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Possible future work relating to commercial fraud

Note by the Secretariat

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I. Introduction

1. At its thirty-fifth session in 2002, the United Nations Commission on International Trade Law (UNCITRAL) considered a proposal that the Secretariat prepare a study of fraudulent financial and trade practices in various areas of trade and finance for consideration at a future session of the Commission.¹

2. At that session, the Commission was informed that fraudulent practices, which are typically international in character, had a significant adverse economic impact on world trade and negatively affected the legitimate devices used in world trade. It was noted that the incidence of these frauds was growing, particularly since the advent of the Internet had offered additional avenues to the perpetrators. It was observed that the consequences of commercial and financial fraud included the following: (1) the compromise of legitimate instruments of trade and commerce; (2) the misuse of international organizations; (3) the loss of confidence in the mechanisms of international monetary transfer; and (4) increased costs to international trade and commerce. It was observed that authorities have had extensive and serious difficulties combating these schemes, stemming from a number of problems. The view was expressed that the Commission combined a governmental perspective with internationally recognized international expertise in international commerce along with a long-standing tradition of cooperation with international organizations in the private sector and collaboration with recognized international experts. Further, it was suggested that the Commission was well-placed to appreciate the workings of institutions of commerce and finance whose cooperation was essential for success, and many of the fraudulent schemes touched upon matters that had been specially addressed by texts elaborated by the Commission. It was proposed that the Commission request the Secretariat to prepare a study of fraudulent financial and trade practices in order to describe the ways in which the risk of common types of fraud affected the value of contractual and financial commitments.²

3. At that session, the Commission noted that measures to counter the growing problem of financial and commercial fraud were of great concern to Governments, and that such fraud adversely affected the trust in the mechanisms of trade, finance and investment, causing a destabilizing effect on the markets. It was recognized that commercial entities from developing countries, inasmuch as they had limited experience with instruments of international trade, were particularly vulnerable and would benefit from information and advice as to how to avoid being defrauded. It was observed that the work of the Commission would also help States, intergovernmental and non-governmental organizations to design or adjust legislative and non-legislative private law regimes that were better suited to prevent fraudulent schemes. After discussion, the Commission agreed that it would be useful to prepare the proposed study for the consideration of the Commission, without at this stage committing the Commission to any action being taken on the basis of the

¹ *Official Records of the General Assembly, Fifty-seventh Session, Supplement No. 17 (A/57/17)*, para. 279-290.

² *Ibid.*, para. 279-285.

study, and on the understanding that the work should only be undertaken to the extent that work did not claim resources needed for other projects on the Commission's agenda.³ Based on these considerations, the Secretariat convened a meeting of experts on 2-4 December 2002 in Vienna, Austria, at the headquarters of the Commission's Secretariat to discuss this issue and to assist in drafting this note for the Commission.⁴

4. This note has been prepared pursuant to the considerations of the Commission. It considers the impact and significance of commercial fraud, the meaning and nature of commercial fraud, general issues of commercial law that are affected by commercial fraud, and possible courses of action that might be undertaken by the Commission.

II. The extent of commercial fraud

5. Commercial fraud is a social and political phenomenon that has grown in recent years into a serious international problem. There are no accurate figures by which losses can be measured but assessments from experts and available anecdotal evidence suggest that commercial fraud is a serious drain on international commerce, with the potential for further losses.

6. Available figures are principally derived from reported court decisions, both civil and criminal. The figures that have been found indicate direct losses of billions of United States (US) dollars per year.⁵ The difficulties with calculating exact amounts of losses are the following:

(a) Two difficulties with stating figures are that losses typically do not fall within one calendar year and that it is difficult to categorize cases and distinguish between commercial fraud, consumer fraud, and other types of similar activity. Nonetheless, attempts that have been made support the estimate given above. For one particular type of commercial fraud, "high yield" or "prime bank" fraud (see

³ Ibid., para. 287 and 290.

⁴ The Secretariat wishes to acknowledge the work of the Institute of International Banking Law & Practice and its Director, Professor James E. Byrne, in the preparation of documents for the experts' meetings.

