for both profits and losses are limited.

<u>Key problems with Egypt's several business organizations laws.</u>

The several business organization laws have both substantive and drafting flaws.

[16] Management of an investment also figures into securities regulation in the U.S. In order to protect as many investors as possible the U.S. Supreme Court ruled years ago that the securities laws apply to any instance where the prospect for success (or loss) in an investment is in the hands of a third party such as a promoter. For this reason, a limited partnership interest is deemed a security but a franchise arrangement is not.

The impact of the drafting weaknesses should not be dismissed as being merely formalistic. Poor draftsmanship means difficulty in both reading and understanding a law. This could discourage a national from creating a formal business organization – and cause a foreign investor to turn instead to one of Egypt's approximately 180 competitors. (Poor translations can also have this result for foreign investors.)

All pertinent provisions of a legal framework should be in the same law – not the case in Egypt. This includes the legal provisions setting forth the types of business organizations, their rules for formation, capitalization, and governance. This enables people to know their legal options for business formation and operation.

In Egypt business organization provisions appear in a minimum of five laws:

1. The Sultanic Decree of 1883,
2. The Companies Law,
3. The Commercial (Trade) Law,
4. The Investment Incentives and Guarantees Law, and
5. The Capital Markets Law.

Reportedly, a draft Unified Companies Law was prepared by the Department of Legislation of the Ministry of Justice and is under Parliamentary review; however we inquired into this and were informed it is simply a compilation of pre-existing laws with some non-fundamental modifications.

## The Sultanic Decree of 1883

This 1883 Turkish decree was the commercial law of Egypt until 1999. Reportedly, Articles 19 – 39 were not repealed by the 1999 Commercial Law are still applicable law. Although an Egyptian commercial lawyer has stated that Articles 19 – 39 only concern general partnerships (which the decree calls "joint stock companies"), the articles also speak of a "commendite company" which appears to be a limited partnership, and a "shareholder" company" (which we believe is a regular corporation.)

The current scope and applicability of the Sultanic Decree needs to be clarified. (Note: under the Companies Law of 1981 a limited partnership is called a limited liability company.)

Further, it is not apparent why these Article 19- 39 survived the general repeal of the Decree. They probably should be addressed in the Companies Law. The terminology used in the English translation is the same as that used for business organizations in the Companies Law.

## The Commercial "Trade" Law

This is an omnibus law containing several subject matters such as contracts and bankruptcy, The individual areas of law should be amended (if not repealed and wholly rewritten) and recodified.

*Commercial Agent Problem in the Commercial Law*

The Law gives unusual legal privileges to Egyptian business agents at the expense of foreign businesses. Reportedly, this was the result of lobbying by Egyptian agents during the drafting of the Commercial Law. <u>These privileges are at the expense of Egypt as a whole as they inhibit the level of foreign business activity in Egypt</u>.

For example, where a contract is for an indefinite term, the law requires the agent to receive a payment if the principal terminates the contract without cause. Interfering with the principle of freedom of contract, the law does not allow the parties to negotiate out this provision.

*More remarkably, a foreign principal has a general obligation to pay an agent if the principal simply decides not to renew a fix-term contract which has expired.*

The Commercial Law also requires foreign companies to inform the Egyptian embassy or consulate in their country of any changes in certain of their agreements with Egyptians.

*Errant Provisions in the Commercial Law*

Certain provisions that should be in the Companies Law are instead in the Commercial Law (Part 2 “Types of Trade Contracts”).

The Companies Law should contain all the business organizations in Egypt. Instead, Part 2 of the Commercial Law enumerates the “commercial companies” in Egypt, namely:

Joint Liability Company (this is the same as a French *Societe Anonyme* and is similar to a U.S. corporation.); a

Partnership in “*commendum*” (might, per Article 23, seems to be similar to a U.S. Limited Partnership) and a

“Joint Stock Company” Article 19.

Moreover, much later in Part 2 one finds in Article 59 the identification of yet another type of company: “commercial companies with no capital or address, namely . . . joint adventurers . . . . “ This is a unique form of business organization. While it may seem to relate to joint ventures [17] it instead concerns so-called “real” companies. These consist of partners without a written agreement one of whom undertakes the business of the company in his own name yet shares profits or losses with the other partners. These companies are not required to register. The purpose of such an organization is to shield the identity of the other partners. This Article has the laudable purpose of seeking to hold these “hidden” partners fiscally responsible for liabilities of the company.

[17] Many joint ventures globally are implemented through a third company established by the joint venturers which indeed has a capital contribution and an address.

# The Companies Law

The Companies Law governs

- Shareholder Companies;

- Joint Stock Companies ("with shares")[even though the title of the law refers to "Partnerships Limited by Shares"] "Joint stock companies" is a misnomer as the provisions here actually describe a limited partnership; and

- Limited Liability Companies.

Three of the major flaws of the Companies Law are:

(1) excessive government involvement

> The first example appears in Article 4 of the introductory Presidential decree indicates that the government will issue "forms of contracts"

(2) personal liability:

> Several sections impose undue personal liability and therefore fail to recognize the importance of limited liability as a major driving force in encouraging people to take risks and establish formal companies.

(3) confusing drafting:

> Provisions regarding the three entities are sometimes mixed with each other, see, *e.g*. Part 3 "Regulations Concerning the Foundation of Different Kinds of Companies" including Article 25 therein. The law would be much easier to read if each business organization was discussed separately.

An example of poor drafting (or perhaps poor translating) appears in the beginning of the Companies Law. Articles 2 and 3 describe two of the three entities. Therefore Article 4 should discuss the final one, *i.e*. Limited Liability Companies (LLC) – but it does not. So, in an already confused law with confusing terms one cannot even find in the beginning a definition of an LLC.

Given the misuse of the term "Joint Stock Company" no foreign reader of the Companies Law would assume that LLC refers to the juridical entity called an LLC that became established in the United States in the 1990s (which indeed it does not).

## 1. "Shareholder Companies"

**(This appears to be a regular corporation)**

> **THE RATIONALE FOR THE CREATION OF CORPORATIONS: The juridical entity called a corporation exists to encourage people to start formal businesses. It encourages this in two ways: it limits the liability of its owners and enables them to acquire capital through the sale of stock.**
>
> **The view and practice in leading economies is that the corporation and its owners are two distinct separate entities. Thus, the personal assets of the owners are not subject to the obligations of the corporation.**
>
> **This distinction is only disregarded where corporate formalities are not followed through the mixing of the activities of the owners and the corporation (for example keeping just one bank account or the failure to hold shareholder's meetings).**
>
> **In such an instance the law may "*pierce the corporate veil*" and utilize personal assets to satisfy corporate obligations.**

*Business Purpose . . .*
- *add any lawful purpose*
- *and remove diversification restriction*

The Companies Law forbids a company from engaging in more than one type of business. In Egypt therefore, if a company wants to diversify it must establish a holding company and or create subsidiaries.

This is unduly costly and restrictive on the "organic" nature of a business. <u>The law should provide that a business organization may be established "for any lawful purpose.</u>" The purpose clause in the charter of the organization, while containing specifics, may also include the catch-all phrase of "any other lawful purpose." This allows businesses to quickly and easily adopt to new business opportunities.

*Government Involvement in Internal Corporate Matters*

Egypt has inherited the French law restrictions on naming business organizations. Thus in Egypt companies cannot in general use creative names.

According to the Commercial Law (a) the "title" (name?) of the company must be comprised of the names of or more of the "partners." (shareholders?), (b) JSCs are forbidden to have the name of the "partner" in the name of the company, and (c) the purpose of the JSC apparently is required to comprise the name. Article 32, 33.

Moreover, Article 2 of The Companies law provides that "The Company shall have a Commercial title deriving from the purpose of its foundation. The Company is not allowed to take from the names of its parties or of any one of then, an address for it."

In the U.S., business organizations are allowed to chose whatever name they want so long as not in violation of trademark law, not already registered. and absent fraud. It should be determined whether the Egyptian restrictions impact on trademark law rights in that businesses the names of which are the names of the owners or the name of the purpose of the company may not qualify for trademark protection in Egypt. [18]

In the U.S. however business organizations *are* often required to include a suffix which denotes the particular type of organization either by full name or abbreviation, such as Incorporated (Inc.), or Limited Liability Company (LLC).

*Quick Start Up for Businesses*

Modern legislation makes easy and quick the starting up of registered businesses. In the U.S., Articles of Incorporation, *i.e.*, the founding charter, are filed with only one office. That office conducts just a superficial review of the Articles of Incorporation for statutory compliance. Official acceptance of the Articles and registration of the corporation can be accomplished in a few days.

In the United States, the following articles are often the only ones required to be in a corporate charter: [19]

- name of company,
- purpose(s) of company,
- classes and number of shares,
- whether or not the shares have par value,
- the duration of the company (perpetual),
- names addresses of the initial board of directors
  (some states allow for one initial director for ease of incorporation),
- address of the principal place of business,
- name and address of the registered agent
  (to receive the summons and complaint in case the company is sued),
- statement that the bylaws have been adopted, and
- signature under pains of perjury.

In some states corporate names can be reserved in advance for a number of days. The price for registration is relatively low so as not to discourage businesses from joining the formal sector.

[18] This question about business names is raised because in the U.S. for example words that are generic or merely descriptive generally do not receive trademark protection. Indeed in the U.S. a business name that is primarily a surname will not receive trademark protection. To receive trademark protection the words must be more creative.

[19] In the United States, it is each individual state rather than the federal government, that enacts the business organization laws and thus there can be some variation from state to state.

*Freedom of Contract Problems*

*The widely-held principle of freedom of contract*
*recognizes the right of private parties to agree to anything*
*so long as it is not unlawful or against public policy.*
*This is not always the case in Egypt.*

To the extent the government dictates contract terms it is violating the freedom of contract principle and making it less attractive for people to do business in Egypt. Additional interference with freedom of contract appears in Article 34 which in part states that corporate officers may be removed even if they have an agreement with the corporation that they cannot be terminated. Article 34

*Government Intervention in Private Contractual Relationships – Freedom of Contract Issues*

Article 8 apparently requires three founders for a LP. This should be changed to two founders because it is simply an obstacle to require a minimum of three. If two people have an idea to start an LP they should be able to do so.

LPs and perhaps the other business organizations are apparently barred from writing their own charter but instead must use one devised by the government. Article 9 Article 16(1) requires that "the model of the act of the constitution of every type of the companies . . . will be laid down by a decree of the relevant minister." [20] Besides being an example of government intervention it is also an example of poor draftsmanship as such related provisions as 9 and 16(1) should either be in the same or in consecutive articles.

Moreover Article 15 requires the charter to contain "all the data prescribed in the executive regulation." This requirement should be scrutinized to ensure that personal and or confidential information is not called for.

Government should not, as it does in this law, determine the forms of contracts and corporate charters (Introduction Art 4), or the maximum limit on wages (Intro Art 3), and should not require companies to publish their amount of paid capital on all printed matter including contracts.

*Valuation of Shares in Certain Circumstances*

Ominously, an entire government-related bureaucratic mechanism must be established to value contributions to capital in certain instances for corporations and LPs. Article 25. Examples are where services or land is contributed. <u>This has been called "a nightmare" by one international lawyer in Egypt</u>. Besides representing unusual government intervention in the private sector this provision impedes the flow of business and adds to a transaction cost as, for example, the valuating body can take up to 60 days to present its findings.

[20] Some modifications to the form handed down by the government are allowed but it is not apparent which changes can be made. Some provisions are mandatory and others are permissive but that is not stated in the document.

The mentality present when government is overly involved in contractual matters between parties is shown in A 60 which provides that the parties must observe their agreement. As this is a cardinal rule of contract law there is no need for the government to stipulate this.

*Mandatory Worker Involvement in Management is a Disincentive*

According to Article 84 workers must be involved in management. This places a heightened role for workers in a corporation and reduces the role of its owners. This requirement will scare away foreign investors. The U.S. view is that the matter of who will run a company is for its owners to decide. However, the E.U. may have a different view on this matter. [21]

*Sparse Registration Provisions*

"Traders" with an initial capitalization of under 20,000 pounds are put in a special category. These businesspeople/businesses register with the registry office of the Ministry of External Trade and are disqualified from the applicability of the Bankruptcy Law. The result is that such a trader cannot voluntarily file for bankruptcy or be involuntarily placed in bankruptcy. <u>Oddly, this exemption from involuntary bankruptcy continues with the life of the business, even if, for example, over time it has annual revenues of millions of pounds</u>.

Egypt should have a separate, unified law for the registration of business organizations. Registration, which in many countries is a detailed law unto itself, is touched upon in Article 40 which states a JSC does not come into being until an order is signed by the *Khedive*. Depending on the role and performance of the *Khedive* this could represent government bureaucracy and delay. But this Article seems mystical as the *Khedive* no longer exists. Articles 48-51 refers to registration of JLCs and PCs.

Recommended provisions for a Business Registration Law appear later in this Report.

*Limiting Potential Liability of Corporate Directors*

This is a major impediment to people joining the formal sector. Personal liability should only be imposed on corporate officers and directors when they act outside the scope of business of their duties either recklessly or in bad faith.

<u>Indeed it is the avoidance of personal liability that prompts people to establish corporations and thus be in the formal business sector. In other words, the corporate device was established in order to stimulate business without people being at personal risk</u>.

To attract qualified directors the law should limit their liability where reasonable.

Article 6 of The Companies Law imposes liability on "any one who intervenes, in the name of the Company" when the amount of paid capital written on "all papers and printed matter" issued by the company is exaggerated. Additionally, the A provides for personal liability under related circumstances.

[21] EC Directive 2001/86/EC, 8 October 2001.

These penalties are further examples of the Egyptian laws' failure to recognize that many inaccuracies and mistakes made in business are unintentional. Certainly, the risk of being personally liable in Egypt represents a major disincentive to establishing a formal business enterprise. In such cases penalties should be moderated if they are to exist at all. See Article 8 imposing unlimited personal liability on founders where the number of shareholders dips below 3.

Provisions such as Article 44 and Article 102 should be changed. Article 44 provides that Administrative Board members are liable to the company's creditors if those members approved a distribution that prevents the company from "confronting its cash liabilities in due time." Such liability should not be placed absent knowledge and intent. Directors should be able to rely on seemingly credible information provided to them by corporate personnel or such professional advisors as attorneys and accountants.

Article 102 says: "No decision issued by the General Assembly will entail the foreclosure of the lawsuit on civil responsibility against the members of the board of administration on account of mistakes perpetrated in the exercise of activities."

The law must sufficiently differentiate between errors committed unintentionally and in good faith from those arising from negligence, recklessness and/or bad faith. <u>The law in Egypt should show that it understands an honest mistake.</u> It is necessary that this distinction be clearly drawn.

This notion of limiting the liability of corporate owners is so strong that in 1989 the E.U. issued a Directive allowing the limitation of liability of an entrepreneur throughout the Community [22].

*The "Business Judgment Rule"*

One way to prudently limit the liability of a director is by the Business Judgment Rule.

> *In the United States the Business Judgment Rule*
> *is a legal presumption that the board of directors acted*
> *in good faith on behalf of the company unless proven otherwise.*

An approach such as this one is very important in order to encourage qualified people to be board members. The Business Judgment Rule holds that corporate board members are not responsible for financial losses to the corporation caused by their errors in judgment so long as they did not breach their fiduciary duties of loyalty and care. In order to bring the case forward a shareholder would need to show the likelihood that such a fiduciary duty was breached.

A U.S. court prominent in commercial matters ruled that The Walt Disney Company board may have breached their duty and therefore may not be protected by the BJR due to an extremely lucrative severance payment given to a former corporate officer.[23]

[22] EC Directive 89/667/EEC, 21 December 1989.
[23] *Brehm v. Eisner*, No. 469, 1998 2000 WL 174619 (Del. Feb. 9, 2000)

*Good Faith Reliance by Board Members on Credible Corporate Information*

Another example of protecting directors is the "Duties of Directors" section of the New York Business Law which in part provides:

> In performing his duties, a director shall be entitled to rely on information, opinions, reports or statements including financial statements and other financial data, in each case prepared or presented by . . . . [24] [specified people such as certain lawyers or accountants.]

*Restriction on Members of the Board of Directors*

The more restrictions that exist on directors of companies the less interest qualified people will have in being directors. Some restrictions are good and necessary such as those regarding conflicts of interest. But the ones in Article 93 are not good.

Article 93 prohibits an individual from sitting on two boards without an affirmative vote of the shareholders. This seems rather redundant as shareholders anyway must elect their board members. Additionally, Article 93; seems to bar an individual from sitting on more than two boards under any circumstances.

The prohibition on sitting on two boards applies only to the Chief Executive Officer (CEO) or the Chairman if he serves as the CEO, in order to avoid conflicts of interest. Other board members may sit on several boards; but to do so they must own at least 10% of the corporation.

The government should not have a say in this as it undercuts the democratic nature of corporate governance.

*Opening the Door to Official Misconduct*

Article 101 bans corporate involvement in political activities but provides the exception that a corporation can give money to a government organ to support an activity important to the company; *e.g.* government doing research of interest to the company. But this has reportedly has been used for improper payments to government officials.

*Shareholders' ("General Assembly") Meetings*

An epicenter of the democratic process in a corporation is the annual shareholders' meeting. This raises several issues regarding transparency and true shareholder participation in the democratic process including the protection of "minority" shareholders rights. Items to scrutinize include proper notice (see implementing regulations per Article 66) and the specific matters that cannot be undertaken by management without an affirmative shareholder vote (Article 63). Such matters should include major transactions. For such matters it is sometimes advisable to require a "supermajority" vote, such as 65% rather than 51%.

[24] New York State Business Law, Section 717.

*Accuracy of Reports, Budget, and Profit and Loss Statement*

It would be consistent with current norms in corporate reporting and accountability to require the CEO of a company to certify as to the completeness and accuracy of such documents.

*Organization of a Corporations Law*

A complete and logical order for the law on Joint Stock Companies could be modeled after the New York State "Business Corporation" law as follows:

1. Short title; definitions; application; certificates; miscellaneous.
2. Corporate purposes and powers
3. Corporate name and service of process.
4. Formation of corporations.
5. Corporate finance.
6. Shareholders.
7. Directors and officers
8. Amendments and changes.
9. Merger or consolidation; guarantee; disposition of assets; share exchanges.
10. Non-judicial dissolution.
11. Judicial dissolution.
12. Receivership.
13. Effective Date.

## 2. <u>"Joint Stock Companies" (Limited Partnerships?)</u>

A reading of the law suggests that there are two different entities: JSCs and JSCs "with shares."

A Joint Stock Company (JSC) is defined as:

> . . . a company whose capital is divided into shares of equal value, which shares are negotiable in the manner prescribed by law. The liability of a shareholder is limited to the value of the shares subscribed for by him. The Company name shall be derived from the objects for which it is to be incorporated and may not include the name of one or more of the shareholders. Companies Law Article 2

A "Joint Stock Company with shares" is defined as:

> a company the capital of which consists of the part or more than what belongs to one or more Joint Partners, and of Shares of equal values subscribed in by one or more shareholders,, and are negotiable in the manner demonstrated by the law. The partner or joint partners are answerable for the liabilities of the Company in unlimited responsibility, but the Shareholder partner is only responsible within the value of the Shares he is subscribing in." Companies Law Article 4

According to Article 1 of the implementing regulations a JSC must have a minimum of three founding shareholders. This should be reduced to one or two in order to make formation of the business easier. The requirement that the name of the JSC include the purpose should be eliminated as an unnecessary holdover from French law.

*Problems with JSCs from a Foreigner's Point of View*

<u>A JSC is very Egypt-centric</u>. A 37 of the Companies Law mandates that when a business incorporates or has an increase in capital, and in the event that 49% of the stock is not already owned by Egyptians, that 49% of the share capital must be offered to Egyptians for a one month period. This seems to mean that the business cannot form as a JSC for this one month period. The majority of the board of directors must be Egyptians. Moreover, this is a requirement on hiring Egyptians, and foreigners can only be hired if Egyptians can not be found for the positions. Reportedly, ministerial approval is required in order to hire non-Egyptian nationals in this situation.

<u>Clearly the above restrictions would be a problem for foreign investors and businesses</u>.

*Delay in Registration*

Article 17 regarding business registration should state the time period in which the government must review and respond to an application to form a business organization. Moreover, Article 17 seems to indicate that application is made to one government agency ("the competent administrative Authority") and then registration is (automatically) effected in the Commercial Register. There should not be two offices involved absent a convincing reason.

The final clause of Article 17 should also be changed as it delays the official existence of the company until 15 days from the recording date. Instead, the law should provide that corporate existence begins upon registration.

*Ownership Rights of Shareholders*

*Free Transferability of Shares*

*"The Right of First Refusal"*

In the U.S. and Egypt a shareholder is generally allowed to transfer his shares. In the U.S. this is only disallowed where a shareholders' agreement prohibits free transferability. In such cases it is often required that the shareholder first offer the sale of the shares to either the corporation itself or the other shareholders. This is often the case with "closed corporations" where the shareholders are reluctant to have strangers (or heirs) as fellow shareholder and is called the "right of first refusal."

To our understanding, the Companies Law would need to be amended in order to have modern standards regarding the transferability of shares. While the law provides for free transferability, it is deficient in setting forth the exceptions to free transferability. The Law provides for restrictions if in the company's original (not amended?) charter and if approved by the board of directors. There should be provisions regarding puts, calls and stock options.

*Other Rights of Shareholders in the U.S.*

- to share in the corporation's profits, if any (distributable as dividends);
- to vote for board members;
- to vote on major corporate transactions and events;
- to inspect the books of the corporation;
- to receive notices; and
- in the event of dissolution - to share in any residue or leftover of value after the satisfaction of creditors and bondholders.

*Valuation of Stock*

*Par Value is a Generally Useless and Confusing Concept*

Par value is an antiquated concept no longer in use in many advanced economies. (Although in business formation in the US the founders might be asked to indicate of the stock has par value.) It does not represent the value of the shares. Instead it is a rather arbitrary number assigned to the price at which stock is first issued – not sold.

*Corporate Governance Issues*

Corporate governance is now recognized as a fundamental building block for capital accumulation and investor confidence. Poor corporate governance and management, including fraud in connection with auditing matters, has defeated billion dollar corporations, such as Enron and MCI.

The requirement in Article 26 that the largest shareholder be the president of the Founders Assembly is unwise. It should be a matter of vote by the shareholders. If the largest shareholder is voted president so be it. But requiring it statutorily makes even stronger the voting power and control of someone who likely already is very influential in the corporation. This could be to the detriment of the "minority" shareholders.

## 3. Limited Liability Companies

As Articles 116 – 129 concern Limited Liability Companies (LLCs). An Egyptian LLC is not to be confused with the recent hybrid business organization in the U. S. with the same name.

Instead, an Egyptian LLC is modeled after the French SARL in which owners participate in a percentage of the capital called "quotas" rather than owning shares. There are no negotiable shares and no board of directors. Instead corporate governance and management flows from the owner through the manager(s) of the business. In an Egyptian LLC all shareholders – even the managers – have liability limited to their capital contribution.

An LLC can have from 2 to 50 shareholders. This limitation suggests that the LLC might serve some of the functions of a "closed corporation" in the U.S., with restrictions on the transferability of their shares; however this observation is only speculation. Toward this end, it should be determined if LLCs rely heavily on "Shareholders Agreements" for their internal understanding, which may include a restriction on share transfer. [25]

Various restrictions appear in the applicable articles of the law and the implementing regulations which should be examined for their rationale and value for a market economy.

These requirements include:

at least one manager of the LLC must be Egyptian (characterized by a lawyer of a major Cairo firm as "a classic problem";

the name of the LCC must contain its business purpose;

the LLC automatically ceases to exist if the number of shareholders falls below two apparently with no exceptions;

the LLC is subject to the requirement that is must distribute to its employees 10% of its net profit if its share capital is 250,000 or more Egyptian pounds. [26]

One responsible director and partners only liable for their amount of investment.

## <u>Commandite Companies Limited by Shares</u>

Another form of business organization in Egypt is a "*commandite* company limited by shares" (CCLS). A *commandite* company is one "whose capital is composed of one or more shares owned by one or more joint partners, as well as from shares of equal value subscribed for by one or more shareholders whose shares are negotiable in the manner prescribed by law." Article 3 of the Companies Law. The ownership interests of joint partners are called "shares owned by joint partners" while the ownership interests of shareholders are called "shares of equal value subscribed to by shareholders."

For an English speaker is it unfortunate that the terms "partner" and "shareholder" are used in the same law; as they apply to very separate types of business organizations in the U.S. This of course would be confusing to a potential foreign investor.

The CCLS must have at least one joint partner with unlimited liability [27] whereas the shareholders have limited liability. In this sense a CCLS seems like a limited partnership in the United States. The managers of the CCLS are called "Partner Managers." The CCLS does have something like a board of directors called a Supervisory Board with oversight of the Partner Managers. A Partner Manager is not allowed to sit on the Supervisory Board. This is not the case in the US where a CEO often sits on the board of directors. However, <u>it is in general a good principle to keep the board "independent" of management.</u>

[25] Such a share transfer provision might, for example, give the LLC or all the shareholders the "right of first refusal" to purchase the shares of a fellow owner before they are offered to others.

[26] This 10% profit to employees requirement does not apply to LLCs registered under the Investment Law but does apply to those registered with the Commercial Register.

[27] As with LLCs, a CCLS in Egypt may be incorporated either through a standard registry process or under the Investment Law which provides some alternative requirements.

Article 29 seems to punish owners who bought their interest "in kind." ("The subscribers of the part in kind will be responsible in front of the others in respect of its assessed value in the act of the Company." This should not be the case especially where the ownership interests are the same.

*Freedom of Contract Problems*

Article 30 provides for liability of founders and managers even where there are explicit contract clauses to the contrary.

Article 34 provides that: "[n]o foundation or profits parts can be created except on surrender of the right accorded by the Government, or on one of the moral rights."

Article 41 and Article 44 concern the 10% profit requirement to employees

# BUSINESS REGISTRATION

As stated in the Business Organizations section, Egypt should have a separate business registration law and just one registry for all business organizations.

<u>Currently there are four different "companies registration departments" in Egypt</u>.

1. The Company House, for companies established under the 1981 Companies Law.
2. The Public Authority for Investment, for companies established under the 1997 Investment Guarantees and Incentives Law
3. The Public Authority for Capital Market, for companies established under Law No. 92/1995, and
4. The Primary Commercial Court (municipal), for companies established under the Sultanic Decree of 1883.

A proposed outline for a business registration law for Egypt is as follows:

Short Title
Purpose
Scope
Definitions
Status of the Registration Office
    (either independent or part of a Ministry or court)
Qualifications, Appointment, Duties and Term of the Registrar
Filed Documents as Public Records
Filing Fees
Filing Requirements
    (the information that must be disclosed for registration)
Operation of the Registry
Errors of the Registrar and Registry Employees
Effective Time and Date of Applications
    Commencement of Corporate Existence

Appeal from Refusal of Registrar to File an Application
Evidentiary Effect of Copy of Filed Document
Limitation of Liability of Registrar and Registry Staff
Records Management
Electronic Records
Paper Records
Name of Business Organization
Registered Agent and Service Upon the Agent
Change of Address of Applicant and/or Registered Agent
Filing and Contents of Corporate Charter
Voluntary Liquidation and Revocation of Voluntary Liquidation
Reports to the Registrar
Automatic Termination
Certificate of Registration

# CAPITAL MARKETS LAW

> A good capital markets law inspires confidence in the market. It shows potential investors, small and large, that they can decide to become corporate owners with the benefit of transparent processes and full and accurate information.
>
> A good capital markets regulator will encourage investment by protecting the rights of investors through various means such as disclosure and reporting requirements and proper use of its disciplinary powers.

The current Capital Markets Law of Egypt is Law No. 95/1992. Its inadequacy was a reason for drafting a new capital markets law which was completed in 2003. The new draft law did not successfully see its way through the legislative process.

However, the necessary further attempt to enact a comprehensive, modern capital markets law should start not with the current law but with the 2003 draft. It is also by far the best translated of the laws we have reviewed.

We recognize the 2003 proposed bill as being in general a good law and the observations below are not meant to suggest otherwise. Although lacking a definitions section, the law did with few exceptions, clearly segregate into Parts the topics to be governed.

Some of the major issues of the law are discussed Part by Part.

