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**The most-favoured-nation clause in the law of treaties: working paper submitted by Mr. Endre Ustor, Special Rapporteur**

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# MOST-FAVOURED-NATION CLAUSE

[Agenda item 3]

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by Mr. Endre Ustor, Special Rapporteur

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### I. Introduction

1. At its sixteenth session, the International Law Commission considered a proposal put forward by one of its members<sup>1</sup> to the effect that it should include in its draft

on the law of treaties a provision on the so-called "most-favoured-nation clause". The suggested provision was intended to reserve formally the clause from the operation of the articles dealing with the problem of the effect of treaties and third States (articles 30 to 33 in the 1966 draft).<sup>2</sup>

<sup>1</sup> Mr. Jiménez de Aréchaga. See *Yearbook of the International Law Commission, 1964*, vol. I, 752nd meeting, pp. 184 and 185, paras. 2-11.

<sup>2</sup> See *Yearbook of the International Law Commission, 1966*, vol. II, document A/6309/Rev.1, part II, pp. 101 and 182.

2. It was urged in the support of the proposal that the broad and general terms in which the articles relating to third States had been provisionally adopted by the Commission might blur the distinction between provisions in favour of third States and the operation of the most-favoured-nation clause, a matter that might be of particular importance in connexion with the article dealing with the revocation or amendment of provisions regarding obligations or rights of States not parties to treaties (article 33 in the 1966 draft).

3. The Commission, however, while recognizing the importance of not prejudicing in any way the operation of most-favoured-nation clauses, did not consider that these clauses were in any way touched by the articles in question and for that reason decided that there was no need to include a saving clause of the kind proposed. In regard to most-favoured-nation clauses in general, the Commission did not think it advisable to deal with them in the codification of the general law of treaties, although it felt that they might at some future time appropriately form the subject of a special study.<sup>3</sup> The Commission maintained this position in the course of its eighteenth session.<sup>4</sup>

4. At its nineteenth session, however, the Commission noted that several representatives in the Sixth Committee at the twenty-first session of the General Assembly had urged that it should deal with the most-favoured-nation clause as an aspect of the general law of treaties. In view of the interest expressed in the matter and of the fact that clarification of its legal aspects might be of assistance to the United Nations Commission on International Trade Law (UNCITRAL) the Commission decided to place on its programme the topic of most-favoured-nation clauses in the law of treaties and appointed a special rapporteur to deal with it.<sup>5</sup>

5. The purpose of the present working paper is to give an account of the preparatory work already undertaken by the special rapporteur, to outline the possible contents of a report on the topic and to solicit advice and comments from the members of the Commission.

## II. History of the clause

6. Mediaeval origins. Capitulations. Treaty of amity and commerce between the United States of America and France signed at Paris on 6 February 1778.<sup>6</sup>

<sup>3</sup> See report of the International Law Commission on the work of its sixteenth session in *Yearbook of the International Law Commission, 1964*, vol. II, document A/5809, p. 176, para. 21.

<sup>4</sup> See report of the International Law Commission on the work of its eighteenth session in *Yearbook of the International Law Commission, 1966*, vol. II, document A/6309/Rev.1, Part II, p. 177, para. 32.

<sup>5</sup> See report of the International Law Commission on the work of its nineteenth session in *Yearbook of the International Law Commission, 1967*, vol. II, document A/6709/Rev.1 and Rev.1/Corr.1, p. 369, para. 48.

<sup>6</sup> William M. Malloy, *Treaties, conventions, international acts, protocols and agreements between the USA and other powers, 1776-1909* (Washington, D.C., 1910), vol. I, p. 468.

Treaty of commerce between Great Britain and France signed at Paris on 23 January 1860, usually known as the Cobden Treaty.<sup>7</sup> Practice of the nineteenth and twentieth centuries. Modern developments:

- (i) General Agreement on Tariffs and Trade signed at Geneva on 30 October 1947;<sup>8</sup>
- (ii) Treaty establishing a free-trade area and instituting the Latin American Free-Trade Association, signed at Montevideo on 18 February 1960, including protocols and resolutions;<sup>9</sup>
- (iii) Proposal submitted by the Soviet Union in 1956 on the preparation within the framework of the United Nations Economic Commission for Europe of an all-European agreement on economic co-operation.<sup>10</sup> This proposal contained an unconditional and unrestricted most-favoured-nation clause.

