What is this thing called international financial law?

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In this first of a four-part series of articles, the author explores the nature of international financial law as an academic and professional discipline. Professionals and academics have always had some mental model in their heads of what they are doing. It is sometimes useful to test that model against the reality of the market and, in so doing, perhaps develop a new model useful for professionals and academics alike.

In these times of financial turmoil, attention is mostly focused on numbers: stock index values, share prices, capital adequacy coefficients, bank accounts.

Some notice is also taken of names. Mainly bank names. Hopefully in the future not many corporate names. In the event, I suppose the consoling thought for those whose names do pop up in the headlines is that even bad publicity is still publicity; for those surviving to bask in, of course.

In any case, few doubt that on the other side of the developing scenario, there will, once again, be a land of plenty. Economies will recover and financial markets will continue to expand. The globalising march of the planet's financial systems will resume after a temporary stay in which markets regroup in the wake of a bout of what Alan Greenspan once described as "irrational exuberance". International financial law will consequently continue to be an object of study and application.

For the foreseeable future, then, both in order to help clean up the toxic fall-out from the recent exuberance, as well as to attend to normal business, lawyers will continue grappling with the perplexities of the global financial markets. The question is: with what mental and professional tools will they do this?

Having established the likelihood of an enduring future for international financial law, let me make what may appear to be an overly ambitious claim. It is my contention that international financial law is an area of modern law which can be treated as a separate discipline. It is also my contention that it represents an area of law subject to a set of rules which, taken together, are not merely the sum total of national legal rules (nor simply the sum total, for example, of the recognised rules of public international law). In my view, this specific area of law is one that possesses an underlying, unifying theme, method and approach which is identifiable as distinctive to it, though not necessarily exclusive to it.

At the same time, to be clear, I would *not* contend that it constitutes a system of law separate and independent of local systems of law. On the other hand, I *would* contend that it is the name that may be given to an sphere of law possessed of a distinctive and autonomous methodology which can be expressed as an identifiable set of rules.

For this reason I believe that it perhaps does merit being described in capital letters and that it may deserve the dignity of an acronym: "IFL" .

Let me try to convince you.

* * *

A hard-bitten veteran of legal battles waged on the international financial markets would most probably have a suitably, hard-bitten, pragmatic view of what international financial law is. Rightly so. After all, what the law is, in the heat of battle, is hardly an academic exercise, more a question of survival. Most likely, when asked what in his/her view the *relevant* law for any international financial transaction would be, the answer might be something like: the sum of all those laws which are involved in the transaction and are . . . well . . . *relevant*. *Why* they are relevant is not necessarily an urgent question requiring the intervention of high theory. You should be fine, as long as an awareness of legal detail is there. And you get it right. This last fact is all that is needed to make the professional content, and a client grateful.

But of course, any legal professional does have an underlying model in mind, which can be more or less sophisticated, more or less consciously appreciated. Before investigating this aspect (which I will do, a little further on), it might be opportune to add focus to the general discussion by referring to a practical example: a cross-border loan, a plain vanilla international financial transaction once considered cutting-edge legal technology, nowadays the type of deal younger professionals tend to cut their milk teeth on.

Consider then the following transaction: an international loan under English law between a bank incorporated and regulated in New York and a Chinese corporate borrower guaranteed by its Italian parent company.

In theory, the legal systems potentially impinging upon this situation include English law (the law of the loan contract), New York and US state or federal law (the law of the lender) Chinese law (the law of the borrower) and Italian law (the law of the guarantor). This multi-system context is typical of the cross-border context in which international finance operates. Such a situation creates a demonstrably more complicated set of legal circumstances than would be the case had the loan been made to a borrower by a bank from the same jurisdiction and was

