DALHUISEN ON TRANSNATIONAL AND COMPARATIVE COMMERCIAL, FINANCIAL AND TRADE LAW

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J H Dalhuisen

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Dalhuisen on Transnational and Comparative Commercial, Financial and Trade Law

Jan H. Dalhuisen Dr. Jur. (Amsterdam), LL.M (UC, Berkeley), FCI Arb (London), Corresponding Member, Royal Netherlands Academy of Arts and Sciences

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Preface to the Third Edition

In this new Edition there are a number of important changes. First, to reflect better the content of the book, the title has been amended to *Transnational and Comparative Commercial, Financial and Trade Law*. Second, chapter 6 has been further up-dated to allow for the completion and implementation of the 1998 EU Action Plan aiming at a Single European Market for Financial Services and for the new BIS capital adequacy regime for banks, now commonly referred to as Basel II. Finally, there are important changes in chapters 4 and 5 which are concerned with the law of chattels and intangibles (especially receivables), and in chapter 5 more in particular with their use in modern finance, often at the international level.

In common law countries personal property has traditionally been neglected largely because of its often modest value and transient nature. The former was never true for documents of title and negotiable instruments, and is no longer true for finished and semi-finished products in manufacturing or for receivables. The latter was never true in respect of investment securities or when replacement assets were included. In civil law, the problem is rather a lack of flexibility in an overly intellectual system. I have been at last able to formulate a broader perspective in respect of this type of property, its use in modern financial products and the resulting bankruptcy resistency (in the event of an insolvency of the counter-party). Proprietary structuring becomes here a risk management tool.

In this connection, it is hardly a new insight that bankruptcy resistency is fundamentally a proprietary issue but this bears repetition, especially since bankruptcy is not universally taught and is often treated as a specialised subject. New financing techniques offer new insights and we must now consider what in a modern system of moveable property the root of proprietary protection truly is in order better to understand its nature as a risk management tool and to prepare the ground for a new law merchant concerning these assets and the proprietary structures developed therein in international finance, much as originally happened in respect of negotiable instruments and documents of title and their use internationally.

Modern property law in respect of chattels and intangible assets on the one hand has to contend with the haphazard way in which, especially in common law, it was assembled historically, where it still depends 'at law' on a narrow physical and anthropomorphic notion of possession in bailment, the remnant of the old seisin. A more abstract notion of ownership which also has some place for property rights and their functioning in respect of receivables, could only develop in equity, therefore in a remedial and more incidental way. Yet this now allows in essence for the recognition of the proprietary nature of all user, enjoyment and income rights in movable property at least if operating in the context of trusts, floating charges, and conditional or finance sales. This allows in turn for an important degree of party autonomy and hence for substantial flexibility in financial structuring.

Equitable proprietary facilities may be virtually unlimited in type and number, but the key is that all of them are cut off at the level of the *bona fide* purchaser or collecting assignee for value or now sometimes even at the level of the purchaser (and perhaps even collecting assignee) in the ordinary course of business, at least for commoditised products. It may thus be seen that, whatever the proprietary rights in them or whatever they may become, commercial flows of any kind are protected against adverse claims of third parties who did not know of these interests when acquiring the property. This is a practical necessity but it also demonstrates a most important insight in common law (equity), even if usually not so broadly analysed while the principle is still developing.

Civil law does not possess a similar escape and remains severely handicapped in its traditional approach to property law, especially in moveable property, as is seen in modern international commerce and finance. Traditionally civil law adheres to the *numerus clausus* or a closed system of proprietary rights and of the ways in which they can be created, transferred and defended. This restrictive approach is joined by widespread confusion on the asset status of claims while in most civil law countries there is also a narrow concept of assets in terms of their identification, leading to particular problems for transfers or assignments in bulk and for the disposition of future or replacement assets. This constrains proper risk management and therefore increases risk for no apparent reason except systematic considerations and tradition. The acceptance of an ever broadening concept of set-off through netting agreements creating no less bankruptcy resistency proved easier in civil law, but it is a more defensive facility and only part of the answer.

The common law approach (in equity) makes for a form of 'privatisation' in proprietary matters that may offer better perspectives and in any event greater flexibility subject to a strong protection of commercial flows. It takes a less dogmatic approach. Even though in modern civil law some creeping 'privatization' or 'contractualisation' is noted in the law of property, it is not easy to accommodate and notions of *bona fide* protection here remain underdeveloped, especially in respect of assignees of receivables.

The essence appears to be that one either has a substantially open proprietary system with strong protection of the flows of goods, services, capital and now possibly also knowledge and technology, or one has a closed system. In view of its greater flexibility and better risk management potential, this book opts for the first approach notwithstanding some recent American research supporting the civil law's closed system of proprietary rights on perceived efficiency grounds connected with the concept of standardization, but it would appear to result in an unnecessary limitation of choice and increase of risk.