[See: Suzanne Basdevant, "La clause de la nation la plus favorisée" in Lapradelle et Niboyet, *Répertoire de Droit International*, (Paris, 1929), vol. III, p. 464; Georg Schwarzenberger, "The most favoured-nation standard in British State practice", *The British Yearbook of International Law*, 1945, XXII (London), p. 96; Arthur Nussbaum, *A concise history of the law of nations* (New York, 1947); Manuel A. Vieira, "La cláusula de la nación más favorecida y el Tratado de Montevideo", *Anuario Uruguayo de Derecho Internacional*, IV, 1965-1966, p. 189].

## III. Definition of the clause and its various types

7. In the most simple form of the clause, the conceding State or promiser undertakes an obligation towards another State—the beneficiary—to treat it, its nationals, goods, etc., on a footing not inferior to the treatment it has been giving or will be giving to the most-favoured third State in pursuance of a separate treaty or otherwise.

8. A clause containing a unilateral promise is only of historical significance. It was characteristic of the capitulations and was also included in the peace treaties concluding the First and Second World Wars to the detriment of the defeated countries (see: Versailles treaty with Germany, articles 264 to 267; Trianon treaty with Hungary, articles 203 and 211 (b); Paris peace treaties with Italy, article 82 and with Hungary, article 33).<sup>11</sup>

Today the clause is never unilateral and the States inserting it in their treaties undertake the obligation to grant the most-favoured-nation treatment reciprocally. Thus the clause now represents a combination of as many promises as there are Contracting Parties: two in a

<sup>7</sup> *British and Foreign State Papers* (London, 1867), vol. L, p. 13.

<sup>8</sup> United Nations, *Treaty Series*, vol. 55, p. 188.

<sup>9</sup> *Multilateral Economic Co-operation in Latin America, 1962*, vol. I, p. 57.

<sup>10</sup> E/ECE/270, parts I, II and III.

<sup>11</sup> *British and Foreign State Papers* (London, 1919), vol. 112, pp. 129 and 130; *ibid.* (London, 1920), vol. 113, pp. 569, 572 and 573; United Nations, *Treaty Series*, vol. 49, pp. 166 and 167; *ibid.*, vol. 41, pp. 204 and 206.

bilateral treaty and as many in a multilateral treaty as the number of the participants. The reciprocal promises of most-favoured-nation treatment result directly from the common participation of the States concerned in the treaty. The reciprocity in the bilateral most-favoured-nation clause, being a "formal" and "subjective" reciprocity, does not ensure the material identity or equivalent of the give and take. This is particularly true as regards the so-called unconditional type of clause. Niboyet points out that "[la clause de la nation la plus favorisée est] une formule de réciprocité abstraite car elle consiste dans l'affirmation d'une méthode sans garantie de ses résultats. [Avec cette clause les Etats] se soucient moins de s'assurer la jouissance d'un droit déterminé que de n'en pas laisser jouir d'autres, s'il ne leur est pas assuré également".<sup>12</sup>

9. Before the First World War, the United States interpreted the most-favoured-nation clause in a narrower sense. According to that interpretation an advantage granted to the nationals of State Y in consideration of a concession made by Y to the United States would accrue to the nationals of the most-favoured State Z only if the United States should receive from Z the same equivalent as was received from Y. The operation of this "conditional" or "reciprocal" most-favoured-nation clause raised vexing questions. Suppose the United States reduced the tariff on Y silk in consideration of a reduction in the Y tariff on American oranges; a lowering of the duties on oranges may, vis-à-vis Z, amount to much less or much more than vis-à-vis Y, not to mention the difficulty of ascertaining the true *quid pro quo* in the Y transaction. Hence the "conditional" most-favoured-nation clause procured for the favoured party no more than a contingent bargaining position, and not even that in the case of a free-trade country, like England at that time, which had no concession left to offer. According to Nolde: "On peut . . . dire que la clause conditionnelle, pratiquement, équivaudra toujours à l'absence de toute clause de la nation la plus favorisée".<sup>13</sup> The American conception was probably influenced by the common law idea that a valid promise normally requires the giving of a "consideration" on the part of the promises; in America the transfusion of this idea into the law of commercial conventions was not hampered by free-trade notions; quite the contrary, it fitted into the ever growing high protectionism of the country. In intra-European relations, however, the unconditional form and interpretation of the clause were entirely dominant, particularly in the period following the Cobden treaty.<sup>14</sup>