⁵ In one case, *Komerčni Banka AS v. Stone and Rolls Ltd.* [Queen's Bench Division (Commercial Court) [2002] EWHC 2263 (Comm), [2002] All ER (D) 239 (Nov)], involving a lending and letter of credit scam touching the United Kingdom of Great Britain and Northern Ireland, the Czech Republic, and Austria, losses of US\$ 400 million are estimated. This case is given by way of example, but is not isolated. For example, in *Nissho Iwai v. Korea First Bank*, No. 147/2002 (NY Ct. App. 2002) [US], involving Japan, Korea, and the United States of America, losses of US\$ 75 million were incurred as a result of fraudulent inducement that led a bank to issue a letter of credit in an amount greater than the bank intended. In *Malaysian International Trading Corp. v. Interamerica Asia Pte. Ltd.* 2002-4 SLR 537, 2002 SLR LEXIS 156 [Singapore], US\$ 75.1 million was lost in the sale of palm olein. In the series of Solo Industries fraud cases, US\$ 300 million was lost (Andy Holder, "\$300m loss underlines the case for due diligence" *Commercial Crime International*, February 2000, 1, 6-7), while banks lost US\$ 600 million to RBG Metals Trading fraud (*Documentary Credit World*, June 2002, 6-7). There are numerous similar examples in the reported civil and criminal cases. In another reported instance, more than US\$ 6 trillion in fraudulent United States "federal notes" were seized recently in Europe and Asia. Such notes are sold extensively and even "traded" throughout the world even though they are not issued by the United States Government and they are worthless. These examples have been chosen randomly, in order to illustrate the seriousness of the problem.

below, para. 25), losses internationally are conservatively estimated at US \$1 billion per year.⁶ By another measure, the International Chamber of Commerce Austria (ICC Austria) estimates the losses from commercial fraud in Austria alone are the equivalent of 100,000 jobs per year;⁷

(b) Another difficulty in estimating the losses resulting from commercial fraud is that, in addition to the actual amounts lost, there are indirect costs such as the cost of investigation and prosecution, the cost of recovery, and the impact of losses on job supply and businesses. These losses are difficult to measure or estimate in individual cases, and even more difficult to measure or estimate in aggregate;

(c) An even greater obstacle to determining the extent of commercial fraud is the conclusion reached by informed observers that the number of instances and the amount of reported losses is greatly exceeded by the number of unreported losses.⁸ Many victims of commercial fraud are reluctant to reveal losses because of embarrassment, the fear of exposing unfavourable information to competitors or lenders, or the conclusion that no recovery is possible or that the time and energy spent in seeking redress would exceed the amount likely to be recovered. Another factor in this reluctance may be due to the limited resources of the criminal justice system in some States, such that the justice system may not be capable of dealing adequately with commercial crime.

7. Despite the absence of precise statistical evidence, it may be credibly argued that commercial fraud has reached epidemic proportions. In addition to its potential for progress, the emergence of a global economy powered by computers and telecommunication technology has opened many destructive possibilities for commercial fraud. Fraudsters have been resourceful and inventive in making their schemes more flexible and attractive as well as more difficult to detect and prosecute.

8. In addition, there are strong indications that organized criminal elements have recognized commercial fraud as a source of significant income at relatively low risk and that they have begun to enter this field. For this reason, as well as its potential for the disruption of economies, commercial fraud offers an opportunity for global terrorism.

9. The threat of commercial fraud extends beyond direct and indirect losses to individual victims, however serious they may be. Commercial fraud has the potential to harm business reputations and destabilize industries, regions, the international banking system, financial markets, instruments of international commerce, international trade, and even nations. At this time, it has already had a

⁶ James E. Byrne, *The Myth of Prime Bank Investment Scams* (Institute of International Banking Law & Practice, 2002), 297 pp., 12.

⁷ This figure is based upon an estimate that the average for one position is €100,000 and that estimated losses are €3 billion for investment fraud, €1.5 billion for import-export fraud, €1 billion for project finance fraud, €3 billion for internal company fraud, €3 billion for corruption, €1.5 billion for espionage, and €700 million for shoplifting. This estimate also illustrates the difficulty inherent in attempting to define a discrete set of issues and a particular type of activity as commercial fraud.

⁸ ICC Austria estimates that only between 5-10 per cent of losses are disclosed.

deleterious impact on some smaller developing countries and, if unchecked, could threaten other countries.