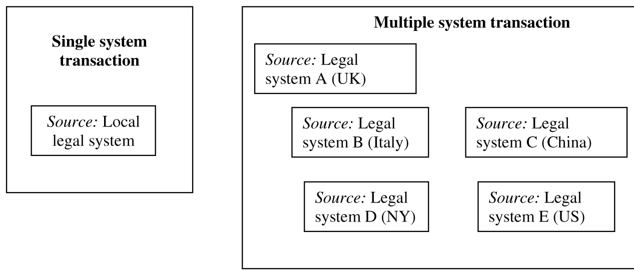

Figure 1

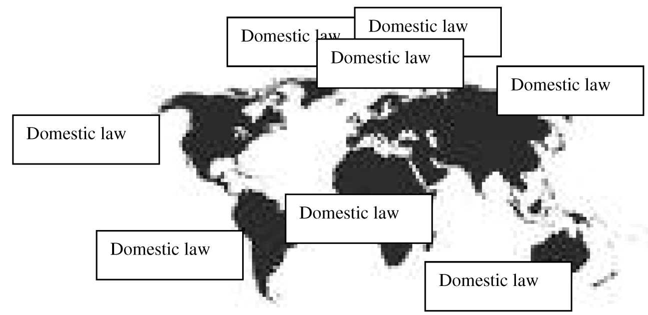

Figure 2

governed by the local law of incorporation of both. In this latter case, the source of law applicable to the case would only be one: the local municipal system.

In the cross-border situation, the legal systems potentially involved are, on the other hand, numerous and the defining sources of applicable legal rules complicated by this fact.
A simple visual mind map to portray of all this would look something like Figure 1.

The principal point here is that the relevant laws affecting the legal outcome of this particular transaction are more than one and that each legal system independently generates applicable rules and regulations; without, one might add, any discernible predominant ordering principle.

A customary way of evaluating this situation would be to tally up all the legal rules in each legal system and apply them in their proper context. So, you would apply English law rules to the contract (English law is the governing law of the contract); Italian law to determine the legality, validity and enforceability of the guarantee issued by the Italian parent; Chinese law to any issues arising with respect to the Chinese corporate borrower; New York and US law in relation to the lender's legal capacity and any regulations to which it is subject in its home jurisdiction. Tick off each item, place it in the conceptual shopping basket and pull out only as needed.

I shall call this the "shopping basket" approach.

Behind this approach there is an underlying conceptual image of the way laws cohabitate the international financial scene. According to this picture of things, Laws exist autonomously in discrete legal spaces and only occasionally bump into each other. The idea could be visually portrayed as shown in Figure 2.

For the more punctilious amongst us, our legal world view might also want to accommodate a sense of how the different domestic systems *interact* with each other. Usually this entails some reference to the traditional notions contained in a law subject taught in most university law curricula (though sometimes only as an elective) and known as "conflict of laws", or in continental legal vernacular, "private international law". In this case, the resulting mental picture might be slightly more sophisticated and look something like Figure 3.

For the really knowledgeable, or simply the more experienced, this legal *Weltanshauung* might even incorporate the legal complication created by the law of international treaties and of regional agreements. Hence, adding a couple of more mental boxes to the scheme of things, you would get the conceptual map shown in Figure 4.

This image of how the legal universe is constructed serves practical purposes well, allowing professionals to deal with legal situations in international finance more than adequately . . . for the most part. It identifies the sources of law at work which are relevant to any international financial transaction, and the workings of the markets themselves . . . for the most part.

For the most part? Well, this conceptual representation of the legal dynamics at play, while not actually wrong, may just be a little inadequate for the times. There are a number of drawbacks underlying this mental frame of reference which I shall now attempt to highlight and explain.

The first drawback with this portrayal of the legal situation inspired by a "shopping basket" approach is a practical one. A major feature of the "shopping basket" paradigm is that it relies on the lawyer knowing the characteristics of each legal system. This is considered essential, in order to