Here some approximation is necessary between the various legal systems, also in terms of the related areas of tracing, agency, assignments and restitution, where civil law lacked the crucial intervention of the chancery courts in equity. It was noted before that traditionally we see here the greatest substantive differences between the civil and common law. But it is not true that mere acceptance of the common law approach in these areas would be sufficient. In common law countries it is also necessary for the law of equity to resume its earlier mode of reform and for it to become more coherent.

At the transnational level, the result would be an integrated system in which the proprietary status of user, enjoyment and income rights in movable assets would be liberally accepted and trusts, floating charges and finance sales (like leases, repos, and factoring of receivables) would freely operate subject to the protection of the *bona fide* purchasers (for value) or purchasers in the ordinary course of business of commoditised assets, in which connection the law of assignment would also be fundamentally re-thought and receivables treated more in the nature of negotiable instruments largely independent therefore from the legal relationships out of which they arise - an early achievement of the law merchant for these instruments.

An important test of sophistication in this area is ultimately a successful reformulation and application of the applicable bankruptcy laws. Here we need another insight, which is that bankruptcy never was about equality of creditors (or the *paritas creditorum*) as an immutable bottom line - still an all too common misunderstanding - but it was always about *equitable* distribution which means ranking, itself a dynamic concept. In practice, newer proprietary rights and no less expanding set-off and netting facilities fundamentally affect and change it all the time, all in turn further affected by modern reorganization statutes in insolvency.

It is in any event a mistake to think that newer financial products and their in-built bankruptcy protection usually come about at the expense of the common creditors. Statistically the latter (of whom banks and professional suppliers are normally the largest) never received much and the introduction of newer financial products is therefore normally a question of the reshuffling of interests amongst professionals, in a proper system subject always to the protection of commercial flows. In this connection, notions of protection of *bona fide* common creditors in terms of reliance on apparent, ostensible or reputed ownership of assets in their debtor have long been in decline and in movable property, appearances or even publication do not or no longer distract from the rights of *bona fide* purchasers of the assets – which, as just mentioned, may increasingly include those acquiring merely user, enjoyment or income rights in trusts, floating charges, finances sales or otherwise, - not even under the filing system of Article 9 UCC in the US unless in respect of junior lienees, who again, are largely professional creditors operating amongst themselves.

Short of an overarching new concept of property as here proposed, at least in finance supported by modern bankruptcy law (subject to reorganization laws and their adjustment facilities), the result is likely to be a products' approach. In such an approach, proprietary status, protection and transfer (and its formalities) may work out quite differently according to product. This is clear even now in the Uniform Commercial Code in the US: in Article 2 on the sale of goods, Article 2A on equipment leases, Article 4A on payment transfers, Article 8 on security entitlements, and Article 9 on secured transactions. Except in Article 2, the UCC is mostly concerned with professional dealings. A similar pragmatic attitude may be spotted in Europe in the new French *Code Monetaire and Financier* (CMF of 2000) and in the recent 2006 amendments of the French law concerning secured transactions in Book IV of the *Code Civil.* At the same time, in many civil law countries new rules covering the holding of investment securities entitlements in depository systems and, in the EU, the Collateral Directive (in the limited area it covers) have infused civil law which much equity thinking, itself creating the need for a more fundamental re-consideration of the proprietary notions of civil law.

Personally, I believe that we can live quite easily with a more abstract and fractured system of proprietary rights and with this reshuffling of interests amongst professionals provided always that commercial flows are protected. This development is unavoidable and reflects present day realities, but the perception has not yet entered the mainstream of legal thinking and practice in Europe and is not properly taught. In short, it is a development that is in need of much more attention and clarification, certainly at the academic level. I have attempted in this new edition to deal with these issues more extensively and hopefully more coherently.

Naturally this approach raises all kind of fears of uncertainty, rational or irrational. *Finality* is clearly a key issue and the ways in which it can and must be enhanced especially in the transfer and use of commoditised movable property including investment securities, in payments, and for risk transfers in derivatives, is an important related area of study in this book. The conclusion is that transnationalisation of the law 'presents important opportunities to prevent disarray through a better protection of flows based not only on stronger and expanded *bona fide* purchaser protection, but also on abstract notions of

property transfers that, once achieved, are not to be undermined by defects in the underlying steps leading up to them, and notions of reliance in the sense that assets that were due to be delivered may be kept by the transferee no matter legal sophistry concerning insufficient disposition rights and transfer defects in respect of the title. Thus transnationalisation should not be feared in these areas (or any other) but rather welcomed whilst the analogy with the earlier law merchant concerning negotiable instruments and their operation is also apparent in this connection.