*The draft Presidential Decree*

The draft decree presents at least a facial problem. It provides that the Companies Law shall govern any relevant matter not covered in the draft Capital Market Law. The problem is that the draft decree might have borrowed from the Companies Law the same confused terminology used to describe the three types of business organizations. (See discussion of this topic under the

Companies Law.) Any capital markets law developed by Egypt should contain correct and prevailing terminology for business organizations.

Article Six of the decree provides for the repeal of any inconsistent provisions in the 1992 Capital Market Law. As the proposed law is quite comprehensive it would be prudent to make it a complete law and entirely repeal the 1992 law or at least specifically cite the provisions of the 1992 law that are to be repealed should the proposed law be enacted.

*Disclosure*

> Disclosure is the backbone of a good capital markets law. Without full and accurate disclosure investors will not have the confidence to buy and thus will not be active participants in the bourse.

The term of art for what type of information must be disclosed is "material." Material information is any and all information that would help a potential investor decide whether a particular investment should be made.

**It must be firmly kept in mind that this definition**

**of "materiality" means that an issuer must**

**conspicuously disclose all the risks pertinent to the investment.**

**How to Achieve the Goal of Full and Accurate Disclosure**

In general, in the United States issuers are required to register their securities with the US Securities and Exchange Commission (SEC). The SEC then makes the registration statements and prospectuses available to the public soon after the filing.

The information required in the registration materials is designed to provide potential investors with the information necessary to make an informed decision on the investment.

Registration exemption can occur in certain instances such as where the monetary value of the issuance is comparatively small. By exempting many small offerings from the registration process, the SEC makes less burdensome for small businesses the accumulation of capital.

The prospectus is a vital document. It is the document in which material facts are disclosed regarding the issuer and the transaction. The prospectus required by the draft CML mandates the reporting of all material information. Article 50 sets forth the contents of a prospectus.

The summary of the offering called for in A51 should be required to include all „material" facts. Otherwise, people might to their peril rely on the summary in the belief that it does include all the information necessary for them to make an informed decision regarding the purchase of the securities.

Alternatively, there should be a statutory requirement that the summary indicates that it does not include all material information and that the reader should see the prospectus before making a purchase decision. Moreover, the practice in the US of including in all offer-related statements that the investment involves risks should be adopted in Egypt.

A question is raised about the discretion allowed the government in A 53 [5] to determine that Part Five does not apply in cicrumstances that are not amongst the four explicit instances listed in A 53. Such discretion could invite lack of transparancy and official misconduct.

Part One - Capital Markets Authority

*The CMA Should be an Independent Regulatory Agency*

As written, the Capital Markets Authority (CMA) is "affiliated" with the "Competent Minister." Article1 This may mean that the CMA would not be an independent regulatory body.

To the greatest extent possible, in order to best perform its statutory duties, the CMA should be isolated from the type of influence that could politicize its decisions. To the extent the agency is self-financing, through fees for instance, it has some political immunity as the legislature cannot curtail its budget. This seems to be somewhat the case in Article 10 but the provision about "local and international loans or grants" prompts initial concern; both for reasons of political influence and improper payments.

*The Board of Commissioners*

The CMA Board is to be comprised of five full time commissioners and two part time. Article 3 This seems excessive. The US SEC, with a much vaster portfolio than that of most countries, has five full time commissioners and no part-time commissioners.

It is recommended that the terms of the Commissioners be "staggered" in order to maintain continuity of experience and "institutional memory." Such is the case with the SEC.

*Public Access to Information*

The law should expressly provide for a public reading room open for all hours on every business day and containing a suitable number of working photocopy machines and clerks.

The term "competition" in Article 7 is ambiguous. Such a provision should be clear and well thought out. Otherwise, as a legislative mandate, the CMA might have conflicting authority with a government agency that has as its mandate the promotion of competition.

The notion of joint jurisdiction appears in Article 12 which provides:

> Authority employees whose names or positions are designated in a decree issued by the Justice Minister in agreement with the Competent Minister shall be invested with judicial powers to prosecute crimes committed in violation of the provisions of this Law or of the decrees issued in implementation thereof. To that end, they shall have access to registers, books, documents and data on the

premises of companies working in the field of securities and of Reporting Companies pursuant to the provisions thereof, at the stock exchanges or wherever they may be located.

The practical and policy reasons for Article 12 should be re-examined. It would be in keeping with the U.S. approach for the Commission to have disciplinary powers over regulated entities and persons associated with them.

## PART TWO – COMPANIES WORKING IN THE FIELD OF SECURITIES

Reference is made in Article 15 to a joint stock company. Care should be given to assuring that this indeed is the type of business organization intended. In Egypt joint stock company does not mean what it does in other countries.

Banks are allowed in Article15 to solicit and underwrite securities subscriptions. Mechanisms should be in place to separate the risk of such activities from the role of custodian of depositors money. (The US Glass-Steagall Act, which forbade banks from having a securities operation, was fairly recently repealed.)

## PART THREE – STOCK EXCHANGES

Part Three should explicitly state that the exchanges are Self-Regulatory Organizations (SROs) if indeed such in the intention. Exchanges in the U.S. are SROs although the SEC maintains jurisdiction over them. SROs in the U.S. include the New York Stock Exchange and the National Association of Securities Dealers, which operates the NASDAQ system.

This means that the CMA would delegate to the exchanges the CMA's authority to regulate the exchanges' broker-members, while not entirely ceding jurisdiction to the exchanges. The CMA would maintain oversight responsibility. The exchanges would be required to create rules for disciplining members for improper conduct and for establishing measures to ensure market integrity and investor protection. In the U.S., proposed rules of SROs are published for comment before final review and approval by the SEC.

Within the spirit of being self-regulatory, the Exchange itself should develop its own bylaws for CMA approval - rather than as in A31 - the bylaws being presented to the Competent Minister by the Board of Commissioners of the CMA.

Certain activities/objectives of the Exchange might be set out; namely to achieve: economic efficiency in the execution of securities transactions, widespread availability of quotation and trade information, and the opportunity for investors' orders to interact without dealer involvement.

Clarification should be given to the meaning in Article 30 of „private" stock exchanges. Is this to be different from „public" stock exchanges?

## PART FOUR – REPORTING COMPANIES

The law regulates „Reporting Companies.“ The criteria for such regulation should not be limited to a company's total number of securities. Article 40 Other factor to consider are the value of the offering itself and whether the offering is private or public.

The terms „public“ and „private“ offering are refernced in Article 40 but their definition is left to the Executive Regulation. These terms are so central to a securities law that indeed their definition should be in (the front of) the law.

The reporting requirement in Article 41 would be strengthened and be in current thinking if the CEO of the Reporting Company was required to certify to the truthfulness of the filing under penalty of perjury.

<u>The major reason for reporting is to require companies to make material information publicly available</u>. Thus Article 43 should provide that the CMA will keep reports for public view in its public reading room as well as, if feasible, on the internet. An excellent model for making documents available to the public on the internet is the SEC's EDGAR system. Reporting to the CMA should be within two business days of material events

## PART FIVE – ISSUING AND OFFERING SECURITIES

Securities take the form of many contracts and transactions and therefore a detailed list of what is a security should appear in the definitions section. The definition should also include a catch-all phrase such as „and any other transaction or document which places the perfomance of a person's investment in the hands of another party.“

*Definition of „Security“*

For purposes of investor protection a "security" in the United States is many types of documents or transactions as follows:

> Any note, stock, treasury stock, bond, debenture, evidence of indebtedness, certificate of interest or participation in any profit-sharing agreement, collateral trust certificate, pre-organization certificate or subscription, transferrable share, investment contract, voting-trust certificate, certificate of deposit for a security, fractional undivided interest in oil, gas, or other mineral rights, any put, call, posit, or group of index securities (including any interest therein or based on the value thereof), or any put, call, straddle, option, or privilege entered into on a national securities exchange relating to foreign currency, or, in general, any interest or instrument generally known as a security, or any certificate of interest or participation in, temporary or interim certificate for, receipt for, guarantee of, or warrant or right to subscribe to or purchase, any of the foregoing.

*Too Much Discretion for CMA?*

Reportedly, the CMA is an overly-activist agency wielding a broad discretionary power that scares potential large investors from the Egyptian bourse. The result has sometimes been undue interference by the CMA in transactions. Involvement beyond the proper regulatory scope can delay or terminate deals and increase transaction costs. Its alleged propensity for *ultra vires* activities should be looked in to.

It is said that the CMA has broadly interpreted certain legal provisions in order to give itself very broad regulatory authority.

For example, even though the Capital Markets Law does not require CMA approval for a public tender offer, the Authority has become quite involved in the tender offer process. One reason cited by a law firm is that the Capital Markets Law is poorly drafted and therefore can be interpreted by the CMA in various ways to justify its power. The provisions on the CMA's jurisdiction should be written with greater specificity to avoid an overly-broad interpretation by the Authority.

The final clause in Article 45 allows the CMA to exempt companies from the securities law requirement, apparently on grounds apart from the statutory grounds for exemption. This is a questionable provision and perhaps should be deleted. At a minimum it should only remain in place if the Commission's decisionmaking is transparent and the grounds given in a written decision; lest wrondoing be suspected.

*Transactions and Issues Exempted from the Reporting Requirement*

Because the main reason for reporting is to protect the investor, there are some transactions that do not need to be registered because of the nature of the buyers. One class of buyer that does not need this protection is in the US called the „Accredited Investor" which includes banks, broker dealers, investment companies and sophisticated investors. Although issuers to Accredited Investors might be exempted from the full reporting requirments they should nonetheless be required to inform the CMA of the issuance through a Notice of Sale and remain liable for fraud in the offer and/or sale of the securities.

*Disclosure and Secondary Distribution*

It should be determined whether the law adequately contemplates the regulation of secondary distributions. There are like offers from original issuers but are made by a control group or person of the offeror or an affiliate. The same disclosure concerns apply.

## PART SIX – OWNERSHIP OF SECURITIES OF REPORTING COMPANIES

The actual subject of this Part should be made clear at the outset. Does it concern treasury shares? Does it concern the reacquisition of outstanding shares?

## PART SEVEN – TENDER OFFERS

It should be determined if there exists a provision setting the buy price at the highest price paid during the previous year. This may have been the approach in the UK and EU but it would retard business combinations which in the longer term might well benefit all shareholders; it prevents control owners from selling control blocks of stock.

*Information on the Acquiror and the Transaction*

Part Seven might include an Article requiring the disclosure of the following information as in the case with tender offers in the US:

- the background, and identity, residence, and citizenship of, and the nature of such beneficial ownership by, such person and all other persons by whom or on whose behalf the purchases have been or are to be effected;

- the source and amount of the funds or other consideration used or to be used in making the purchases, and if any part of the purchase price is represented or is to be represented by funds or other consideration borrowed or otherwise obtained for the purpose of acquiring, holding, or trading such security, a description of the transaction and the names of the parties thereto, except that where a source of funds is a loan made in the ordinary course of business by a bank, if the person filing such statement so requests, the name of the bank shall not be made available to the public;

- if the purpose of the purchases or prospective purchases is to acquire control of the business of the issuer of the securities, any plans or proposals which such persons may have to liquidate such issuer, to sell its assets to or merge it with any other persons, or to make any other major change in its business or corporate structure;

the number of shares of such security which are beneficially owned, and the number of shares concerning which there is a right to acquire, directly or indirectly, by (i) such person, and (ii) by each associate of such person, giving the background, identity, residence, and citizenship of each such associate; and

information as to any contracts, arrangements, or understandings with any person with respect to any securities of the issuer, including but not limited to transfer of any of the securities, joint ventures, loan or option arrangements, puts or calls, guaranties of loans, guaranties against loss or guaranties of profits, division of losses or profits, or the giving or withholding of proxies, naming the persons with whom such contracts, arrangements, or understandings have been entered into, and giving the details thereof. [28]

The law should also govern the disclosure in materials used to solicit shareholders' votes in annual or special meetings held for the election of directors and the approval of other major corporate action. This information, contained in proxy materials, should be filed with the CMA sufficiently in advance of any solicitation to ensure compliance with the disclosure rules.

[28] Section 13 (d) of the US Securities Exchange Act of 1934

Solicitations, whether by management or shareholder groups, must disclose all important facts concerning the issues on which holders are asked to vote.

Reportedly, the CMA involves itself in the process of share valuation in tender offers. This governmental intrusion is not the role of a regulator in a market economy.

## PART EIGHT – INVESTMENT FUNDS

*Definition of Investment Company*

The definition section in the beginning of the Capital Markets Law should include the term „Investment Company." A suggested definition of investment company is that which appears in the U.S. Investment Company Law as follows:

> When used in this title, "investment company" means any issuer which-
>
> > is or holds itself out as being engaged primarily, or proposes to engage primarily, in the business of investing, reinvesting, or trading in securities;
> >
> > is engaged or proposes to engage in the business of issuing face-amount certificates of the installment type, or has been engaged in such business and has any such certificate outstanding; or
> >
> > is engaged or proposes to engage in the business of investing, reinvesting, owning, holding, or trading in securities, and owns or proposes to acquire investment securities having a value exceeding 40 percentum of the value of such issuer's total assets (exclusive of Government securities and cash items) on an unconsolidated basis. [29]

Article 70 defers twice to subsequent implementing Executive Regulations. This is a potential problem for two reasons: (1) it devoids the law itself of certain central provisions and (2) it invites the possibility that such Regulations may never be put into force or may be at variance with the letter and spirit of this law. Provisions that are central to a law should be put in the law and not deferred to regulations.

The requirement in Article71 that an Investment Fund must be a joint stock company should be revisited to ensure that, in light of the ambiguity of terms, it is indeed a joint stock company that is meant. The prospectus provision in Article 73 might be more detailed as to what the prospectus should contain.

## PART NINE – PROTECTION OF MINORITY RIGHTS

These are corporate governance provisions.

Article 83 concerns tender offers and might more properly be in the tender offer Part of this law.

[29] The Investment Company Act of 1940 (US)

Article 85 is suggestive of a US-style shareholder derivative suit or a class action. In a shareholder derivative suit the shareholders sue the management on behalf of the company. The Egyptian law should provide for such a mechanism. Such lawsuits are private and to be initiated by the shareholders themselves. This Article should be amended to the extent that it provides for the CMA, rather than the shareholders, to initiate a law suit against, apparently, corporate management.

Article 85 should perhaps also have an „opt out" clause. The participation in a class action is voluntary. Class members who do not want to be in a class action settlement „opt out" usually with the intention of suing individually. This is important because one person might have 100 pounds of damages while another has 1,000,000 pounds of damages. The latter aggrieved party would not want to share in the same recovery as the many who have been far less injured.

## PART TEN – CLOSING PROVISIONS

A 89 seems to suggest that a court can undo a transaction and put the claimant back in his original place. But doing so might have wider ramifications. For example, the effect on any good faith third parties. It should be reexamined.

It is not clear why A90 singles out just two terms for defining by Executive Regulation. („affiliate" and „effective control.") All terms pertinent to the Capital Markets Law should be defined in the beginning of the Law itself. How can anyone know the meaning of the terms when the Law is enacted if their definitions await promulgation through an executive regulation months later?

Article 91 forestalls judicial review of complaints against the government and the exchange until heard by a special committee. It is important that this committee be constrained by time limitations in its procedures and final ruling so that the aggrieved, can, if necessary, get timely judicial review.

## PART ELEVEN – PENALTIES

Legislative drafters are divided on how to design penalty provisions. One school advocates placing in the regular definitions section of the law the definitions of the acts or ommission for which penalties are levied. We subscribe to this view. The other school advocates placing the components of the act or omission in the penalties section itself. Such may be the view of the drafters of the proposed Capital Markets Law, as for example, here is the penalty provision for market manipulation.

A penalty of X shall be imposed on any person who commits any of the following acts:

> Transacts on securities in the aim of creating a false impresion of active trading in such securities or manipulating their price in order to facilitate their sale. **Price manipulation shall be deemed to include any transaction that involves no change in the beneficial owner of the securities; pre-arranged transactions for the purpose of inducing the**

> **belief of an active market in the securities; the circulation of false and misleading rumours with respect to**
>
> **securities, including statements of an imminent change in the price of such securities in order to raise or depress their market price; the participation by the issuer of securities in subscriptions to such securities – in other than the cases permitted under this Law – in order to affect their price.**

The language which we have placed in bold above is a definition of price manipulation which we suggest should more usefully appear in the definitions section of the law.

## *CAPITAL MARKETS ABUSES*

As stated by the E.U. the importance of legislation against market abuse it „to ensure the integrity of ... financial markets and to enhance investor confidence in those markets.“ [30]

### *INSIDER TRADING*

The U.S. securities laws broadly prohibit fraudulent activities of any kind in connection with the offer, purchase, or sale of securities. These provisions are the basis for many types of disciplinary actions, including actions against fraudulent insider trading. In the U.S., illegal insider trading takes place when someone with a duty to withhold material nonpublic information that could impact on the price of a security trades that security.

#### *Market Manipulation*

The definition of “market manipulation” can be extensive, [31] but essentially it involved fraudulent activity regarding the offer or sale of a security.

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[30] EU Directive 2003/6/EC (28 January 2003) on Insider Dealing and Market Manipulation.

[31] "Market manipulation" in the EU means:

(a) transactions or orders to trade:
- which give, or are likely to give, false or misleading signals as to the supply of, demand for or price of financial instruments, or
- which secure, by a person, or persons acting in collaboration, the price of one or several financial instruments at an abnormal or artificial level,

unless the person who entered into the transactions or issued the orders to trade establishes that his reasons for so doing are legitimate and that these transactions or orders to trade conform to accepted market practices on the regulated market concerned;

(b) transactions or orders to trade which employ fictitious devices or any other form of deception or contrivance;

(c) dissemination of information through the media, including the Internet, or by any other means, which gives, or is likely to give, false or misleading signals as to financial instruments, including the dissemination of rumours and false or misleading news, where the person who made the dissemination knew, or ought to have known, that the information was false or misleading. In respect of journalists when they act in their professional capacity such dissemination of information is to be assessed, without prejudice to Article 11, taking into account the rules governing their profession, unless those persons

derive, directly or indirectly, an advantage or profits from the dissemination of the information in question. In particular, the following instances are derived from the core definition given in points (a), (b) and (c) above:
- conduct by a person, or persons acting in collaboration, to secure a dominant position over the supply of or demand for a financial instrument which has the effect of fixing, directly or indirectly, purchase or sale prices or creating other unfair trading conditions,
- the buying or selling of financial instruments at the close of the market with the effect of misleading investors acting on the basis of closing prices,
- taking advantage of occasional or regular access to the traditional or electronic media by voicing an opinion about a financial instrument (or indirectly about its issuer) while having previously taken positions on that financial instrument and profiting subsequently from the impact of the opinions voiced on the price of that instrument, without having simultaneously disclosed that conflict of interest to the public in a proper and effective way.

# COMPETITION LAW

Egypt does not have a competition (anti-monopoly) law. It should have one, which possibly should establish an anti-monopoly agency. Currently, several government agencies arguably have jurisdiction over competition. There are some competition-related provisions in the Civil Code regarding the labor contract and others in the Commercial Law. Reportedly, Egypt has monopolies in telecommunications (2 privately owned companies), cement, iron and steel, drugs, sugar, and airlines – none of which may be natural monopolies.

# CONTRACT LAW

Articles 47 – 299 of The Commercial Law are on "Commercial Obligations and Contracts."

> Contract law principles in a market economy entitle private parties to agree on any contract term so long as it is lawful and not against public policy. This notion of "freedom of contract" enables the parties to negotiate the best working arrangement for their particular undertaking.

As 2 and 3 also are expressly related to contractual relations and thus should appear in the same section as the bulk of the contract provisions.

*Government Interference with Freedom of Contract*

As with other laws, we see in these provisions statutory stipulations that instead should be decided by the parties to a contract.

Examples are:

Article 53 seems to impose a requirement on the delivery of goods that would supercede the agreement between the parties and which only should apply if the parties failed to include that term in their contract.

Article 57 is ambiguous as it seems to dictate that contractual obligations can only be performed during working hours as provided by law or custom; but rather it probably means that unless the parties agree otherwise contractual obligations should be executed according to norms.

Article 66 provides that "All acts contravening the customs and norms observed in commercial dealings, shall be considered an illegal competition." Freedom of contract allows parties to agree to anything so long as it is not illegal or against public policy. Thus "customs" and "norms" should not as a general rule supercede terms agreed to by the parties. (The term "competition" in the preceding quoted sentence obviously is confusing.)

Article 78 requires the supplier to provide "spare parts" to the importer upon the latter's request or advise the importer where such parts are available. This should be decided by the parties.

Article 82 provides that payment may be in a lump sum or in installments.

Article 86 "entitles" the parties to discuss renewal of terminated contracts. Under contract law it is axiomatic that the parties may do this.

Article 116 "If agreement is reached on a term for supply, this term is supposed to be stipulated in the interest of the two parties. Hence, it shall not be amended except with their approval." [Contracts theoretically are never amended without the approval of both parties.]

Article 118 – This forbids exclusive supply contracts from being for more than five years.

*Gap Filling*

Sometimes parties to a commercial contract forget to include a certain essential term. The law should contemplate this contingency. This approach is provided for in Article 89 of the Commercial Law. As 88 – 103 concern the sale of goods as between "traders." This is akin to Article 2 of the Uniform Commercial Code (UCC) of the United States.

The purpose of many of the provisions here and in Article 2 is to help the wheels of commerce continue to move where the parties inadvertently failed to include certain essential terms in their contract. Typically past practice between the parties or industry custom are looked to for filling the contractual gap.

*Terminology*

Some terminology, at least in the English translation, is inappropriate. For example, As 54 and 55 refer to a "debtor." This is neither the right term nor concept for a seller-buyer or licensor/licensee relationship. Moreover, in Egypt the term "debtor" is laden with a negative connotation. (It is not impossible that this misuse of terminology could cause a foreign reader to think that As 47 though 64 constitute Egypt's debtor-creditor law.)

*Confused Concepts*

Article 56 speaks of the right to rescind a contract. It provides that by virtue of performing on a contract a party loses his right to rescind the contract. (Perhaps this is a translation problem.) However, this is a confused concept. Clearly the party who has indeed performed on the contract would not then rescind it. For example, if a builder built a house for buyer the builder would not then rescind the contract.

*The Issue of a Written Contract*

Article 74 requires that a technology transfer contract must be in writing otherwise it is null and void.

This raises the question of the validity of oral contracts. Article 74 itself expressly recognizes that a contract existed but it was not written. This A would prevent the performing party from suing to receive damages for the other party's breach of contract. This raises a question of equity (fairness) and in the U.S. there are equitable remedies based for example on the principle of "detrimental reliance."

*The Statute of Frauds*

It is recommended that the writing requirement of Article 74 be reconsidered. It does not fall into any of the rationales for the limited instances in which a written contract is required.

In the United States, as a general rule, contracts can be either written or oral. There are some instances in which a contract must be in writing to be legally enforceable. Those exceptions appear in the common law (even though stated as a statutory rule) and collectively are known as the "Statute of Frauds" below.

Under the "Statute of Frauds" in the United States the following kinds of contracts may not be enforced unless they are embodied in a written document: (a) a contract of an executor or administrator to answer for a duty of the decedent; (b) a contract to stand as surety or otherwise to answer for the duty of another; (c) a contract made upon consideration of marriage (but <u>not</u> a contract to marry); (d) a contract for the sale of land or an interest in land; and (e) a contract not to be performed within a year of its making. [32]

To avoid the Statute of Frauds the writing need not be a formal written contract. It simply must reasonably identify the subject matter of the contract; sufficiently indicate that a contract has been made or offered; and (3) state with reasonable certainty the essential terms. [33]

*The Parol Evidence Rule*

The parol evidence rule in the U.S., though stated as a rule of evidence, is really a rule of substantive law. It provides that an oral agreement cannot modify the terms of a written contract the contract is (a) in writing; (b) integrated (i.e., all of its essential terms are present); and (c) is unambiguous. [34]

*What if there is not Either an Oral or Written Contract?*

*Promissory Estoppel*

This relates to "detrimental reliance." The principle of promissory estoppel provides that except in cases where the statute of frauds applies, a promise is enforceable even in the absence of a contract if: (a) the promise is clear and unambiguous; (b) the promisor knows or should know that the promisee will rely upon it; (c) the promise does reasonably relies upon the promise to his

[32] At common law, the following contracts were unenforceable unless in writing, but this rule has been modified by the U. S. Uniform Commercial Code: (i) for the sale of goods for $500 or more; (ii) for the sale of securities; and (iii) for the sale of other personal property where the damages for breach of contract exceed $5,000.

[33] Section 110 of the *Restatement of Contracts* (U.S).

[34] As stated by one U. S. Court: "Where a full and complete agreement is encompassed within a written contract, a separate oral agreement is barred by the parol evidence rule." *See Mellon Bank v. First Union Real Estate*, 951 F.2d 1399 (1991).

or her detriment; and (d) hardship or unfairness can be avoided only by enforcement of the promise. [35]

*Provisions on Competition*

Article 66 2 and maybe also 66 1 concerns illegal competition. Competition provisions do not belong in a contract law as competitors do not enter into contracts to compete with each other. Egypt should have a separate competition law.

*Personal Injury, Product Liability and Privity of Contract*

Article 67 is a product liability provision. It raises a large question over whether the manufacturer of a product owes a duty to a retail buyer where there is no "privity of contract" between the parties and the buyer is physically harmed due to a defect in the product. Privity of contract means that parties actually have a contractual relationship and consequently responsibilities to one another.

In 1916 in the United States it was ruled that privity of contract is not necessary for a manufacturer to be liable to a retail buyer in a products liability case. [36] This case concerned a car going out of control and severely injuring the driver. Theretofore, unless a product was inherently dangerous like dynamite, an injured party could not obtain a recovery from a manufacturer because there was no contract between the consumer and the wholesaler. The court saw the unfairness of this and greatly limited the privity of contract requirement in products liability cases.

*Transfer of Technology Contract Issues*

Articles 72 through 87 are on "Transfer of Technology" (TT). This has implications for foreign businesses and investors. The very first article itself shows the danger of poor translating; especially in matters concerning foreign investors. The foreign businessperson should not have to wonder what the following means: "No criterion in both cases shall be observed as regards the nationality of the parties to the agreement or their places of residence." Article 72.

*General Estimation of the TT Provisions*

From the standpoint of the foreign technology provider these provisions are highly discouraging. They water down the normal rights of a foreign provider and amount to almost a giveaway of their assets. <u>The unfortunate result for Egypt is that it therefore receives less and lower technology than it otherwise could</u>.

Typically definite limitations exist on the right of the receiver with respect to the technology.

Some provisions that prove this point:

[35] Section 90, *Restatement of Contracts* (US).
[36] *MacPherson v. Buick*, 111 N.E. 1050, 1053, 1055 (N.Y. 1916).

Any condition which is liable to restrict the freedom of the user of the technology in using or developing the technology, labeling or advertising licensed products is voidable at the licensee's option

It is at least arguable that these provisions could curtail the supplier's right to insist that the licensee meet its design, performance and quality specifications.

*A Real Deal-Breaker*

Article 87 limits the jurisdiction and venue of resolution of TT disputes to Egypt and Egyptian law either through the judicial system or through Arbitration in Egypt according to Egyptian law. In part it reads:

> "The Egyptian courts shall have the jurisdiction of deciding the disputes arising from [technology transfer contracts] …. In all cases, deciding the subject of the dispute shall be according to the provisions of Egyptian law, and all agreement to the contrary shall be null and invalid."

It is axiomatic in international business law that the foreign entity does not want a dispute heard in the other country. Thus, most parties agree to neutral arbitration in a third country.

*This provision therefore is likely to deter foreign parties from entering into any agreement with an Egyptian party, which includes provisions for some kind of transfer of technology or could be construed under Egyptian Law as "technology transfer contracts".* [37]

There are a variety of reasons for such deterrence.

Firstly, every foreign party would perceive itself as disadvantaged against the local Egyptian party that would have a natural "home court" advantage (unless perhaps if it had excellent local legal counsel.). Enforcement of contractual provisions by litigious means would be perceived as not take place on a level playing field to the disadvantage of the foreign supplier.