10. In 1922 the United States made a concession to economic liberalism by turning from the conditional to the unconditional type of the most-favoured-nation clause. The reason for this departure from previous practice was explained as follows by the United States

Tariff Commission: ". . . the use by the United States of the conditional interpretation of the most-favoured-nation clause has for half a century occasioned, and, if it is persisted in, will continue to occasion frequent controversies between the United States and European countries."<sup>15</sup>

#### IV. Literature and bibliography

11. There is a considerable literature on the subject. The greater part of it, however, deals with the economic and political rather than the legal aspects of the most-favoured-nation clauses and it is not easy to find guidance on the questions of law which arise.<sup>16</sup>

#### V. Tables of cases

12. See the tables of cases of the Permanent Court of International Justice, the International Court of Justice and of international and national tribunals.

#### VI. Previous attempts at codification

13. League of Nations: convention opened for signature by the Pan American Union on 15 July 1934.<sup>17</sup> Sessions of the *Institut de droit international* of 1934, 1936 and 1967.

#### VII. Field of application of the clause and scope of the report

14. The fields in which most-favoured-nation clauses are applied are extremely varied. They may be classified as follows:

- (a) International regulation of trade and payments.
- (b) Treatment of foreign means of transport (ships, aircraft, trains, motor vehicles, etc.).
- (c) Establishment, personal statute and professional activities of foreign physical and juridical persons.
- (d) Privileges and immunities of diplomatic, consular and trade missions.
- (e) Intellectual property (patents, copyrights, etc.).
- (f) Recognition and execution of foreign judgments and arbitral awards.

15. The most important of these fields is international trade. Here the clause is a permanent feature of treaties regulating export and import trade in general and questions of tariffs, customs and other duties in particular. This has been implicitly recognized by the International Law Commission when in the decision mentioned above in paragraph 4 it referred to UNCITRAL.

<sup>12</sup> J. P. Niboyet, *Traité de droit international privé français* (Paris, 1938), vol. II, p. 245.

<sup>13</sup> Boris E. Nolde, *La clause de la nation la plus favorisée et les tarifs préférentiels* (La Haye), Académie de droit international, *Recueil de cours*, 1932, I, vol. 39, p. 91.

<sup>14</sup> Arthur Nussbaum, *A concise history of the law of nations* (New York, revised edition 1954), pp. 205 and 206.

<sup>15</sup> Quoted by Charles Hyde, in *International Law*, second revised edition (Boston, 1947), vol. 2, p. 1506, foot-note 13.

<sup>16</sup> See the bibliography in Lord McNair, *The Law of Treaties* (Oxford, 1961), p. 272.

<sup>17</sup> Manley Hudson, *International Legislation* (Washington, D.C., 1937), vol. VI, p. 927.

16. A thorough study of all the fields in which most-favoured-nation clauses are used would reveal many particular problems.<sup>18</sup> Since, however, the Commission does not intend to deal with the matter from the economic point of view, the Special Rapporteur does not propose to examine the whole spectrum of the use of the clause, notwithstanding some brief excursions in the field of commerce. The Commission may therefore wish to confine itself to the formal and legal aspects of the clause<sup>19</sup> without, of course, dealing with the matter out of the context of realities.

### VIII. Nature and effect of the clause

17. The most-favoured-nation clause has a harmonizing and levelling effect.<sup>20</sup> Although until quite recently the clause appeared mostly in bilateral treaties, it now transcends the bilateralism of commercial relations and produces a tendency to multilateralism. Its effect is automatic. Since the provision ensuring favours to a third party applies automatically vis-à-vis the beneficiary, it renders the conclusion of new individual agreements superfluous.<sup>21</sup> It can be linked to the most diverse systems of economic policy, to free trade as well as to protectionism.<sup>22</sup> Embodied in commercial treaties, it creates favourable conditions for the development of mutual commercial relations between States. It consists of two main factors: the granting of favours and the elimination of discrimination.