Figure 3

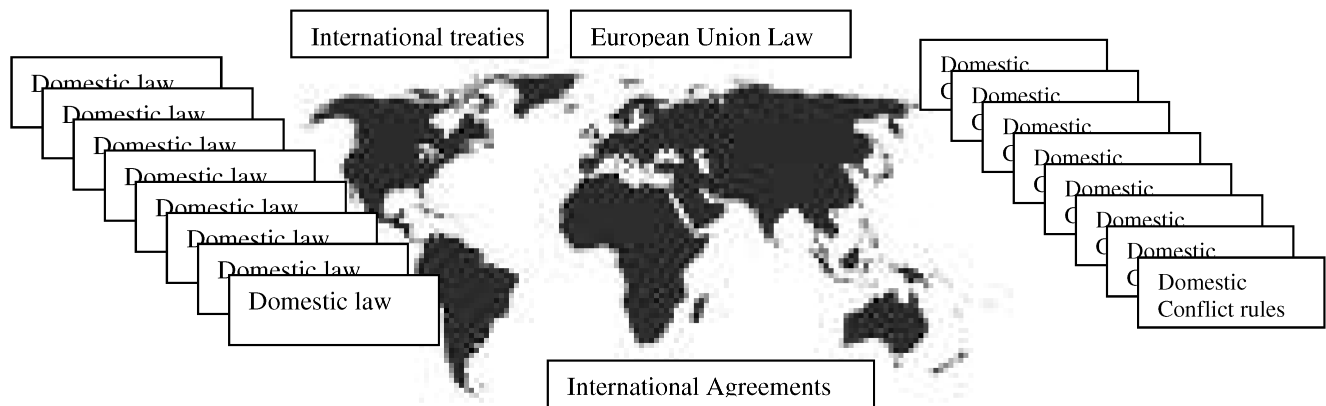

Figure 4

properly determine the extent to which each potentially relevant system may be relevant to the legal situation under scrutiny. In practice, it is entirely possible for a lawyer to have an adequate grasp of the attributes of different legal systems by relying heavily on practical experience. So, in the case of the loan agreement cited above, the issues that arise under each individual legal system may well be familiar to participants and their lawyers. It might be that the deal resembles one completed previously for which it is felt all the legal issues have already been identified and evaluated.

It does not take much thought to understand that there is a potential trap here. It resides in the obvious fact that the current deal may not be exactly the same as the previous one, in all relevant details. In any one of the jurisdictions involved, this circumstance may well give rise to different legal rules applying in the given case (even if the new case is only slightly different from its predecessor).

Local counsel

One method used in order to avoid this risk, for each particular transaction, is to rely on the advice of local counsel from each jurisdiction that is different from your own. Through an appropriate, formal legal opinion, each local counsel supplies the lawyer running the deal with the requisite detail, principles and framework deriving from the various legal systems which that lawyer feels might be relevant to the particular transaction. This strategy seems to satisfy the basic need of the principal lawyer for informed knowledge on the content of the relevant laws applying to the deal in question.

Unfortunately, in practice such a strategy is not a complete legal answer, much less a general panacea. Aside from the risk that all counsel in all jurisdictions may not be of the same quality and reliability that one would hope for – a question of fact (an opinion is only as good as the lawyer giving it), there is also a problem connected with the nature of the opinion offered – a question of law. While lawyers supplying opinions in some jurisdictions are subject to rigorous tortious liability (many common law lawyers, for example, are subject to direct liability for any negligent statements made in their opinions), colleagues issuing opinions in other jurisdictions may not be.[1] While some jurisdictions impose liability on professionals for any negligent statements made in legal opinions, others do not. For example, some jurisdictions merely require that an opinion be given in good faith or in the honest belief that the declarations of law are correct for the situation under review. Whether they are, or not, is not a legal concern. The opinion is just that: just an opinion. On the other hand, where liability reigns, it is possible to sue the lawyer or his firm for damages (which can be substantial); this later sort of opinion is more akin to a commitment.

All this means that a legal opinion issued from a jurisdiction where there is no liability attached may, rightly or wrongly, be regarded by some as providing less value. Without impugning the general quality of individual lawyers from jurisdictions without tortious liability (education, experience and commitment, makes for good lawyers, not dread of liability), it is also the case that in those jurisdictions where there are no institutionalised incentives pushing all professionals towards high standards of diligence in order to avoid being sued, only personal, ethical and professional, instincts will act as incentives. In market terms, this may be felt to translate into a lower level of reliability in a statistical sense. In other words, the reliability of legal opinions issued in jurisdictions without opinion liability may, in each individual case, be at least as good, or better, than those issued in liability jurisdictions. Rightly or wrongly, it may nonetheless be felt by some that the proportion of those that are not particularly attentive or incisive, technically impeccable or comprehensive may be greater than in non-liability jurisdictions. In reality, the writer is not aware of any available statistics on comparative reliability.

Nevertheless, the underlying difference will matter. One class of opinion may give rise to legal liability (the law puts its money where its mouth is, as it were), whereas another does not. By imposing the so-called "hard" sanction of liability, some opinions potentially provide added value to the extent that they create a monetary surrogate (damages) for intellectual accuracy: can't be sure it's right, but in case it isn't, some compensation is available. Where there is no legal liability, the sanction is solely reputational (a so-called "soft" sanction). While this sort of sanction is felt to be highly effective in transparent markets, and of certain benefit to future clients, it would not be of much help to past clients.