Secondly, the determination/interpretation of whether an agreement concluded between a foreign and a local party could be seen as a technology transfer agreement and thus be triggering exclusive competence of local Egyptian court is entirely up to the Egyptian courts. That would be ominous for a potential technology supplier.

Indeed, a local party to a contract could petition the local courts to adjudicate a commercial transaction that may in one way or another be perceived as involving a transfer of technology, even if this was not the initial intention of the parties.

Thirdly, even if a foreign party would accede to litigation or arbitration in Egypt and could obtain a favorable decision, it may find it very difficult to enforce such decisions.

[37] The Egyptian Arbitration Law No. 27/1994 gives the parties the liberty to chose the applicable law and competent jurisdiction. However, Article 87 of the Commercial Law post-dates the Arbitration law and therefore governs regarding technology transfer contracts.

Modern international business practice therefore avoids the imposition of the home jurisdiction of one party on an international transaction. Thus, most parties agree to neutral arbitration in a third country.

Appendix 4 provides an example of some standard provisions for an international arbitration agreement.

*Bankruptcy-Related Provision*

The following provision appears in Article 106. It should be harmonized with a new bankruptcy law, amended, or omitted.

> Subject to the provisions prescribed in the Part on Bankruptcy, the provision on retaining possession of the item shall not be enforced *via-a-vis* third parties unless the said condition is written on a paper having a registered date preceding the third party's right, or prior to the implementation procedures adopted by the creditors on the sold item.

*Criminal Provision*

Article 107 says that a party can be jailed for up to six months for disposing of an item acquired on installment before (apparently) paying the full price. And curiously, Art 105 provides that a court cannot rescind an installment transaction where the buyer has paid 75% of the purchase price.

# CORPORATE GOVERNANCE

Corporate governance is important for many reasons. It is based on democratic principles and thus could have a collateral benefit to a country-at-large. In addition, it protects the rights of owners of a corporation.

Corporate governance is an issue where there is a separation of ownership and control of the corporation. Where, in a small business, the owners are also the mangers of the business, corporate governance plays a lesser role. But where ownership and management are separated, management has a duty to carry out the will of the owners.

*The Responsibility of Management to Owners*

The shareholders elect the members of the board of directors. When standing for board positions, the position of the candidate board members is set forth either by current management and/or by those who want to see the policies or performance of current management change.

*The Duties of Care and Loyalty*

*Avoidance of Conflicts of Interest*

Often there is a normal human tendency to forget about one's duties and instead think foremostly about the benefit to oneself. This often happens with corporate management. Abuses include insider trading and erecting self-serving barriers to takeover efforts of other companies. For this reason, there is a heightened importance to have an "independent" board of directors. Plus, as has been seen recently with Enron and MCI, auditors must be independent in terms of limited involvement in other financial activities of the corporation.

Senior corporate management and the board of directors have two fiduciary duties to the shareholders: care and loyalty. Boards are required to have oversight over management for the benefit of the shareholders. They should satisfy themselves that management is acting for the benefit of the shareholders, does not have any conflicts of interest, is performing well financially, and is being audited properly. Because the view of boards and management might differ it is important that boards be "independent" of management. This is accomplished by having "outside" directors.

*Shareholders' Rights Include*

- Information Rights
- Voting Rights such as the:

right to vote on major events such as board of directors, amendments to the corporate charter, and approval of extraordinary transactions

right to place items on the agenda of annual shareholder meetings

rght to vote by proxy (this is even more important where there are foreign shareholders)

> Share custodians should enlist and abide by the owner's position on items voted or for the owners to vote their shares directly. At a minimum the custodian should inform shareholders that upon disclosure of the impending vote the custodian will vote the shares as it believes is in the shareholder's benefit unless it hears otherwise.

right to receive proxy materials sufficiently in advance of the shareholders' meeting
right to vote for free

*Enforcement of shareholder rights*

*The ability to obtain timely redress and enforce rights is an important draw for potential shareholders Investors large and small but mostly large will shy away from equity positions in companies whose countries lacks mechanisms for shareholder redress and enforcement of their rights.*
*In the US, for example, two of these mechanisms are the shareholder derivative lawsuit and the class action lawsuit.*

*Shareholder Derivative Actions*

In a shareholder derivative action the shareholder sues management on behalf of the corporation. Such lawsuits often are filed when corporate management rejects a tender offer. The shareholder will claim that management violated either or both of their duties of loyalty and care The plaintiff will maintain that there was no good business purpose in rejecting the offer and that the offer was rejected solely to enable management to keep their jobs and thus there was a conflict of interest. Thus, shareholder-plaintiff would allege, the management cannot hide behind the Business Judgment Rule. .

*Class Actions*

In a class action one person sues the corporation on behalf of all the shareholders.

# FOREIGN INVESTMENT LAW

Egypt is not known as an investor-friendly country. The difficulty of doing business here not only thwarts prospective foreign investors but has also caused actual foreign investors to wind down their businesses and leave Egypt in exasperation.

Egypt has more than 180 competitors. Therefore, its foreign investment law must be precisely written to achieve its purpose; namely, to attract foreign investment. The presence of counter-productive provisions will likely cause a foreign investor to look elsewhere. Most counter-productive provisions concern government entanglement and unnecessary regulation of foreign investments.
The problems faced by foreign investors exist in various laws and in the system itself. Adding to the problem is that Egypt does not have a foreign investment law.

Egypt should enact a foreign investment law [38] and establish a foreign investment promotion agency. [39] Some people apparently think that the Investment Incentives and Guarantees Law suffices for a foreign investment law. But it does not.

A favorable investment climate should benefit Egypt in several ways.

A good foreign investment law would: (a) help attract foreign capital, technology[40], know-how, and managerial skills; (b) advance privatization and private sector development; (c) result in a higher level of commerce and private sector employment; and (d) provide Egypt with a greater competitive position in the world economy.

[38] Law 43-419-77 "Arabic and Foreign Investments" arising out of President Sadat's "open door" policy, was repealed a few years ago.

[39] Reportedly there is a "General Authority for Investment" which has foreign investment as part of its jurisdiction and which is setting up an investment facilitation office due to open in October, 2003. *The Egyptian Gazette*, July 16, 2002. p2. If the GAI is indeed intended to be Egypt's foreign investment promotion agency it should have that mandate as its sole area of activity.

[40] We note in the contracts section the problems with technology transfer to Egypt.

The law must assure the investor that he will have control over his investment and its proceeds. It should provide the framework for successful commercial relations between the investor and both the private and public sectors of Egypt.

Egypt's legal framework for foreign investment must be commercially reasonable, transparent and stable. Excessive governmental regulation raises issues of delay and non-transparency. Stability, both politically and legally, is of primary importance to a foreign investor. In the case of laws this means that they should not change absent a rational reason; and indeed the preferred foreign investment law would have a "stabilization" clause that any subsequently-enacted laws adverse to foreign investors will not effect current foreign investors at least for a certain number of years.

Egypt's foreign investment law should be designed to appeal equally to large, medium and small investors. Too often one thinks only of large multinationals as foreign investors. It may be best for the law to appeal equally to investors in almost all industries as it limits the industries in which the foreigner must be a minority owner and not providing special treatment for any specific industry.

While a favorable investment climate has at its heart an effective foreign investment law, other laws will also be considered by the prospective foreign investor. These include the laws on: business enterprises, business registration, taxation, customs, secured transactions, labor, privatization, securities and capital markets, environment, concessions, intellectual property, bankruptcy and banking. To maximize the chances of foreign investment they should all be brought to present international norms and be consistent each other.

*A Foreign Investment Promotion Agency*

Foreign investment in Egypt should be benefited by an agency which has as its sole purpose the promotion and facilitation of foreign investment. The agency should publicize Egypt's fields of comparative advantage and help foreign investors work with the relevant government agencies for market entry.

The Agency should not be a barrier to foreign investment. The Agency would likely discourage foreign investment if it imposes regulations on the investor. Governmental intervention, with its potential for delay and arbitrary and opaque treatment, discourages foreign investment. Foreign investments should be governed the same as wholly domestically-owned business organizations and not have more restrictions. This is called "national treatment."

It should be considered whether the Agency should be a quasi-governmental body. Investor confidence might be heightened if the Agency has the look and feel of a commercial, rather than a governmental, organization.

Most foreign investment laws contain provisions which by now have become standard. Many of those provisions are meant to create a favorable investment climate. However, some laws are more aggressive than others. For example, some foreign investment laws contain absolute prohibitions against expropriation, provide for tax holidays, and for the duty-free importation of capital equipment to be used for the investment.

The preferred law would strike a balanced approach by providing a wide variety of guarantees and protections (itemized below) while deviating as little as possible from normal commercial practices, such as taxation on profits. Commercial norms are distorted by granting foreign investors special privileges, such as tax holidays, and therefore should be employed only when necessary.[41]

*What the Foreign Investment Law Should Not Have*

Requirement of government approval of transactions.

Reciprocity requirement (while good in principle it will only hurt Egypt by either disqualifying foreign investors or by creating uncertainty in their minds regarding future developments),

A high percentage rate, such as 50% of foreign ownership in order to qualify under the Foreign Investment Law. (Instead should be lower, such as 25%.)

Separate "penal" provisions. Foreign investors will instead be subject to national treatment and to the same legal norms as nationals.

*Some Recommended Provisions for Egypt's Foreign Investment Law*

*The Concept of National Treatment*

A standard and central principle of most foreign investment laws is the guarantee of "national treatment" to the foreign investor. National treatment, strictly speaking, provides identical rights and obligations to foreign investors as to nationals. In other words, the foreign investor is treated like a national investor. [42]

A sound investment climate is built on the general principle that to the extent the circumstances of the foreign and local investor are similar they should be treated equally, in part to avoid a competitive disadvantage to the local investor. However, there are some situations where the difference between foreign and local investors is unavoidable. For example, the need for the repatriation of investment capital.

And, there are some features in a foreign investment law designed to attract foreign investors.

While national treatment can be used by the foreign investor as a "sword" to assert in the courts or otherwise certain rights and privileges; it is not a "shield" which the foreign investor can use against any unfavorable treatment accorded to nationals. Accordingly, national treatment can have a harmful affect on foreign investments. Therefore, the law should provide some

[41] These policy points are echoed in our discussion on the Investment Guarantees and Incentive Law which some people mistake as a suitable substitute for a foreign investment law.

[42] However, the question of national treatment in Egypt is somewhat complicated by the decision of the Prime Minister that Egyptians have priority in governmental tenders.

assurances to foreign investors which might not be available to Egyptians in order to induce foreign investment.

Guarantees for foreign investors could include: including: national treatment, certain special treatment, full protection under the law, real property rights, protection of minority shareholders, taxation, protection against government owner, protections regarding expropriation, redress for extraordinary losses, guarantees for unrestricted use of income including repatriation, convertibility of currency, protection from gray market practices and intellectual property abuses, access to public information, protection against the retroactive application of adverse laws, choice of more favorable subsequent law, prohibition against favoritism and discrimination, and freedom to contract including freedom to agree with the Egyptian party on an arbitration forum anywhere in the world, and freedom to hire.

Enforcement of intellectual property laws so as to minimize any injury to foreign investors arising from gray market activities;

Requirement that government officials comply with the 1997 Convention on Combating Bribery of Foreign Government Officials in International Business Transactions;

Equal treatment of foreign nationals of all states (of perhaps particular importance to competitors of a given sector and bidders for the same government tender);

One hundred percent ownership of businesses in all but a few industries; and 49% ownership in those industries;

Repatriation of monetary proceeds of the foreign investment;

Convertibility of currency;

Expropriation only under compelling circumstances from a public policy viewpoint and only with prompt compensation representing the fair market value of the asset expropriated;

The rights of "minority" shareholders are of particular importance to a foreign investor who will acquire less than half of the ownership-voting rights of the business;

A provision that the government stands in the shoes of private investor where it is a party to the contract and/or a part owner of the enterprise which is deemed to be a foreign investment;

A "stabilization clause" protecting a foreign investor against retroactivity of adverse laws so that a foreign investor will be in no worse situation if other laws are later enacted which provide less rights, guarantees and protections than the one in effect at the time his investment was made..

Finally, the Egyptian foreign investment law should provide that resolution of disputes arising from the foreign investment can be heard in a third-country neutral forum chosen by the parties.

# INVESTMENT GUARANTEES AND INCENTIVE LAW

The rationale for the contents of much of this law is unclear. By containing an overly-broad list of beneficiary sectors this seems to be a social security law for Egypt's industry.

The law should only help those sectors which are the best candidates for helping the Egyptian economy.

Moreover, a key aim of investment incentives should be the attainment of business behavior and practices beneficial to society, such as those promoting health, safety and environmental protection, rather than helping certain industries per se.[43]

It should be empirically determined if this law benefits the Egyptian economy.

Facially, it seems to achieve the opposite and be a money loser. The law allows industries to keep tax revenues the benefit of which is clearly needed by the average Egyptian. It affords many tax incentives to qualifying companies, including, *inter alia*, 5, 10, or 20 year tax holidays depending on where the company is set up; waiver of certain fees and duties; fixed customs duties; and exemption from tax of certain profits and dividends.

Another money loser for Egypt, and potential catalyst for official misconduct, is Article 28 which provides that the Council of Ministers may grant and transfer state owned land to companies incorporated under the Law whose activities are within one of the many specified sectors.

Another questionable provision is that which absolutely bars confiscation and expropriation. There is sometimes a compelling need for a governmental taking and in such circumstances in the United States it is deemed acceptable so long as the government pays full market value for the asset.

The dispute resolution provision of a contract is key to a major investor. To help attract investors an investment law should not restrict the parties in their choice of dispute resolution fora. Unfortunately, the Investment Law does appear to limit the choice of dispute resolution.

Likewise, an investor will be put off by the requirement that the Prime Minister or a designee must approve the sale of shares of a company during the first two years of its existence and that increases in capital must be approved by an [unnamed] administrative authority. This is an example of government intrusion.

[43] With regard to helping certain sectors it should be kept in mind that such assistance often, rather than helping an industry as a whole, is helping specific companies, some of which may have had undue influence in the enactment of the legislation.

# PART II

# THE GOVERNMENTAL AND EDUCATIONAL UNDERPINNINGS OF COMMERCIAL LAW IN EGYPT

## DEFICIENT INSTITUTIONAL CAPABILITIES

The legal structure in Egypt lacks the capacity to enforce the country's commercial laws. This is for several reasons identified below; amongst the key of which are lack of training of judges and lawyers in commercial law and an overburdened court system.

### 1.
### Faculty of Law and its Students

- Egypt does not have law schools as they exist in the west .
- The Egyptian legal education consists of four years. It is not separate from Bachelor degree program. The student enters the law faculty upon graduation from high school.
- The graduated student from the faculty of law acquires a bachelor degree. (Faculty of law requires only a low high school grade for admission.)
- The curriculum of the Law Faculty provides for about 12 subjects a year.
- <u>Very few students attend class because there are no chairs - and there is no requirement for classroom attendance</u>!
- Commercial law is one of the topics.
- English courses are taught in the faculties of law but they are weak courses with vocabulary and translation programs.
- No professional Ethics/Responsibility courses in the faculty of law.
- Recently a new department established in faculty of law Cairo University which called the English department.
- This department is expensive for the public that it costs 1,800 pounds per year.

- The number of students in this department is suitable (100 student) and the possibility of the required link and contact between the students and professors is existing in a good way.

- A high school graduated is attached directly to the law school. Faculties of law do not rely upon personal interviews or tests or any other skills but on high school grade.

- There are no elective classes in Egyptian faculties of law

- The commercial courses taught in the faculty of law are insufficient; they depend on the commercial law only. But many other related courses like for example Stock Exchange, Money Market , Arbitration , are taught during the high studies , i.e for student who prepare diploma in law , but not during the essential 4 years of the bachelor degree . High studies are optional for the faculty of law graduate.

- The number of students in a single law school exceeds 2000 in the first year. while the number of faculties of law in Egypt is nearly 12.

- There is no creation in the PH-D s prepared and the theses might be repeated in the same law area in one single faculty of law.

- There are no internships and no apprenticeships and the government is disable neither to provide graduated lawyers with jobs nor provides students with training programs, and there is no contact between professors and students.

- The absence of the law school's role in giving consultations or organizing seminars, conferences for studying the bills drafted by the government or even for the practical problems faced by the judges and lawyers.

- When seminar or conference is organized, usually conclusions and recommendations are not considered by the governmental authorities.

## 2.
## The Legal Profession

- Lawyers are simply graduates of the so-called "law faculties" with no post-graduate education.

- Lawyers are not required to sit for and pass bar exams to ensure their competence of candidates. They only need to complete a form and satisfy some administrative requirements to be a lawyer.
- The trainee lawyer has to attend preparation courses in the Bar Institute to be qualified to practice law before First Instance Degree Courts – however these courses are far from adequate. The trainee lawyer does not have to pass any exams after the preparation courses.

- The failure of the system to require any qualifications is especially unfortunate in the case of Egypt where law faculty students are amongst the lowest performing of all secondary school graduates.

- The lawyers have no training in specialization.

3.
<u>The Judiciary</u>

In general, judges are not sufficiently well trained to handle commercial law matters. As shown below, there is no commercial law training, and judges make rulings independent of a proper application of the facts to the law.

- The National Center for Judicial Studies does not have a commercial law training program for judges.

- There are no specialized judges in commercial law (even though the Law of Judicial Authority provides for the specialization of judges in many areas including commercial law.)

- There are commercial courts however the judges are not "commercial" judges and simply rotate from one subject matter to another.

- Trial judges hear over 80 cases a week and thus are overburdened.

- Trial judges usually hear small matters befitting a small claims court (which Egypt does not have.) This creates a disincentive for larger businesses to use the judicial system to resolve their disputes.

- Judges in the commercial courts (who are not commercial law specialists) rely in part upon their limited knowledge of commercial law matters resulting in increased delays and legal rulings based neither on the law or the facts.

- Judges in the commercial courts also in part rely on purported experts even where the given question is one of pure law. Most of the time, these "experts" are not really experts. This again is a cause for delay and for incorrect judicial decisions.

- Moreover, judges turn to "Decision Guides" written in 1960 to help them make decisions. Judges resort to these Decision Guides because they are over-burdened and do not know the areas of law. The results are decisions that are not based on proper application of the current law to the facts and consequently often contrary to equity.

- One consequence of the above is that trial court judgments are often overturned by higher courts.

- Another consequence is poor public perception of the judiciary, due to:

  lack of judicial competence and credibility, and
  lack of judicial independence.

- Exacerbating the court load is a deficiency of competent staff including clerks and of computerization of the courts.

**Intermediaries**

A department in the Ministry of Justice (MOJ) is the middleman between parties.

It should be noted that from the point of view of distinguishing the roles of various government institutions that this person is from the executive and not the judicial branch. The plaintiff must send the complaint to this MOJ department which then due to an abuse of discretion and/or inefficiency does or does not serve the complaint upon the defendant. This role invites and results in official misconduct and delays. Actions have been dismissed due to payoffs of these people. This too is a disincentive for going to the courts

**The Supreme Court ("Court of Cassation")**

Once a case is appealed to the Court of Cassation it takes at least three years simply for the Court to determine if it will hear that case.

One of the adverse results of such delays is that the business community is left with uncertainty as to the meaning and applicability of certain laws/provisions. This makes the use of laws unpredictable – one of the greatest disincentives to foreign investment.

## II.

## The Executive Branch

The executive branch of the Egyptian government is not equipped to properly develop and maintain a commercial code.

One of the key problems concerns legislative drafting.

### A.
### SPECIFIC PROCEDURES AND PROBLEMS WITH LEGISLATIVE DRAFTING IN EGYPT

- Bills are poorly drafted and include major terms that are not known or are ambiguous.

- New laws or amendments to laws are drafted by the Legislative Department of the MOJ which is usually comprised of judges employed full time in the Ministry and/or (genuine) law experts specialized in the given area of law.

- But these judges write the drafts of a wide variety of laws relating to such disparate areas of law as from Antimonopoly to Divorce.

- The Legislative Department may ask for the help of genuine experts from the Ministry with jurisdiction for the given law.

- The legal department of the jurisdictional Ministry will often draft its own proposed law although it has no experts either in drafting laws or in the particular subject matter.

- Even thought the Ministries other than MOJ do not have drafting competence; they write their own laws without consulting other Ministries. Moreover, they then send the bills directly to Parliament.

- <u>A major concern is that sometimes the ministry of justice and the jurisdictional ministry each present their own draft directly to the parliament on the same topic</u>.

- This leads to one might say "legislative anarchy."

- The ministry drafting the bill only seeks to fulfill its own interest; for example increasing its budget and granting itself the upper hand in the implementation of certain rules.

- There is no harmonization between the ministry drafting a bill and relevant experts such as economists, either before or after drafting the bill.

- This has taken place for example in connection with the drafting of the new banking law, the commercial law, and the intellectual property rights law.

- As a result of the above problems, when the law is enacted and published, it is often strongly criticized by lawyers and experts, who say the law should be repealed or amended. This causes further instability in the legal system.

- An example of such widespread criticism are the provisions in the Commercial Code regarding checks, the implementation of which was postponed several times.

*Regarding Unconstitutionality of Laws*

- Often in the drafting process insufficient consideration is given to the constitutionality of the provisions which leads to their annulment by the Supreme Constitutional Court and additional insecurity in the legal system.

A recent example is the annulment of the compulsory arbitration provision in certain laws, such Capital Market Law no 95/ 1992.

- The Parliament is empowered to reject an entire proposed law which is obviously unconstitutional. However, the Parliament has rarely practiced this right.

The Supreme Constitutional Court is not empowered to strike an entire law, but can only reject the unconstitutional provisions challenged by parties. The Supreme Constitutional Court has rejected several provisions since 1971.

The legal terminologies adopted by the Egyptian legislator frequently are not accurate. Dr. Abd El Satar Ashra, Director of the Union of Commercial Chambers stated in an interview that the International Chamber of Commerce issued the INCOTERMS for this purpose.

- Dr. Abou El Enein, Director of Cairo Regional Center for International Commercial Arbitration believes that the Egyptian commercial law has many areas that need to be reconsidered to enable the law to be opened to the international trade. He added in an our interview that "we cannot be isolated from the rest of the world"

- Dr. Khaled El Shalakany, a private attorney at law, recommends changes in the criminal law provisions dealing with commercial matters.

# III

# GOVERNMENTAL MISCONDUCT

Although statistics are rare, practical experience and general knowledge points to the conclusion that there is a high level of official misconduct in relation to the totality of governmental activity.

*An Example: The Judicial Inspector*

The Egyptian judicial system includes a position called "Judicial Inspector" (JI). Although JIs are from the executive branch they are under the supervision of judges.

They are appointed pursuant to Article 23 of the Criminal Procedures Law which permits the Ministry of Justice and the competent ministry to appoint inspectors. JI's interpose themselves in the lives of individuals. For example, they conduct monthly inspections of businesses from which they often derive personal benefit.

Factory owners, traders and businessmen suffer and complain from the misconduct of JIs, especially in connection with their monthly inspections. There are the taxes, agricultural, industrial, and investment inspectors.

They turned to be a spots of powers (more and more powerful) producing many legal problems such as breaching the licence conditions, violating health

- JIs misconduct has caused health and safety problems. In Egypt is it well-known that thousands of buildings have been constructed with illegal permits acquired through the payment of *backshish.*

- Official misconduct is fomented by a culture which deems it a national norm and by the low salaries of government personnel causing them to rely upon illegal payments for their livelihood.

- The role of *backshish* is increased because the government requirements on businesses are so complex that businesses need the special assistance of government officials to guide them through.

- Additionally, officials may sometimes abusively file a claim against the citizen or trader who refuses to pay *backshish*. This is a contributing factor to the 18 million claims currently pending in Egypt's courts.

- The government pays the officials a commission (in effect) on the number of fines and claims the official undertakes.

- Thus these officials benefit financially in either event: they are paid *backshish* by the citizen or they are paid a bonus by the governments.

Judicial inspector's misconduct contributed in increasing the numbers of small claims filed before the courts as follows:

18 million claims before the courts were filed in 2001.
Most of these are small claims and a significant amount of those were due to the activities of the "Judicial Inspectors." A precipitating factor for the cases filed by the Judicial Inspectors is that court fees represent a significant part of governmental revenues. Thus the Inspectors will get into trouble if they do not force many claims.

Official Misconduct in the Banking Sector

Events in the banking sector in the 1990s present a clear example of official misconduct in Egypt.

Principally they involved unsecured loans by banks to parliament members reportedly amounting to 12 billion Egyptian pounds..

On 31 July 2002 the state security court (disbanded in 2003) issued a judgment in the infamous Nouab el koroud case. The result was the loss of billions of Egyptian pounds

In addition, these members of parliament bought items on credit and never paid for them.

An important aspect here is the nature of the vehicles used by the government officials to obtain the loans. The documents submitted to the court say that some of these entities were like shell corporations and were established through forged documents and licenses from Dakahlia Bank. That bank in collaboration with the members of parliament falsely indicated the level of capitalization of the shell companies.

Example: one business organization that was established with a capital of 90,000 pounds was able to borrow a loan from El Dakahlia Bank with a value of 4.6 million pounds.

# IV
# DISPUTE RESOLUTION

**The current status in Egypt of commercial dispute resolution:**
**court procedures, mediation, arbitration, and conciliation.**

*Court Procedures*

Court procedures in Egypt are extremely lengthy and delayed. This leaves parties in uncertainty as to the outcome of their cases. Moreover, in commercial law matters it can leave businesses uncertain about the judicial interpretation of crucial legal provisions. Such uncertainty is very detrimental both for local and foreign businesspeople.

Mr Nabil Omran provides the somewhat different view believes that the cause in delay is due to the lack of training of judges and lawyers.

Mr. Omran points ordinary claims may take seven to nine years just for the court to schedule a hearing, while so-called “summary” claims may take four to five years.

Arbitration centers were established in as an alternative to the slow judicial system.

*Arbitration*

- Dr. Mohamed Abou El Enein emphasizes that the adoption of the United Nations Commission on International Law (UNCITRAL) rules helps Egypt to apply modern legal system for international conflicts.

- Dr. Abou El Enein seemed to take full cognizance of the value of neutral third party arbitration. He noted that it has become an ordinary matter to see a U.S. arbitrator working with another arbitrator from Far East present and for the parties to submit their claims without prejudice.

The problems with arbitration in Egypt may not so much be with the legislation it self, but by its linkage to the litigation procedures. The resulting delay is a cause for complaint by some businessmen and investors.

- Dr. Khaled El Shalakany expressed some concerns about the competence of the appeals court to null the arbitration awards.

- The arbitration legislation itself should be amended. There are vague provisions, for example, regarding the appointment of the arbitrator. The parties may spend more than 6 months in a dispute before the national courts for this reason before the arbitration process starts.

- One of major problems faced, practically, by businessmen in Egypt, is the annulment by the courts of arbitral awards. This dilemma departs from the notion of independence and integrity of the arbitration process. It also causes the courts to become more overburdened.

*Conciliation and Mediation*

- There are no actual conciliation and mediation procedures in Egypt. However, it is compulsory for the arbitrators to conciliate between the parties before starting the arbitration. Usually this conciliation takes place in a routine way simply to fulfill the formal requirements of the law and there is no actual, effective conciliation.

- Attorney Dr. Khaled El Shalakany agrees that we have to encourage other ways of settling disputes such as conciliation and mediation also we should know well how to differentiate between both of them, and he is adding that we should establish training centers for theses two methods (not existing yet in Egypt). He also recommends having a list of mediators and conciliators.

## FINAL RECOMMENDATIONS

### Legislation Process and Drafting

Technical training and support should be provided to the legislative drafting department of the Ministry of Justice and to those involved in legislative drafting in the Parliament.

New commercial laws should be drafted in an organized fashion and in compliance with modern day, market economy principles and norms.

- Adequate consultations take place with experts and stakeholders when a law is drafted.

Consideration should be given to the inefficiencies and criticisms of the previous legislation in order to avoid the same mistakes.

Proposed legislation should be reviewed for consistency with already-existing legislation and other applied rules, regulations, or governmental decrees.

- There should be modern techniques in publicizing the legislation, such as through the internet on a government website, so as to make sure that the laws are known as soon as they are issued.

- The review of all the commercial laws and its terminologies in the light of developed foreign legal systems.