10. The underlying causes of this growth in commercial fraud are manifold. They include the advances in technology and the globalization of commerce, including the internationalization of banking and finance. International commerce provides an ideal environment for commercial frauds in that it permits fraudsters to take advantage of both weaknesses in international systems designed for commercial interests acting in good faith and the difficulties inherent in pursuing civil or criminal actions in cross-border situations. Furthermore, current systems of banking and transport have not kept pace with the realities of modern commerce at the level of law and practice, and operate on the basis of interim measures instead of fundamental reforms. These temporary measures create opportunities for fraud.

11. While it would be useful to develop statistical information regarding the extent of commercial fraud and while such work should be encouraged, there is sufficient evidence of its size and impact to justify the conclusion that commercial fraud is an international problem of sufficiently serious proportion to warrant the considered attention of Governments and of the commercial community as to the nature of the problem and the need and possibilities for concerted action.

III. The nature of commercial fraud

12. It is not possible or necessary to define commercial fraud with precision. For the purposes of this note, it may be described as commercial conduct that seriously deviates from the acceptable range of commercial norms, using legitimate commercial forms illegitimately. It may have civil, regulatory, or criminal consequences and may also touch on matters more properly within the sphere of consumer law or regulation.

13. Commercial fraud need not involve affirmative conduct and, in some situations, may arise where silence or inaction is misleading and where there is an obligation of disclosure arising as a matter of law, commercial usage, or as a result of partial disclosures or representations.

14. The conduct that constitutes commercial fraud may resemble or also be actionable under general legal concepts, such as negligence or deliberate torts. While negligent conduct would not in itself constitute commercial fraud, actions of extreme recklessness or wilful disregard of minimal acceptable commercial conduct would closely resemble commercial fraud. In some systems, the same conduct that would constitute commercial fraud may give rise to actions based on deliberate tortious conduct such as misrepresentation or deceit.

15. There is some uncertainty as to how the presence of commercial fraud is to be determined. In one approach, the existence of commercial fraud is said to be determined by the fraudulent intent of the perpetrator. Although this approach serves as a valid explanation of many cases involving commercial fraud, it is less useful in borderline situations where intent, in effect, is implied. Other approaches equate commercial fraud with the lack of good faith, although the value of that characterization may depend on the meaning and significance given to the notion of good faith. In all cases it may be said that the presence of bad faith would constitute

commercial fraud, but the concept of bad faith is not universally known and is rarely defined with precision. Since the concept of lack of good faith is not precise, its use as a measure for commercial fraud sometimes serves as an explanation of a conclusion that commercial fraud has occurred rather than as a measure by which its presence can be determined, especially in borderline situations.

16. While there is no agreed typology of commercial fraud, there are commonly recognized patterns of commercial fraud that are useful in identifying it and in illustrating the issues that arise in attempting to distinguish it from other similar phenomena.

17. It is common for commercial fraud schemes to take advantage of the international nature of a transaction, and: (1) to misuse instruments of international commerce; (2) to use or rely on the international payment and banking systems; and (3) to involve some level of collaboration between several distinct persons appearing to act independently.

18. The greatest challenge for commercial law is to distinguish commercial fraud from a breach of contract or obligation.⁹ The latter, while it is actionable and would result in legal damages, would not be understood to constitute commercial fraud. In this sense, the degree of the departure from accepted commercial norms assumes considerable importance. For commercial fraud, there must be a distinct departure from acceptable commercial norms.

19. For example, it is accepted that in commercial activities there will be situations where a party is in breach of a contractual obligation which itself could be understood as a departure from accepted commercial norms. Whether the breach is fraudulent depends upon the degree of the breach. Where the breach is not deliberate, typically there is no commercial fraud. Where the action is deliberate, however, it is less clear whether there is commercial fraud. Where, for example, there is a deviation regarding the quality of the goods, it is likely that there is a breach of contract but no commercial fraud, even if the deviation is a deliberate act on the part of the seller. When there is a deliberate refusal to deliver goods in order to obtain a better price from another buyer, it is unclear whether there would be commercial fraud. Such conduct is a breach of contract, permitting avoidance in most cases, but would not generally be regarded as an instance of commercial fraud, absent additional circumstances. Similarly, a refusal on the part of a buyer to perform in order to take advantage of a better price would not be acceptable commercial conduct and would result in damages, but would not generally be regarded as commercial fraud. As a result, the extent or degree of the departure from acceptable commercial norms, while imprecise, is a practical measure of the existence of commercial fraud.