Clearly, the effective value of the hard sanction will always be a function of the economic stature of the opinion

provider. Men of straw do not provide much economic comfort. The emergence of limited liability partnerships for legal professionals has also in recent years curtailed the amount of damages available for defective opinions (no longer unlimited for each firm as a whole, but circumscribed to the liability of each involved partner to the extent prescribed in the constitutive documents). So, from the point of view of the client, the value of the liability coverage is perhaps less than it once was. However, the incentivising sanction is still there from the point of view of the professional. Perhaps, in the event, there may no longer be any risk of the partnership floundering due to inadequate professional performance of one of its partners. Still, for each individual partner, it remains enough of an unwelcome development, in terms of personal finances, to focus the mind wonderfully.

It is true that professional indemnity insurance covered by deep-pocketed insurance companies has stepped in to plug the gap. This appears to be a development in weak liability jurisdictions as well. Naturally this fact, *per se*, does not fundamentally change the nature of the problem: coverage will still normally only be available to the extent that there is liability at law.

Another important aspect to consider is that even where there are judicial incentives for high standards of diligence, the coverage afforded by legal opinions is never complete even in the best of cases. Opinions tend to be highly technical documents addressing specific details of a contract, legal relationship or legislative provision, rather than general analysis of a transaction or of a legal situation in its entirety. Any number of legal questions may not be addressed in it, some of which may even turn out to be potentially relevant. Only those legal questions raised in the opinion will be addressed and answered in it. A rule of thumb seems to be: the wider and more general the brief to be answered in the opinion, the less categorical and absolute the opinion given. In short, as has been often noted elsewhere, legal *opinions* are never a substitute for legal *advice.*[2]

It seems to be consolidated practice in international finance transactions to provide legal opinions with a tripartite structure. Conceptually (and very often, visually) the first part of the opinion is dedicated to an enunciation of "assumptions." This comprises a list of those legal and factual presumptions which form the basis of the opinion. The items included in this section will refer to elements of the specific fact situation under review; these are declared to be presuppositions for the validity of the opinion given. In other words, should any of the assumptions cited not be correct, then the opinion is not to be considered applicable to the situation of the client. Since the existence of different facts may radically alter the legal situation (some facts may not be fully disclosed or may perhaps not even be known to the parties involved), this cautious approach is understandable. Typical caveats included in this section include: assumptions in relation to the nature and form of the documentation looked at for the purposes of the opinion; a presumption in relation to the genuineness of documents reviewed; suppositions in relation to the due existence of authorisations and of corporate powers, of necessary authorisations and consents; assumptions in relation to the location of certain parties involved, of the place of performance, and sundry other factual matters. Another important part of this section is the declaration that limits the opinion to an opinion of the law of the opinion-giver (the law applicable in the jurisdiction of his/her professional qualification) and disclaims any representation or liability in relation to any other ("foreign") law. Whereas other attributes of the typical financial law legal opinion are now also common in domestic legal opinions, this last declaration still tends to be peculiar to "international" opinions (opinions referring to transactions involving multiple jurisdictions).

At the core of the legal opinion is the next section: the set of declarations pertaining to the legal principles applicable to the fact situation under review. These statements are the opinion proper.

Following this part, one usually finds a section listing a litany of "qualifications". These normally provide a copious array of legal exceptions in relation to the legal principles otherwise confidently asserted in absolute terms in the opinion itself. Normally, the qualifications listed relate to jurisprudential announcements or legislative provisions which limit or better define the general legal principles enunciated previously. Many of these exclusions and exemptions are not mere casuistry but need to made in order to provide proper information. For example, it is an obvious consideration that the legal principles applying to any business transaction under review will, among other things, be subject to the provisions of insolvency law applying to creditors generally and to the discretion of the courts, to the extent that these may, or could, be exercised. At times it is more efficient and convenient to state this precept as a general consideration at the end, rather than do so a myriad of times in the main text of the legal opinion. One regular feature of international opinions is that one or more qualifications are dedicated to the limits that the local court may impose on an otherwise valid choice of applicable law and jurisdiction made by the parties to the transaction. This is a dimension which, as we shall see further on, is of central importance.

Since the opinion itself would be practically worthless if some attempt were not made at providing the client with a firm legal foothold to stand on in the fact situation, then legal opinions should make an effort to fix a core of legal statements as applicable to the facts (and commit to them) and only then proceed to hedge these. It must be said that this is normally done. Hence the tripartite structure, the heart of which is a statement of the law as applied to the particular circumstances of fact. Not to provide a core of statements relating to a specific application of the law to the specific facts would be a rather unsatisfying alternative, merely a general academic treatise on the relevant law without any effort to apply it to the transaction.