- Professional legal translation for commercial legislations is essential for foreign investment, *i.e.* an official, clear, precise translation should be provided for the foreign investor and shall have the power to be acceptable before the national courts as well as the other dispute settlement means.

**The Judicial Process**

Recommendations related to judges and court personnel including clerks

- Training courses in commercial law should be established for judges.
- 
- Consideration should be given to establishing continuing legal education for the judiciary.
- There should be judges (and perhaps courts as well) specializing in commercial law.
- Support should be given to the National Center for Judicial Studies
- There should be an increase in the number of judges to alleviate the caseload.

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- Support staff at courts, such as clerks, should receive better training and higher salaries.
- The same should be done for the experts of Ministry of Justice.

**B) Recommendations related to the court procedures**

- Delays and duplication of work could be ameliorated by:

  -Establishing small courts for civil and commercial claims.
  -Supporting the role of emergency ("summary") courts.
  Increasing the number of judicial circuits.

*Court Awards*

In Egypt, compensation awarded by a court often does not equal actual damages. This should be changed.

*Computerization*

Court should be computerized so as to help avoid delays and clerical mistakes and overcome official misconduct problems. The courts should switch from a paper system to a computer system.

### The commercial criminal courts

A normal consequence of globalization is the evolution worldwide of commercial crimes and the existence of new crimes. This includes “white collar” crimes. There should be a mechanism for the Egyptian system to become aware of these developments and terms.

- The notion of the criminal liability for businesses need to be modernized. Proportionate sanctions should be levied.

### Alternative Dispute Resolution (ADR) in Egypt

One of the key solutions for the overburdened judges is the alternative dispute resolution means which helps courts to proceed efficiently and effectively. However, these mechanisms need to be further developed and strengthened in Egypt.

- The mechanisms of mediation and conciliation are barely existent in Egypt and should be developed.
- Although the Egyptian Arbitration law adopts the UNCITRAL model which requires conciliation before arbitration, it is merely perfunctorily performed here as a formality and prelude to the inevitable arbitration.

# ATTACHMENTS

1. Discussion on Rulemaking in the United States ........................................................ 1-1

2. Final Rule (excerpts) issued by the U. S. Securities and Exchange Commission (SEC) ....... 2-1

3. Document of the U. S. Congress, *How Our Laws are Made* ................................................. 3-1

4. Standard provisions of modern international arbitration agreement...................................... 4-1

# I. DISCUSSION ON RULEMAKING

Rulemaking on the federal level in the United States involves several steps as follows

1. Publication.

Under U.S. law, all regulations and rules of government agencies are required to be published, so that they will be available to citizens and businesses that may be affected by them. Publication takes place in a periodical called the *Federal Register*, which is issued every business day by the National Archives Service.

2. Advance Notice or Notice of Inquiry.

With certain limited exceptions (such as rules dealing with the internal procedures of an agency), an agency contemplating issuance of a new regulation or amendment of an existing regulation must publish a notice of proposed rulemaking that informs interested persons of

what it proposes to do and gives them the opportunity to provide comments on its proposal. Often, an agency will publish a concept paper, called an Advance Notice of Proposed Rulemaking (ANPRM) or a Notice of Inquiry (NOI), to let members of the public know that it is contemplating issuing a regulation of some sort covering a specified subject. Interested persons may send written comments to the agency. In those comments they will argue that it is either a good idea or not a good idea to issue the regulation dealing with that subject.

3. Notice of Proposed Rulemaking.

If, after considering the comments on the ANPRM or the NOI, the agency decides to issue a new or amended regulation, it must publish the proposed text of the regulation in a Notice of Proposed Rulemaking (NPRM). The purpose of the NPRM is to allow interested persons to file written comments with the agency, discussing the merits or demerits of the specific regulatory text the agency proposes to adopt. The final regulation must be within the general scope of the NPRM. If the agency concludes that different issues must be addressed and those issues are outside the scope of the NPRM, it must issue a new NPRM, called a Re-notice of Proposed Rule Making.

4. Final Rule.

After considering the comments on the NPRM or the Re-notice, the agency may, if it continues to believe that a new or amended regulation is in order, publish a final rule, putting the new or amended regulation in force. A new or amended regulation may not be made effective less than 30 days following publication, unless the agency makes specific findings as to why a shorter period is in the public interest. The final rule must be accompanied by a "preamble" which discusses the basis and purpose of the regulation.

5. Judicial review.

In most cases, an agency's action in issuing a regulation may be reviewed in the courts on petition by any person who is "aggrieved" by the regulation. The court cannot overturn the agency's decisions unless it finds that the agency has been "arbitrary and capricious," that is, acted in an irrational manner or failed to follow the proper procedural steps. The final arbiter can be the Supreme Court of the United States.

# 2. FINAL RULE (EXCERPTS) ISSUED BY THE U. S. SECURITIES AND EXCHANGE COMMISSION (SEC)

**EXAMPLE OF A FINAL RULE IN THE UNITED STATES. EXCERPTED DUE TO LENGTH**

**Final Rule:**
**Improper Influence on Conduct of Audits**
**SECURITIES AND EXCHANGE COMMISSION**
**17 CFR Part 240**
**[Release Nos. 34-47890, IC-26050; FR-71; File No. S7-39-02]**
**RIN 3235-AI67**

**IMPROPER INFLUENCE ON CONDUCT OF AUDITS**

**Agency:** Securities and Exchange Commission.

**Action:** Final rule.

**Summary:** As directed by section 303 of the Sarbanes-Oxley Act of 2002, we are adopting rules to prohibit officers and directors of an issuer, and persons acting under the direction of an officer or director, from taking any action to coerce, manipulate, mislead, or fraudulently influence the auditor of the issuer's financial statements if that person knew or should have known that such action, if successful, could result in rendering the financial statements materially misleading.

**Effective Date:** 6/27/2003

**For Further Information Contact:** Michael J. Kigin, Associate Chief Accountant, or Robert E. Burns, Chief Counsel, at (202) 942-4400, Office of the Chief Accountant, or David M. Estabrook, Associate Chief Accountant, at (202) 942-4510, Division of Enforcement, U.S. Securities and Exchange Commission, 450 Fifth Street, NW, Washington, DC 20549.

**Supplementary Information:** We are redesignating rule 13b2-2 of Regulation 13B-2[1] as rule 13b2-2(a) and adding new rules 13b2-2(b) and (c).

## I. EXECUTIVE SUMMARY

On July 30, 2002, the Sarbanes-Oxley Act of 2002 (the "Act")[2] was enacted. Section 303(a) of the Act states:

It shall be unlawful, in contravention of such rules or regulations as the Commission shall prescribe as necessary or appropriate in the public interest and for the protection of investors, for any officer or director of an issuer, or any other person acting under the direction thereof, to take any action to fraudulently influence, coerce, manipulate, or mislead any independent public or certified accountant engaged in the performance of an audit of the financial statements of that issuer for the purpose of rendering such financial statements materially misleading.

As mandated by the Act, the Commission is adopting rules to implement section 303(a).[3] The rules, in combination with the existing rules under Regulation 13B-2, are designed to ensure that management makes open and full disclosures to, and has honest discussions with, the auditor of the issuer's financial statements. These rules prohibit officers or directors of an issuer, or persons acting under their direction, from subverting the auditor's responsibilities to investors to conduct a diligent audit of the financial statements and to provide a true report of the auditor's findings.

# II. DISCUSSION OF FINAL RULES

## A. INTRODUCTION

The new rules supplement the rules currently in Regulation 13B-2, which address the falsification of books, records and accounts[4] and false or misleading statements, or omissions to make certain statements, to accountants.[5] New rule 13b2-2(b)(1) specifically prohibits officers and directors, and persons acting under their direction, from coercing, manipulating, misleading, or fraudulently influencing (collectively referred to herein as "improperly influencing") the auditor of the issuer's financial statements when the officer, director or other person knew or should have known that the action, if successful, could result in rendering the issuer's financial statements materially misleading.[6] New rule 13b2-2(b)(2) provides examples of actions that improperly influence an auditor that could result in "rendering the issuer's financial statements materially misleading." This paragraph also clarifies that such actions should not occur at any time that the auditor is called upon to exercise professional judgment related to the issuer's financial statements. New rule 13b2-2(c) applies similar provisions to audits of investment companies' financial statements.

## B. DISCUSSION

**Definition of "issuer."** In the proposing release, we noted that the definition of the term "issuer" in section 3 of the Securities Exchange Act of 1934 ("Exchange Act") would apply to the term as used in the rule. This definition includes, with certain exceptions, any person who issues or proposes to issue securities.[7] One commenter noted that this definition would include all private issuers of securities and suggested that we use the definition of "issuer" in the Sarbanes-Oxley Act.[8] The definition in that Act generally would limit application of the rule to issuers whose securities are registered with the Commission under section 12 of the Exchange Act, that are required to file reports with the Commission under section 15(d) of the Exchange Act, or that have filed registration statements with the Commission that have not yet become effective and have not been withdrawn.[9] We continue to believe that the definition of the term "issuer" in section 3 of the Exchange Act applies to the use of the term in the new rules.[10] The term "issuer," as defined in the Exchange Act, has been used in Rule 13b2-2 since it was adopted in 1979,[11] and we believe that the amendments do not require a change in the meaning of the term. In addition, because the new rule specifically applies to improperly influencing auditors of issuers' financial statements "that are required to be filed with the Commission," the commenter's concern that this definition would extend the scope of the rule to all private issuers of securities has been addressed. Accordingly, the term "issuer" in the new rule should be defined as stated in section 3 of the Exchange Act.

**Definition of "officer."** New rule 13b2-2(b)(1) addresses activities by an officer or director of an issuer, or any other person acting under the direction of an officer or director.[12] The

Commission has defined the term "officer" to include the company's "president, vice president, secretary, treasurer or principal financial officer, comptroller or principal accounting officer, and any person routinely performing corresponding functions with respect to any organization whether incorporated or unincorporated."[13] The term "executive officer" includes an issuer's chief executive officer and other officers who perform policy-making functions for the issuer.[14] Some commenters suggested that the term "officer" should include all those responsible for corporate governance matters[15] or who influence the preparation of an issuer's financial statements.[16] Commenters also suggested that the definition include an issuer's general counsel or chief legal officer.[17] We do not believe at this time that it is necessary to amend the existing definition of "officer" or "executive officer," or to write a new definition specifically for Regulation 13B-2. The existing definitions cover, among others, those who set corporate governance policies and legal policies for an issuer. Should we note that members of management not encompassed by the existing definitions of "officer" and "executive officer" are engaging in the conduct addressed in the rule, we may revisit this issue.

**[omitted]**

**"Fraudulently influence."** New rules 13b2-2(b)(1) and (c)(2) address certain actions "to coerce, manipulate, mislead, or fraudulently influence" the auditor of the issuer's financial statements. Much of the conduct addressed by the rules, particularly efforts to "manipulate or mislead" the auditor, generally would be subject to other provisions of the securities laws and the Commission's regulations, including the existing rules in Regulation 13B-2.[40] The new rules, however, would provide an additional means to address conduct to coerce, manipulate, mislead, or fraudulently influence an auditor during his or her examination or review of the issuer's financial statements, including conduct that did not succeed in affecting the audit or review.[41]

In the proposing release, we noted that in the rule the word "fraudulently" modifies influence but not coerce, manipulate or mislead. Several commenters suggested that the Commission should amend this interpretation and state that "fraudulently" modifies all four types of conduct.[42] Some commenters indicated that intent to materially mislead the auditor should be required[43] and others stated any attempt to purposely skew the issuer's disclosure should violate the rule.[44] One commenter noted that fraudulent intent should not be required for officers, directors or employees, but should be required for third parties such as vendors and customers.[45]

We have decided not to amend our view that the word "fraudulently" modifies only "influence." To emphasize this point, we have reordered the words to place "fraudulently influence" at the end of the list instead of at the beginning.[46] The new rule, therefore, reads that no officer or director or person acting under his or her direction "shall directly or indirectly take any action to coerce, manipulate, mislead, or fraudulently influence" any accountant engaged in the performance of an audit or review of an issuer's financial statements.

In the context of the new rule, the words "coerce" and "manipulate" imply compelling the auditor to act in a certain way through pressure, threats, trickery, intimidation or some other form of purposeful action,[47] and further modifiers are not necessary. Regarding the term "mislead," pre-existing rule 13b2-2 for many years has prohibited officers and directors from directly or indirectly making or causing to be made materially misleading statements to auditors. Causing[48] misleading statements to be made to auditors has included, and will continue to include, an officer or director entering into an arrangement with a third party to send a misleading confirmation or to provide other misleading information or data to the auditor of the issuer's financial statements.[49] The new rule does not alter this approach. As noted above, a primary purpose for enactment of the Sarbanes-Oxley Act is the restoration of investor confidence in the integrity of financial reports. Such a purpose would not be served by imposing what would

amount to a new scienter requirement on the pre-existing provision prohibiting officers and directors from causing misleading statements or omissions to be made to auditors.
**Types of Conduct.** As stated in the proposing release, types of conduct that the Commission believes could constitute improper influence (if the person engaged in that conduct knows or should know that the conduct, if successful, could result in rendering the issuer's financial statements materially misleading) include, but are not limited to, directly or indirectly:

- Offering or paying bribes or other financial incentives, including offering future employment or contracts for non-audit services,
- Providing an auditor with an inaccurate or misleading legal analysis,
- Threatening to cancel or canceling existing non-audit or audit engagements if the auditor objects to the issuer's accounting,
- Seeking to have a partner removed from the audit engagement because the partner objects to the issuer's accounting,
- Blackmailing, and
- Making physical threats.

The facts and circumstances of each case would be relevant to determining whether the conduct would violate the new rule.

**[omitted]**

**Definition of "independent public or certified public accountant."** The new rule addresses the improper influence of "any independent public or certified public accountant" engaged in the performance of an audit or review of an issuer's financial statements.[62] Prior to the adoption of the Act, similar phrases commonly were used in the securities laws and the Commission's regulations to refer to the accountant providing audit and review services to a Commission registrant. Although the Act, in anticipation of accounting firms registering with the Public Company Accounting Oversight Board (the "Board"),[63] changed several of these references,[64] such terms continue to appear in certain sections of the securities laws[65] and related schedules.[66] We believe that section 303 of the Act includes all accountants[67] engaged in auditing or reviewing an issuer's financial statements or issuing attestation reports[68] to be filed with the Commission. Once firms are registered with the Board, the term "independent public or certified public accountant," as used in the new rule, would include registered public accounting firms[69] and persons associated with such a public accounting firm,[70] as defined in the Act. While some commenters expressed concern with the use of different definitions to describe the independent auditor,[71] they generally did not object to the use of the term in the new rule.[72]
**[omitted]**

**"Rendering financial statements materially misleading."** One of the criteria that must be met in order for the improper influence on the auditor by officers, directors, or persons acting under their direction to be actionable under the new rule is that the improper influence, if successful, could result in "rendering [the issuer's] financial statements materially misleading."[78] Because

the financial statements are prepared by management and the auditor conducts an audit or review of those financial statements, the auditor would not directly "render [the] financial statements materially misleading." Rather, the auditor might be improperly influenced to, among other things, issue an unwarranted report on the financial statements,[79] including suggesting or acquiescing in the use of inappropriate accounting treatments[80] or not proposing adjustments required for the financial statements to conform with generally accepted accounting principles.[81] An auditor also might be coerced, manipulated, misled, or fraudulently influenced not to perform audit or review procedures that, if performed, might divulge material misstatements in the financial statements. Other examples of activities that would fall within the rule would be for an officer, director, or person acting under an officer or director's direction, to improperly influence an auditor either not to withdraw a previously issued audit report when required by generally accepted auditing standards,[82] or not to communicate appropriate matters to the audit committee.[83] New rule 13b2-2(b)(2) makes it clear that subparagraph (b)(1) would apply in such circumstances. As noted, the rule is not limited to the audit of the annual financial statements, but would include, among other things, improperly influencing an auditor during a review of interim financial statements[84] or in connection with the issuance of a consent to the use of an auditor's report.[85] Conducting reviews of interim financial statements and issuing consents to use past audit reports are sufficiently connected to the audit process, and improper influences during those processes are sufficiently connected to the harms that the Act seeks to prevent, that they should be within the scope of the rule. The list of examples in the rule is only illustrative; other actions also could result in rendering the financial statements materially misleading.
**[omitted]**

**"Knew or should have known."** Section 303(a) states that conduct by an officer, director, or person acting under the direction of the officer or director designed to improperly influence an issuer's auditor is actionable if undertaken "for the purpose of rendering [the issuer's] financial statements materially misleading." We proposed, however, the rule state that an officer, director, or person acting under the direction of the officer, who engaged in conduct to improperly influence an auditor would be culpable if he or she "knew or was unreasonable in not knowing" that the improper influence, if successful, could result in rendering financial statements materially misleading. In the proposing release we noted that we would consider changing this wording to another phrase to convey that proving a particular purpose or intent is not required. We are adopting in the final rule the phrase "knew or should have known," which historically has indicated the existence of a negligence standard.[90] As noted elsewhere in this release, this standard is consistent with the Commission's enforcement actions in this area.[91]
**[omitted]**

# IV. Costs and Benefits

The new rules implement a Congressional mandate. We recognize that any implementation of the Act likely will result in costs and benefits and have an effect on the economy. We are sensitive to the costs and benefits imposed by our rules and, in the proposing release, we identified certain costs and benefits of the proposed rule.

The new rules prohibit officers and directors of an issuer, and persons acting under the direction of an officer or director, from taking any action to coerce, manipulate mislead, or fraudulently influence the auditor of the issuer's financial statements if that person knew or should have known that such action, if successful, could result in rendering the financial statements materially misleading.

Some commenters were concerned that the rules could have a chilling effect on communications between the auditor and third parties,[109] or dampen the debate on accounting issues between auditors and issuers.[110] Such a chilling effect on communications between third parties and auditors, or between auditors and the issuer, could result in an added cost associated with the rule. We believe, however, that the conduct addressed by the new rules generally was prohibited under provisions of the securities laws that existed before enactment of the Sarbanes-Oxley Act.[111] Because the new rule is consistent with previous law, rules, and cases[112] we do not anticipate that the new rules will increase significantly costs for issuers or accounting firms. Nonetheless, the Act and new rules might prompt some issuers to adopt procedures or guidelines that would assure additional care is used by an issuer's officers and directors, and others acting under their direction, in communicating with auditors of the issuer's financial statements. For example, some issuers might require that more discussions include members of senior management or the issuer's legal counsel. Because no particular procedures related to such communications are required, and the nature and scope of those procedures are likely to vary among issuers, it is difficult to provide an accurate cost estimate.

As noted above, in some circumstances the new rules might apply before the professional engagement period begins. For example, the rules would apply if an officer, director, or person acting under the direction of an officer or director, offers to engage an accounting firm on the condition that the firm either issue an unqualified audit report on financial statements that do not conform with generally accepted accounting principles, or limit the scope or performance of audit or review procedures in violation of generally accepted auditing standards. We believe, however, that such conduct would not be permitted under existing laws and regulations and, accordingly, the rules should not result in a significant increase in costs for issuers.
Potential benefits of the rules include increased investor confidence in the integrity of the audit process and, in turn, in the reliability of reported financial information. One of the most important factors in the successful operation of our securities markets is the trust that investors have in the reliability of the information used to make voting and investment decisions.[113] Section 303(a) and the new rules are designed to provide added assurance that the full-disclosure purposes of the securities laws are fulfilled,[114] and to help restore the faith of America's investors in the integrity of the audit process and in the reliability of reported financial information. If section 303 of the Act and the new rules lead to increased investor confidence in financial reporting, they also might facilitate capital formation. An increased willingness of investors to participate in the securities markets could result in issuers being able to lower their cost of capital.
**[OMITTED]**

## V. FINAL REGULATORY FLEXIBILITY ANALYSIS

This Final Regulatory Flexibility Act Analysis has been prepared in accordance with 5 U.S.C. 604. It relates to revised rule 13b2-2 of Regulation 13B-2, which implements the statutory prohibition on officers and directors of an issuer, and persons acting under their direction, improperly influencing the conduct of an audit or review of the issuer's financial statements.

## A. REASONS FOR, AND OBJECTIVES OF, THE RULES

The purpose of the new rules is to implement section 303(a) of the Act. The rules prohibit officers and directors of issuers, including "small businesses," and persons acting under their direction, from improperly influencing an accounting firm's audit or review of the issuer's financial statements. Regardless of the application of section 303(a) and the new rules, such conduct would violate the anti-fraud or other provisions of the securities laws or aid and abet or cause the issuer's violations of those sections. The new rules, and section 303(a) of the Act, provide the Commission with an additional means to address such conduct and are intended to enhance the credibility of financial statements.
**[OMITTED]**

# VI. CONSIDERATION OF IMPACT ECONOMY, BURDEN ON COMPETITION, AND PROMOTION OF EFFICIENCY, COMPETITION AND CAPITAL FORMATION

Section 23(a)(2) of the Exchange Act[128] requires us, when adopting rules under the Exchange Act, to consider the impact on competition of any rule we adopt. Section 2(b) of the 1933 Act,[129] section 3(f) of the Exchange Act,[130] and section 2(c) of the Investment Company Act of 1940,[131] require us, when engaging in rulemaking where we are required to consider or determine whether the action is necessary or appropriate in the public interest, to consider, in addition to the protection of investors, whether the action will promote efficiency, competition and capital formation.

The new rules prohibit improper influences on auditors in connection with their reviews and audits of financial statements filed with the Commission. The proposals, therefore, should enhance investor confidence in the audit process and in the quality of information available to them, and lead to a more efficient market.

Because of the nature of the new rules, we do not believe that they would impose any burden on competition. They prohibit equally all officers and directors of public companies (and persons acting under their direction) from improperly influencing the auditor.

As noted in the cost-benefit section, if section 303 of the Act and the new rules lead to increased investor confidence in financial reporting, they also may facilitate capital formation. An increased willingness of investors to participate in the securities markets might result in issuers being able to lower their cost of capital.

We received no comments indicating that the rule would impact competition, efficiency or capital formation.

# VII. STATUTORY AUTHORITY

We are adopting the new rules under the authority set forth in sections 3(a) and 303 of the Act; Schedule A and sections 5, 6, 7, 8, 10 and 19 of the 1933 Act; Sections 3, 10A, 12, 13, 14, 15, 17 and 23 of the Exchange Act; and Sections 6, 8, 20, 30, 31 and 38 of the Investment Company Act of 1940.

**TEXT OF RULES AND AMENDMENTS**
**List of Subjects in 17 CFR Part 240**

Securities

In accordance with the foregoing, Title 17, Chapter II, of the Code of Federal Regulations is amended as follows:

**PART 240 - GENERAL RULES AND REGULATIONS, SECURITIES EXCHANGE ACT OF 1934**

1. The authority citation for Part 240 continues to read, in part, as follows:
Authority: 15 U.S.C. 77c, 77d, 77g, 77j, 77s, 77z-2, 77z-3, 77eee, 77ggg, 77nnn, 77sss, 77ttt, 78c, 78d, 78e, 78f, 78g, 78i, 78j, 78j-1, 78k, 78k-1, 78l, 78m, 78n, 78o, 78p, 78q, 78s, 78u-5, 78w, 78x, 78ll, 78mm, 79q, 79t, 80a-20, 80a-23, 80a-29, 80a-37, 80b-3, 80b-4 and 80b-11, unless otherwise noted.

* * * * *

2. Section 240.13b2-2 is revised to read as follows:

**§240.13b2-2 Representations and conduct in connection with the preparation of required reports and documents.**

(a) No director or officer of an issuer shall, directly or indirectly:

(1) Make or cause to be made a materially false or misleading statement to an accountant in connection with; or

(2) Omit to state, or cause another person to omit to state, any material fact necessary in order to make statements made, in light of the circumstances under which such statements were made, not misleading, to an accountant in connection with:

(i) Any audit, review or examination of the financial statements of the issuer required to be made pursuant to this subpart; or

(ii) The preparation or filing of any document or report required to be filed with the Commission pursuant to this subpart or otherwise.

(b)(1) No officer or director of an issuer, or any other person acting under the direction thereof, shall directly or indirectly take any action to coerce, manipulate, mislead, or fraudulently influence any independent public or certified public accountant engaged in the performance of an audit or review of the financial statements of that issuer that are required to be filed with the Commission pursuant to this subpart or otherwise if that person knew or should have known that such action, if successful, could result in rendering the issuer's financial statements materially misleading.

(2) For purposes of paragraphs (b)(1) and (c)(2) of this section, actions that, "if successful, could result in rendering the issuer's financial statements materially misleading" include, but are not limited to, actions taken at any time with respect to the professional engagement period to coerce, manipulate, mislead, or fraudulently influence an auditor:

(i) To issue or reissue a report on an issuer's financial statements that is not warranted in the circumstances (due to material violations of generally accepted accounting principles, generally accepted auditing standards, or other professional or regulatory standards);

(ii) Not to perform audit, review or other procedures required by generally accepted auditing standards or other professional standards;

(iii) Not to withdraw an issued report; or

(iv) Not to communicate matters to an issuer's audit committee.

(c) In addition, in the case of an investment company registered under section 8 of the Investment Company Act of 1940 (15 U.S.C. 80a-8), or a business development company as defined in section 2(a)(48) of the Investment Company Act of 1940 (15 U.S.C. 80a-2(a)(48)), no officer or director of the company's investment adviser, sponsor, depositor, trustee, or administrator (or, in the case of paragraph (c)(2) of this section, any other person acting under the direction thereof) shall, directly or indirectly:

(1)(i) Make or cause to be made a materially false or misleading statement to an accountant in connection with; or

(ii) Omit to state, or cause another person to omit to state, any material fact necessary in order to make statements made, in light of the circumstances under which such statements were made, not misleading to an accountant in connection with:

(A) Any audit, review, or examination of the financial statements of the investment company required to be made pursuant to this subpart; or

(B) The preparation or filing of any document or report required to be filed with the Commission pursuant to this subpart or otherwise; or

(2) Take any action to coerce, manipulate, mislead, or fraudulently influence any independent public or certified public accountant engaged in the performance of an audit or review of the financial statements of that investment company that are required

to be filed with the Commission pursuant to this subpart or otherwise if that person knew or should have known that such action, if successful, could result in rendering the investment company's financial statements materially misleading.

By the Commission.

Margaret H. McFarland
Deputy Secretary

May 20, 2003

**[FOOTNOTES OMITTED DUE TO LENGTH]**

# 3. DOCUMENT OF THE U. S. CONGRESS, *HOW OUR LAWS ARE MADE*

106TH CONGRESS, 2d Session — HOUSE OF REPRESENTATIVES — DOCUMENT 106–197

# HOW OUR LAWS ARE MADE

Revised and Updated

By Charles W. Johnson, Parliamentarian,
U.S. House of Representatives

Presented by Mr. Thomas
January 31, 2000.—Ordered to be printed

U.S. GOVERNMENT PRINTING OFFICE
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H. Con. Res. 221 Agreed to January 31, 2000

Pursuant to H. Con. Res. 221 it was ordered on January 31, 2000, during the 106th Congress, for the printing of the revised version of How Our Laws Are Made. This document was compiled by the Office of the Parliamentarian of the U.S. House of Representatives in consultation with the Office of the Parliamentarian of the U.S. Senate, and at the direction of Chairman Bill Thomas of the Joint Committee on Printing. This document was printed by the Government Printing Office.

## FOREWORD

First published in 1953 by the Committee on the Judiciary of the House of Representatives, this 22nd edition of "How Our Laws Are Made" reflects changes in congressional procedures since the 21st edition, which was revised and updated in 1997. This edition was prepared by the Office of the Parliamentarian of the U.S. House of Representatives in consultation with the Office of the Parliamentarian of the U.S. Senate.

The framers of our Constitution created a strong federal government resting on the concept of "separation of powers."

In Article I, Section 1, of the Constitution, the Legislative Branch is created by the following language: "All legislative Powers herein granted shall be vested in a Congress of the United States, which shall consist of a Senate and House of Representatives." Article I, Section 5, of the Constitution provides that: "Each House may determine the Rules of its Proceedings, . . .".

Upon this elegant, yet simple, grant of legislative powers and rulemaking authority has grown an exceedingly complex and evolving legislative process—much of it unique to each House of Congress. To aid the public's understanding of the legislative process, we have revised this popular brochure. For more detailed information on how our laws are made and for the text of the laws themselves, the reader should refer to government internet sites or pertinent House and Senate publications available from the Superintendent of Documents, U.S. Government Printing Office, Washington, D.C. 20402.