From the beginning I have argued for and accepted a dynamic concept of the law, certainly in business, even in proprietary matters. It is my view and experience that professionals can live with dynamism reflecting the reality of practical need much better than with legal certainties that confine them to atavistic parochial legal systems and perceptions, thus holding them back. In this connection it was posited all along that legal certainty especially of a domestic nature can be of such a low quality that it becomes a substantial hindrance to business and a particular danger to adequate and effective risk management, more in particular in international dealings for which local laws were never made.

But even domestically, the uncertainties that unavoidably arise in private law from rapid legal evolution are ultimately paired only by self-restraint in the relevant community as a whole and by its own experiences rather than by legislative action or through case law. In any event in international commercial and financial transactions, reasonable predictability and guidance can hardly be expected from domestic laws, even if, like (only) in the US, frequent adjustments of commercial law (in the UCC) – which is now in truth financial law - were common place. In Europe, even the recent French Financial Code and amendments to the *Code Civil* just mentioned show - as did earlier and more severely the new Dutch Civil Code of 1992 - the modest quality and lack of perception of domestic statutory intervention in this area. Such law is hardly suitable or likely to support any international financial activity.

Modern business unavoidably proceeds in an ever self-renewing legal framework. It is in nobody's interest that it should be otherwise, or, if it should be, it must be so for clear public policy reasons, in international transactions balanced by notions of international public order or subjected to accepted transnational minimum standards, important issues much considered in the text since the Second Edition. Developments over the last 25 years have made it abundantly clear that the law, at least in the professional sphere, no longer works in any other way. Ever changing practices, custom and general legal principle have pervaded the application of all business law, expressed in more general and objective notions of good faith in contract law (and discussed extensively elsewhere in this book), and now increasingly also in new proprietary notions in the law of moveable property, especially reinforced in international finance at the transnational level. That may be or become more obvious amongst international arbitrators, but even in domestic courts it is ever clearer that the older often anthropomorphic attitudes to contract and property are increasingly difficult to place and have no real future in modern business and finance.

If we accept that law is there to provide some structure to improve daily life including its business variant, prevent problems and avoid or contain chaos–and certainly not to add to it–it is necessary to constantly develop and articulate new intellectual frameworks or models that relate, in property law as much as anywhere, to better, newer realities and needs so as to allow participants to move forward while re-establishing predictable outcomes at a more advanced and often more abstract level. This involves a dynamic ongoing process of law formation, not the straightjacket of statist systems fixed in time or place. It means that a more universal rationality must be found not merely in the law as it was but more in particular in its constant change. In the law of movable property it means in my view advancing on the basis of a new conceptual approach of the kind briefly explained above.

In terms of articulation and spokesman functions, short of the operation of a new international commercial court (for which a strong plea was made in the Second Edition) in international commerce and finance these now appear to be the tasks not of domestic legislators or even courts but of international arbitrators and academics. Conceptual innovation is the only true attribute of academics and the prime reason for their existence. The law as it was can be described just as well, if not better, by practitioners who have greater resources and more experience in its application.

From an academic perspective, we should thus concentrate on defining what in respect of the new financial structures the key modern legal requirements and elements are, rather than try to elaborate in UNCITRAL, UNIDROIT or elsewhere, even in the EU, entire legislative systems. That is premature and it may be considered that the ICC always did here a better job in terms of practical support. Nothing more than conceptualizing is needed. Any other approach is likely to be over ambitious and all that it sets in concrete is likely to be inflexible and incapable of regular adjustment through amendment. Sets of Principles are enough and should remain principles, no more.

If in international professional dealings the view of the law as a dynamic concept - closely related to commercial and financial structuring and its inherent reliance on party autonomy, embedded as it then is in the inner balance and self-restraint of a business community that sees the finality of its dealings and the protection of its flows confirmed - may become better understood and find greater acceptance, much of the present day frustration with this part (as well as many other parts) of the law is likely to disappear. For international transactions, this frustration is related to the increasing unpredictability of result under our present domestic legal models and perceptions, the often wishful and aberrant intervention of the legislator even in private law amongst professionals, the unavoidably erratic behaviour in many lower courts, and the confusion in the higher courts where there is often too little knowledge or understanding of and interest in modern international business practices and needs, and much misconception of what public policy requires in terms of supervision and limitation.

There has, however, never been an easy method or methodology with which to pierce the fog. Much of this will sound familiar to those aware of von Savigny's views on legal sources and methods in his time of equally dramatic change. He meant to find them in the perceptions and practices of national communities (even if ultimately they were more readily found in an analysis of classical Roman law). Similarly in international business, the new law must now be found in the perceptions, practices, rationalities and utilities of the international community. This is more reminiscent of the approach of Grotius.