20. On the other hand, where the seller ships goods that have no commercial value whatsoever or where the buyer receives the goods and without any commercial justification evades payment, there is likely to be commercial fraud. Additional factors may make a non-fraudulent breach of contract a commercial fraud. For

⁹ Actions for breach of contract or obligation may also contain elements of fraud, but there are adequate legal remedies for breach of contract in the law of contracts or under the United Nations Convention on Contracts for the International Sale of Goods. The type of commercial fraud addressed by this note is activity that involves a serious deviation from commercial norms.

example, where there is a material misrepresentation regarding the quality of the goods and that misrepresentation cloaks a serious flaw in the goods that would render their use in violation of health or safety rules, there may be commercial fraud.

21. In addition, there may be commercial fraud in a general sense even where there is no breach as between the parties to a contract. For example, where there is the purchase and sale of an otherwise legal commodity that is controlled by criminal interests and that commodity is obtained without paying local taxes, the contracts of the buyers and sellers may be legitimate and not contain any indication of commercial fraud, but the entire chain of transactions itself is of concern to the commercial community as an instance of commercial fraud because it threatens the ability of legitimate producers who pay taxes to operate at competitive equality. In this sense in which there may be no civil remedy, the laundering of goods is nonetheless of equal concern with the laundering of funds that are obtained in circumvention of law.

22. Commercial transactions are often conducted by the use of documents representing the shipment, storage, inspection, or other facets connected with the delivery or production of goods. A forged document is generally understood to contain a forged signature or to have been altered improperly whereas a fraudulent document is one that is altogether false. The terms are often used interchangeably. Forgery or fraudulent documents will give rise to commercial fraud, sometimes even in situations where the goods themselves meet the requirements of the contract between buyer and seller. For example, where financing or payment is based on forged documents of title, the actual conformity of the goods is irrelevant. Moreover, where there is reliance on representations of a documentary character, the forged or fraudulent documents constitute commercial fraud whether or not the person proffering them is innocent of any knowledge of their fraudulent character.

23. Where financial instruments representing undertakings are used for a commercial transaction, their fraudulent inducement, issuance, or use for a commercially improper purpose also constitutes commercial fraud, as does their forgery, fraudulent creation, or modification.

24. Other examples of commercial fraud include:

(a) The misuse of securities, including government securities, in connection with a commercial transaction that were fraudulently obtained, forged, or fraudulent also constitutes commercial fraud;

(b) The misuse or abuse of transport or storage of goods, including related documents, also constitutes commercial fraud. Such fraud may occur through the shipment of non-existent or seriously defective goods that are misrepresented on the transport or storage document, through the forgery, fraudulent creation, or modification of the documents, or through the sale of the same cargo (existent or non-existent) represented by the documents to more than one buyer;

(c) False or fraudulent claims on insurance policies are another instance of commercial fraud;

(d) The abuse of financing systems to obtain funding where there are no assets or where the assets are pledged to more than one creditor without disclosure would constitute commercial fraud;

(e) The misuse of insolvency to hide or transfer assets in advance or to defraud creditors would constitute commercial fraud.

Any of these commercial frauds can be combined with other types of commercial fraud and can occur at any stage of the transaction from the outset of the bargaining to the performance of the transaction or payment.

25. In addition to these actions which are rooted in legitimate transactions, even though they are misused or distorted, there is a species of transaction that mirrors the world of legitimate commerce but which has no commercial dimension. While these transactions vary with regard to the nature of the investment or transaction, they promise disproportionate returns for risk-free investments based on yields supposedly received from trading on secret markets. These schemes, known as “high yield” or “prime bank” investment schemes, use the instruments and institutions of international business and banking in order to convince the victim to invest and sometimes enlist investors to solicit other investors, often returning some of the very funds invested to them as if they constituted the promised returns on the investment.

26. Another species of fraudulent scheme without any legitimate basis is one that solicits assistance and advance funds or bank account information from the victim in order to assist in transferring illicit funds from a given country for a percentage. While the typical victim of this scheme is a consumer, many businesses have been victimized as well. The consequences of this fraud and its close identification with certain countries have rendered it difficult for legitimate businesses and citizens of these countries to conduct legitimate business because of the suspicion attached to them.