CHARLES W. JOHNSON

# EARLIER PRINTINGS

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| 1953, H. Doc. 210, 83d Cong. (H. Res. 251 by Mr. Reed) | 36,771 |
| 1953, H. Doc. 210, 83d Cong. (H. Res. 251 by Mr. Reed) | 122,732 |
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| 1956, H. Doc. 451, 84th Cong. (H. Con. Res. 251 by Mr. Willis) | 30,385 |
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| 1959, H. Doc. 156, 86th Cong. (H. Con. Res. 95 by Mr. Lesinski) | 228,591 |
| 1961, H. Doc. 136, 87th Cong. (H. Con. Res. 81 by Mr. Willis) | 211,797 |
| 1963, H. Doc. 103, 88th Cong. (H. Con. Res. 108 by Mr. Willis) | 14,000 |
| 1965, H. Doc. 103, 88th Cong. (S. Res. 9 by Senator Mansfield) | 196,414 |
| 1965, H. Doc. 164, 89th Cong. (H. Con. Res. 165 by Mr. Willis) | 319,766 |
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| 1969, H. Doc. 127, 91st Cong. (H. Con. Res. 192 by Mr. Celler) | 174,500 |
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| 1972, H. Doc. 323, 92d Cong. (H. Con. Res. 530 by Mr. Celler) | 292,500 |
| 1974, H. Doc. 377, 93d Cong. (H. Con. Res. 201 by Mr. Rodino) | 246,000 |
| 1976, H. Doc. 509, 94th Cong. (H. Con. Res. 540 by Mr. Rodino) | 282,400 |
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| 1981, H. Doc. 120, 97th Cong. (H. Con. Res. 106 by Mr. Rodino) | 298,000 |
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| 1989, H. Doc. 139, 101st Cong. (H. Con. Res. 193 by Mr. Brooks) | 323,000 |
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# HOW OUR LAWS ARE MADE

## I. INTRODUCTION

This brochure is intended to provide a basic outline of the numerous steps of our federal lawmaking process from the source of an idea for a legislative proposal through its publication as a statute. The legislative process is a matter about which every person should be well informed in order to understand and appreciate the work of Congress.

It is hoped that this guide will enable readers to gain a greater understanding of the federal legislative process and its role as one of the foundations of our representative system. One of the most practical safeguards of the American democratic way of life is this legislative process with its emphasis on the protection of the minority, allowing ample opportunity to all sides to be heard and make their views known. The fact that a proposal cannot become a law without consideration and approval by both Houses of Congress is an outstanding virtue of our bicameral legislative system. The open and full discussion provided under the Constitution often results in the notable improvement of a bill by amendment before it becomes law or in the eventual defeat of an inadvisable proposal.

As the majority of laws originate in the House of Representatives, this discussion will focus principally on the procedure in that body.

## II. THE CONGRESS

Article I, Section 1, of the United States Constitution, provides that:

> All legislative Powers herein granted shall be vested in a Congress of the United States, which shall consist of a Senate and House of Representatives.

The Senate is composed of 100 Members—two from each state, regardless of population or area—elected by the people in accordance with the 17th Amendment to the Constitution. The 17th Amendment changed the former constitutional method under which Senators were chosen by the respective state legislatures. A Senator must be at least 30 years of age, have been a citizen of the United States for nine years, and, when elected, be a resident of the state for which the Senator is chosen. The term of office is six years and one-third of the total membership of the Senate is elected every second year. The terms of both Senators from a particular state are arranged so that they do not terminate at the same time. Of the two Senators from a state serving at the same time the one who was elected first—or if both were elected at the same time, the one elected for a full term—is referred to as the "senior" Senator from that state. The other is referred to as the "junior" Senator. If a Senator dies or resigns during the term, the governor of the state must call a special election unless the state legislature has authorized the governor to appoint a successor until the next election, at which time a successor is elected for the balance of the term. Most of the state legislatures have granted their governors the power of appointment.

Each Senator has one vote.

As constituted in the 106th Congress, the House of Representatives is composed of 435 Members elected every two years from among the 50 states, apportioned to their total populations. The permanent number of 435 was established by federal law following the Thirteenth Decennial Census in 1910, in accordance with Article I, Section 2, of the Constitution. This number was increased temporarily to 437 for the 87th Congress to provide for one Representative each for Alaska and Hawaii. The Constitution limits the number of Representatives to not more than one for every 30,000 of population. Under a former apportionment in one state, a particular Representative represented more than 900,000 constituents, while another in the same state was elected from a district having a population of only 175,000. The Supreme Court has since held unconstitutional a Missouri statute permitting a maximum population variance of 3.1 percent from mathematical equality. The Court ruled in *Kirkpatrick* v. *Preisler*, 394 U.S. 526 (1969), that the variances among the districts were not unavoidable and, therefore, were invalid. That decision was an interpretation of the Court's earlier ruling in *Wesberry* v. *Sanders*, 376 U.S. 1 (1964), that the Constitution requires that "as nearly as is practicable one man's vote in a congressional election is to be worth as much as another's".

A law enacted in 1967 abolished all "at-large" elections except in those less populous states entitled to only one Representative. An "at-large" election is one in which a Representative is elected by the voters of the entire state rather than by the voters in a congressional district within the state.

A Representative must be at least 25 years of age, have been a citizen of the United States for seven years, and, when elected, be a resident of the state in which the Representative is chosen. If a Representative dies or resigns during the term, the governor of the state must call a special election pursuant to state law for the choosing of a successor to serve for the unexpired portion of the term.

Each Representative has one vote.

In addition to the Representatives from each of the States, a Resident Commissioner from the Commonwealth of Puerto Rico and Delegates from the District of Columbia, American Samoa, Guam, and the Virgin Islands are elected pursuant to federal law. The Resident Commissioner and the Delegates have most of the prerogatives of Representatives including the right to vote in committees to which they are elected. However, the Resident Commissioner and the Delegates do not have the right to vote on matters before the House.

Under the provisions of Section 2 of the 20th Amendment to the Constitution, Congress must assemble at least once every year, at noon on the third day of January, unless by law they appoint a different day.

A Congress lasts for two years, commencing in January of the year following the biennial election of Members. A Congress is divided into two sessions.

The Constitution authorizes each House to determine the rules of its proceedings. Pursuant to that authority, the House of Representatives adopts its rules on the opening day of each Congress. The Senate considers itself a continuing body and operates under continuous standing rules that it amends from time to time.

Unlike some other parliamentary bodies, both the Senate and the House of Representatives have equal legislative functions and powers with certain exceptions. For example, the Constitution provides that only the House of Representatives originate revenue bills. By tradition, the House also originates appropriation bills. As both bodies have equal legislative powers, the designation of one as the "upper" House and the other as the "lower" House is not appropriate.

The chief function of Congress is the making of laws. In addition, the Senate has the function of advising and consenting to treaties and to certain nominations by the President. However under the 25th Amendment to the Constitution, both Houses confirm the President's nomination for Vice-President when there is a vacancy in that office. In the matter of impeachments, the House of Representatives presents the charges—a function similar to that of a grand jury—and the Senate sits as a court to try the impeachment. No impeached person may be removed without a two-thirds vote of the Senate. The Congress also plays a role in presidential elections. Both Houses meet in joint session on the sixth day of January, following a presidential election, unless by law they appoint a different day, to count the electoral votes. If no candidate receives a majority of the total electoral votes, the House of Representatives, each state delegation having one vote, chooses the President from among the three candidates having the largest number of electoral votes. The Senate, each Senator having one vote, chooses the Vice President from the two candidates having the largest number of votes for that office.

## III. SOURCES OF LEGISLATION

Sources of ideas for legislation are unlimited and proposed drafts of bills originate in many diverse quarters. Primary among these is the idea and draft conceived by a Member or Delegate. This may emanate from the election campaign during which the Member had promised, if elected, to introduce legislation on a particular subject. The Member may have also become aware after taking office of the need for amendment to or repeal of an existing law or the enactment of a statute in an entirely new field.

In addition, the Member's constituents, either as individuals or through citizen groups, may avail themselves of the right to petition and transmit their proposals to the Member. The right to petition is guaranteed by the First Amendment to the Constitution. Many excellent laws have originated in this way, as some organizations, because of their vital concern with various areas of legislation, have considerable knowledge regarding the laws affecting their interests and have the services of legislative draftspersons for this purpose. Similarly, state legislatures may "memorialize" Congress to enact specified federal laws by passing resolutions to be transmitted to the House and Senate as memorials. If favorably impressed by the idea, a Member may introduce the proposal in the form in which it has been submitted or may redraft it. In any event, a Member may consult with the Legislative Counsel of the House or the Senate to frame the ideas in suitable legislative language and form.

In modern times, the "executive communication" has become a prolific source of legislative proposals. The communication is usually in the form of a message or letter from a member of the President's Cabinet, the head of an independent agency, or the President himself, transmitting a draft of a proposed bill to the Speaker of the House of Representatives and the President of the Senate. Despite the structure of separation of powers, Article II, Section 3, of the Constitution imposes an obligation on the President to report to Congress from time to time on the "State of the Union" and to recommend for consideration such measures as the President considers necessary and expedient. Many of these executive communications follow on the President's message to Congress on the state of the Union. The communication is then referred to the standing committee or committees having jurisdiction of the subject matter of the proposal. The chairman or the ranking minority member of the relevant committee usually introduces the bill promptly either in the form in which it was received or with desired changes. This practice is usually followed even when the majority of the House and the President are not of the same political party, although there is no constitutional or statutory requirement that a bill be introduced to effectuate the recommendations. The committee or one of its subcommittees may also decide to examine the communication to determine whether a bill should be introduced. The most important of the regular executive communications is the annual message from the President transmitting the proposed budget to Congress. The President's budget proposal, together with testimony by officials of the various branches of the government before the Appropriations Committees of the House and Senate, is the basis of the several appropriation bills that are drafted by the Committee on Appropriations of the House.

Many of the executive departments and independent agencies employ legislative counsels who are charged with the drafting of bills. These legislative proposals are forwarded to Congress with a request for their enactment.

The drafting of statutes is an art that requires great skill, knowledge, and experience. In some instances, a draft is the result of a study covering a period of a year or more by a commission or committee designated by the President or a member of the Cabinet. The Administrative Procedure Act and the Uniform Code of Military Justice are two examples of enactments resulting from such studies. In addition, congressional committees sometimes draft bills after studies and hearings covering periods of a year or more.

## IV. FORMS OF CONGRESSIONAL ACTION

The work of Congress is initiated by the introduction of a proposal in one of four forms: the bill, the joint resolution, the concurrent resolution, and the simple resolution. The most customary form used in both Houses is the bill. During the 105th Congress (1997–1998), 7,529 bills and 200 joint resolutions were introduced in both Houses. Of the total number introduced, 4,874 bills and 140 joint resolutions originated in the House of Representatives.

For the purpose of simplicity, this discussion will be confined generally to the procedure on a House of Representatives bill, with brief comment on each of the forms.

BILLS

A bill is the form used for most legislation, whether permanent or temporary, general or special, public or private.

The form of a House bill is as follows:

A BILL

For the establishment, etc. [as the title may be].

*Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,* That, etc.

The enacting clause was prescribed by law in 1871 and is identical in all bills, whether they originate in the House of Representatives or in the Senate.

Bills may originate in either the House of Representatives or the Senate with one notable exception provided for in the Constitution. Article I, Section 7, of the Constitution provides that all bills for raising revenue shall originate in the House of Representatives but that the Senate may propose or concur with amendments. By tradition, general appropriation bills also originate in the House of Representatives.

There are two types of bills—public and private. A public bill is one that affects the public generally. A bill that affects a specified individual or a private entity rather than the population at large is called a private bill. A typical private bill is used for relief in matters such as immigration and naturalization and claims against the United States.

A bill originating in the House of Representatives is designated by the letters "H.R." followed by a number that it retains throughout all its parliamentary stages. The letters signify "House of Representatives" and not, as is sometimes incorrectly assumed, "House resolution". A Senate bill is designated by the letter "S." followed by its number. The term "companion bill" is used to describe a bill introduced in one House of Congress that is similar or identical to a bill introduced in the other House of Congress.

A bill that has been agreed to in identical form by both bodies becomes the law of the land only after—

(1) Presidential approval; or

(2) failure by the President to return it with objections to the House in which it originated within 10 days while Congress is in session; or

(3) the overriding of a presidential veto by a two-thirds vote in each House.

It does not become law without the President's signature if Congress by their final adjournment prevent its return with objections. This is known as a "pocket veto". For a discussion of presidential action on legislation, see Part XVIII.

## JOINT RESOLUTIONS

Joint resolutions may originate either in the House of Representatives or in the Senate—not, as is sometimes incorrectly assumed, jointly in both Houses. There is little practical difference between a bill and a joint resolution and the two forms are often used interchangeably. One difference in form is that a joint resolution may include a preamble preceding the resolving clause. Statutes that have been initiated as bills have later been amended by a joint resolution and vice versa. Both are subject to the same procedure except for a joint resolution proposing an amendment to the Constitution. When a joint resolution amending the Constitution is approved by two-thirds of both Houses, it is not presented to the President for approval. Following congressional approval, a joint resolution to amend the Constitution is sent directly to the Archivist of the United States for submission to the several states where ratification by the legislatures of three-fourths of the states within the period of time prescribed in the joint resolution is necessary for the amendment to become part of the Constitution.

The form of a House joint resolution is as follows:

JOINT RESOLUTION

Authorizing, etc. [as the title may be].

*Resolved by the Senate and House of Representatives of the United States of America in Congress assembled,* That all, etc.

The resolving clause is identical in both House and Senate joint resolutions as prescribed by statute in 1871. It is frequently preceded by a preamble consisting of one or more "whereas" clauses indicating the necessity for or the desirability of the joint resolution.

A joint resolution originating in the House of Representatives is designated "H.J. Res." followed by its individual number which it retains throughout all its parliamentary stages. One originating in the Senate is designated "S.J. Res." followed by its number.

Joint resolutions, with the exception of proposed amendments to the Constitution, become law in the same manner as bills.

## CONCURRENT RESOLUTIONS

A matter affecting the operations of both Houses is usually initiated by a concurrent resolution. In modern practice, and as determined by the Supreme Court in *INS* v. *Chadha,* 462 U.S. 919 (1983), concurrent and simple resolutions normally are not legislative in character since not "presented" to the President for approval, but are used merely for expressing facts, principles, opinions, and purposes of the two Houses. A concurrent resolution is not equivalent to a bill and its use is narrowly limited within these bounds. The term "concurrent", like "joint", does not signify simultaneous introduction and consideration in both Houses.

A concurrent resolution originating in the House of Representatives is designated "H. Con. Res." followed by its individual number, while a Senate concurrent resolution is designated "S. Con. Res." together with its number. On approval by both Houses, they are signed by the Clerk of the House and the Secretary of the Senate and transmitted to the Archivist of the United States for publication in a special part of the Statutes at Large volume covering that session of Congress.

### SIMPLE RESOLUTIONS

A matter concerning the rules, the operation, or the opinion of either House alone is initiated by a simple resolution. A resolution affecting the House of Representatives is designated "H. Res." followed by its number, while a Senate resolution is designated "S. Res." together with its number. Simple resolutions are considered only by the body in which they were introduced. Upon adoption, simple resolutions are attested to by the Clerk of the House of Representatives or the Secretary of the Senate and are published in the Congressional Record.

## V. INTRODUCTION AND REFERRAL TO COMMITTEE

Any Member, the Resident Commissioner from Puerto Rico, or the Delegates in the House of Representatives may introduce a bill at any time while the House is in session by simply placing it in the "hopper", a wooden box provided for that purpose located on the side of the rostrum in the House Chamber. Permission is not required to introduce the measure. Printed blank forms for an original bill are available through the Clerk's office. The Member introducing the bill is known as the primary sponsor. An unlimited number of Members may cosponsor a bill. To prevent the possibility that a bill might be introduced in the House on behalf of a Member without that Member's prior approval, the primary sponsor's signature must appear on the bill before it is accepted for introduction. Members who cosponsor a bill upon its date of introduction are original cosponsors. Members who cosponsor a bill after its introduction are additional cosponsors. Cosponsors are not required to sign the bill. A Member may not be added or deleted as a cosponsor after the bill has been reported by the last committee authorized to consider it, but in no event shall the Speaker entertain a request to delete the name of the primary sponsor. In the Senate, unlimited multiple sponsorship of a bill is permitted. Occasionally, a Member may insert the words "by request" after the Member's name to indicate that the introduction of the measure is at the suggestion of some other person or group.

In the Senate, a Senator usually introduces a bill or resolution by presenting it to one of the clerks at the Presiding Officer's desk, without commenting on it from the floor of the Senate. However, a Senator may use a more formal procedure by rising and introducing the bill or resolution from the floor. A Senator usually makes a statement about the measure when introducing it on the floor. Frequently, Senators obtain consent to have the bill or resolution printed in the Congressional Record following their formal statement.

If any Senator objects to the introduction of a bill or resolution, the introduction of the bill or resolution is postponed until the next day. If there is no objection, the bill is read by title and referred to the appropriate committee.

In the House of Representatives, it is no longer the custom to read bills—even by title—at the time of introduction. The title is entered in the Journal and printed in the Congressional Record, thus preserving the purpose of the custom. The bill is assigned its legislative number by the Clerk. The bill is then referred as required by the rules of the House to the appropriate committee or committees by the Speaker, the Member elected by the Members to be the Presiding Officer of the House, with the assistance of the Parliamentarian. The bill number and committee referral appear in the next issue of the Congressional Record. It is then sent to the Government Printing Office where it is printed in its introduced form and printed copies are made available in the document rooms of both Houses. Printed and electronic versions of the bill are also made available to the public.

Copies of the bill are sent to the office of the chairman of the committee to which it has been referred. The clerk of the committee enters it on the committee's Legislative Calendar.

Perhaps the most important phase of the legislative process is the action by committees. The committees provide the most intensive consideration to a proposed measure as well as the forum where the public is given their opportunity to be heard. A tremendous volume of work, often overlooked by the public, is done by the Members in this phase. There are, at present, 19 standing committees in the House and 16 in the Senate as well as several select committees. In addition, there are four standing joint committees of the two Houses, with oversight responsibilities but no legislative jurisdiction. The House may also create select committees or task forces to study specific issues and report on them to the House. A task force may be established formally through a resolution passed by the House or informally through organization of interested Members by the House leadership.

Each committee's jurisdiction is divided into certain subject matters under the rules of each House and all measures affecting a particular area of the law are referred to the committee with jurisdiction over that particular subject matter. For example, the Committee on the Judiciary in the House has jurisdiction over measures relating to judicial proceedings generally, and 17 other categories, including constitutional amendments, immigration and naturalization, bankruptcy, patents, copyrights, and trademarks. In total, the rules of the House and of the Senate each provide for over 200 different classifications of measures to be referred to committees. Until 1975, the Speaker of the House could refer a bill to only one committee. In modern practice, the Speaker may refer an introduced bill to multiple committees for consideration of those provisions of the bill within the jurisdiction of each committee concerned. The Speaker must designate a primary committee of jurisdiction on bills referred to multiple committees. The Speaker may place time limits on the consideration of bills by all committees, but usually time limits are placed only on additional committees. Additional committees are committees other than the primary committee to which a bill has been referred, either initially on its introduction or sequentially following the report of the primary committee. A time limit is placed on an additional committee only when the primary committee has reported its version to the House.

Membership on the various committees is divided between the two major political parties. The proportion of the Members of the minority party to the Members of the majority party is determined by the majority party, except that half of the members on the Committee on Standards of Official Conduct are from the majority party and half from the minority party. The respective party caucuses nominate Members of the caucus to be elected to each standing committee at the beginning of each Congress. Membership on a standing committee during the course of a Congress is contingent on continuing membership in the party caucus that nominated a Member for election to the committee. If a Member ceases to be a Member of the party caucus, a Member automatically ceases to be a member of the standing committee.

Members of the House may serve on only two committees and four subcommittees with certain exceptions. However, the rules of the caucus of the majority party in the House provide that a Member may be chairman of only one subcommittee of a committee or select committee with legislative jurisdiction, except for certain committees performing housekeeping functions and joint committees.

A Member usually seeks election to the committee that has jurisdiction over a field in which the Member is most qualified and interested. For example, the Committee on the Judiciary traditionally is composed almost entirely of lawyers. Many Members are nationally recognized experts in the specialty of their particular committee or subcommittee.

Members rank in seniority in accordance with the order of their appointment to the full committee and the ranking majority member with the most continuous service is usually elected chairman. The rules of the House require that committee chairmen be elected from nominations submitted by the majority party caucus at the commencement of each Congress. In the 106th Congress, no Member of the House may serve as chairman of the same standing committee or of the same subcommittee thereof for more than three consecutive Congresses.

The rules of the House prohibit a committee that maintains a subcommittee on oversight from having more than six subcommittees with the exception of the Committee on Appropriations and the Committee on Government Reform.

Each committee is provided with a professional staff to assist it in the innumerable administrative details involved in the consideration of bills and its oversight responsibilities. For standing committees, the professional staff is limited to 30 persons appointed by a vote of the committee. Two-thirds of the committee staff are selected by a majority vote of the majority committee members and one-third of the committee staff are selected by a majority vote of minority committee members. All staff appointments are made without regard to race, creed, sex, or age. Minority staff requirements do not apply to the Committee on Standards of Official Conduct because of its bipartisan nature. The Committee on Appropriations has special authority under the rules of the House for appointment of staff for the minority.

## VI. CONSIDERATION BY COMMITTEE

One of the first actions taken by a committee is to seek the input of the relevant departments and agencies about a bill. Frequently, the bill is also submitted to the General Accounting Office with a request for an official report of views on the necessity or desirability of enacting the bill into law. Normally, ample time is given for the submission of the reports and they are accorded serious consideration. However, these reports are not binding on the committee in determining whether or not to act favorably on the bill. Reports of the departments and agencies in the executive branch are submitted first to the Office of Management and Budget to determine whether they are consistent with the program of the President. Many committees adopt rules requiring referral of measures to the appropriate subcommittee unless the full committee votes to retain the measure at the full committee.

### COMMITTEE MEETINGS

Standing committees are required to have regular meeting days at least once a month. The chairman of the committee may also call and convene additional meetings. Three or more members of a standing committee may file with the committee a written request that the chairman call a special meeting. The request must specify the measure or matter to be considered. If the chairman does not call the requested special meeting within three calendar days after the filing of the request, to be held within seven calendar days after the filing of the request, a majority of the members of the committee may call the special meeting by filing with the committee written notice specifying the date, hour, and the measure or matter to be considered at the meeting. In the Senate, the Chair may still control the agenda of the special meeting through the power of recognition. Committee meetings may be held for various purposes including the “markup” of legislation, authorizing subpoenas, or internal budget and personnel matters.

A subpoena may be authorized and issued at a meeting by a vote of a committee or subcommittee with a majority of members present. The power to authorize and issue subpoenas also may be delegated to the chairman of the committee. A subpoena may require both testimonial and documentary evidence to be furnished to the committee. A subpoena is signed by the chairman of the committee or by a member designated by the committee.

All meetings for the transaction of business of standing committees or subcommittees, except the Committee on Standards of Official Conduct, must be open to the public, except when the committee or subcommittee, in open session with a majority present, determines by record vote that all or part of the remainder of the meeting on that day shall be closed to the public. Members of the committee may authorize congressional staff and departmental representatives to be present at any meeting that has been closed to the public. Open committee meetings may be covered by the media. Permission to cover hearings and meetings is granted under detailed conditions as provided in the rules of the House.

The rules of the House provide that House committees may not meet during a joint session of the House and Senate or during a recess when a joint meeting of the House and Senate is in progress. Committees may meet at other times during an adjournment or recess up to the expiration of the constitutional term.

### PUBLIC HEARINGS

If the bill is of sufficient importance, the committee may set a date for public hearings. The chairman of each committee, except for the Committee on Rules, is required to make public announcement of the date, place, and subject matter of any hearing at least one week before the commencement of that hearing, unless the committee chairman with the concurrence of the ranking minority member or the committee by majority vote determines that there is good cause to begin the hearing at an earlier date. If that determination is made, the chairman must make a public announcement to that effect at the earliest possible date. Public announcements are published in the Daily Digest portion of the Congressional Record as soon as possible after an announcement is made and are often noted by the media. Personal notice of the hearing, usually in the form of a letter, is sometimes sent to relevant individuals, organizations, and government departments and agencies.

Each hearing by a committee and subcommittee, except the Committee on Standards of Official Conduct, is required to be open to the public except when the committee or subcommittee, in open session and with a majority present, determines by record vote that all or part of the remainder of the hearing on that day shall be closed to the public because disclosure of testimony, evidence, or other matters to be considered would endanger national security, would compromise sensitive law enforcement information, or would violate a law or a rule of the House. The committee or subcommittee may by the same procedure vote to close one subsequent day of hearing, except that the Committees on Appropriations, Armed Services, and the Permanent Select Committee on Intelligence, and subcommittees thereof, may vote to close up to five additional, consecutive days of hearings. When a quorum for taking testimony is present, a majority of the members present may close a hearing to discuss whether the evidence or testimony to be received would endanger national security or would tend to defame, degrade, or incriminate any person. A committee or subcommittee may vote to release or make public matters originally received in a closed hearing or meeting. Open committee hearings may be covered by the media. Permission to cover hearings and meetings is granted under detailed conditions as provided in the rules of the House.

Hearings on the Budget are required to be held by the Committee on Appropriations in open session within 30 days after its transmittal to Congress, except when the committee, in open session and with a quorum present, determines by record vote that the testimony to be taken at that hearing on that day may be related to a matter of national security. The committee may by the same procedure close one subsequent day of hearing.

On the day set for a public hearing in a committee or subcommittee, an official reporter is present to record the testimony. After a brief introductory statement by the chairman and often by the ranking minority member or other committee member, the first witness is called. Members or Senators who wish to be heard sometimes testify first out of courtesy and due to the limitations on their time. Cabinet officers and high-ranking government officials, as well as interested private individuals, testify either voluntarily or by subpoena.

So far as practicable, committees require that witnesses who appear before it file a written statement of their proposed testimony in advance of their appearance and limit their oral presentations to a brief summary of their arguments. In the case of a witness appearing in a nongovernmental capacity, a written statement of proposed testimony shall include a curriculum vitae and a disclosure of certain federal grants and contracts.

Minority party members of the committee are entitled to call witnesses of their own to testify on a measure during at least one day of the hearing.

Each member of the committee is provided only five minutes in the interrogation of each witness until each member of the committee who desires to question a witness has had an opportunity to do so. In addition, a committee may adopt a rule or motion to permit committee members to question a witness for a specified period not longer than one hour. Committee staff may also be permitted to question a witness for a specified period not longer than one hour.

A transcript of the testimony taken at a public hearing is made available for inspection in the office of the clerk of the committee. Frequently, the complete transcript is printed and distributed widely by the committee.

### MARKUP

After hearings are completed, the subcommittee usually will consider the bill in a session that is popularly known as the "markup" session. The views of both sides are studied in detail and at the conclusion of deliberation a vote is taken to determine the action of the subcommittee. It may decide to report the bill favorably to the full committee, with or without amendment, or unfavorably, or without recommendation. The subcommittee may also suggest that the committee "table" it or postpone action indefinitely. Each member of the subcommittee, regardless of party affiliation, has one vote. Proxy voting is no longer permitted in House committees.

### FINAL COMMITTEE ACTION

At full committee meetings, reports on bills may be made by subcommittees. Bills are read for amendment in committees by section and members may offer germane amendments. Committee amendments are only proposals to change the bill as introduced and are subject to acceptance or rejection by the House itself. A vote of committee members is taken to determine whether the full committee will report favorably or table the bill. If the committee votes to report the bill favorably to the House, it may report the bill without amendments or may introduce and report a "clean bill". If the committee has approved extensive amendments, the committee may decide to report the original bill with one "amendment in the nature of a substitute" consisting of all the amendments previously adopted, or may report a new bill incorporating those amendments, commonly known as a clean bill. The new bill is introduced (usually by the chairman of the committee), and, after referral back to the committee, is reported favorably to the House by the committee. A committee may table a bill or not take action on it, thereby preventing further action on a bill. This makes adverse reports to the House by a committee unusual. On rare occasions, a committee may report a bill without recommendation or adversely. The House also has the ability to discharge a bill from committee. For a discussion of the motion to discharge, see Part X.