It follows that in international business transactions, more sophisticated transnational notions of private law must be considered increasingly to prevail over the traditional private international law or conflict of laws approaches which all too likely point to irrelevant or worn-out domestic concepts in international business transactions. The hierarchy of substantive norms that applies here was explored in the earlier Editions and was considered the essence of the modern law merchant or *lex mercatoria*. This remains the main pillar of the approach of this book. It accepts nevertheless local law as the residual rule, making therefore for a complete legal system, but transnationalisation of private law along these lines whilst giving precedence to transnational custom, practices and general principle presents a new substantive approach and makes the finding and formulation of the applicable substantive private law in international transactions similar to the approach we more traditionally find in public international law.

I have said before that this book describes the way I have learnt that commercial and financial law works from the perspective of the international lawyer, banker, regulator, and arbitrator at the level I have been privileged to see and practice it. It presents an approach that I believe makes it possible not only to comprehend better what is going on, but, as

legislator or regulator, judge, arbitrator, or transaction lawyer also to understand more fully the direction in which we are heading and to help steer new developments. I have a feeling that in this Edition I have pushed it as far as I can.

At the end of this second revision, I would like to thank Lord Bingham of Cornhill KG, Senior Law Lord, Sir Konrad Schiemann at the European Court of Justice, Professor Robert Post at Yale, Professor Sir Roy Goode at Oxford, Professor Guenther Teubner in Frankfurt, Professors Robin Morse and Anthony Guest QC at King's College London, Professor Sarah Worthington at LSE, and Professor Mads Andenas, now in Leicester, for their continued interest in my work. As always I thank my teacher and mentor of more than 40 years, Professor Herman Schoordijk of Amsterdam and Tilburg, now well into his 80th year and my present and former PhD students Dr. Lodewijk van Setten LLM, now Managing Director of Morgan Stanley and Visiting Professor at King's College and Dr. Ondrej Petr LLM now at the International Capital Markets Association (ICMA), also Visiting at King's. I would also like to mention Professors Martin Hunter and Johnny Veeder QC and Mr. Toby Landau also Visiting at King's College and Dr. Michael Schillig LLM and Mr. Mihael Jeklic LLM, equally at King's College London. In particular I must thank my colleagues at Boalt Hall, UC Berkeley, for allowing me for the last nine winters the benefit of their environment of intellectual freedom and academic investigation. Many had to endure the role of sounding board. All had the wit to survive, ostensibly unharmed. I am most grateful.

UC Berkeley, Winter 2007

Preface to the Second Edition

It is pleasing that so soon after the first edition a second edition of this book became necessary. I have taken the opportunity to introduce a number of clarifications, remove unnecessary duplication (although I have not hesitated to repeat where cross-referencing seemed less opportune), and correct some mistakes. Teaching experience in the graduate programs in which this book is mostly used suggested further that some parts of Chapters I, III and VI be rewritten. In respect of Chapter VI, that became necessary also because of the many new EU Directives in the financial area as part of the EU Action Program aiming at a Single European Market for Financial Services and the looming impact of the Basel II Accord on the capital adequacy requirements for banks. The part on book-entry systems for investment securities in Chapter IV was also revisited. Important changes were also required because of the new texts of Articles 1 and 9 UCC in the USA, the revised Commercial Code and the new Financial Code in France, the amendments to the German Civil Code (BGB) in the area of contract law, the completion of the Mobile Equipment Convention of Unidroit and the Receivable Finance Convention of Uncitral, and the entering into force of the EU Collateral Directive.

I am well aware that a book of this nature is a work in progress that can never be finished. The best that can be expected is to give interested readers, practitioners, academics and students up-to-date information and insights that may contribute to their better understanding of the forces that now shape international commercial and financial law and of the positive law that so emerges. The emphasis on finance derives here from the fact that it has become the modern motor of commercial law replacing to some considerable extent the more traditional sale of goods and trade or mercantile impetus. The main aim of the book remains the contribution to a more informed debate on the impact of these forces and the development of a view concerning the applicable law that results from them. This law is not here viewed as static but as a forward moving set of internationalized principles and rules that is largely articulated by participants themselves and draws widely from their practical needs, established ways of dealing, and best practices. It is submitted that only in this more *functional* manner the law in this area will be able to retain the necessary relevance in the distribution of risks and tasks between participants and in the solution of their disputes either in the ordinary courts or ever more often through international commercial arbitrations or other forms of ADR that are forced increasingly to ignore a more formal and purely domestic concept of law. In this connection it should not be forgotten that the law only provides one way of solving or avoiding disputes and can only effectively continue to do so if it remains convincing in its responses at the level of practicalities.