18. The system of the most-favoured treatment which creates a situation of equal rights for the States participating in international trade does not and cannot affect the economic system of the States. A different solution could not be admitted because it would amount to an interference in the internal life of other countries.<sup>23</sup> In this connexion, it is necessary to study the interrelation of such principles as the sovereign equality of States, the duty of States to co-operate with one another in accordance with the Charter of the United Nations, equal rights and self-determination of peoples, non-discrimination and reciprocity.

19. Technically the most-favoured-nation clause is a *renvoi* to another treaty, whereas the national treatment

clause is a *renvoi* to municipal law.<sup>24</sup> Georges Scelle analysed the clause as follows:

*La clause de la nation la plus favorisée . . . est un procédé de communication automatique du régime réglementaire de traités particuliers à des sujets de droit d'Etats non signataires . . . les nouveaux traités . . . jouent . . . le rôle d'actes-condition, cependant que la clause elle-même s'analyse en un acte-règle liant . . . la compétence des gouvernements signataires . . .*

*La clause agit donc tout ensemble comme une prévention de l'exclusivisme des traités, comme une extension automatique d'un ordre juridique nouveau, et spécialisé, et, en définitive, comme un facteur d'unification du droit des gens.*<sup>25</sup>

### IX. Form of the clause

20. The most-favoured-nation clause is part of a treaty as this term is defined in article 2.1 (a) of the 1966 draft articles on the law of treaties. By definition the clause as such cannot be part of an international agreement not concluded in written form. This does not preclude the possibility of granting the most-favoured-nation treatment orally or by tacit agreement. States may also grant such treatment by autonomous action.

21. The treaty embodying the clause must be concluded between States; it may be bilateral or multilateral. The collateral agreement—that which accords the favour or preferential treatment to a third State—need not be in written form.

### X. Application of the clause to individuals

22. Although the Contracting Parties promising each other most-favoured-nation treatment are always States, the object of the treatment is not a State but its nationals, inhabitants, juristic persons, groups of individuals, ships, aircraft, products, etc. Thus the treaty embodying a most-favoured-nation clause provides for rights to be performed or enjoyed by individuals. Since the International Law Commission, when codifying the law of treaties, left aside the question of the application of treaties to individuals, it is not proposed to go into this matter in connexion with the study of the clause.<sup>26</sup>

<sup>18</sup> Alice Piot, "La clause de la nation la plus favorisée", *Revue critique de droit international privé* (Paris, 1956), XLV, p. 1.

<sup>19</sup> See the statement by Mr. Jiménez de Aréchaga summarized in paragraph 16 of the record of the 741st meeting of the Commission, *Yearbook of the International Law Commission*, 1964, vol. I, p. 114.

<sup>20</sup> Georg Erler, *Gründprobleme des internationalen Wirtschaftrechts* (Göttingen, 1956), pp. 53 and 99.

<sup>21</sup> Georg Dahm, *Völkerrecht* (Stuttgart, 1958), vol. II, p. 594.

<sup>22</sup> *Ibid.*, p. 593.

<sup>23</sup> D. M. Genkin, *Printsip naibolshevo blagopriatstvovania v torgovykh dogovorakh gosudarstv* (The most-favoured-nation principle in the commercial treaties of States), *Sovietskoe gosudarstvo i pravo* (Soviet State and Law), 1958, 9, p. 22. See also the meeting of experts called in Rome in February 1958 by the International Association of Legal Science.

<sup>24</sup> See the statement by Mr. Reuter summarized in paragraph 14 of the record of the 741st meeting of the Commission, *Yearbook of the International Law Commission*, 1964 vol. I, p. 113.

<sup>25</sup> Georges Scelle, "Règles générales du droit de la paix", *Académie de droit international, Recueil de cours*, 1933, IV, vol. 46, pp. 461 and 462.

<sup>26</sup> See the commentary to article 66 in the third report on the law of treaties by Sir Humphrey Waldock (*Yearbook of the International Law Commission*, 1964, vol. II, document A/CN.4/167 and Add.1-3, p. 45) and paragraph 33 of the report of the Commission on the work of its eighteenth session in *Yearbook of the International Law Commission*, 1966, vol. II, document A/6309/Rev.1, Part II, p. 177.