Generally, a majority of the committee or subcommittee constitutes a quorum. A quorum is the number of members who must be present in order for the committee to report. This ensures participation by both sides in the action taken. However, a committee may vary the number of members necessary for a quorum for certain actions. For example, a committee may fix the number of its members, but not less than two, necessary for a quorum for taking testimony and receiving evidence. Except for the Committees on Appropriations, the Budget, and Ways and Means, a committee may fix the number of its members, but not less than one-third, necessary for a quorum for taking certain other actions. The absence of a quorum is subject to a point of order, an objection that the proceedings are in violation of a rule of the committee or of the House, because the required number of members are not present.

### POINTS OF ORDER WITH RESPECT TO COMMITTEE HEARING PROCEDURE

A point of order in the House does not lie with respect to a measure reported by a committee on the ground that hearings on the measure were not conducted in accordance with required committee procedure. However, certain points of order may be made by a member of the committee that reported the measure if, in the committee hearing on that measure, that point of order was (1) timely made and (2) improperly disposed of.

## VII. REPORTED BILLS

If the committee votes to report the bill to the House, the committee staff writes a committee report. The report describes the purpose and scope of the bill and the reasons for its recommended approval. Generally, a section-by-section analysis is set forth explaining precisely what each section is intended to accomplish. All changes in existing law must be indicated in the report and the text of laws being repealed must be set out. This requirement is known as the "Ramseyer" rule. A similar rule in the Senate is known as the "Cordon" rule. Committee amendments also must be set out at the beginning of the report and explanations of them are included. Executive communications regarding the bill may be referenced in the report.

If at the time of approval of a bill by a committee, except for the Committee on Rules, a member of the committee gives notice of an intention to file supplemental, minority, or additional views, that member is entitled to not less than two additional calendar days after the day of such notice (excluding Saturdays, Sundays, and legal holidays unless the House is in session on those days) in which to file those views with the clerk of the committee. Those views that are timely filed must be included in the report on the bill. Committee reports must be filed while the House is in session unless unanimous consent is obtained from the House to file at a later time or the committee is awaiting additional views.

The report is assigned a report number upon its filing and is sent to the Government Printing Office for printing. House reports are given a prefix-designator that indicates the number of the Congress. For example, the first House report in the 106th Congress was numbered 106–1.

In the printed report, committee amendments are indicated by showing new matter in italics and deleted matter in line-through type. The report number is printed on the bill and the calendar number is shown on both the first and back pages of the bill. However, in the case of a bill that was referred to two or more committees for consideration in sequence, the calendar number is printed only on the bill as reported by the last committee to consider it. For a discussion of House calendars, see Part IX.

Committee reports are perhaps the most valuable single element of the legislative history of a law. They are used by the courts, executive departments, and the public as a source of information regarding the purpose and meaning of the law.

## CONTENTS OF REPORTS

The report of a committee on a measure that has been approved by the committee must include: (1) the committee's oversight findings and recommendations; (2) a statement required by the Congressional Budget Act of 1974, if the measure is a bill or joint resolution providing new budget authority (other than continuing appropriations) or an increase or decrease in revenues or tax expenditures; (3) a cost estimate and comparison prepared by the Director of the Congressional Budget Office whenever the Director has submitted that estimate and comparison to the committee prior to the filing of the report; and (4) a summary of the oversight findings and recommendations made by the Committee on Government Reform whenever they have been submitted to the reporting committee in a timely fashion to allow an opportunity to consider the findings and recommendations during the committee's deliberations on the measure. Each report accompanying a bill or joint resolution relating to employment or access to public services or accommodations must describe the manner in which the provisions apply to the legislative branch. Each of these items are set out separately and clearly identified in the report.

With respect to each record vote by a committee, the total number of votes cast for, and the total number of votes cast against any public measure or matter or amendment thereto and the names of those voting for and against, must be included in the committee report.

In addition, each report of a committee on a public bill or public joint resolution must contain a statement citing the specific powers granted to Congress in the Constitution to enact the law proposed by the bill or joint resolution. Committee reports that accompany bills or resolutions that contain federal unfunded mandates are also required to include an estimate prepared by the Congressional

Budget Office on the cost of the mandates on state, local, and tribal governments. If an estimate is not available at the time a report is filed, committees are required to publish the estimate in the Congressional Record. Each report also must contain an estimate, made by the committee, of the costs which would be incurred in carrying out that bill or joint resolution in the fiscal year reported and in each of the five fiscal years thereafter or for the duration of the program authorized if less than five years. The report must include a comparison of the estimates of those costs with any estimate made by any Government agency and submitted to that committee. The Committees on Appropriations, House Administration, Rules, and Standards of Official Conduct are not required to include cost estimates in their reports. In addition, the committee's own cost estimates are not required to be included in reports when a cost estimate and comparison prepared by the Director of the Congressional Budget Office has been submitted prior to the filing of the report and included in the report.

### FILING OF REPORTS

Measures approved by a committee must be reported promptly after approval. A majority of the members of the committee may file a written request with the clerk of the committee for the reporting of the measure. When the request is filed, the clerk must immediately notify the chairman of the committee of the filing of the request, and the report on the measure must be filed within seven calendar days (excluding days on which the House is not in session) after the day on which the request is filed. This does not apply to a report of the Committee on Rules with respect to a rule, joint rule, or order of business of the House or to the reporting of a resolution of inquiry addressed to the head of an executive department.

### AVAILABILITY OF REPORTS AND HEARINGS

A measure or matter reported by a committee (except the Committee on Rules in the case of a resolution providing a rule, joint rule, or order of business) may not be considered in the House until the third calendar day (excluding Saturdays, Sundays, and legal holidays unless the House is in session on those days) on which the report of that committee on that measure has been available to the Members of the House. This rule is subject to certain exceptions including resolutions providing for certain privileged matters, measures declaring war or other national emergency, and government agency decisions, determinations, and actions that are effective unless disapproved or otherwise invalidated by one or both Houses of Congress. However, it is always in order to consider a report from the Committee on Rules specifically providing for the consideration of a reported measure or matter notwithstanding this restriction. If hearings were held on a measure or matter so reported, the committee is required to make every reasonable effort to have those hearings printed and available for distribution to the Members of the House prior to the consideration of the measure in the House. Committees are also required, to the maximum extent feasible, to make their publications available in electronic form. A general appropriation bill reported by the Committee on Appropriations may not be considered until printed committee hearings and a committee report thereon have been available to the Members of the House for at least three calendar days (excluding Saturdays, Sundays, and legal holidays unless the House is in session on those days).

## VIII. LEGISLATIVE OVERSIGHT BY STANDING COMMITTEES

Each standing committee, other than the Committees on Appropriations and on the Budget, is required to review and study, on a continuing basis, the application, administration, execution, and effectiveness of the laws dealing with the subject matter over which the committee has jurisdiction and the organization and operation of federal agencies and entities having responsibility for the administration and evaluation of those laws.

The purpose of the review and study is to determine whether laws and the programs created by Congress are being implemented and carried out in accordance with the intent of Congress and whether those programs should be continued, curtailed, or eliminated. In addition, each committee having oversight responsibility is required to review and study any conditions or circumstances that may indicate the necessity or desirability of enacting new or additional legislation within the jurisdiction of that committee, and must undertake, on a continuing basis, future research and forecasting on matters within the jurisdiction of that committee. Each standing committee also has the function of reviewing and studying, on a continuing basis, the impact or probable impact of tax policies on subjects within its jurisdiction.

The rules of the House provide for special treatment of an investigative or oversight report of a committee. Committees are allowed to file joint investigative reports and to file investigative and activities reports after the House has completed its final session of a Congress. In addition, several of the standing committees have special oversight responsibilities. The details of those responsibilities are set forth in the rules of the House.

## IX. CALENDARS

The House of Representatives has five calendars of business: the Union Calendar, the House Calendar, the Private Calendar, the Corrections Calendar, and the Calendar of Motions to Discharge Committees. The calendars are compiled in one publication printed each day the House is in session. This publication also contains a history of Senate-passed bills, House bills reported out of committee, bills on which the House has acted, and other useful information.

When a public bill is favorably reported by all committees to which referred, it is assigned a calendar number on either the Union Calendar or the House Calendar, the two principal calendars of business. The calendar number is printed on the first page of the bill and, in certain instances, is printed also on the back page. In the case of a bill that was referred to multiple committees for consideration in sequence, the calendar number is printed only on the bill as reported by the last committee to consider it.

## UNION CALENDAR

The rules of the House provide that there shall be:

A Calendar of the Committee of the Whole House on the state of the Union, to which shall be referred public bills and public resolutions raising revenue, involving a tax or charge on the people, directly or indirectly making appropriations of money or property or requiring such appropriations to be made, authorizing payments out of appropriations already made, releasing any liability to the United States for money or property, or referring a claim to the Court of Claims.

The large majority of public bills and resolutions reported to the House are placed on the Union Calendar. For a discussion of the Committee of the Whole House, see Part XI.

## HOUSE CALENDAR

The rules further provide that there shall be:

A House Calendar, to which shall be referred all public bills and public resolutions not requiring referral to the Calendar of the Committee of the Whole House on the state of the Union.

Bills not involving a cost to the government and resolutions providing special orders of business are examples of bills and resolutions placed on the House Calendar.

## PRIVATE CALENDAR

The rules also provide that there shall be:

A Private Calendar, . . . to which shall be referred all private bills and private resolutions.

All private bills reported to the House are placed on the Private Calendar. The Private Calendar is called on the first and third Tuesdays of each month. If two or more Members object to the consideration of any measure called, it is recommitted to the committee that reported it. There are six official objectors, three on the majority side and three on the minority side, who make a careful study of each bill or resolution on the Private Calendar. The official objectors' role is to object to a measure that does not conform to the requirements for that calendar and prevent the passage without debate of nonmeritorious bills and resolutions. Private bills that have been reported from committee are only considered under the private calendar procedure. Alternative procedures reserved for public bills are not applicable for reported private bills.

## CORRECTIONS CALENDAR

If a measure pending on either the House or Union Calendar is of a noncontroversial nature, it may be placed on the Corrections Calendar. The Corrections Calendar was created to address specific problems with federal rules, regulations, or court decisions that bipartisan and narrowly targeted bills could expeditiously correct. After a bill has been favorably reported and is on either the House or Union Calendar, the Speaker may, after consultation with the Minority Leader, file with the Clerk a notice requesting that such bill also be placed upon a special calendar known as the Corrections Calendar. On the second and fourth Tuesdays of each month, the Speaker directs the Clerk to call any bill that has been on the Corrections Calendar for three legislative days. A three-fifths vote of the Members voting is required to pass any bill called from the

Corrections Calendar. A failure to adopt a bill from the Corrections Calendar does not necessarily mean the final defeat of the bill because it may then be brought up for consideration in the same way as any other bill on the House or Union Calendar.

#### CALENDAR OF MOTIONS TO DISCHARGE COMMITTEES

When a majority of the Members of the House sign a motion to discharge a committee from consideration of a public bill or resolution, that motion is referred to the Calendar of Motions to Discharge Committees. For a discussion of the motion to discharge, see Part X.

## X. OBTAINING CONSIDERATION OF MEASURES

Certain measures, either pending on the House and Union Calendars or unreported and pending in committee, are more important and urgent than others and a system permitting their consideration ahead of those that do not require immediate action is necessary. If the calendar numbers alone were the determining factor, the bill reported most recently would be the last to be taken up as all measures are placed on the House and Union Calendars in the order reported.

#### UNANIMOUS CONSENT

The House occasionally employs the practice of allowing reported or unreported measures to be considered by the unanimous agreement of all Members in the House Chamber. The power to recognize Members for a unanimous consent request is ultimately in the discretion of the Chair but recent Speakers have issued strict guidelines on when such a request is to be entertained. Most unanimous consent requests for consideration of measures may only be entertained by the Chair when assured that the majority and minority floor and committee leaderships have no objection.

#### SPECIAL RESOLUTION OR "RULE"

To avoid delays and to allow selectivity in the consideration of public measures, it is possible to have them taken up out of their order on their respective calendar or to have them discharged from the committee or committees to which referred by obtaining from the Committee on Rules a special resolution or "rule" for their consideration. The Committee on Rules, which is composed of majority and minority members but with a larger proportion of majority members than other committees, is specifically granted jurisdiction over resolutions relating to the order of business of the House. Typically, the chairman of the committee that has favorably reported the bill requests the Committee on Rules to originate a resolution that will provide for its immediate or subsequent consideration. Under unusual circumstances, the Committee on Rules may originate a resolution providing for the "discharge" and consideration of a measure that has not been reported by the legislative committee or committees of jurisdiction. If the Committee on Rules has determined that the measure should be taken up, it may report a resolution reading substantially as follows with respect to a bill on the Union Calendar or an unreported bill:

*Resolved,* That upon the adoption of this resolution the Speaker declares pursuant to rule XVIII that the House resolve itself into the Committee of the Whole House on the State of the Union for the consideration of the bill (H.R.______) entitled, etc., and the first reading of the bill shall be dispensed with. After general debate, which shall be confined to the bill and shall continue not to exceed ______ hours, to be equally divided and controlled by the chairman and ranking minority member of the Committee on ______, the bill shall be read for amendment under the five-minute rule. At the conclusion of the consideration of the bill for amendment, the Committee shall rise and report the bill to the House with such amendments as may have been adopted, and the previous question shall be considered as ordered on the bill and amendments thereto to final passage without intervening motion except one motion to recommit with or without instructions.

If the measure is on the House Calendar or the recommendation is to avoid consideration in the Committee of the Whole, the resolution reads substantially as follows:

*Resolved,* That upon the adoption of this resolution it shall be in order to consider the bill (H.R. ______) entitled, etc., in the House.

The resolution may waive points of order against the bill. A point of order is an objection that a pending matter or proceeding is in violation of a rule of the House. The bill may be susceptible to various points of order that may be made against its consideration, including an assertion that the bill carries a retroactive federal income tax increase, contains a federal unfunded mandate, or has not been reported from committee properly. When a rule limits or prevents floor amendments, it is popularly known as a "closed rule" or "modified closed rule." However, a rule may not deny the minority party the right to offer a motion to recommit the bill with amendatory or general instructions. For a discussion of the motion to recommit, see Part XI.

### CONSIDERATION OF MEASURES MADE IN ORDER BY RULE REPORTED FROM THE COMMITTEE ON RULES

When a rule has been reported to the House and is not considered immediately, it is referred to the calendar and, if not called up for consideration by the Member who filed the report within seven legislative days thereafter, any member of the Committee on Rules may call it up as a privileged matter, after having given one calendar day notice of the Member's intention to do so. The Speaker will recognize any member of the committee seeking recognition for that purpose.

If the House has adopted a resolution making in order a motion to consider a bill, and such a motion has not been offered within seven calendar days thereafter, such a motion shall be privileged if offered by direction of all reporting committees having initial jurisdiction of the bill.

There are several other methods of obtaining consideration of bills that either have not been reported by a committee or, if reported, for which a rule has not been granted. Two of those methods, a motion to discharge a committee and a motion to suspend the rules, are discussed below.

### MOTION TO DISCHARGE COMMITTEE

A Member may present to the Clerk a motion in writing to discharge a committee from the consideration of a public bill or resolution that has been referred to it 30 legislative days prior thereto.

A Member also may file a motion to discharge the Committee on Rules from further consideration of a resolution providing a special rule for the consideration of a public bill or resolution reported by a standing committee, or a special rule for the consideration of a public bill or resolution that has been referred to a standing committee for 30 legislative days. This motion to discharge the Committee on Rules may be made only when the resolution has been referred to that committee at least seven legislative days prior to the filing of the motion to discharge. The motion may not permit consideration of nongermane amendments. The motion is placed in the custody of the Journal Clerk, where Members may sign it at the House rostrum only when the House is in session. The names of Members who have signed a discharge motion are made available electronically and published in the Congressional Record on a weekly basis. When a majority of the total membership of the House (218 Members) have signed the motion, it is entered in the Journal, printed with all the signatures thereto in the Congressional Record, and referred to the Calendar of Motions to Discharge Committees.

On the second and fourth Mondays of each month, except during the last six days of a session, a Member who has signed a motion to discharge that has been on the calendar at least seven legislative days may seek recognition and be recognized for the purpose of calling up the motion. The motion to discharge is debated for 20 minutes, one-half in favor of the proposition and one-half in opposition.

If the motion to discharge the Committee on Rules from a resolution prevails, the House shall immediately consider such resolution. If the resolution is adopted, the House proceeds to its execution. This is the modern practice for utilization of the discharge rule.

If the motion to discharge a standing committee of the House from a public bill or resolution pending before the committee prevails, a Member who signed the motion may move that the House proceed to the immediate consideration of the bill or resolution. If the motion is agreed to, the bill or resolution is considered immediately under the general rules of the House. If the House votes against the motion for immediate consideration, the bill or resolution is referred to its proper calendar with the same status as if reported by a standing committee.

## MOTION TO SUSPEND THE RULES

On Monday and Tuesday of each week and during the last six days of a session, the Speaker may entertain a motion to suspend the rules of the House and pass a public bill or resolution. Members need to arrange in advance with the Speaker to be recognized to offer such a motion. The Speaker usually recognizes only a majority member of the committee that has reported or has primary jurisdiction over the bill. The motion to suspend the rules and pass the bill is debatable for 40 minutes, one-half of the time in favor of the proposition and one-half in opposition. The motion may not be separately amended but may be amended in the form of a manager's amendment included in the motion when it is offered. Because the rules may be suspended and the bill passed only by affirmative vote of two-thirds of the Members voting, a quorum being present, this procedure is usually used only for expedited consideration of relatively noncontroversial public measures.

The Speaker may postpone all recorded and yea-nay votes on certain questions before the House, including a motion to suspend the rules and on passage of bills and resolutions, until a specified time on that legislative day or the next two legislative days. At that time, the House disposes of the postponed votes consecutively without further debate. After an initial fifteen-minute vote is taken, the Speaker may reduce to not less than five minutes the time period for subsequent votes. If the House adjourns before completing action on postponed votes, the postponed votes must be the first order of business on the next legislative day. Eliminating intermittent recorded votes on suspensions reduces interruptions of committee activity and allows more efficient scheduling of voting.

### CALENDAR WEDNESDAY

On Wednesday of each week, unless dispensed with by unanimous consent or by affirmative vote of two-thirds of the Members voting, a quorum being present, the standing committees are called in alphabetical order. A committee when named may call up for consideration any bill reported by it on a previous day and pending on either the House or Union Calendar. The report on the bill must have been available for three days and must not be privileged under the rules of the House. General debate is limited to two hours on any Calendar Wednesday measure and must be confined to the subject matter of the measure, the time being equally divided between those for and those against. An affirmative vote of a simple majority of the Members present is sufficient to pass the measure. The purpose of this rarely utilized procedure is to provide an alternative method of consideration when the Committee on Rules has not reported a rule for a specific bill.

### DISTRICT OF COLUMBIA BUSINESS

On the second and fourth Mondays of each month, after the disposition of motions to discharge committees and after the disposal of business on the Speaker's table requiring only referral to committee, the Committee on Government Reform may call up for consideration any District of Columbia business reported from that committee.

### QUESTIONS OF PRIVILEGE

House rules provide special privilege to questions of privilege. Questions of privilege are classified as those questions: (1) affecting the rights of the House collectively, its safety, dignity, and the integrity of its proceedings; and (2) affecting the rights, reputations, and conduct of Members, individually, in their representative capacity. A question of privilege has been held to take precedence over all questions except the motion to adjourn. Questions of the privileges of the House, those concerning the rights of the House collectively, take the form of a resolution which may be called up by any Member after proper notice. A question of personal privilege, affecting the rights, reputation, and conduct of individual Members, may be raised from the floor without formal notice. Debate on a question of privilege proceeds under the hour rule, with debate on a question of the privileges of the House divided between the proponent and the leader of the opposing party or a designee.

### PRIVILEGED MATTERS

Under the rules of the House, certain matters are regarded as privileged matters and may interrupt the order of business. Conference reports, veto messages from the President, and certain amendments to measures by the Senate after the stage of disagreement between the two Houses are examples of privileged matters. Certain reports from House committees are also privileged, including reports from the Committee on Rules, reports from the Committee on Appropriations on the general appropriation bills, printing and committee funding resolutions reported from the Committee on House Administration, and reports on Member's conduct from the Committee on Standards of Official Conduct. Bills, joint resolutions, and motions may also take on privileged status as a result of special procedures written into statute. The Member in charge of such a matter may call it up at practically any time for immediate consideration when no other business is pending. Usually, this is done after consultation with both the majority and minority floor leaders so that the Members of both parties will have advance notice.

At any time after the reading of the Journal, a Member, by direction of the Committee on Appropriations, may move that the House resolve itself into the Committee of the Whole House on the state of the Union for the purpose of considering a general appropriation bill. A general appropriation bill may not be considered in the House until three calendar days (excluding Saturdays, Sundays, and legal holidays unless the House is in session on those days) after printed committee reports and hearings on the bill have been available to the Members. The limit on general debate on such a bill is generally fixed by a rule reported from the Committee on Rules.

## XI. CONSIDERATION AND DEBATE

Our democratic tradition demands that bills be given consideration by the entire membership usually with adequate opportunity for debate and the proposing of amendments.

### COMMITTEE OF THE WHOLE HOUSE

In order to expedite the consideration of bills and resolutions, the rules of the House provide for a parliamentary mechanism, known as the Committee of the Whole House on the state of the Union, that enables the House to act with a quorum of less than the requisite majority of 218. A quorum in the Committee of the Whole is 100 members. All measures on the Union Calendar—those involving a tax, making appropriations, authorizing payments out of appropriations already made, or disposing of property—must be first considered in the Committee of the Whole.

The Committee on Rules reports a rule allowing for immediate consideration of a measure by the Committee of the Whole. After adoption of the rule by the House, the Speaker may declare the

House resolved into the Committee of the Whole. When the House resolves into the Committee of the Whole, the Speaker leaves the chair after appointing a Chairman to preside.

The rule referred to in the preceding paragraph also fixes the length of the debate in the Committee of the Whole. This may vary according to the importance of the measure. As provided in the rule, the control of the time is usually divided equally between the chairman and the ranking minority member of the relevant committee. Members seeking to speak for or against the measure may arrange in advance with the Member in control of the time on their respective side to be allowed a certain amount of time in the debate. Members may also ask the Member speaking at the time to yield to them for a question or a brief statement. A transcript of the proceedings in the House and the Senate is printed daily in the Congressional Record. Frequently, permission is granted a Member by unanimous consent to revise and extend his remarks in the Congressional Record if sufficient time to make a lengthy oral statement is not available during actual debate. These revisions and extensions are printed in a distinctive type and cannot substantively alter the verbatim transcript.

The conduct of the debate is governed principally by the rules of the House that are adopted at the opening of each Congress. In the 106th Congress, the rules were recodified for simplification and clarity. *Jefferson's Manual,* prepared by Thomas Jefferson for his own guidance as President of the Senate from 1797 to 1801, is another recognized authority. The House has a long-standing rule that the provisions of *Jefferson's Manual* should govern the House in all applicable cases and where they are not inconsistent with the rules of the House. The House also relies on an 11-volume compilation of parliamentary precedents, entitled *Hinds' Precedents and Cannon's Precedents of the House of Representatives,* dating from 1789 to 1935, to guide its action. A later compilation, *Deschler-Brown Precedents of the House of Representatives,* spans 15 volumes and covers 1936 to date. In addition, a summary of the House precedents prior to 1959 can be found in a single volume entitled *Cannon's Procedure in the House of Representatives. Procedure in the U.S. House of Representatives,* fourth edition, as supplemented, and *House Practice,* published in 1996, are more recent compilations of the precedents of the House, in summary form, together with other useful related material. Also, various rulings of the Chair are set out as notes in the current *House Rules and Manual.* Most parliamentary questions arising during the course of debate are responded to by a ruling based on a precedent of action in a similar situation. The Parliamentarian of the House is present in the House Chamber in order to assist the Speaker or the Chairman in making a correct ruling on parliamentary questions.

### SECOND READING

During general debate on a bill, an accurate account of the time used on both sides is kept and the Chairman terminates the debate when all the time allowed under the rule has been consumed. After general debate, the second reading of the bill begins. The second reading is a section-by-section reading during which time germane amendments may be offered to a section when it is read. Under some special "modified closed" rules adopted by the House, certain bills are considered as read and open only to prescribed amendments under limited time allocations. Under the normal "open" amendment process, a Member is permitted five minutes to explain the proposed amendment, after which the Member who is first recognized by the Chair is allowed to speak for five minutes in opposition to it. There is technically no further debate on that amendment, thereby effectively preventing filibuster-like tactics. This is known as the "five-minute rule". However, Members may offer an amendment to the amendment, for separate five-minute debate, or may offer a pro forma amendment—"to strike out the last word"—which does not change the language of the amendment but allows the Member five minutes for debate. Each substantive amendment and amendment thereto is put to the Committee of the Whole for adoption unless the House has adopted a special rule "self-executing" the adoption of certain amendments in the Committee of the Whole.

At any time after debate has begun on proposed amendments to a section or paragraph of a bill under the five-minute rule, the Committee of the Whole may by majority vote of the Members present close debate on the section or paragraph. However, if debate is closed on a section or paragraph before there has been debate on an amendment that a Member has caused to be printed in the Congressional Record at least one day prior to floor consideration of the amendment, the Member who caused the amendment to be printed in the Record is given five minutes in which to explain the amendment. Five minutes is also given to speak in opposition to the amendment and no further debate on the amendment is allowed. Amendments placed in the Congressional Record must indicate the full text of the proposed amendment, the name of the Member proposing it, the number of the bill or amendment to which it will be offered, and the point in the bill or amendment thereto where the amendment is intended to be offered. These amendments appear in the portion of the Record designated for that purpose.

## AMENDMENTS AND THE GERMANENESS RULE

The rules of the House prohibit amendments of a subject matter different from the text under consideration. This rule, commonly known as the germaneness rule, is considered the single most important rule of the House of Representatives because of the obvious need to keep the focus of a body the size of the House on a predictable subject matter. The germaneness rule applies to the proceedings in the House, the Committee of the Whole, and the standing committees. There are hundreds of prior rulings or "precedents" on germaneness available to guide the Chair.

## THE COMMITTEE "RISES"

At the conclusion of the consideration of a bill for amendment, the Committee of the Whole "rises" and reports the bill to the House with any amendments that have been adopted. In rising, the Committee of the Whole reverts back to the House and the Chairman of the Committee is replaced in the chair by the Speaker of the House. The House then acts on the bill and any amendments adopted by the Committee of the Whole.

## HOUSE ACTION

Debate on a bill in the House is cut off by moving and ordering "the previous question". All debate is cut off on the bill if this motion is carried by a majority of the Members voting, a quorum being present, or by a special rule ordering the previous question upon the rising of the Committee of the Whole. The Speaker then puts the question: "Shall the bill be engrossed and read a third time?" If this question is decided in the affirmative, the bill is read a third time by title only and voted on for passage.

If the previous question has been ordered by the terms of the rule on a bill reported by the Committee of the Whole, the House immediately votes on whatever amendments have been reported by the Committee in the order in which they appear in the bill unless voted on en bloc. After completion of voting on the amendments, the House immediately votes on the passage of the bill with the amendments it has adopted. However, a motion to recommit, as described in the next section, may be offered and voted on prior to the vote on passage.

The Speaker may postpone a recorded vote on final passage of a bill or resolution or agreement to a conference report for up to two legislative days.

Measures that do not have to be considered in the Committee of the Whole are considered in the House in accordance with the terms of the rule limiting debate on the measure or under the "hour rule". The hour rule limits the amount of time that a Member may occupy in debate on a pending question to 60 minutes. Generally, the opportunity for debate may also be curtailed when the Speaker makes the rare determination that a motion is dilatory.

After passage or rejection of the bill by the House, a pro forma motion to reconsider it is automatically made and laid on the table. The motion to reconsider is tabled to prohibit this motion from being made at a later date because the vote of the House on a proposition is not final and conclusive until there has been an opportunity to reconsider it.