By attempting to understand and deal with this in essence dynamic nature of the law as it develops in the commercial and financial area at the international level, there results quite naturally a strong reconfirmation of party autonomy, its reach and evolution into practices, even in areas not traditionally at the free disposition of the parties (like in property law). Another important aspect is to determine in how far this law must continue to respect and support domestic policies in international situations. In the absence of a uniquely competent legislator in this international area, there naturally follows a questioning attitude to any written law in this field especially where it interferes with party autonomy in a mandatory fashion. Another issue is here how domestic legislation should be drafted to best achieve any remaining support function, what its content should be, and how it should be applied and interpreted in international cases, but more in particular also how written uniform law

should be conceptualized (in terms of restatements or treaty law) and what its true weight in international transactions is. By promoting greater awareness of issues like these, it is hoped that this book may be of some use also to those who are still engaged in drafting domestic commercial and financial legislation but are becoming increasingly aware of the international dimensions of modern commerce and finance and of the changing and more confined role of domestic legislation in it. Greater awareness of the process of internationalization and its effects on private law in this manner might also help in the drafting of harmonising EU law in the commercial and financial field.

In practice, as far as the reach of party autonomy is concerned, the emphasis is increasingly on legal structuring that avoids the risk of having inappropriate or atavistic domestic laws or remote regulatory systems applied. As far as any written law is concerned, much will have to be in the form of compilations of principles and practices, rather in the manner of restatements that will be regularly updated and adjusted by those most directly involved and affected. That suggests the style the ICC has been adopting with great effect (but only in limited areas like Incoterms and UCP) for many years. It is also the style of the American Law Institute in the Restatements and its preparatory work (together with the NCUSL) in the updating of the UCC.

The essence is here not only the abandonment of nineteenth century concepts of contract and property law that are anthropomorphic (therefore centered on physical persons and their relationships and dealings amongst themselves) that often led to closed systems of rights but also of any prescriptive approach in more modern times particularly associated with consumer protection needs particularly in contract law and its spill-over effect into the professional sphere. As an important key factor in this approach is the acceptance of a progressive and continuous reformulation of the law on the basis of justified practical needs that change all the time, established legal rules and principles are believed to operate in this depersonalized approach foremost as *guidance* and not as absolutes even if they might sometimes be more objective and compelling, *e.g.* in the area op proprietary laws. Barring overarching fundamental legal principles, including those aimed at the avoidance of fraud and other forms of manipulation and anti-competitive behaviour, and barring also relevant public policy limitations (emanating from states that may be justly deemed concerned in the particular international case), it seems to me that there are here in dealings amongst professionals few fundamental obstacles in terms of preordained balances of interests, abstract standards of behaviour, permanencies of legal systems, or the application of national laws.

In my view, the foremost task of academia in this area is to help adjust our traditional legal perceptions so as to respond to the new internationalised environment, its dynamics and needs, whilst indicating at the same time when, why and to what extent practical considerations of this nature may sometimes become exhausted. In commercial and financial law, such academic endeavour should thus hasten the adjustment of our more traditional notions of contract, property and tort in order better to capture modern realities. In international commerce and finance, it implies finding or redefining legal concepts that may now transcend national borders and that may serve as yardsticks against which the positive law of a national or transnational type can be independently tested for its strengths and weaknesses. Any real success of academia in re-defining the basic legal structures (especially in contract and property) in the light of these modern needs in a less time and place determined manner could be of great help. To (re)define these legal structures, legal history and comparative law may help, but the key is to find ones that can deal with present day realities and dynamics and articulate them into law.

Thus in contract, the old model of offer and acceptance, of consensus and bargain may be superseded by more modern notions of partnership in which we must distinguish between the pre-contractual, contractual or post-contractual phases, define the parties rights and

duties in each of them, and accept evolving forms of dependency. It may impose objective standards of behaviour that then transcend the will of the parties, but may still work out differently for professionals as compared to others. Thus once a relationship is entered, the future behaviour of the parties may no longer be considered merely a question of the original choice as everyone entering any type of relationship will know. Certainly in complex business dealings, reference to the parties' original intent becomes here a nebulous concept. Justified reliance and, where appropriate, duties of care are likely to take its place. They can only be articulated on the basis of what the reasonable expectations between participants are in their various business environments, in international commerce and finance therefore between well-informed professionals. They may on the other hand not need or expect much protection beyond what they have expressly negotiated and set as the applicable behavioral standard amongst themselves. In civil law, notions of good faith in contract may underline and support this new approach already in many domestic laws.