Alas, it now seems quite a common experience to receive legal opinions where the core, the actual opinion proper, is confined to a restricted few *lines* of text, preceded by *pages* of "assumptions" and an equal if not greater number of *pages* of "qualifications". It is sometimes difficult to tell whether the committed content is anything definite or whether it is so hemmed in by conditionality as to offer little certainty about essential issues.

Yet more disquieting is the fact that a logical analysis of the text of less intellectually dazzling opinions reveals a veritable logical round robin. As is to be expected in international transactions, more than one opinion will be produced. An opinion will often be issued from a number of relevant jurisdictions and in order to gain an effective idea of the legal profile of a transaction one needs to piece all these together as if putting together a legal jigsaw puzzle. Unfortunately, due to a round robin effect, there is sometimes more than one piece missing. In those cases where this occurs, logical implosion ensues along something like the following lines: one text (Legal Opinion 1) will assert that in its opinion a legal principle (let us call it "X") is true. However, from the tenor of the "assumptions" or "qualifications" in the opinion one deduces that this will be so only if a certain legal situation "Y" is true in another jurisdiction (let's call it jurisdiction 2). Legal Opinion 2 (issued in jurisdiction 2) will in its turn opine that "Y" is true , so long as situation "Z" is the case in another legal system (jurisdiction 3; as it turns out, the subject matter of Legal Opinion 3). Fortunately, Legal Opinion 3 which deals with this latter system confidently confirms that it is so, that Z is true, on the basis, however, that there is an opinion (in our case, this would be Legal Opinion 1) that confirms that "X" is true. But Legal Opinion 1 confirms "X" is true only if . . . and the roundabout continues! This is not make-believe; I recall an actual experience.

Local legal correspondents are therefore good proxies for knowledge collection, but not definitive answers to the problem. Uncertainty in the nature of things continues to reign, at the very least, residually. While the markets seem to live with this, in part perhaps due to blissful ignorance, the lawyer should not underestimate the importance of the issues involved or overrate the nature of local legal opinions (in any case, essential support) by misunderstanding their nature.

The evident

Another major problem with the "shopping basket" approach is that the list is composed merely on the basis of what is immediately evident. Normally, the determination of what jurisdictions are going to be involved is often made on a rough-and-ready basis. One adds to the list of jurisdictions that ought to be considered those jurisdictions associated with the various counterparties involved. However, as we shall see later, there may be counterparties that may not appear to be involved, but are. Actual experience of the market may generate, over time, a mug-shot collection of the usual suspect counterparties and jurisdictions for which one should be on the lookout. But this may not be enough. A classic example of unforeseeable intervention (always unnerving, because the failure to notice in this regard is potentially damaging) is the uninvited involvement of public regulatory authorities in jurisdictions that at first glance do not seem to be relevant. One hardy perennial in this regard is the US Securities and Exchange Commission (SEC). Returning to our loan transaction example, let us say that the Chinese company in our example decided to issue an international bond instead of asking for a loan. Even though the issue was arranged by, say, English and French banks and no US banks appeared to be involved, it is quite possible that, for reasons which may not be evident on the surface, the rules and regulations of the SEC might in any case be pertinent. How could one foresee this? Making a list of the contractual counterparties to the transaction will not help since no US regulator would appear on such a list as a potential stakeholder in the deal. In reality, it is difficult to predict the involvement of third-party regulatory agencies such as the SEC unless one understands the nature of the international financial markets and has a model in mind of the way legal systems work within them. Only then does the unseen become evident (why the SEC might obviously – evidently – be involved in an international bond issue will be discussed later when we look at the nature of public regulation in IFL) .

Change

So, it seems fairly evident that reliance on local legal opinions, on the immediately evident, or on past experience, may not be the answer. There is one aspect in particular in which the "shopping basket" approach is wanting. It cannot manage the effects of future change.

While the Shopping Basket is effective in dealing with routine transactions in unchanging contexts and can in those circumstances affirm which laws would be relevant on the basis of past experience, of itself it certainly cannot predict which rules and legal jurisdictions might be involved in any number of changing circumstances. Typically, these circumstances include:

(a) Changes in relation to the law

The "shopping basket" approach will identify relevant applicable law on the basis of current knowledge. What it cannot do is predict the laws that might be applicable in case of a future change of law in one or more relevant jurisdictions. Examples of changes in law which have in the past affected cross-border financial transactions include changes in tax law, changes in regulatory principles, changes that can create illegality, changes in rules which affect the validity or enforceability of contract, of the security or of other components of the international transaction.