IV. The commercial law dimension of commercial fraud

27. It is common for commercial fraud to be punishable under criminal law. Indeed, there has been an expanding criminalization of misconduct that has increased the overlap between civil and criminal systems. As a result, the widespread assumption that commercial fraud is solely an issue for criminal law ignores or overlooks the commercial elements and implications of commercial fraud. In reality, however, commercial fraud is as much an issue for commerce and commercial law as it is for criminal law.

28. In many instances, it is difficult to delineate the border between criminal and commercial law with respect to commercial fraud. The same commercially fraudulent conduct may be at the same time the subject of civil actions and criminal actions. In addition, there may be a regulatory dimension to commercial fraud which adds a third possible source of actions. As a result, the response to commercial fraud could be either administrative, civil, or criminal or some combination thereof. Moreover, it is not uncommon for commercial fraud to affect the commercial sphere without any regulatory or criminal involvement.

29. Whatever the form or source of legal action, commercial fraud has a direct and immediate impact on commercial entities and commerce. The commercial dimension of commercial fraud includes its impact on victims, ongoing legitimate

businesses, employees and their families, creditors, and the surrounding geographical area that would be affected by losses or closure of a business.

30. All of these aspects of commercial fraud have consequences and implications for commercial law. In particular, commercial law can afford through civil actions some means of redress to those entities affected by commercial fraud. Civil actions have certain advantages over criminal actions under some circumstances, including a different and usually lower standard of proof, greater speed in pursuing assets, and more flexibility in pursuing options.

31. Commercial law could also be an effective tool for the prevention and control of complex and rapidly moving cases of commercial fraud. Since commerce is the target and focus of commercial fraud, the commercial community is in an ideal position to work toward prevention, education, disruption, and investigation of commercial fraud.

32. While cooperation with criminal law enforcement and regulatory authorities should be encouraged, there is an important independent role for the commercial community and commercial law in preventing and combating commercial fraud.

A. Remedies

33. There is a certain convergence of criminal and civil systems with respect to the proceeds of commercial fraud in that in both systems of law the question arises of compensation to the victims of commercial fraud. It is in the calculation and determination of these amounts that difficulties and differences often arise. Indeed, commercial frauds are often designed to move funds across borders in order to take advantage of difficulties, inconsistencies, and impracticalities between various countries and systems. In this respect, the perpetrators of commercial fraud often achieve a level of organization and cooperation that eludes those combating it.

34. One of the distinctions between a civil and a criminal remedy for commercial fraud is with respect to the sanction imposed. In the case of a civil action, monetary damages or specific performance will be awarded, whereas the primary characteristic of a criminal remedy is punishment, whether by fine, imprisonment, or both. With respect to regulatory actions, the penalties depend on the applicable law and may include elements of criminal and civil damages.

35. An important principle underlying civil damages in the case of commercial fraud should be to make the injured party whole. This may be accomplished either by enabling the injured party to have the benefit of the bargain when appropriate, or to restore to it funds lost, plus expenses, while permitting it to avoid the contract.

36. In civil cases of commercial fraud, courts tend to interpret the requirements for liability for damages more broadly than insisting on elements of damage theory that would otherwise be applicable in an action for ordinary breach of contract, such as requiring that damages be foreseeable. As a result, they are able to compensate third parties who may be harmed by commercial fraud.

37. In some legal systems, exemplary or punitive damages may be appropriately awarded in cases of commercial fraud. While such damages are regarded as only properly awarded to the State in some systems, in others it is recognized that they

can be awarded to victims, although in every system where such an award is permitted, it is rarely granted in the case of truly commercial activity.

38. In many situations involving commercial fraud, however, there are insufficient funds to meet the competing civil claims from private parties. In such situations, it is necessary to allocate proceeds among the claimants. The process of allocating funds is often complicated by the international character of the commercial fraud and is affected considerably by the location of the funds. It is also affected by the practice of some fraudsters of paying some victims with funds taken from others, making later “investors” bear the losses.

39. Where there are parallel proceedings in different jurisdictions involving different victims and different governmental units, there is considerable opportunity for confusion, redundancy, and additional loss. There is a considerable advantage in communication between the various entities who are interested in recovery in a given case, and even greater advantages in fostering such cooperation and communication systematically within a given jurisdiction and in cross-border situations.