In property law, especially regarding chattels and intangibles, the traditional (civil law) approach based on one integrated closed system of proprietary rights may no longer suffice either. To deal with the convulsions in the traditional domestic laws of property when becoming inadequate or even dysfunctional, e.g. to support the new financial structures that international business requires, more flexibility is needed and a more fractured set-up much more akin that of equity (in common law terms) may become the better model. That set-up is in essence open, subject to a better protection of *bona fide* purchasers. It concerns here especially the operation of floating charges, constructive trust and tracing notions, trusts, conditional and temporary ownership rights in repos and finance leases, assignments without notification, set-off and netting facilities, and the proprietary aspects of agency, all areas where civil law has had greater problems to come to terms with modern life than common law (in its equity variant). New models, proto- or ideal types should thus enter the national and transnational commercial and financial law. They are likely to be the result of judicial reinterpretation or re-characterisation in the light of a greater role for party autonomy even in property matters and of a much broader acceptance of new practices or customs also in this area. In commerce and finance, these are now likely to be internationalized and to become embedded in the modern *lex mercatoria*.

In this vein, I have tried to develop a number of themes that were perhaps less obvious in the first edition. First, as a general proposition and on a more philosophical note, I do not believe that in the law's application it is entirely possible to separate the law that 'is' from the law that 'ought to be' and it may not even be desirable. The American 'realist' or more functional approaches in 'law and economics', 'law and sociology', and 'law and ethics' confirm this and more attention is therefore paid to them in this edition. This separation can in any event not easily be achieved when newer fact situations and practices present themselves all the time. To repeat, law in order to remain living and relevant must move with society serving its justified needs as best it can whilst promoting at least in our Western culture the ongoing objective of achieving order in a more just, peaceful and efficient manner. In a changing world, it can in its formulation and application not be static or depend for its adjustment solely on legislators or domestic precedent, certainly not in an international setting even if it must be hoped that its basic values are more permanent and universal. It follows that the positive law (except where it remains absolutely settled) cannot always present a set of preconceived solutions, certainly not where it must now also deal with internationalization or globalization issues and from there with its own trans-nationalisation.

Whilst noting this, it should be acknowledged that the European legal culture of today, both on the European Continent and in England, remains largely positivist, formal and also nationalistic, at least in private law. It also remains perceived as essentially static, even in an EU context which would appear to require a much more outward looking perspective and a

willingness to transform. It would seem that the more unstable the private law by its very nature becomes in an uncertain and transforming world, the more there is (at least in Europe) a longing for certainty which is often expected still to result from a mathematical application of existing black letter law from domestic legal systems that are supposed to supply a solution for all eventualities, even in international cases. In this attitude, novelty is not considered a supreme evolutionary challenge but a disrupting factor.

In modern international commerce and finance, the desire for certainty has an obvious, more practical, root in a need for predictability in the division of tasks and the proper management of risk, but it can no longer be expected from a simple reliance on fixed domestic rules or tradition. These may in fact become a major distorting and thereby destabilizing force themselves around which parties must try to manage their risk and structure their deals often by opting for other more neutral and flexible laws to the extent they can do so, which could include an option for the *lex mercatoria*, although the room for manoeuvre will be limited, particularly in proprietary and public policy issues as already mentioned.

This is all far removed from the more *realist* or functional attitude since long adopted in the USA which lives in constant search for a better law and accepts and has learnt to live with the unavoidable uncertainties whilst trying to limit and manage them with a much more incidental but also more modern approach. This is so even in proprietary law where equitable principles are developed further. That is reflected in the proprietary paragraphs of Articles 2 (sale of goods), 2A (finance leases), 4A (electronic payments), 8 (security entitlements) and 9 (secured transactions) UCC. Naturally, given the unavoidable complications, especially in the last four Articles, there is here increasingly emphasis on dealings and proprietary relationships between professionals only.

Even if, in order to retain its credibility, the law develops cautiously, develop it must and that development is now often fast in all its aspects, in Europe no less than elsewhere, all the more so in commerce and finance. Whatever the root cause is, it is for the modern academic to spot the needs, articulate the trends, help formulate answers and define the legal structures to assist both the judicial and legislative functions in this process. I find it fascinating and of the greatest practical and intellectual interest to try to do so for private law now that it so clearly stands at the beginning of an new era of legal development leading to its trans-nationalisation in its response to the fundamental internationalization or globalisation of all commerce and finance in the professional sphere.