A change in law will tend in practice to produce one of the following effects: it may change the content of a particular rule applying to the transaction under the law of a relevant jurisdiction; it may make another jurisdiction relevant to the transaction; or it may have the effect of disapplying a given rule which previously applied. In all of these cases, the parties to the transaction will not be indifferent to the consequences produced, which for one or more of the parties involved will often have significant economic price tags attached.

(b) Change in relation to new products

New product innovation on the financial markets will sometimes spawn legal innovation. Product innovation in a cross-border context will almost invariably create new legal relations that require a fresh look at the major legal issues

involved, as treated in each applicable jurisdiction. Over recent decades, as the recently maligned products generated by structured finance bestrode the world's jurisdictions, they attracted a host of new relevant laws in the process of being created, executed and performed. Products such as derivatives, synthetics, securitisations, asset-backed products, etc, are products of a globalising process which tended to link together different markets, financially and geographically. Just as they looped together various markets economically in new and unexpected ways (and so created, as it turns out, a regulatorory nightmare and sometimes produced what are now labelled "toxic" results), their innate intricacy also created legal complexity. They involved multiple jurisdictions, sometimes in somewhat unexpected ways. An understanding of the legal complexities will now be essential to untangling the resulting imbroglio. Prior to a default situation and the unwinding, voluntarily or otherwise, of the transaction, the "shopping basket" approach is ill suited to pre-emptively identifying the complexity born of this sort of legal innovation.

(c) In relation to new processes

Adjustments to a financial product and technological or other developments in the financial markets often create new processes or modify existing ones. This type of innovation may become legally relevant. The "shopping basket" approach is not suited to incorporating legal protection against this sort of process innovation.

(d) In relation to two characteristics of the international financial markets which have tended to be peculiarly associated with it: risk shifting and system interaction

Another defect in the "shopping basket" approach is that it fails to take into account modern legal developments related to risk shifting occurring on the international arena. Merely listing the legal risk inherent in the different legal systems involved does not take account of the fact that international financial lawyers often play at a higher level. Markets (and their legal advisers) have devised various methods for risk shifting between parties. Initially these were entirely peculiar to the international markets, before domestic markets thought some were a good idea and adopted them locally. In essence, these techniques have the effect, sometimes intended, sometimes, unintended, of consensually placing the burden of certain risks on the shoulders of parties that would not normally have to bear them directly. This process of risk shifting is at the heart of international financial law and would be missed if one applied a static model such as the "shopping basket" approach.

Amongst these techniques are clauses which were born in the early years of the market in order to alleviate the extra risk associated with cross-border financial transactions. International lending tended to involve lending without security since much was interbank lending or transactions involving sovereigns, multinationals, or large international corporates (and because the taking of foreign security was generally considered involved and uncertain in effect, from the point of view of lenders unfamiliar with foreign practices). As a result, a number of legal techniques were introduced which evolved into what are now standard clauses of international financial contracts. These clauses include clauses that so far as is possible seek to maintain creditor parity (*pari passu*, cross-default and negative pledge clauses), those which attempt to immunise the risk associated with lending into foreign jurisdictions (gross up, illegality, increased costs), and a host of other covenants, undertakings and default clauses which aim to mitigate other risks associated with cross-border activity. In the end, these clauses attempt to otherwise mould the legal situation which would normally apply to a transaction if one were to simply apply the rules of each jurisdiction individually and in isolation from each other.

It goes without saying that, in any given instance, the legal and economic effect of these market inventions might be significant. Consider this example: in the case of our loan transaction example, if the Chinese government imposed a moratorium on all payments due to foreign lenders from a local Chinese corporation (in legal terms creating impossibility or frustration or *force majeure*) and the normal principle effectively applying in the Chinese jurisdiction were that the "loss lies where it lies" (translated: bad luck for the creditor), then the creditor would not be able to recover (no affirmation is being made in this article in relation to what is actually the case under Chinese law). Notwithstanding this, it may be that by dint of particular risk-shifting clauses in the contract which are effective under the applicable law of contract (which may not be Chinese), then the creditor can now recover his money either directly or indirectly in another jurisdiction, through enforcing the contract, any security associated with it or by effecting set off elsewhere than in China. For example, the guarantee of the Italian parent company may continue to be useful since it may be provide that impossibility, frustration or *force majeure* or similar category under the law of the principal contract will not discharge it; it might then be enforceable under Italian law. If the contracts were in English law, then judgment might be obtained under such law and then an *exequatur* action pursued.