40. The relative priority of criminal and civil actions also raises important questions. There are advantages of speed in a civil action with respect to the seizure of funds before they can be hidden or dispersed. Where a civil action commences and is followed by a criminal or regulatory action, there is a need for coordination between the actions. Such coordination may be different in the jurisdictions where civil action defers to criminal action.

41. Because commercial frauds are designed in part to take advantage of the inconsistencies between various systems and jurisdictions, coordination between those combating commercial fraud should occur and useful efforts by non-governmental entities should be encouraged to the discomfiture of the perpetrators.

B. Interim measures of protection or attachment of funds

42. One of the most important tools in combating commercial fraud is the ability to obtain interim measures of protection in freezing or attaching funds. While rules regarding these measures differ, most legal systems have a mechanism by which a court can intervene in some fashion to preserve the status quo or to require that funds not be moved or disbursed. Arbitral tribunals are also increasingly using similar powers granted by regimes governing arbitration proceedings.¹⁰ Such remedies could be of considerable value in cross-border situations and should be made available to the extent possible.

43. However, such tools can also be used as a means to gain unfair advantage or even as a means of commercial fraud. As a result, care must be exercised to determine whether such interim measures of protection are consistent with the allocation of risk as between the parties and the relative rights of the various parties,

¹⁰ Working Group II (Arbitration) is currently considering the issue of interim measures of protection. Revised drafts of Article 17 of the UNCITRAL Model Law on International Commercial Arbitration were considered at the thirty-seventh session of the Working Group (A/CN.9/523).

particularly where such measures are sought on an *ex parte* basis, i.e. without first hearing the party against whom the measure is directed.

44. For the same reasons, it is desirable that parties to arbitral proceedings are able to obtain orders for interim measures of protection from the arbitral tribunal, have access to courts for the purpose of obtaining court-ordered interim measures of protection, and for the enforcement of such decisions.

C. Risk allocation

45. Parties commonly allocate the risk of commercial fraud expressly or such allocation is implicit in their agreements, commercial laws or rules of customary practice. Where such allocations exist, the risk should be placed where it can be controlled. Likewise, disclaimers or clauses for indemnities serve similar functions and are enforced absent unusual circumstances between commercial parties.

46. Insurance also represents an important means of allocating the risk of commercial fraud but can itself be a source or target of commercial fraud.

D. Innocent third parties

47. It is not uncommon for third parties to be caught up in a commercial fraud. In such situations, it is necessary to determine their relative rights and entitlements. International commercial law has long recognized that innocent third parties who acted in good faith or without knowledge of commercial fraud and in accordance with ordinary business practices were to be given priority with respect to property that they purchased. Generally, this rule is essential to protect the integrity of markets and systems.

48. Nevertheless, the full extent and scope of the doctrine of innocent purchase together with its exceptions may require further study from the international community in a manner that elaborates the underlying principles that animate it.

E. Deterrence and education

49. One of the most potent tools to avoid and defeat commercial fraud is the existence of systems that assure transparency and accountability and that, when losses occur, enable the various resources of the victim to be marshalled to stabilize the situation and to recover losses. The commercial community is encouraged to have systems in place that reduce the risk of commercial fraud, and to have contingency plans in place to address problems of commercial fraud that may arise.

50. In addition, education regarding commercial fraud at all levels of commercial life is essential in combating it. In particular, it would be valuable to identify the patterns of commercial fraud and ascertain potential targets so as to structure programmes to warn and prepare potential victims. Such programmes should be encouraged and conducted not only at the local and national level but also at the international level.

F. The role of professionals

51. Professionals such as attorneys, accountants and financial advisors are essential to modern commerce. As such, they assume disproportionate importance in regard to commercial fraud. Where they are vigilant, they are often able to identify the signs of fraudulent schemes (such as inconsistencies or implausibilities that are absent in legitimate transactions) before innocent parties are victimized.

52. One of the characteristics of many commercial frauds, however, has been the direct or indirect involvement of professionals who have lent their authority to the scheme. Where professionals engage in conduct that assists in carrying out fraudulent schemes, it is essential that the profession itself or regulatory authorities intervene in order to protect the integrity of the professional office, or that there be appropriate liability standards for professionals if they issue statements for a company involved in a fraud and those statements are relied upon by third parties who were defrauded.