One must thus accept that domestic legal systems and tradition no longer hold the key to the future development especially of commercial and financial law. They can no longer provide certainty that also guarantees adequate quality. A better understanding of risk and the way it can be handled and must be shared is more likely to do so. This is far removed from nationalism or statist laws. It is the international business community *itself* that through its reliance, restraint and practices holds this world together, therefore no longer in the first instance domestic laws whatever their pretence. It follows that in international business, certainty must come foremost from the behavioural patterns of the participants themselves, their own discipline, and from the way they habitually handle risk, including the risk of a lesser reliance on domestic laws if proving wholly inappropriate or inadequate. It cannot or no longer come from mere intellectualization or abstract schemes resulting in more or less logical systems of law.

It follows that in identifying the new law, I am not necessarily looking for a common core in domestic laws. I also believe it largely a mistake to dwell here much on (domestic) cultural patterns and divides. In any event, it is an established fact that in most countries many of the basic structures of private law were, at least in contract and property, always borrowed from other legal cultures, be they Roman or Byzantine for much of civil law, and Anglo-Saxon (therefore germanic) or feudal (therefore frankish) for much of the common

law. But just as relevant is that these domestic laws of whatever origin were mostly recast by nineteenth century analysis and thinking which could not have a sufficient perspective nor realistic claim on future legal needs and developments. This is only to re-emphasise that the past or even what is done at present in various countries only proves of limited help and guidance for the future and that the present commercial and financial law structures must be constantly revisited, tested for their validity and effectiveness on the basis of ever and often rapidly evolving practicalities and needs, now more and more in an international context, and adjusted accordingly.

In this connection, I am also convinced that attempts at gathering the principles e.g. of modern contract law in the manner of the Unidroit Principles of International Commercial Contracts and of the Principles of European Contract Law have often been misguided. First, they are largely driven by a consumer ethos in an old- fashioned psychological and anthropomorphic notion of contract law and the protections it must bring. Second, they have no clear concept of what modern commerce and finance is, of what it needs legally to advance, and of how the law deals with dynamism. They were never demanded by practitioners and appear to be driven by a misguided paternalism. The EU seems nevertheless determined to continue on this course. It is to be appreciated in this connection that a codification of this type is now only considered as an alternative for parties to opt into. It is as such unlikely to make much of an impact. For it to be of any real value, there would appear to be a need for an entirely different mindset. That would be no less needed for any similar compilations of proprietary laws.[1] A practitioners' approach would be necessary in which intellectualization would be the end, not the beginning of the process.

This is the way of the modern *lex mercatoria*, whose development as the modern transnational law of commerce and finance in this dynamic sense is here perceived as a matter of the autonomous development of *private* law within the international commercial and financial legal order. How this *lex mercatoria* and its development is to be known and articulated was largely the topic of the first edition, although the notion of legal orders itself receives further attention in this one.

In preparing the second edition, another more particular concern has been the already referred to evolution of state intervention in private law and the determination of the proper place and legal status of domestic *public* policies or governmental interests in international commerce and finance. The true issue here is to what extent these domestic public policies or interests remain relevant in the internationalisation of the commercial and financial flows and must be accepted and prevail over the *lex mercatoria* in civil litigation wherever initiated or in international commercial arbitrations. It could also be cast in terms of how the conflicts between the international commercial and financial legal order on the one hand and domestic legal orders on the other is to be resolved where governmental interests are involved.

There is no single or simple answer to this conundrum. Party autonomy cannot be the entire solution, as indeed it is not in policy issues that arise in international commercial and financial order itself. That might to some extent even be the case with the international contractual or proprietary structures that are developed therein as just mentioned. As far as domestic public policies are concerned, obviously, the importance of the issues to be resolved relates for the relevant domestic authorities foremost to any conduct and resulting effect on their territory and more generally to the closeness of their policies with, or remoteness from the case if arising elsewhere (e.g. in the protection of nationals against

[1] Only the Trust Law Principles so far developed appear to hold out some greater promise as may the Insolvency Principles of the World Bank and IMF.

foreign security frauds or anti-competitive abuse). It concerns here often the extraterritorial reach of mandatory domestic policies (or jurisdiction to prescribe) when rebounding at home. It poses the important question to what extent such domestic policies or preferences are internationally justified and acceptable whilst the proportionality of the application of these policies in international cases may also need to be weighed.

At least in the American approach, there is in this area some return to seventeenth and eighteenth century Dutch *comity* thinking as introduced by Story in nineteenth century America. The Restatements reflect this in Restatement (Second) of Conflict of Laws, s. 6 and Restatement (Third) of Foreign Relations, ss. 402 and 403. There is some resonance of this in Art. 7 of the EU Rome Convention on the Law Applicable to Contractual Obligations. In the USA, it fits well in the interest analysis now more generally adopted in conflicts cases. In this approach, there are no hard and fast rules and much depends on the facts and on more abstract notions of substantive justice and fairness. In view of the resulting discretionary undertones, the competency of courts and international arbitrators (in terms of arbitrability) becomes here unavoidably another matter of great importance. Again, a form of discretion in terms of a more modern contact approach or *forum non-conveniens* attitude is likely to redress excessive claims to jurisdiction.