## MOTION TO RECOMMIT

After the previous question has been ordered on the passage of a bill or joint resolution, it is in order to offer one motion to recommit the bill or joint resolution to a committee and the Speaker is required to give preference in recognition for that purpose to a minority party Member who is opposed to the bill or joint resolution. This motion is normally not subject to debate. However, a motion to recommit with instructions offered after the previous question has been ordered is debatable for 10 minutes, except that the majority floor manager may demand that the debate be extended to one hour. Whatever time is allotted for debate is divided equally between the proponent and opponent of the motion. Instructions in the motion to recommit normally take the form of germane amendments proposed by the minority to immediately change the final form of the bill prior to passage. Instructions may also be "general," directing the committee to take specified actions such as to review the bill with a particular political viewpoint or to hold further hearings.

QUORUM CALLS AND ROLLCALLS

Article I, Section 5, of the Constitution provides that a majority of each House constitutes a quorum to do business and authorizes a smaller number than a quorum to compel the attendance of absent Members. In order to fulfill this constitutional responsibility, the rules of the House provide alternative procedures for quorum calls in the House and the Committee of the Whole.

In the absence of a quorum, 15 Members may initiate a call of the House to compel the attendance of absent Members. Such a call of the House must be ordered by a majority vote. A call of the House is then ordered and the call is taken by electronic device or by response to the alphabetical call of the roll of Members. Absent Members have a minimum of 15 minutes from the ordering of the call of the House by electronic device to have their presence recorded. If sufficient excuse is not offered for their absence, they may be sent for by the Sergeant-at-Arms and their attendance secured and retained. The House then determines the conditions on which they may be discharged. Members who voluntarily appear are, unless the House otherwise directs, immediately admitted to the Hall of the House and must report their names to the Clerk to be entered on the Journal as present. Compulsory attendance or arrest of Members has been rare in modern practice.

The rules of the House provide special authority for the Speaker to recognize a Member of the Speaker's choice to move a call of the House at any time.

When a question is put to a vote by the Speaker and a quorum fails to vote on such question, if a quorum is not present and objection is made for that reason, there is a call of the House unless the House adjourns. The call is taken by electronic device and the Sergeant-at-Arms may bring in absent Members. The yeas and nays on the pending question are at the same time considered as ordered and an "automatic" recorded vote is taken. The Clerk utilizes the electronic system or calls the roll and each Member who is present may vote on the pending question. If those voting on the question and those who are present and decline to vote together make a majority of the House, the Speaker declares that a quorum is constituted and the pending question is decided as the majority of those voting have determined.

The rules of the House prohibit points of order of no quorum unless the Speaker has put a question to a vote.

The rules for quorum calls are different in some respects in the Committee of the Whole. The first time the Committee of the Whole finds itself without a quorum during a day the Chairman is required to order the roll to be called by electronic device, unless the Chairman orders a call of the Committee. However, the Chairman may refuse to entertain a point of order of no quorum during general debate. If on a call, a quorum (100 Members) appears, the Committee continues its business. If a quorum does not appear, the Committee rises and the Chairman reports the names of the absentees to the House. The rules provide for the expeditious conduct of quorum calls in the Committee of the Whole. The Chairman may suspend a quorum call after 100 Members have recorded their presence. Under such a short quorum call, the Committee will not rise and proceedings under the quorum call are vacated. In that case, a recorded vote, if ordered immediately following the termination of the short quorum call, is a minimum of 15 minutes. In the alternative, the Chair may choose to permit a full 15 minute quorum call, wherein all Members are recorded as present or absent, to be followed by a five-minute record vote on the pending question. Once a quorum of the Committee of the Whole has been established for a day, a quorum call in the Committee is only in order when the Committee is operating under the five-minute rule and the Chairman has put the pending question to a vote. The rules prohibit a point of order of no quorum against a vote in which the Committee of the Whole agrees to rise. However, an appropriate point of no quorum would be permitted against a vote defeating a motion to rise.

## VOTING

There are three methods of voting in the Committee of the Whole that are also employed in the House. These are the voice vote, the division, and the recorded vote. The yea-and-nay vote is an additional method used only in the House, which may be automatic if a Member objects to the vote on the ground that a quorum is not present.

To conduct a voice vote the Chair puts the question: “As many as are in favor (as the question may be) say ‘Aye’. As many as are opposed, say ‘No’ ”. The Chair determines the result on a comparison of the volume of ayes and noes. This is the form in which the vote is ordinarily taken in the first instance.

If it is difficult to determine the result of a voice vote, a division may be demanded by a Member or initiated by the Chair. The Chair then states: “As many as are in favor will rise and stand until counted”. After counting those in favor he calls on those opposed to stand and be counted, thereby determining the number in favor of and those opposed to the question.

If any Member requests a recorded vote and that request is supported by at least one-fifth of a quorum of the House (44 Members), or 25 Members in the Committee of the Whole, the vote is taken by electronic device. After the recorded vote is concluded, the names of those voting and those not voting are entered in the Journal. Members have a minimum of 15 minutes to be counted from the time the record vote is ordered. The Speaker may reduce the period for voting to five minutes on subsequent votes in certain situations where there has been no intervening debate or business. The Speaker is not required to vote unless the Speaker’s vote would be decisive.

In the House, if the yeas and nays are demanded, the Speaker directs those in favor of taking the vote by that method to stand and be counted. The support of one-fifth of the Members present is necessary for ordering the yeas and nays. When the yeas and nays are ordered or a point of order is made that a quorum is not present, the Speaker states: “As many as are in favor of the proposition will vote ‘Aye’.” “As many as are opposed will vote ‘No’.” The

Clerk activates the electronic system or calls the roll and reports the result to the Speaker, who announces it to the House.

The rules of the House require a three-fifths vote to pass a bill, joint resolution, amendment, or conference report that contains a specified type of federal income tax rate increase.

The rules prohibit a Member from: (1) casting another Member's vote or recording another Member's presence in the House or the Committee of the Whole; or (2) authorizing another individual to cast a vote or record the Member's presence in the House or the Committee of the Whole.

### ELECTRONIC VOTING

Recorded votes are usually taken by electronic device, except when the Speaker orders the vote to be recorded by other methods prescribed by the rules of the House, or in the failure of the electronic device to function. In addition, quorum calls are generally taken by electronic device. The electronic system works as follows: A number of vote stations are attached to selected chairs in the Chamber. Each station is equipped with a vote card slot and four indicators, marked "yea", "nay", "present", and "open" that are lit when a vote is in progress and the system is ready to accept votes. Each Member is provided with a personalized Vote-ID Card. A Member votes by inserting the voting card into any one of the vote stations and depressing the appropriate button to indicate the Member's choice. If a Member is without a Vote-ID Card or wishes to change his vote during the last five minutes of a vote, the Member may be recorded by handing a paper ballot to the Tally Clerk, who then records the vote electronically according to the indicated preference of the Member. The paper ballots are green for "yea", red for "nay", and amber for "present". The voting machine records the votes and reports the result when the vote is completed.

### PAIRING OF MEMBERS

The former system of pairing of Members, where a Member could arrange in advance to be recorded as being either in favor of or opposed to the question by being "paired" with another absent Member who holds contrary views on the question, has largely been eliminated. The rules still allow for "live pairs". A live pair is where a Member votes as if not paired, subsequently withdraws that vote, and then asks to be marked "present" to protect the other Member. The most common practice is for absent Members to submit statements for the Record stating how they would have voted if present on specific votes.

### SYSTEM OF LIGHTS AND BELLS

Due to the diverse nature of daily tasks that they have to perform, it is not practicable for Members to be present in the House or Senate Chamber at every minute that the body is in session. Furthermore, many of the routine matters do not require the personal attendance of all the Members. A legislative call system consisting of electric lights and bells or buzzers located in various parts of the Capitol Building and House and Senate Office Buildings alerts Members to certain occurrences in the House and Senate Chambers.

In the House, the Speaker has ordered that the bells and lights comprising the system be utilized as follows:

1 long ring followed by a pause and then 3 rings and 3 lights on the left—Start or continuation of a notice or short quorum call in the Committee of the Whole that will be vacated if and when 100 Members appear on the floor. Bells are repeated every five minutes unless the call is vacated or the call is converted into a regular quorum call.

1 long ring and extinguishing of 3 lights on the left—Short or notice quorum call vacated.

2 rings and 2 lights on the left—15 minute recorded vote, yea-and-nay vote or automatic rollcall vote by electronic device. The bells are repeated five minutes after the first ring.

2 rings and 2 lights on the left followed by a pause and then 2 more rings—Automatic rollcall vote or yea-and-nay vote taken by a call of the roll in the House. The bells are repeated when the Clerk reaches the R's in the first call of the roll.

2 rings followed by a pause and then 5 rings—First vote under Suspension of the Rules or on clustered votes. Two bells are repeated five minutes after the first ring. The first vote will take 15 minutes with successive votes at intervals of not less than five minutes. Each successive vote is signaled by five rings.

3 rings and 3 lights on the left—15 minute quorum call in either the House or in the Committee of the Whole by electronic device. The bells are repeated five minutes after the first ring.

3 rings followed by a pause and then 3 more rings—15 minute quorum call by a call of the roll. The bells are repeated when the Clerk reaches the R's in the first call of the roll.

3 rings followed by a pause and then 5 more rings—Quorum call in the Committee of the Whole that may be followed immediately by a five-minute recorded vote.

4 rings and 4 lights on the left—Adjournment of the House.

5 rings and 5 lights on the left—Any five-minute vote.

6 rings and 6 lights on the left—Recess of the House.

12 rings at 2–second intervals with 6 lights on the left—Civil Defense Warning.

The 7th light indicates that the House is in session.

### RECESS AUTHORITY

The House may by vote authorize the Speaker to declare a recess under the rules of the House. The Speaker also has the authority to declare the House in recess for a short time when no question is pending before the House.

### LIVE COVERAGE OF FLOOR PROCEEDINGS

The rules of the House provide for unedited radio and television broadcasting and recording of proceedings on the floor of the House. However, the rules prohibit the use of these broadcasts and recordings for any political purpose or in any commercial advertisement. The rules of the Senate also provide for broadcasting and recording of proceedings in the Senate Chamber with similar restrictions.

## XII. CONGRESSIONAL BUDGET PROCESS

The Congressional Budget and Impoundment Control Act of 1974 as amended provides Congress with a procedure establishing appropriate spending and revenue levels for each year. The congressional budget process, as set out in the 1974 Budget Act, is designed to coordinate decisions on sources and levels of revenues and on objects and levels of expenditures. Its basic method is to prescribe the overall size of the fiscal pie and the particular sizes of its various pieces. Each year the Congress adopts a concurrent resolution imposing overall constraints on revenues and spending and distributing the overall constraint on spending among groups of programs and activities.

Congress aims to complete action on a concurrent resolution on the budget for the next fiscal year by April 15. Congress may adopt a later budget resolution that revises the most recently adopted budget resolution. One of the mechanisms Congress uses to implement the constraints on revenue and spending is called the reconciliation process. Reconciliation is a two-step process designed to bring existing law in conformity with the most recently adopted concurrent resolution on the budget. The first step in the reconciliation process is the language found in a concurrent resolution on the budget instructing House and Senate committees to determine and recommend changes in laws or bills that will achieve the constraints established in the concurrent resolution on the budget. The instructions to a committee specify the amount of spending reductions or revenue changes a committee must attain and leave to the discretion of the committee the specific changes to laws or bills that must be made. The second step involves the combination of the various instructed committees' recommendations into an omnibus reconciliation bill which is reported by the Committee on the Budget or by the one committee instructed, if only one committee has been instructed, and considered by the whole House.

The Budget Act maintains that reconciliation provisions must be related to reconciling the budget. This principle is codified in section 313 of the Budget Act, the so-called Byrd Rule, named after Senator Robert C. Byrd of West Virginia. Section 313 provides a point of order in the Senate against extraneous matter in reconciliation bills. Determining what is extraneous is a difficult task for the Senate's Presiding Officer. The Byrd Rule may only be waived in the Senate by a three-fifths vote and sixty votes are required to overturn the presiding officer's ruling.

Congress aims to complete action on a reconciliation bill or resolution by June 15 of each year. After Congress has completed action on a concurrent resolution on the budget for a fiscal year, it is generally not in order to consider legislation that does not conform to the constraints on spending and revenue set out in the resolution.

Congress has enacted legislation under which breaches are remedied by "sequestration", that is, automatic cancellations of spending authority. Sequestration results when the statutory parameters for the deficit, discretionary spending, or the "Paygo" requirement have been exceeded. Paygo requires that tax reductions or increases in entitlements must be offset by tax increases or reductions in entitlements.

The Unfunded Mandates Reform Act of 1995, through an amendment to the Congressional Budget Act, established requirements on committees with respect to measures containing unfunded intergovernmental mandates. An unfunded intergovernmental mandate is the imposition of a substantial financial requirement or obligation on a state, local, or tribal government. The Act also established a unique point of order to enforce the requirements of the Act with respect to intergovernmental mandates in excess of fifty million dollars annually. In the House, an unfunded mandate point of order is not disposed of by a ruling of the Chair but by the Chair putting the question of consideration to the body. The House or the Committee of the Whole then decides by vote whether or not to proceed with the measure with the alleged mandate contained therein.

## XIII. ENGROSSMENT AND MESSAGE TO SENATE

The preparation of a copy of the bill in the form in which it has passed the House can be a detailed and complicated process because of the large number and complexity of amendments to some bills adopted by the House. Frequently, these amendments are offered during a spirited debate with little or no prior formal preparation. The amendment may be for the purpose of inserting new language, substituting different words for those set out in the bill, or deleting portions of the bill. It is not unusual to have more than 100 amendments adopted, including those proposed by the committee at the time the bill is reported and those offered from the floor during the consideration of the bill in the Chamber. In some cases, amendments offered from the floor are written in longhand. Each amendment must be inserted in precisely the proper place in the bill, with the spelling and punctuation exactly as it was adopted by the House. It is extremely important that the Senate receive a copy of the bill in the precise form in which it has passed the House. The preparation of such a copy is the function of the enrolling clerk.

In the House, the enrolling clerk is under the Clerk of the House. In the Senate, the enrolling clerk is under the Secretary of the Senate. The enrolling clerk receives all the papers relating to the bill, including the official Clerk's copy of the bill as reported by the standing committee and each amendment adopted by the House. From this material, the enrolling clerk prepares the engrossed copy of the bill as passed, containing all the amendments agreed to by the House. At this point, the measure ceases technically to be called a bill and is termed "An Act" signifying that it is the act of one body of the Congress, although it is still popularly referred to as a bill. The engrossed bill is printed on blue paper and is signed by the Clerk of the House. Bills may also originate in the Senate with certain exceptions. For a discussion of bills originating in the Senate, see Part XVI.

## XIV. SENATE ACTION

The Parliamentarian, in the name of the Vice President, as the President of the Senate, refers the engrossed bill to the appropriate standing committee of the Senate in conformity with the rules of the Senate. The bill is reprinted immediately and copies are made available in the document rooms of both Houses. This printing is known as the "Act print" or the "Senate referred print".

### COMMITTEE CONSIDERATION

Senate committees give the bill the same detailed consideration as it received in the House and may report it with or without amendment. A committee member who wishes to express an individual view or a group of Members who wish to file a minority report may do so by giving notice, at the time of the approval of a report on the measure, of an intention to file supplemental, minority, or additional views. These views may be filed within three days with the clerk of the committee and become a part of the report. When a committee reports a bill, it is reprinted with the committee amendments indicated by showing new matter in italics and deleted matter in line-through type. The calendar number and report number are indicated on the first and back pages, together with the name of the Senator making the report. The committee report and any minority or individual views accompanying the bill also are printed at the same time.

All committee meetings, including those to conduct hearings, must be open to the public. However, a majority of the members of a committee or subcommittee may, after discussion in closed session, vote in open session to close a meeting or series of meetings on the same subject for no longer than 14 days if it is determined that the matters to be discussed or testimony to be taken will disclose matters necessary to be kept secret in the interests of national defense or the confidential conduct of the foreign relations of the United States; will relate solely to internal committee staff management or procedure; will tend to charge an individual with a crime or misconduct, to disgrace or injure the professional standing of an individual, or otherwise to expose an individual to public contempt, or will represent a clearly unwarranted invasion of the privacy of an individual; will disclose law enforcement information that is required to be kept secret; will disclose certain information regarding certain trade secrets; or may disclose matters required to be kept confidential under other provisions of law or government regulation.

### CHAMBER PROCEDURE

The rules of procedure in the Senate differ to a large extent from those in the House. The Senate relies heavily on the practice of obtaining unanimous consent for actions to be taken. For example, at the time that a bill is reported, the Majority Leader may ask unanimous consent for the immediate consideration of the bill. If the bill is of a noncontroversial nature and there is no objection, the Senate may pass the bill with little or no debate and with only a brief explanation of its purpose and effect. Even in this instance, the bill is subject to amendment by any Senator. A simple majority vote is necessary to carry an amendment as well as to pass the bill. If there is any objection, the report must lie over one legislative day and the bill is placed on the calendar.

Measures reported by standing committees of the Senate may not be considered unless the report of that committee has been available to Senate Members for at least two days (excluding Sundays and legal holidays) prior to consideration of the measure in the Senate. This requirement, however, may be waived by agreement of the Majority and Minority leaders and does not apply in certain emergency situations.

In the Senate, measures are brought up for consideration by a simple unanimous consent request, by a complex unanimous consent agreement, or by a motion to proceed to the consideration of a measure on the calendar. A unanimous consent agreement, sometimes referred to as a "time agreement", makes the consideration of a measure in order and often limits the amount of debate that will take place on the measure and lists the amendments that will be considered. The offering of a unanimous consent request to consider a measure or the offering of a motion to proceed to the consideration of a measure is reserved, by tradition, to the Majority Leader.

Usually a motion to consider a measure on the calendar is made only when unanimous consent to consider the measure cannot be obtained. There are two calendars in the Senate, the Calendar of Business and the Executive Calendar. All legislation is placed on the Calendar of Business and treaties and nominations are placed on the Executive Calendar. Unlike the House, there is no differentiation on the Calendar of Business between the treatment of: (1) bills raising revenue, general appropriation bills, and bills of a public character appropriating money or property; and (2) other bills of a public character not appropriating money or property.

The rules of the Senate provide that at the conclusion of the morning business for each "legislative day" the Senate proceeds to the consideration of the calendar. In the Senate, the term "legislative day" means the period of time from when the Senate adjourns until the next time the Senate adjourns. Because the Senate often "recesses" rather than "adjourns" at the end of a daily session, the legislative day usually does not correspond to the 24–hour period comprising a calendar day. Thus, a legislative day may cover a long period of time—from days to weeks, or even months. Because of this and the modern practice of waiving the call of the calendar by unanimous consent at the start of a new legislative day, it is rare to have a call of the calendar. When the calendar is called, bills that are not objected to are taken up in their order, and each Senator is entitled to speak once and for five minutes only on any question. Objection may be interposed at any stage of the proceedings, but on motion the Senate may continue consideration after the call of the calendar is completed, and the limitations on debate then do not apply.

On any day (other than a Monday that begins a new legislative day), following the announcement of the close of morning business, any Senator, usually the Majority Leader, obtaining recognition may move to take up any bill out of its regular order on the calendar. The five-minute limitation on debate does not apply to the consideration of a bill taken up in this manner, and debate may continue until the hour when the Presiding Officer of the Senate "lays down" the unfinished business of the day. At that point consideration of the bill is discontinued and the measure reverts back to the Calendar of Business and may again be called up at another time under the same conditions.

When a bill has been objected to and passed over on the call of the calendar it is not necessarily lost. The Majority Leader, after consulting the Minority Leader, determines the time at which the bill will be considered. At that time, a motion is made to consider the bill. The motion is debatable if made after the morning hour.

Once a Senator is recognized by the Presiding Officer, the Senator may speak for as long as the Senator wishes and loses the floor only when the Senator yields it or takes certain parliamentary actions that forfeit the Senator's right to the floor. However, a Senator may not speak more than twice on any one question in debate on the same legislative day without leave of the Senate. Debate ends when a Senator yields the floor and no other Senator seeks recognition, or when a unanimous consent agreement limiting the time of debate is operating.

On occasion, Senators opposed to a measure may extend debate by making lengthy speeches or a number of speeches at various stages of consideration intended to prevent or defeat action on the measure. This is the tactic known as "filibustering". Debate, however, may be closed if 16 Senators sign a motion to that effect and the motion is carried by three-fifths of the Senators duly chosen and sworn. Such a motion is voted on one hour after the Senate convenes, following a quorum call on the next day after a day of session has intervened. This procedure is called "invoking cloture". In 1986, the Senate amended its rules to limit "post-cloture" consideration to 30 hours. A Senator may speak for not more than one hour and may yield all or a part of that time to the majority or minority floor managers of the bill under consideration or to the Majority or Minority leader. The Senate may increase the time for "post-cloture" debate by a vote of three-fifths of the Senators duly chosen and sworn. After the time for debate has expired, the Senate may consider only amendments actually pending before voting on the bill.

While a measure is being considered it is subject to amendment and each amendment, including those proposed by the committee that reported the bill, is considered separately. Generally, there is no requirement that proposed amendments be germane to the subject matter of the bill except in the case of general appropriation bills or where "cloture" has been invoked. Under the rules, a "rider", an amendment proposing substantive legislation to an appropriation bill, is prohibited. However, this prohibition may be suspended by two-thirds vote on a motion to permit consideration of such an amendment on one day's notice in writing. Debate must be germane during the first three hours after business is laid down unless determined to the contrary by unanimous consent or on motion without debate. After final action on the amendments the bill is ready for engrossment and the third reading, which is by title only. The Presiding Officer then puts the question on the passage and a voice vote is usually taken although a yea-and-nay vote is in order if demanded by one-fifth of the Senators present. A simple majority is necessary for passage. Before an amended measure is cleared for its return to the House of Representatives, or an unamended measure is cleared for enrollment, a Senator who voted with the prevailing side, or who abstained from voting, may make a motion within the next two days to reconsider the action. If the measure was passed without a recorded vote, any Senator may make the motion to reconsider. That motion is usually tabled and its tabling constitutes a final determination. If, however, the motion is granted, the Senate, by majority vote, may either affirm its action, which then becomes final, or reverse it.

The original engrossed House bill, together with the engrossed Senate amendments, if any, or the original engrossed Senate bill, as the case may be, is then returned to the House with a message stating the action taken by the Senate. Where the Senate has adopted amendments, the message requests that the House concur in them.

For a more detailed discussion of Senate procedure, see *Enactment of a Law*, by Robert B. Dove, Parliamentarian of the Senate.

## XV. FINAL ACTION ON AMENDED BILL

On their return to the House, the official papers relating to the amended measure are placed on the Speaker's table to await House action on the Senate amendments. Although rarely exercised, the Speaker has the authority to refer Senate amendments to the appropriate committee or committees with or without time limits on their consideration. If the amendments are of a minor or noncontroversial nature, any Member, usually the chairman of a committee that reported the bill, may, at the direction of the committee, ask unanimous consent to take the bill with the amendments from the Speaker's table and agree to the Senate amendments. At this point, the Clerk reads the title of the bill and the Senate amendments. If there is no objection, the amendments are then declared to be agreed to, and the bill is ready to be enrolled for presentation to the President. If unanimous consent is not obtainable, the few bills that do not require consideration in the Committee of the Whole are privileged and may be called up from the Speaker's table by motion for immediate consideration of the amendments. A simple majority is necessary to carry the motion and thereby complete floor action on the measure. A Senate amendment to a House bill is subject to a point of order that it must first be considered in the Committee of the Whole, if, originating in the House, it would be subject to that point of order. Most Senate amendments require consideration in the Committee of the Whole and this procedure by privileged motion is seldom utilized.

### REQUEST FOR A CONFERENCE

The mere fact that each House may have separately passed its own bill on a subject is not sufficient to make either bill eligible for conference. One House must first take the additional step of amending and then passing the bill of the other House to form the basis for a conference. If the amendments of the Senate are substantial or controversial, a Member, usually the chairman of the committee of jurisdiction, may request unanimous consent to take the House bill with the Senate amendments from the Speaker's table, disagree to the amendments and request or agree to a conference with the Senate to resolve the disagreeing votes of the two Houses. In the case of a Senate bill with House amendments, the House may insist on the House amendments and request a conference. For a discussion of bills originating in the Senate, see Part

XVI. If there is objection, the Speaker may recognize a Member for a motion, if offered by the direction of the primary committee and of all reporting committees that had initial referral of the bill, to: (1) disagree to the Senate amendments and ask for or agree to a conference; or (2) insist on the House amendments to a Senate bill and request or agree to a conference. This may also be accomplished by a motion to suspend the rules with a two-thirds vote or by a rule from the Committee on Rules. If there is no objection to the request, or if the motion is carried, a motion to instruct the managers of the conference would be in order. This initial motion to instruct is the prerogative of the minority party. The instructions to conferees usually urge the managers to accept or reject a particular Senate or House provision or to take a more generally described political position to the extent possible within the scope of the conference. However, such instructions are not binding on House or Senate conferees. After the motion to instruct is disposed of, the Speaker then appoints the managers, informally known as conferees, on the part of the House and a message is sent to the Senate advising it of the House action. A majority of the Members appointed to be conferees must have been supporters of the House position, as determined by the Speaker. The Speaker must appoint Members primarily responsible for the legislation and must include, to the fullest extent feasible, the principal proponents of the major provisions of the bill as it passed the House. The Speaker usually follows the suggestion of the committee chairman in designating the conferees on the part of the House from among the members of the committee with jurisdiction over the House or Senate provisions. Occasionally, the Speaker appoints conferees from more than one committee and may specify the portions of the House and Senate versions to which they are assigned. The number is fixed by the Speaker and majority party representation generally reflects the ratio for the full House committee, but may be greater on important bills. The Speaker also has the authority to name substitute conferees on specific provisions and add or remove conferees after his original appointment. Representation of both major parties is an important attribute of all our parliamentary procedures but, in the case of conference committees, it is important that the views of the House on the House measure be fully represented.

If the Senate agrees to the request for a conference, a similar committee is appointed by unanimous consent by the Presiding Officer of the Senate. Both political parties may be represented on the Senate conference committee. The Senate and House committees need not be the same size but each House has one vote in conference as determined by a majority within each set or subset of conferees.

The request for a conference may only be made by the body in possession of the official papers. Occasionally, the Senate, anticipating that the House will not concur in its amendments, votes to insist on its amendments and requests a conference on passage of the bill prior to returning the bill to the House. This practice serves to expedite the matter because time may be saved by the designation of the Senate conferees before returning the bill to the House. The matter of which body requests the conference is not without significance because the body asking for the conference normally acts last on the report to be submitted by the conferees and a motion to recommit the conference report is not available to the body that acts last.

## AUTHORITY OF CONFEREES

The conference committee is sometimes popularly referred to as the "Third House of Congress". Although the managers on the part of each House meet together as one committee they are in effect two separate committees, each of which votes separately and acts by a majority vote. For this reason, the number of managers from each House is largely immaterial.

The conferees are strictly limited in their consideration to matters in disagreement between the two Houses. Consequently, they may not strike out or amend any portion of the bill that was not amended by the other House. Furthermore, they may not insert new matter that is not germane to or that is beyond the scope of the differences between the two Houses. Where the Senate amendment revises a figure or an amount contained in the bill, the conferees are limited to the difference between the two numbers and may neither increase the greater nor decrease the smaller figure. Neither House may alone, by instructions, empower its managers to make a change in the text to which both Houses have agreed.

When a disagreement to an amendment in the nature of a substitute is committed to a conference committee, managers on the part of the House may propose a substitute that is a germane modification of the matter in disagreement, but the introduction of any language in that substitute presenting specific additional matter not committed to the conference committee by either House is not in order. Moreover, their report may not include matter not committed to the conference committee by either House. The report may not include a modification of any specific matter committed to the conference committee by either or both Houses if that modification is beyond the scope of that specific matter as committed to the conference committee.

The managers on the part of the House are under specific guidelines when in conference on general appropriation bills. An amendment by the Senate to a general appropriation bill which would be in violation of the rules of the House, if such amendment had originated in the House, including an amendment changing existing law, providing appropriations not authorized by law, or providing reappropriations of unexpended balances, or an amendment by the Senate providing for an appropriation on a bill other than a general appropriation bill, may not be agreed to by the managers on the part of the House. However, the House may grant specific authority to agree to such an amendment by a separate vote on a motion to instruct on each specific amendment.