G. Third party intermediaries

53. Many commercial frauds depend on the unwitting support and assistance of intermediaries (such as banks, carriers, freight forwarders, etc.) whose role in commercial transactions is necessarily and properly limited. While it would be damaging to international commerce in many cases to expand the obligation of such intermediaries, it would be useful to identify certain basic principles of commercial conduct that should be observed and enforced. One such rule is that no document should be issued without understanding its commercial significance. Lending one's name to a statement that makes no commercial sense is an invitation for it to be misused. Likewise, no commercial entity should make a statement that is known to be untrue. Such rules are not only a foundation of basic business morality but essential to avoid placing in the hands of fraudsters materials that will be used to the disadvantage of others and that may redound to the ultimate regret of the person issuing it.

H. Confidentiality of data

54. There are numerous competing policies at stake in the confidentiality of data. With respect to the debate that surrounds these issues, however, it should be observed that any respect for the privacy of commercial data that is consistently used by fraudsters to hide or obscure the proceeds of commercial fraud requires careful re-examination.

I. Electronic commerce and cybercrime

55. The advent of electronic commerce has not only provided increased opportunities for legitimate business, but also increased opportunities for commercial fraud. While many of the means by which electronic commerce is used in a fraudulent manner are consumer-oriented, there are also uses that contribute to commercial fraud. One source of difficulty is that persons are able to find and deal

with each other through electronic commerce at a distance without knowing the other party. In the past, such transactions would have commonly occurred through membership in a closed system in which there was a certain assurance of the authenticity of the counterparty and its legitimacy.

56. UNCITRAL has done important work in the area of electronic commerce but many of the systems by which counterparties can be verified are outside the realm of statute and legislation. The requisite degree of verification is a matter of private risk assessment. On the other hand, it is important that law permit the creation of commercial systems of authentication of messages and verification of other aspects of the transaction, taking into account the protection of privacy rights.

57. The Internet, in particular, has permitted the use of names of entities or of similar entities in ways that could be misleading and the medium permits a wide publication and circulation of messages designed to commit fraud. Internet service providers have a potentially significant role to play in addressing the problem of harmful content of web sites, including, under certain circumstances, facilitating transmission of complaints to the proper public authorities and removing web sites that promote commercial fraud. It may be desirable to study this issue and, in any case, encourage voluntary efforts by Internet service providers and participants in electronic commerce. At this stage, however, it may be preferable for any efforts to be voluntary and for such efforts to be encouraged.

58. There is a link between commercial fraud and cybercrime. Cybercrime consists of three general areas of crime: (1) crimes in which a computer or computer system is the target (such as hacking or intrusion crimes), (2) crimes in which computers are the medium by which the criminal conduct is committed (such as use of a computer to e-mail fraudulent solicitations), and (3) crimes in which computers are used incidentally to the criminal offence (such as when fraudsters store evidence of the fraud on computers).

59. While the Internet and computer technology have increased the perpetration of traditional crimes (such as identity theft, intellectual property theft, copyright infringement, credit card fraud, software piracy, stalking, extortion and other crimes), they have also increased the threat to businesses and Governments via attacks on critical infrastructures (such as utilities, energy, transportation and communications).

60. These issues are linked to questions of cybercrime which, because of technological and communication developments, poses a serious threat to international commerce. The Council of Europe's 2001 Convention on Cybercrime,¹¹ which was drafted with the active cooperation of non-member States, deals with such crime and warrants consideration.

J. Insolvency

61. Insolvency can be used both to hide the proceeds of commercial fraud and to commit commercial fraud. In the former situation, the fraudster declares itself insolvent in one jurisdiction but the proceeds of commercial fraud are hidden in

¹¹ Council of Europe, Convention on Cybercrime, ETS 185, 23 November 2001, published electronically at <http://conventions.coe.int/Treaty/EN/CadreListeTraites.htm>

various other jurisdictions or fraudulently transferred to other related persons. Typically, these assets are difficult to find and secure. It should also be recognized that cross-border movement of the proceeds of crime also occurs without the formal declaration of insolvency but the result is identical, in that the person entitled to the proceeds is defrauded of its right to recovery. In the latter situation, the assets of a company that is about to declare itself insolvent are transferred or hidden, often to other jurisdictions, prior to the petition to commence insolvency proceedings and under the guise of payments made in the ordinary course of business in order to defraud creditors.

