Why English law?

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English law is an international public utility. That is because English law is habitually chosen as the governing law of large financial contracts, such as bank syndications, international bond issues and derivatives. It shares that position with New York law. Together they have a very large share of the governing law of large financial and commercial contracts between international parties.

This brief note is an explanation of what English law offers against three other main possibilities - the law of France, Germany and the US. France was the main champion of the Napoleonic group which has many adherents including Luxembourg, Belgium, Italy and Spain. Germany was the main champion of the Roman-Germanic system which also has many adherents, including the Netherlands, Sweden and Switzerland. So what is said for the sponsoring member of the group is reflected more or less in the other members of the group. Thus there are many similarities between France, Belgium and Luxembourg.

The three legal philosophies of the English common law, the Napoleonic and the Roman-Germanic are for historical reasons the basis of more than 85 per cent of the relevant law of the 321 or so jurisdictions of the world. They each have been phenomenally successful.

Yet, also for historical reasons, they are very different, as is New York law. All four are now ideologies which no longer belong to the countries which originally sponsored them. These countries are custodians of their ideologies. This is not a competition between nations. It is not a football match. It is a competition between universal ideologies which are above narrow patriotism.

The differences between the ideologies do not mean that one is good and the others bad. They each present a spectrum of solutions which are all within the range of what is legitimate and defensible. The question is - what ideology do you want for you particular transactions, what is most suitable, what is most protective of the interests you want to protect, the risks you want to avoid in that particular case, eg an international loan agreement for project finance. If you are riding over rough terrain, you need a mountain bike. If you are riding in a race in a velodrome, you need a slim racing bike. Your choice of bike makes a great deal of difference to your chances of winning (and keeping out of trouble). Ideologies matter.

Legal systems have to make choices, eg between whether to protect debtors or creditors or between predictability and what the courts on the day, not the parties, think is fair. Those choices are often hard to make and each has strengths and weaknesses. The secret is to choose the legal system with the most strengths for your particular deal. The comparison of legal systems is routine for international lawyers.

When parties choose a governing law, they also typically choose the courts of the country of the governing law as well, either exclusively or non-exclusively. That means that the court is interpreting its own law and also applies its own conflict of laws doctrines: hence you know where you are. Similar principles apply to choice of law as to choice of courts, eg commercial orientation, protection of the transaction, predictability, certainty, fairness, familiarity and the like.

One of the most hard-fought decisions in the case of the bankruptcy of Greece in 2012 was whether the new bonds issued by Greece in exchange of its old bonds would be governed by English law, which is what the bondholders wanted, or by one of the 17 eurozone systems of law, which is what Greece and the eurozone wanted A legal memorandum produced at the time on behalf of the bondholders set two tests which were essential to the then structure – whether the jurisdiction had a trust and whether it had protective case law on an IMF Agreement article allowing countries to escape their obligations by enacting exchange controls Only English law passed both tests. None of the 17 passed both the two tests – some passed one of them but not the other, and some did not pass either. So in that case English law was the most suitable for the deal. English law was used also for other intergovernmental financial contracts with Greece from EU countries, including an EU Commission bond issue.

It may incidentally be remarked that a country does not have to be a member of the EU to have a good system of law for financial contracts. For example, the State of New York is not a member of the EU, nor is Hong Kong or Singapore.

I deal here only with transactions between sophisticated wholesale parties of equal bargaining power, not consumers. The following covers a few points which are some of the main comparative points - in fact there are dozens of them.

1. Predictability

If you choose English law, you get what you agreed.

If the contract states that the loan or bond is immediately accelerable on an event of default, it means what it says. Immediately means today, not next Wednesday week.

If the contract states that the security can be immediately enforced or the aircraft or ship immediately repossessed, then that can be done as stated. Banks and corporations control their own deals

For example, in the famous Monday/Friday case of *The Laconia* (1977), the ship charter hire fell due on a Sunday. So the charterer paid on Monday. The shipowner repossessed the ship. The hire was payable in advance so it should have been paid on the Friday. This was an express event of default. *Held* by the House of Lords: the shipowner was entitled to repossess. The charterer could have negotiated a grace period but didn't. So what was the court to do – three days, three weeks, three months, who knows? The court said it was up to the parties to agree their risks. If there was any doubt about whether the shipowner could repossess and the shipowner was wrong, then it would be liable for very substantial damages.

In the *Shepherd and Cooper* case (1996), the bank was entitled to accelerate and enforce a secured loan immediately on a default in payment. The bank sent in receivers one hour after demanding payment. *Held:* the appointment of the receiver was valid. It was clear that the borrower could not pay.

There is a long and consistent line of cases to the same effect. Of course banks usually do not pounce. But there are times when they need to, eg in fast-moving markets where minutes or even seconds can count in relation to a close-out or sale. It is on those occasions when creditors should not have to run the risk of substantial and possibly huge damages for wrongful damage, as well as large losses in a plunging market.

If the contract states that the arranger has no liability to a business buyer of a derivative or for statements of an issuer in an offering circular outside public issues or a bank syndicate offering memorandum, that will be normally be upheld by the English courts except for fraud or the like.

Again there is a long line of English cases which uphold disclaimer clauses which state that the counterparties are not to rely on the arranger and that the arranger or underwriter has no duty to check the information of the borrower or issuer. For example, in the *IFE Fund* case (2006), Goldman Sachs was held not liable for an information memorandum which was allegedly wrong but had a standard disclaimer. In the *Springwell* case (2010) JPMorgan Chase was not liable to a Greek family-owned shipping company for selling notes based on Russian GKOs. Springwell claimed $700 million. The court upheld the exclusion of liability clause.