## MEETINGS AND ACTION OF CONFEREES

The rules of the House require that one conference meeting be open, unless the House, in open session, determines by a record vote that a meeting will be closed to the public. When the report of the conference committee is read in the House, a point of order may be made that the conferees failed to comply with the House rule requiring an open conference meeting. If the point of order is sustained, the conference report is considered rejected by the House and a new conference is deemed to have been requested.

There are generally four forms of recommendations available to the conferees when reporting back to their bodies:

(1) The Senate recede from all (or certain of) its amendments.

(2) The House recede from its disagreement to all (or certain of) the Senate amendments and agree thereto.

(3) The House recede from its disagreement to all (or certain of) the Senate amendments and agree thereto with amendments.

(4) The House recede from all (or certain of) its amendments to the Senate amendments or its amendments to Senate bill.

In most instances, the result of the conference is a compromise growing out of the third type of recommendation available to the conferees because one House has originally substituted its own bill to be considered as a single amendment. The complete report may be composed of any one or more of these recommendations with respect to the various amendments where there are numbered amendments. Occasionally, on general appropriation bills with numbered Senate amendments, because of the special rules preventing House conferees from agreeing to Senate amendments changing existing law or appropriations not authorized by law, the conferees find themselves, under the rules or in fact, unable to reach an agreement with respect to one or more amendments and report back a statement of their inability to agree on those particular amendments. These amendments may then be acted upon separately. This partial disagreement is not practicable where, as is most often the case, one House strikes out all after the enacting clause and substitutes its own bill that must be considered as a single amendment.

If they are unable to reach any agreement whatsoever, the conferees report that fact to their respective bodies and the amendments may be disposed of by motion. Usually, new conferees may be appointed in either or both Houses. In addition, the Houses may provide a new nonbinding instruction to the conferees as to the position they are to take.

After House conferees on any bill or resolution in conference between the two bodies have been appointed for 20 calendar days and have failed to make a report, a motion to instruct the House conferees, or discharge them and appoint new conferees is privileged. The motion can be made only after the Member announces his intention to offer the motion and only at a time designated by the Speaker in the legislative schedule of the following day. In addition, during the last six days of a session, it is a privileged motion to move to discharge, appoint, or instruct House conferees after House conferees have been appointed 36 hours without having made a report.

## CONFERENCE REPORTS

When the conferees, by majority vote of each group, have reached complete agreement or find that they are able to agree with respect to some but not all separately numbered amendments, they make their recommendations in a report made in duplicate that must be signed by a majority of the conferees appointed by each body on each provision to which they are appointed. The minority of the managers have no authority to file a statement of minority views in connection with the conference report. The report is required to be printed in both Houses and must be accompanied by an explanatory statement prepared jointly by the conferees on the part of the House and the conferees on the part of the Senate. The statement must be sufficiently detailed and explicit to inform Congress of the effects of the report on the matters committed to conference. The engrossed bill and amendments and one copy of the report are delivered to the body that is to act first on the report, usually, the body that agreed to the conference requested by the other.

In the Senate, the presentation of a conference report always is in order except when the Journal is being read, a point of order or motion to adjourn is pending, or while the Senate is voting or ascertaining the presence of a quorum. When the report is received, the question of proceeding to the consideration of the report, if raised, is immediately voted on without debate. The report is not subject to amendment in either body and must be accepted or rejected as an entirety. If the time for debate on the adoption of the report is limited, the time allotted must be equally divided between the majority and minority party. The Senate, acting first, prior to voting on agreeing to the report may by majority vote order it recommitted to the conferees. When the Senate agrees to the report, its managers are thereby discharged and it then delivers the original papers to the House with a message advising that body of its action.

A report that contains any recommendations which extend beyond the scope of differences between the two Houses is subject to a point of order in its entirety unless that point of order is waived in the House by unanimous consent, adoption of a rule reported from the Committee on Rules, or the suspension of the rules by a two-thirds vote.

The presentation of a conference report in the House is in order at any time, except during a reading of the Journal or the conduct of a record vote, a vote by division, or a quorum call. The report is considered in the House and may not be sent to the Committee of the Whole on the suggestion that it contains matters ordinarily requiring consideration in that Committee. The report may not be received by the House if the required joint statement does not accompany it.

However, it is not in order to consider either: (1) a conference report; or (2) a motion to dispose of a Senate amendment (including an amendment in the nature of a substitute) reported in disagreement by a conference committee, until the third calendar day (excluding Saturdays, Sundays, and legal holidays unless the House is in session on those days) after the report and accompanying statement have been filed in the House and made available to the Members in the Congressional Record. However, these provisions do not apply during the last six days of the session. It is also not in order to consider a conference report or a motion to dispose of a Senate amendment reported in disagreement unless copies of the report and accompanying statement, together with the text of the amendment, have been available to Members for at least two hours before their consideration. By contrast, it is always in order to call up for consideration a report from the Committee on Rules on the same day reported that proposes only to waive the availability requirements for a conference report or a Senate amendment reported in disagreement. The time allotted for debate on a conference report or motion is one hour, equally divided between the majority party and the minority party. However, if the majority and minority floor managers both support the conference report or motion, one-third of the debate time must be allotted to a Member who is opposed. If the House does not agree to a conference report that the Senate has already agreed to, the report may not be recommitted to conference. In that situation, the Senate conferees are discharged when the Senate agrees to the report. The House may then request a new conference with the Senate and conferees must be reappointed.

If a conference report is called up before the House containing matter which would be in violation of the rules of the House with respect to germaneness if the matter had been offered as an amendment in the House, and which is contained either: (1) in the Senate bill or Senate amendment to the House measure (including a Senate amendment in the nature of a substitute for the text of that measure as passed by the House) and accepted by the House conferees or agreed to by the conference committee with modification; or (2) in a substitute amendment agreed to by the conference committee, a point of order may be made at the beginning of consideration that nongermane matter is contained in the report. The point of order may also be waived by a special rule. If the point of order is sustained, a motion to reject the nongermane matter identified by the point of order is privileged. The motion is debatable for 40 minutes, one-half of the time in favor of, and one-half in opposition to, the motion. Notwithstanding the final disposition of a point of order made with respect to the report, or of a motion to reject nongermane matter, further points of order may be made with respect to the report, and further motions may be made to reject other nongermane matter in the conference report not covered by any previous point of order which has been sustained. If a motion to reject has been adopted, after final disposition of all points of order and motions to reject, the conference report is considered rejected and the question then pending before the House is whether: (1) to recede and concur with an amendment that consists of that portion of the conference report not rejected; or (2) to insist on the House amendment. If all motions to reject are defeated and the House thereby decides to permit the inclusion of the nongermane Senate matter in the conference report, then, after the allocation of time for debate on the conference report, it is in order to move the previous question on the adoption of the conference report.

Similar procedures are available in the House when the Senate proposes an amendment to a measure that would be in violation of the rule against nongermane amendments, and thereafter it is (1) reported in disagreement by a committee of conference or (2) before the House and the stage of disagreement is reached.

The numbered amendments of the Senate reported in disagreement may be voted on separately and may be adopted by a majority vote after the adoption of the conference report itself as though no conference had been had with respect to those amendments. The Senate may recede from all amendments, or from certain of its amendments, insisting on the others with or without a request for a further conference with respect to them. If the House does not accept the amendments insisted on by the Senate, the entire conference process may begin again with respect to them. One House may also further amend an amendment of the other House until the third degree stage of amendment within that House is reached.

CUSTODY OF PAPERS

The custody of the original official papers is important in conference procedure because either body may act on a conference report only when in possession of the papers. The papers are transmitted to the body agreeing to the conference and from that body to the managers of the House that asked for the conference. The latter in turn carry the papers with them to the conference and at its conclusion turn them over to the managers of the House that agreed to the conference. The managers of the House that agreed to the conference deliver them to their own House, that acts first on the report, and then delivers the papers to the other House for final action on the report. However, if the managers on the part of the House agreeing to the conference surrender the papers to the House asking for the conference, the report may be acted on first by the House asking for the conference.

At the conclusion of the conference, each group of conferees retains one copy of the report that has been made in duplicate and signed by a majority of the managers of each body. The House copy is signed first by the House managers and the Senate copy is signed first by its managers.

A bill cannot become a law of the land until it has been approved in identical form by both Houses of Congress. When the bill has finally been approved by both Houses, all the original papers are transmitted to the enrolling clerk of the body in which the bill originated.

## XVI. BILL ORIGINATING IN SENATE

The preceding discussion has described the legislative process for bills originating in the House. When a bill originates in the Senate, this process is reversed. When the Senate passes a bill that originated in the Senate, it is sent to the House for consideration unless it is held by unanimous consent to become a vehicle for a similar House bill if and when passed by the House. The Senate bill is referred to the appropriate House committee for consideration or held at the Speaker's table for possible amendment following action on a companion House bill. If the committee reports the bill to the full House and if the bill is passed by the House without amendment, it is ready for enrollment. If the House passes an amended version of the Senate bill, the bill is returned to the Senate for action on the House amendments. The Senate may agree to the amendments or request a conference to resolve the disagreement over the House amendments or may further amend the House amendments. In accordance with the Constitution, the Senate cannot originate revenue measures. By tradition, the House also originates general appropriation bills. If the Senate does originate a revenue measure either as a Senate bill or an amendment to a non-revenue House bill, it can be returned to the Senate by a vote of the House as an infringement of the constitutional prerogative of the House.

## XVII. ENROLLMENT

When the bill has been agreed to in identical form by both bodies—either: (1) without amendment by the Senate; (2) by House concurrence in Senate amendments; (3) by Senate concurrence in House amendments; or (4) by agreement in both bodies to the conference report—a copy of the bill is enrolled for presentation to the President.

The preparation of the enrolled bill is a painstaking and important task because it must reflect precisely the effect of all amendments, either by way of deletion, substitution, or addition, agreed to by both bodies. The enrolling clerk of the House, with respect to bills originating in the House, receives the original engrossed bill, the engrossed Senate amendments, the signed conference report, the several messages from the Senate, and a notation of the final action by the House, for the purpose of preparing the enrolled copy. From these documents, the enrolling clerk must meticulously prepare for presentation to the President the final form of the bill as it was agreed to by both Houses. On occasion, as many as 500 amendments have been adopted, each of which must be set out in the enrollment exactly as agreed to, and all punctuation must be in accord with the action taken.

The enrolled bill is printed on parchment paper and certified by the Clerk of the House stating that the bill originated in the House of Representatives. A bill originating in the Senate is examined and certified by the Secretary of the Senate. A House bill is then examined for accuracy by the Committee on House Administration. When the committee is satisfied with the accuracy of the bill, the chairman of the committee attaches a slip stating that it finds the bill truly enrolled and sends it to the Speaker of the House for signature. All bills, regardless of the body in which they originated, are signed first by the Speaker and then by the Vice President of the United States, who, under the Constitution, serves as the President of the Senate. The President pro tempore of the Senate may also sign enrolled bills. The Speaker of the House may sign enrolled bills whether or not the House is in session. The President of the Senate may sign bills only while the Senate is actually sitting but advance permission is normally granted to sign during a recess or after adjournment. If the Speaker or the President of the Senate is unable to sign the bill, it may be signed by an authorized Member of the respective House. After both signatures are affixed, a House bill is returned to the Committee on House Administration for presentation to the President for action under the Constitution. A Senate bill is presented to the President by the Secretary of the Senate.

## XVIII. PRESIDENTIAL ACTION

Article I, Section 7, of the Constitution provides in part that—

> Every Bill which shall have passed the House of Representatives and the Senate, shall, before it becomes a Law, be presented to the President of the United States.

In actual practice, a clerk of the Committee on House Administration, or the Secretary of the Senate when the bill originated in that body, delivers the original enrolled bill to a clerk at the White House and obtains a receipt. The fact of the delivery is then reported to the House by the chairman of the committee. Delivery to a White House clerk has customarily been regarded as presentation to the President and as commencing the 10-day constitutional period for presidential action.

Copies of the enrolled bill usually are transmitted by the White House to the various departments interested in the subject matter so that they may advise the President on the issues surrounding the bill.

If the President approves the bill, he signs it and usually writes the word "approved" and the date. However, the Constitution requires only that the President sign it.

The bill may become law without the President's signature by virtue of the constitutional provision that if the President does not return a bill with objections within 10 days (excluding Sundays) after it has been presented to the President, it becomes law as if the President had signed it. However, if Congress by their adjournment prevent its return, it does not become law. This is known as a "pocket veto"; that is, the bill does not become law even though the President has not sent his objections to the Congress. The Congress has interpreted the President's ability to pocket veto a bill to be limited to final adjournment "sine die" of a Congress where Congress has finally prevented return by the originating House and not to interim adjournments or first session adjournments where the originating House of Congress through its agents is able to receive a veto message for subsequent reconsideration by that Congress when it reconvenes. The extent of pocket veto authority has not been definitively decided by the courts.

Notice of the signing of a bill by the President is sent by message to the House in which it originated and that House informs the other, although this action is not necessary for the act to be valid. The action is also noted in the Congressional Record.

A bill becomes law on the date of approval or passage over the President's veto, unless it expressly provides a different effective date.

### VETO MESSAGE

By the terms of the Constitution, if the President does not approve the bill "he shall return it, with his Objections to that House in which it shall have originated, who shall enter the Objections at large on their Journal, and proceed to reconsider it". A bill returned with the President's objections, need not be voted on at once when laid before the House since the vetoed bill can be postponed, referred back to committee, or tabled before the question on passage is pending. A vetoed bill is always privileged until directly voted upon, and a motion to take it from the table or from committee is in order at any time.

Once the relevant Member moves the previous question on the question of override, the question is then put by the Speaker as follows: “Will the House on reconsideration agree to pass the bill, the objections of the President to the contrary notwithstanding?” Under the Constitution, a vote by the yeas and nays is required to pass a bill over the President’s veto. The Clerk activates the electronic system or calls the roll with those in favor of passing the bill answering “Aye”, and those opposed “No”. If fewer than two-thirds of the Members present vote in the affirmative, a quorum being present, the bill is rejected, and a message is sent to the Senate advising that body of the House action. However, if two-thirds vote in the affirmative, the bill is sent with the President’s objections to the Senate, unless that body has acted first, together with a message advising it of the action in the House.

The procedure in the Senate is the same as a two-thirds affirmative vote is also necessary to pass the bill over the President’s objections. If the Senate joins the House and votes two-thirds in the affirmative to pass the bill, the measure becomes the law of the land notwithstanding the objections of the President, and it is ready for publication as a binding statute.

### LINE ITEM VETO

From 1997 until it was declared unconstitutional in 1998, the Line Item Veto Act provided the President authority to cancel certain individual items contained in a bill or joint resolution that he had signed into law. The law allowed the President to cancel only three types of fiscal items: a dollar amount of discretionary budget authority, an item of new direct spending, and a tax change benefiting a class of 100 or fewer. The cancellations had to be received by the House and Senate within five calendar days of the enactment of such a law and were effective unless disapproved. The President had to submit a single message to both Houses containing all the cancellations per law. The Act also provided special expedited procedures by which the House and Senate could consider a bill or joint resolution disapproving a President’s cancellation. Such a “disapproval bill” was subject to a majority vote in the House and Senate and was presented to the President for his signature or veto under the Constitution. If the disapproval bill were vetoed by the President, the House and Senate could override the veto by a two-thirds vote in each House in which case the President’s cancellations would be null and void. While the Act has not been repealed, the Supreme Court in *Clinton* v. *City of New York,* 118 S. Ct. 2091 (1998), struck down the Line Item Veto Act as unconstitutional.

## XIX. PUBLICATION

One of the important steps in the enactment of a valid law is the requirement that it shall be made known to the people who are to be bound by it. There would be no justice if the state were to hold its people responsible for their conduct before it made known to them the unlawfulness of such behavior. In practice, our laws are published immediately upon their enactment so that the public will be aware of them.

If the President approves a bill, or allows it to become law without signing it, the original enrolled bill is sent from the White House to the Archivist of the United States for publication. If a bill is passed by both Houses over the objections of the President, the body that last overrides the veto transmits it. It is then assigned a public law number, and paginated for the Statutes at Large volume covering that session of Congress. The public and private law numbers run in sequence starting anew at the beginning of each Congress and are prefixed for ready identification by the number of the Congress. For example, the first public law of the 106th Congress is designated Public Law 106–1 and the first private law of the 106th Congress is designated Private Law 106–1. Subsequent laws of this Congress also will contain the same prefix designator.

## SLIP LAWS

The first official publication of the statute is in the form generally known as the "slip law". In this form, each law is published separately as an unbound pamphlet. The heading indicates the public or private law number, the date of approval, and the bill number. The heading of a slip law for a public law also indicates the United States Statutes at Large citation. If the statute has been passed over the veto of the President, or has become law without the President's signature because he did not return it with objections, an appropriate statement is inserted instead of the usual notation of approval.

The Office of the Federal Register, National Archives and Records Administration prepares the slip laws and provides marginal editorial notes giving the citations to laws mentioned in the text and other explanatory details. The marginal notes also give the United States Code classifications, enabling the reader immediately to determine where the statute will appear in the Code. Each slip law also includes an informative guide to the legislative history of the law consisting of the committee report number, the name of the committee in each House, as well as the date of consideration and passage in each House, with a reference to the Congressional Record by volume, year, and date. A reference to presidential statements relating to the approval of a bill or the veto of a bill when the veto was overridden and the bill becomes law is included in the legislative history as a citation to the Weekly Compilation of Presidential Documents.

Copies of the slip laws are delivered to the document rooms of both Houses where they are available to officials and the public. They may also be obtained by annual subscription or individual purchase from the Government Printing Office and are available in electronic form. Section 113 of title 1 of the United States Code provides that slip laws are competent evidence in all the federal and state courts, tribunals, and public offices.

## STATUTES AT LARGE

The United States Statutes at Large, prepared by the Office of the Federal Register, National Archives and Records Administration, provide a permanent collection of the laws of each session of

Congress in bound volumes. The latest volume containing the laws of the first session of the 105th Congress is number 111 in the series. Each volume contains a complete index and a table of contents. A legislative history appears at the end of each law. There are also extensive marginal notes referring to laws in earlier volumes and to earlier and later matters in the same volume.

Under the provisions of a statute originally enacted in 1895, these volumes are legal evidence of the laws contained in them and will be accepted as proof of those laws in any court in the United States.

The Statutes at Large are a chronological arrangement of the laws exactly as they have been enacted. The laws are not arranged according to subject matter and do not reflect the present status of an earlier law that has been amended. The laws are organized in that manner in the code of laws.

### UNITED STATES CODE

The United States Code contains a consolidation and codification of the general and permanent laws of the United States arranged according to subject matter under 50 title headings, largely in alphabetical order. It sets out the current status of the laws, as amended, without repeating all the language of the amendatory acts except where necessary. The Code is declared to be prima facie evidence of those laws. Its purpose is to present the laws in a concise and usable form without requiring recourse to the many volumes of the Statutes at Large containing the individual amendments.

The Code is prepared by the Law Revision Counsel of the House of Representatives. New editions are published every six years and cumulative supplements are published after the conclusion of each regular session of the Congress. The Code is also available in electronic form.

Twenty-three of the 50 titles have been revised and enacted into positive law, and two have been eliminated by consolidation with other titles. Titles that have been revised and enacted into positive law are legal evidence of the law and the courts will receive them as proof of those laws. Eventually all the titles will be revised and enacted into positive law. At that point, they will be updated by direct amendment.

# APPENDIX

## SELECT LIST OF GOVERNMENT PUBLICATIONS

### Constitution of the United States of America

Analysis and Interpretation, with annotations of cases decided by the Supreme Court of the United States to June 29, 1992; prepared by Congressional Research Service, Library of Congress, Johnny H. Killian, George A. Costello, co-editors: Senate Document 103–6 (1996).

### House Rules and Manual

Constitution, Jefferson's Manual, and Rules of the House of Representatives of the United States, prepared by Charles W. Johnson, Parliamentarian of the House, House Document 105–358 (1999). New editions are published each Congress.

### Senate Manual

Containing the rules, orders, laws, and resolutions affecting the business of the United States Senate; Jefferson's Manual, Declaration of Independence, Articles of Confederation, Constitution of the United States, etc., prepared under the direction of Senate Committee on Rules and Administration. New editions are published each Congress.

### Hinds' and Cannon's Precedents of the House of Representatives

Including references to provisions of the Constitution, laws, and decisions of the Senate, by Asher C. Hinds. Vols. 1–5 (1907).

Vols. 6–8 (1935), as compiled by Clarence Cannon, are supplementary to vols. 1–5 and cover the 28-year period from 1907 to 1935, revised up to and including the 73d Congress.

Vols. 9–11 (1941) are index-digest to vols. 1–8.

### Deschler-Brown Precedents of the United States House of Representatives

Including references to provisions of the Constitution and laws, and to decisions of the courts, covering the period from 1928 to date, by Lewis Deschler, J.D., D.J., M.P.L., LL.D., Parliamentarian of the House (1928–1974), Wm. Holmes Brown, Parliamentarian of the House (1974–1994).

Vols. 1–15 have been published, additional volumes in preparation.

### Cannon's Procedure in the House of Representatives

By Clarence Cannon, A.M., LL.B., LL.D., Member of Congress, sometime Parliamentarian of the House, Speaker pro tempore, Chairman of the Committee of the Whole, Chairman of the Committee on Appropriations, etc.

### House Practice, A Guide to the Rules, Precedents and Procedures of the House

By Wm. Holmes Brown, Parliamentarian of the House (1974–1994).

### Procedure in the U.S. House of Representatives, Fourth Edition (1982) (1987 Supp.)

By Lewis Deschler, J.D., D.J., M.P.L., LL.D., Parliamentarian of the House (1928–1974), and Wm. Holmes Brown, Parliamentarian of the House (1974–1994).

## Senate Procedure

By Floyd M. Riddick, Parliamentarian Emeritus of the Senate, Alan S. Frumin, Parliamentarian of the Senate: Senate Document No. 101–28 (1992).

## Calendars of the House of Representatives and History of Legislation

Published each day the House is in session; prepared under the direction of the Clerk of the House of Representatives.

## Committee Calendars

Published periodically by most of the standing committees of the House of Representatives and Senate, containing the history of bills and resolutions referred to the particular committee.

## Digest of Public General Bills and Resolutions

A brief synopsis of public bills and resolutions, and changes made therein during the legislative process; prepared by American Law Division, Congressional Research Service, Library of Congress.

## Congressional Record

Proceedings and debates of the House and Senate, published daily, and bound with an index and history of bills and resolutions at the conclusion of each session of the Congress. The record of debates prior to 1874 was published in the Annals of Congress (1789–1824), The Register of Debates (1824–1837), and the Congressional Globe (1833–1873).

## Journal of the House of Representatives

Official record of the proceedings of the House, published at the conclusion of each session under the direction of the Clerk of the House.

## Journal of the United States Senate

Official record of the proceedings of the Senate, published at the conclusion of each session under the direction of the Secretary of the Senate.

## United States Statutes at Large

Containing the laws and concurrent resolutions enacted, and reorganization plans and proclamations promulgated during each session of the Congress, published annually under the direction of the Archivist of the United States by the Office of the Federal Register, National Archives and Records Administration, Washington, D.C. 20408.

Supplemental volumes: Tables of Laws Affected, Volumes 70–84 (1956–1970), Volumes 85–89 (1971–1975), containing tables of prior laws amended, repealed, or patently affected by provisions of public laws enacted during that period.

Additional parts, containing treaties and international agreements other than treaties, published annually under the direction of the Secretary of State until 1950.

## United States Code

The general and permanent laws of the United States in force on the day preceding the commencement of the session following the last session the legislation of which is included: arranged in 50 titles; prepared under the direction and supervision of the Law Revision Counsel of the House of Representatives. New editions are published every six years and cumulative supplements are published annually.

## Federal Register

Presidential Proclamations, Executive Orders, and federal agency orders, regulations, and notices, and general documents of public applicability and legal effect, published daily. The regulations therein amend the Code of Federal Regulations. Published by the Office of the Federal Register, National Archives and Records Administration, Washington, D.C. 20408.

## Code of Federal Regulations

Cumulates in bound volumes the general and permanent rules and regulations of Federal agencies published in the Federal Register, including Presidential documents. Each volume of the Code is revised at least once each calendar year and issued on a quarterly basis. Published by the Office of the Federal Register, National Archives and Records Administration, Washington, D.C. 20408.

## Weekly Compilation of Presidential Documents

Containing statements, messages, and other presidential materials released by the White House during the preceding week, published every Monday by the Office of the Federal Register, National Archives and Records Administration, Washington, D.C. 20408.

## History of the United States House of Representatives

Prepared by Congressional Research Service, Library of Congress, House Document 103–324.

## The Senate, 1789–1989, Addresses on the History of the United States Senate, Vol. 1

By Senator Robert C. Byrd, Senate Document No. 100–20 (1988).

## Historical Almanac of the United States Senate

By Senator Bob Dole, Senate Document No. 100–35 (1989).

# 4. STANDARD PROVISIONS OF MODERN INTERNATIONAL ARBITRATION AGREEMENT

If any matter arises involving the performance or interpretation of this contract which the parties are unable to settle by mutual agreement, all such matters shall be settled and determined by a Board of Arbitration consisting of three members, one member to be named by each of the parties hereto and the third to be selected by the two so named.

If the two arbitrators are unable to agree upon a third arbitrator within ten days, then the third arbitrator shall be selected and named by the International Chamber of Commerce [or any other neutral forum decided by the parties] in Paris, France. If either party fails to name and select its arbitrator within ten days after the proposal of arbitration, such party shall be deemed to have designated its chief executive officer as its arbitrator.

The arbitration proceedings shall otherwise be conducted in accordance with the prevailing rules and regulations of the International Chamber of Commerce, and the findings and conclusions of a majority of said Board of Arbitration shall be binding on both of the parties to this contract. Procedure. Such arbitration may be initiated by written notice from either party to the other setting forth a demand for arbitration and detailing with specificity the nature of the dispute, claim or controversy to be arbitrated. Time is of the essence of this arbitration procedure, and the arbitrator(s) shall be instructed and required to render his decision within ten (10) days following completion of the arbitration.

Discovery Rules.  The parties and arbitrator(s) shall have all of the rights and duties relating to discovery provided by Section of the _______Code of Civil Procedure, which is hereby made a part of this Agreement, except that the arbitrator(s) shall have the right to disapprove or to limit any discovery which such arbitrator(s) deems to be for purposes of delay or otherwise unnecessarily burdensome or oppressive.

Qualifications of Arbitrator(s). The arbitrator(s) in any such arbitration shall, insofar as is practicable, be a person who is expert in the subject matter of the dispute.

Governing Law. The arbitrator(s) shall follow any applicable _____law and _________law (with respect to all matters of substantive law) in rendering an award.

Opportunity to Present Evidence. Prior to rendering his determination or award, the arbitrator(s) shall afford each party an opportunity to express its views as to the proper determination of the matters under arbitration, orally or in writing as the arbitrator(s) may deem appropriate; provided, however, that (A) either party submitting written material shall be required to submit a copy of that material to the other party who shall have the opportunity to submit a written reply to that material within ten (10) days, and (B) if either party is to submit oral statements, the other party shall be afforded a reasonable opportunity to be present at the time at which these oral statements are made before the arbitrator(s) and to reply orally.

Costs of Arbitration. The cost of the arbitration proceeding and any proceeding in court to confirm or to vacate any arbitration award, as applicable (including, without limitation, attorneys' fees and costs), shall be borne by the unsuccessful party or at the discretion of the arbitrator(s), may be prorated between the parties in such proportion as the arbitrator(s) determines to be equitable and shall be awarded as part of the arbitrator's judgment.

Waiver of jury trial. Both parties hereby waive their right to trial by Jury with respect to any dispute arising under this agreement, and they agree that _________ county shall be the venue for any litigation arising under this agreement. The agreements contained in this section will remain In effect in the event that the reference procedures described in this Section are not followed, are declared unenforceable, or are otherwise unavailable. By their initials below, the parties acknowledge that they Have reviewed this provision (waver of jury trial) and have had the Opportunity to seek independent legal advice as to its meaning and effect.