## XI. Scope of the rights arising out of the clause

23. *Scope ratione materiae.* There can be no doubt that, through the operation of a specific grant to another country, the clause can only attract, in principle, rights of the same kind or order, or belonging to the same class, as those contemplated therein. The subject matter or category of subject matters must be the same: the grant of most-favoured-nation rights relating to one subject matter or category of subject matters cannot confer a right to enjoy the treatment granted to another country in respect of a different subject matter or category of subject matters.<sup>27</sup> It is essential to bear in mind the exact scope of each particular clause for most-favoured-nation treatment can be claimed only with respect to favours *ejusdem generis* granted by the promiser to third States. One has to examine each point of the preferential treaty in order to ascertain whether the beneficiary or the third State is more favoured. The comparison cannot take place *in globo*, which would have no sense, but point by point, in detail. If the new arrangement deals with tariffs, the duties paid by the beneficiary and by the third State have to be examined rubric by rubric, position by position.

24. *Scope ratione personae.* The rules of diplomatic protection apply (nationality, nationality of companies, double nationality, etc.). The question arises, however, whether this matter should be dealt with in the report in view of the observations in paragraph 22 above.

25. *Territorial scope.* The rule of article 25 of the International Law Commission draft on the law of treaties applies.

26. *Scope ratione temporis.* In cases where it is not otherwise expressly provided (e.g. clause *pro futuro*), the presumption militates for a general unconditional most-favoured-nation treatment.<sup>28</sup> The clause begins to operate when the third State becomes entitled to claim a certain treatment whether or not it actually claims the treatment.<sup>29</sup> The clause ceases to operate when the right of the third State to a certain treatment expires.<sup>30</sup>

27. *Scope ratione originis beneficii.* The right of the beneficiary to a most-favoured-nation treatment extends to all favours granted by the conceding State to a third State independently of the fact whether the favour granted originated in a treaty, in a mere practice of reciprocity or in the operation of the internal law of the

promiser.<sup>31</sup> This right is created by the treaty embodying the most-favoured-nation clause and not by the treaty between the conceding State and the third State, which is a *res inter alios acta* for the beneficiary.<sup>32</sup> The operation of the clause extends also to preferential treatment granted by multilateral treaties. Some have objected to this view on the ground that multilateral treaties are results of reciprocal concessions and that it would, therefore, be unjust that the beneficiary of the clause should enjoy the preferences without having made concessions himself.<sup>33</sup> But this introduces the idea of the reciprocity of concessions which, while it applies to the conditional most-favoured-nation clause, is alien to its unconditional form.<sup>34</sup>

## XII. Customary and conventional exceptions to the operation of the clause

28. The following exceptions can be cited:

- (i) Customs unions;
- (ii) Frontier traffic;
- (iii) Interests of developing countries;<sup>35</sup>

<sup>31</sup> Knapp, *op. cit.*, pp. 297 and 306; McNair, *op. cit.*, p. 280; Genkin, *op. cit.*, p. 25. See also the following extract from a study dated 12 September 1936 by the Economic Committee of the League of Nations:

"Broadly it may be said that the clause . . . implies a right to claim immediately, as of right . . . all reductions of duties and charges . . . accorded to the nation most favoured in customs matters, whether such reductions . . . result from autonomous action or from conventions concluded with third countries." (League of Nations, document 1936.II.B.9, p. 10).

<sup>32</sup> *Anglo-Iranian Oil Co. Case (jurisdiction), Judgment of 22 July 1952, I.C.J. Reports, 1952, p. 109*; Hildebrando Accioly, *Traité de droit international public* (Paris, 1941), tome II, p. 479; Marcel Sibert, *Traité de droit international public* (Paris, 1951), tome II, p. 255. For the opposite view see: Dissenting opinion of Judge Hackworth, *I.C.J. Reports 1952, p. 141*; L. Oppenheim, *International Law*, vol. I, 8th edition by H. Lauterpacht (London, 1955), para. 522; Paul Fauchille, *Traité de droit international* (Paris, 1926), tome I, 3<sup>e</sup> partie, p. 359.

<sup>33</sup> Scelle, *op. cit.*, p. 463.

<sup>34</sup> Knapp, *op. cit.*, pp. 306 and 307.