62. Where the proceeds of a commercial fraud are fraudulently transferred or hidden, there are various civil and criminal means by which they can be followed and obtained. There are relative advantages in terms of time and flexibility to both approaches and the various approaches that are available differ and sometimes conflict or interfere with one another from jurisdiction to jurisdiction. There is no catalogue of such remedies nor any harmonization of them, which makes this approach particularly attractive to fraudsters.

63. The UNCITRAL Model Law on Cross-Border Insolvency addresses some of these issues and provides a mechanism to address some of the methods of hiding assets in other jurisdictions by empowering an insolvency administrator or judge in one jurisdiction to request the assistance of a court or insolvency administrator in another jurisdiction with regard to obtaining information or issuing interim relief. Additional mechanisms are either in place or being created by which criminal law authorities can trace and claim the proceeds of crimes including commercial fraud. Such mechanisms should be encouraged.

V. Recommendations for consideration by the Commission

64. In considering how to address the problems of commercial fraud, the Commission may wish to take into account the following possible steps.

A. An international colloquium

65. The growth and impact of commercial fraud suggest that there is a need by Governments and the international commercial community for greater attention to this problem and for collaboration among those seeking to expose and combat it. At present, no organization has been able to bridge governmental and private interests in a manner that fosters such collaboration on an international scale. In this respect, UNCITRAL, in view of its experience, reputation and working methods, which include close cooperation between Governments and non-governmental organizations, may fulfil such a role. Moreover, part of its mandate is coordination of such efforts in the field of international law and commerce.¹²

66. A vehicle by which such collaboration could be initiated could be to hold an international colloquium to address the various aspects of the problem of commercial fraud and to permit an exchange of views from various interested parties. Invitees would be Governments, intergovernmental organizations, and

¹² General Assembly resolution 2205 (XXI).

others engaged in combating commercial fraud. The Commission could invite the co-sponsorship of other interested United Nations bodies and others. Such a step could be structured so as to provide impetus for similar gatherings with the encouragement of UNCITRAL but without requiring the use of its resources. As a result, through a relatively modest investment of time and resources, collaboration among concerned organizations could be fostered. Moreover, such a gathering itself could lead to further efforts and proposals to UNCITRAL or other bodies.

67. Such a colloquium could also provide an opportunity for promoting exchanges of view with the criminal law and regulatory sectors that combat commercial fraud and an identification of those matters that can be coordinated or harmonized.

B. United Nations Convention against Transnational Organized Crime

68. In view of the close relationship between the civil and criminal prosecution of commercial fraud, the Commission may wish to consider the United Nations Convention against Transnational Organized Crime and protocols thereto.¹³ The behaviour proscribed under this Convention and the instruments established by it to combat transnational organized crime would typically encompass commercial fraud provided that it was punishable under national criminal law “by a maximum deprivation of liberty of at least four years or a more serious penalty”, pursuant to article 2 (b) defining “Serious crime”. The Commission, after considering the matter and on the basis of appropriate advice, in addition to calling to the attention of Governments the advantages of the Convention with respect to issues of commercial fraud, might also call to the attention of Governments the linkage between the criminal laws and the Convention so as to encourage them to bring instances of commercial fraud within the ambit of the Convention. Where commercial fraud falls within the definitional structure of the Convention, there are available to law enforcement authorities numerous tools on an international scale that would be of considerable use in cross-border commercial fraud.

C. Focus on the fraudulent dimensions of commercial activities in future work

69. Some of the texts of UNCITRAL have incidentally touched on issues of commercial fraud, such as the United Nations Convention on Independent Guarantees and Stand-by Letters of Credit, the United Nations Convention on the Assignment of Claims in International Trade, the UNCITRAL Model Law on Cross-Border Insolvency, and the UNCITRAL Model Law on the Procurement of Goods, Construction, and Services. These issues were addressed because they were inherent in the topics under consideration. The Commission may wish to give these existing texts greater profile from the perspective of their usefulness in combating commercial fraud.

¹³ New York, 15 November 2000, the Protocol to Prevent, Suppress and Punish Trafficking in Persons, Especially Women and Children, the Protocol against the Smuggling of Migrants by Land, Sea and Air, and the Protocol against the Illicit Manufacturing of and Trafficking in Firearms, Their Parts and Components and Ammunition.

70. In addition, in its future work, these considerations may enable the Commission to give more deliberate consideration to the possibilities of commercial fraud in the areas in which it is preparing texts and to include in those texts appropriate measures that would address the problem.