Mutual respect between legal orders is an important issue. At least in this aspect, their cultural and sociological origin and contours may play an important role, therefore not mainly in an evolutionary sense in as far as the evolution of the positive transnational law or *lex mercatoria* is concerned but more in particular also in the approach to the legal rules of different legal orders when in potential conflict and in the question which rules then prevail. The *lex mercatoria* having been perceived in this book as essentially a hierarchy of norms must thus continue not only to acknowledge existing domestic rules of private law if no transnational solution can yet be found but must at the same time also be aware of overriding domestic public policy interests and develop a notion of legitimacy and of proper authority or jurisdiction of the own as well as of competing statist legal orders. The latter have to do the same in respect of the *lex mercatoria.*

In view of the foregoing, it may well be that an *international (commercial) court system* may be helpful in the further development and steadying of the *lex mercatoria* whilst better dealing with the discretionary elements within it and governmental interest or public policy issues encroaching on it. In some reviews of the first edition, this thought was considered far-fetched if not utopian. But it need not be and had already found important supporters. This support was originally confined to an international review court mainly in respect of international arbitral awards, but it is not too extreme also to allow interested parties in civil proceedings or international arbitrations to seek binding opinions from such a court on *lex mercatoria* issues as well as on the proper recognition of governmental policies and interests in its application.

In this connection, it is not too far-fetched either to consider domestic civil courts themselves as being international courts when deciding such issues[2] whilst in a later stage their decisions could even become appealable to such an international court. It should in this connection usefully be remembered that, at least in the EU, domestic courts sit as European courts in EU matters and must seek binding guidance from the European Court of Justice whenever issues of European law have remained unclear. It is true that where national courts sit as international courts in deciding public international law matters they do so as yet without a guidance possibility from the International Court of Justice. Nevertheless, the idea of international judicial co-operation under an international court in this manner is not unprecedented. Neither is it extraordinary.

[2] So the English Court of Appeal in *Amin Rasheed Shipping Corporation v Kuwait Insurance Company*, [1983] 1 WLR 241.

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Preface to the First Edition

This book is written for students and younger researchers or practitioners who may be interested in a more conceptual approach to some of the basic themes of international commercial, financial and trade law. It contains the expanded texts of the lectures which I have given since 1990, first at the University of Utrecht and later at King's College in London, the University of California at Berkeley (Boalt Hall), and at the Institute of International Relations (MGIMO) in Moscow. They also reflect seminars I gave at Boston College in Boston, at the Asser Institute in The Hague, and in the Pallas Program of the University of Nymwegen, as well as guest lectures in the Universities of Edinburgh and Warsaw and at the Humboldt University in Berlin. All elaborated on the ideas first set out in my Inaugural Address at Utrecht in 1991. The research was concluded per 1 May 2000.

Whatever its size may suggest, the book is no more than an introduction and comment on modern international commercial, financial and trade law and its development as I have come to understand it at first as legal practitioner, later as investment banker, regulator, international arbitrator, and academic. It sums up most of what I have learned, how I see the law in the professional sphere developing and how to apply it. By concentrating my efforts entirely on the globalisation of the law for professionals, I have tried to take similar contributions of others a step further. Perhaps at this stage, this is no more than providing some direction and mapping out and condensing the field. I hope that the result will benefit the more ambitious students and make them better aware of the modern trends and the problems with which we struggle. Much more could have been said and many more useful sources and comments could have been included, especially those in other languages. I hope that I may be forgiven for not having done so. In a book in English with this limited objective, it could hardly have been otherwise. The amount of information it contains, certainly also on civil law developments, is probably already excessive.

It is my view that the more specialised areas of the law must always be considered from the perspective of the broader legal requirements of the community the law serves and therefore be placed in the broader legal framework operating for that community. That is most certainly also true for commercial, financial and trade law. This community is here the international business community and the legal framework is here an internationalised legal framework or order. The existence of the former is hardly contested in a globalised market place, but the existence of the latter is still debated. It is clear, however, that the globalisation has led to a receding impact of local restrictions on the cross-border flows of talent, goods, services, payment and captial and has resulted in a significant form of liberalisation which is doing away also with undue limitations imposed by domestic private laws. It leaves ample room for spontaneous law formation at a trans-national level leading to a form of 'privatisation' of modern business law within a legal order of its own. It is logical and only a historical repeat that these tendencies should be clearest in commerce and finance. It makes it in my view possible and all the more necessary to revisit the core legal themes of private law themselves, now in this international or trans-nationalised environment.