<sup>35</sup> ". . . New preferential concessions, both tariff and non-tariff, should be made to developing countries as a whole and such preferences should not be extended to developed countries. Developing countries need not extend to developed countries preferential treatment in operation amongst them." (General Principle Eight, adopted by the United Nations Conference on Trade and Development, see *Proceedings of the United Nations Conference on Trade and Development*, vol. I, *Final Act and Report*, p. 20.

. . . The traditional most-favoured-nation principle is designed to establish equality of treatment . . . but it does not take account of the fact that there are in the world inequalities in economic structure and levels of development; to treat equally countries that are economically unequal, constitutes equality of treatment only from a formal point of view but amounts actually to inequality of treatment." Hence the necessity of granting preferences in favour of developing countries (see report by the Secretariat of the United Nations Conference on Trade and Development, entitled: "A system of preferences for exports of manufactures and semi-manufactures from developing to developed countries", *Proceedings of the United Nations Conference on Trade and Development, Second Session*, vol. III, *Problems and policies of trade in manufactures and semi-manufactures*, document TD/12/Supp.1, document TD/B/C.2/AC.1/7, p. 11, para. 9.

<sup>27</sup> Sir Gerald Fitzmaurice, "The law and procedure of the International Court of Justice, 1951-1954, miscellaneous points of substantive law", Part II, *The British Yearbook of International Law, 1955-1956, XXXII* (London, 1957), p. 84.

<sup>28</sup> Schwarzenberger, *op. cit.*, p. 108; Blaise Knapp, *Le système préférentiel et les Etats tiers* (Genève, 1959), p. 287.

<sup>29</sup> McNair, *op. cit.*, pp. 278-280; Knapp, *op. cit.*, p. 298.

<sup>30</sup> Proposal submitted by Mr. Jiménez de Aréchaga; see *Yearbook of the International Law Commission, 1964*, vol. I, 752nd meeting, para. 1; *Case concerning rights of nationals of the United States in Morocco. Judgment of 27 August 1952, I.C.J. Reports 1952*, pp. 191-192; Genkin, *op. cit.*, p. 25. It should be noted that the situation is different in the GATT system (see articles III and XXVIII of the General Agreement on Tariffs and Trade, United Nations, *Treaty Series*, vol. 55, pp. 204, 206, 208, 276 and 278).

- (iv) Interests of public policy and security of the contracting parties;<sup>36</sup>
- (v) Other exceptions.<sup>37</sup>

### XIII. Exceptions resulting from treaties

29. Article XXV of the General Treaty on Central American Economic Integration, signed at Managua on 13 December 1960,<sup>38</sup> provides that:

The Signatory States . . . agree . . . to maintain the "Central American exception clause" in any trade agreements they may conclude on the basis of most-favoured-nation treatment with countries other than the Contracting Parties.

30. Paragraph 1 of article 10 of the Convention on Transit Trade of Land Locked States, signed in New

<sup>36</sup> Articles XX and XXI of the General Agreement on Tariffs and Trade, United Nations, *Treaty Series*, vol. 55, pp. 262, 264 and 266.

<sup>37</sup> Paul Guggenheim, *Traité de droit international public*, vol. I, p. 104.

<sup>38</sup> United Nations, *Treaty Series*, vol. 455, p. 90.

York on 8 July 1965, contains the following provision:

1. The Contracting States agree that the facilities and special rights accorded by this Convention to land-locked States in view of their special geographical position are excluded from the operation of the most-favoured-nation clause . . .<sup>39</sup>

### XIV. Violations of the clause

31. Mention should be made in this connexion of indirect discrimination<sup>40</sup> and of the adoption of unduly specialized tariffs. A classical example of the latter is provided by the Additional Commercial Treaty of 1904 between Germany and Switzerland.<sup>41</sup> By this treaty, Germany conceded to Switzerland a reduced tariff for heifer calves "reared at 300 metres above sea level" with "at least one month of grazing at at least 800 metres above sea level". No such calves could be produced by the Netherlands and other most-favoured-nations.

<sup>39</sup> United Nations, *Treaty Series*, vol. 597, p. 54.

<sup>40</sup> McNair, *op. cit.*, p. 299.

<sup>41</sup> *Recueil officiel des lois et ordonnances de la Confédération suisse* (Berne, 1906), tome XXI, Annex A, p. 428.