Either consciously or not, deliberately or inadvertently, international financial lawyers deal in pre-empting the results of local laws and, as far as possible, steering these towards results which create the risk profiles most amenable to their clients. Historically speaking, risk shifting and risk management has always been part of the DNA of international financial law.

This added dynamic dimension did not grow naturally out of think-tanks and academic discussion, before unpleasant crises actually occurred on the markets, but rather in response over time to these events. Understanding that these techniques arise from the nature of the markets and the precise manner in which legal systems interact in them helps in understanding the way in which these private, self-help, remedies can in future be used to manage new developments, before they occur. The important point here is that a useful IFL model should be able to foresee the problem in a general sense in a multi-jurisdictional matrix.

Prior to the South American debt crisis of the1970s, most contemporary legal "shopping baskets" would not have had incorporated the item "one illegality clause please". It was not the type of risk that would arise in the normal

course of events in domestic situations. It only arose when foreign jurisdictions started creating moratoria on payments to foreign creditors (debtor-side "illegality") or when trading with certain foreign countries was prohibited (creditor "illegality", deriving from trading with the enemy legislation). After the event, the illegal item found its place in legal precedents and in the "Shopping Basket". In the ensuing decades, many neophyte practitioners would scratch their heads over such abstrusely worded clauses which were, as it were, in the basket but which seemed to have no readily discernible relevance to the exuberant markets of their time. Then, there would be a new crisis and that clause or seemingly redundant provision would become suddenly and extremely relevant.

Still, you might say: it *was* in the basket of must-include clauses. The problem was that some forms of the clause, or of similar provisions incorporated in other clauses, did not exactly match the slightly new circumstances of the new crisis. In 1990, for example, following the occupation of Kuwait by the Iraqi army, the banks in Kuwait became effectively controlled by the regime in Baghdad, rather than by their original Kuwaiti board of directors or shareholders. Legislation in many countries prohibited trading with the Iraqi regime or its entities following a UN resolution declaring the occupation of Kuwait and the expropriation of Kuwaiti assets an illegal act. This meant that many international banks which had any credit lines or loans open with Iraqi banks had to terminate that relationship. In legal terms, they were required to demand repayment of the loans and rescind the relationship in being. This could be done easily if the counterparties were Iraqi entities. Trading with Iraqi entities was obviously illegal and would just as obviously be caught by the existing standard clause in the "shopping basket". Unfortunately, trading with a non-Iraqi, Kuwaiti bank (and its branch in a third country) would not obviously be caught, even if it had become the effective puppet of an Iraqi entity. This produced some scratching of heads. It also produced legal pain where a lender was required to rescind the relationship, yet had no real legal grounds contractually in which to legitimately do so.

A major problem with the "shopping basket" approach is that it would only really work if it was predicated on a large knowledge-base akin to an enyclopaedic mainframe database. Given the large number of dependent and independent variables that might be relevant to any given transaction, it would be very time-consuming and difficult to construct a database of information relating to all the possible specific rules, norms, regulations and laws that may apply to a given instrument or relationship in international finance. It would be difficult to research. It would be laborious to classify and to catalogue. It would date and become out-of-date quite rapidly. Rather than having a list based on past experiences, it would be better to have an understanding of the underlying legal and market dynamics which lead to those experiences in the first place.

Recourse to the "shopping basket" approach has and will be an eminently practical solution to the day-to-day problems faced by international financial lawyers, especially those that practise in large firms which have built up extensive experience, know-how and databases for an extensive number of jurisdictions. As hit and miss as it sometimes can be, it is close enough to be good enough, for most purposes. Rarely do the market participants get it truly wrong. Well, actually, this last statement is not correct, but for the sake of simplifying the discussion for present purposes, it is doubtlessly politic to concede the benefit of the doubt.

IFL as a separate legal discipline

If one were to justify the existence of a discipline of IFL, it needs to bring something extra to the table relative to the "shopping basket" approach.

To summarise: the "shopping basket" approach has a number of fundamental drawbacks associated with it. It is essentially backward looking and is predicated on lists of specific legal items which have been historically associated with any given jurisdiction.

It tends to be static and ill-adapted to coping with change in legal rules or factual circumstances. What may have been the case in the past may no longer be the case, even at the outset of a transaction, much less over time.

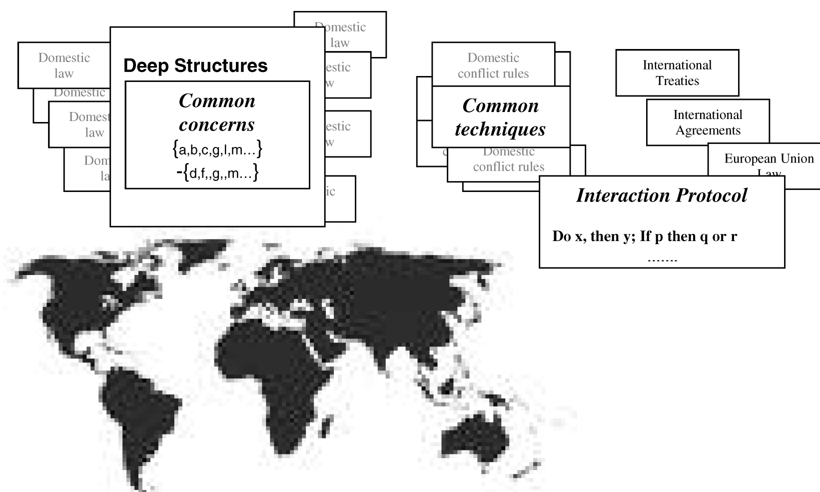

Figure 5

Any new fresh "shopping basket" of legal issues obtained at any given time unfortunately fails to provide any mechanisms for coping with subsequent legal or commercial change. All seems to be set in stone. Legal change during the life of a legal relationship is not managed by the parties and can only be passively borne by the participants as exogenous events unavoidably altering initial legal and commercial equilibria.

It offers no private party devices for predicting the nature and impact of change normally associated with legal structures on the financial markets. Much is left to the working out of the public rules of the legal systems involved as they sort out their individual institutional responses to change.

It completely ignores the possibility of anticipating and managing legal and commercial change.

One of the basic reasons for the inability of the "shopping basket" approach to provide adequate answers to the legal problems of international finance is due to its failure to understand the manner in which laws interact in the globalised markets. Legal systems seem to react in ways which go beyond that normally managed by traditional conflict rules. Moreover, interacting sets of rules tend to produce results that breed geometric rather than arithmetic complications.

IFL should represent a systematised approach to providing a more adequate way of managing the legal issues, present and future.

A mental map of the legal world according to this model of international financial law would resemble the pictorial representation shown in Figure 5.

According to this legal vision of things, in each jurisdiction not only the black-letter law, but the legal policies and mental structures behind such black-letter law, can be discerned and isolated for study. These later attributes may be called the *deep structures* of legal systems.

It is also possible to study and describe the strategies adopted by the markets in order to manage legal risk, changes in law, novel circumstances and risk shifting. It is possible to analyse the merits and limits of these strategies, which I have called *common techniques*.

Precisely because there seem to be common legal themes and issues and common approaches to solutions, it is possible to develop a structured approach to problem resolution (in the legal situations arising on the international financial markets). I call this the IFL *interaction protocol*.

Crucially, it needs to be emphasised that the legal methodology involved is essentially forward looking, aiming to provide the tools for predicting, to the extent possible, legal and commercial change, and furnishing devices which are useful for managing it. It does not simply involve reviewing the sum of all individual sets of substantive legal rules or the subset of associated private international law rules.

In short: it is my contention that IFL has a special nature. As a field of academic study and of professional engagement, it involves a distinct legal subject matter when compared to domestic financial law, and non-financial international law, and the sister disciplines of conflicts of laws and comparative law. It also represents a unique legal methodology.

In the next article I intend to explain in detail what I have just asserted in very general terms. I shall take each individual pillar underpinning IFL, as I see it, and proceed to describe it.

Do tune in. ■

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1 In English law, and related jurisdictions, the seminal case for the liability arising from professional negligence is *Hedley Byrne & Co Ltd v Heller & Partners Ltd* [1964] AC 465. Good illustrations of the application of the principle to solicitors are found in *Ross v Caunters* [1980] Ch 297and *White v Jones* [1995] 2 AC 207. Over recent decades, there have been a number of cases of successful suits against English lawyers. Liability suits for misconduct, malpractice and negligence in the United States are legendary.

2 A point underscored, for example, by Roger McCormick in *Legal Risk in the Financial Markets* (Oxford University Press, 2006), 261ff.