The rationale is that in the offering circular cases, the claimant is often just looking for a big pocket to pay - the prospectus is that of the issuer, not the arranger. In the misselling cases outside the consumer arena, typically the counterparty has just lost the bet. If the counterparty did not understand the risk, it should have got its own advice and paid for it, instead of attempting to negate the deal after the event after the horse tripped on the fence.

The effect is that the parties are in charge of and control the documents which they negotiated, not the courts.

You do not get the same consistent result in the case of France, Germany or the US. They all have statutory overrides for vague "good faith" which in practice is often used to delay creditors, sometimes for months or (in the case of France) even years, and to override their disclaimers, eg where the counterparty is endeavouring to evade a deal which went against it. In France the courts are specifically authorised to defer payments for up to two years and reduce the interest rate. Litigation in the US is a nightmare. You can choose that approach if that is what you want. But if you want the deal which you negotiated to be upheld, you get that from English law.

The amounts at risk in these situations can be truly enormous – hundreds of millions or even billions, plus in the case of the US treble punitive damages.

To ensure predictability, the English courts have a doctrine that lower courts will follow higher courts (precedent) so that you know where you are. This is specifically not the case in France or Germany, nor in practice is it the case in New York – largely because of jury trials and for other reasons. The result in these other jurisdictions is that the courts are inherently less predictable so that creditors are exposed to potentially large losses if they get it wrong in the eyes of the particular court – the court does not have to follow previous cases.

The French courts are particularly famous for re-writing contracts in favour of debtors and re-ordering reorganisation plans. The Civil Code instructs the courts to back debtors in case of ambiguity.

2. Insulation

A fundamental reason for a choice of law which is external to the country of the borrower of counterparty is to insulate the obligation against changes in the law of the debtor country. Most jurisdictions recognise changes of law under the chosen governing law. English law insulates against these foreign intrusions: see for example the *Terruzzi* case (1976). But this insulation is overridden in France, Germany and Luxembourg because of case law on a provision in the IMF Agreement which requires member states (more or less the whole world) to recognise complying exchange controls. See for example the German *Lessinger* case (1955), the Paris *de Boer* case (1962) and the Luxembourg *Jourdan* case (1955). In other words, the government of the country of the counterparty can unilaterally change the deal by an exchange control - which they often do on insolvency if the sovereign itself is the debtor or if the counterparty is locally important. This does not happen under English law in the case of bonds, bank loans etc.

In practice exchange controls are the most frequent way in which countries postpone or discount their foreign obligations – a kind of legally ok repudiation. Exchange controls can block the country's whole corporate sector and its banks. They are particularly common in emerging countries, thereby striking at project finance and local corporate and bank finance. India, China and South Africa have exchange controls. In the European region exchange controls were recently introduced in Greece, Iceland, Cyprus and the Ukraine. If a debt-ridden country gets into trouble or one of its dominant companies has problems, this is a weapon they reach for to reschedule their debt unilaterally.

Taking a credit risk is one thing. Having your deal annulled is a completely different situation. So in this area you do at least have the choice of a reliable governing law on that issue.

3. Creditor orientation

English law is pro-creditor, not pro-debtor. This is dramatically shown by the super-priority granted to the triple privileged claims – insolvency set-off (and netting), a universal security interest easily enforceable and the universal trust, eg for custodianship, client assets, syndicate agents and bondholder trustees.

Each of this famous trio of common law protections reduces risks massively and protects habitual creditors such as banks and bondholders, as well as insurance companies. If you strip aside all the veils of incorporation, it is not the bank which is the lender. It is the citizen who places his or her salary in the bank who is the ultimate creditor, the creditor who is being protected in substance. It is the citizen who switches on the light. So it is not unreasonable to protect the citizen.

The flows in foreign exchange, derivative and securities markets get through world GDP every few days. The trio are systemic issues. In England set-off is compulsory and automatic on insolvency in all material cases. That is not so in France. You can contract into the English set-off by having the debt owed to the insolvent governed by English law. The set-off has to be bullet-proof. If we did not have the colossal risk reductions through set-off and netting in financial markets and through central counterparties, there would be nothing on the plate for breakfast.

In England a corporate can create a security interest over all its present and future assets generically to secure all present and future debt generically in four lines, register it and enforce it immediately on a default privately. In France and Germany, all those are out of the question, especially in France. Collateral is crucial – from projects to securities markets, from small businesses to central counterparties.

In England anybody can declare a trust of any transferable property without fuss. This covers custodianship of securities at a depository (essential for collective schemes, central securities depositories and many others), a bondholder trustee or an agent bank holding security for the syndicate. You do not have to have untested parallel debt clauses, as in Germany. In France you have to register a trust. In many cases, not just under the Hague Trust Convention 1985, you can choose the governing law which validates the trust. So it makes sense to choose a system of law which has a full unfussy trust.

If the trust is not recognised, the assets of the trustee go to its private creditors, not the beneficiaries – a mournful prospect if the assets are a few hundred million. You are effectively expropriated.

Neither France nor Germany has *all three* super-priority claimants in that form, nor do most members of their family group.

New York does have all three but less convincingly. In New York, and more commonly in the other groups, there are carve-outs for financial markets here and there, But these carve-out statutes are fiendishly complicated and you have to check impenetrable detail to see if you are in or out of the statute. Traders on the floor can't be expected to do that. A single mistake on some abstruse and unexepcted legal point can cost billions in losses. In addition the bankruptcy regime in the US (as is the case in France) is notoriously pro-debtor. This point was sharply accentuated by the symbolic *Perpetual* cases on waterfall flip clauses on identical facts in the English and New York courts. The English courts were determined to uphold legitimate market techniques, the New York courts were not.

The more pro-debtor bias of France and Germany on insolvency is demonstrated by the compulsion of directors to apply for an insolvency proceeding when the company is insolvent, thereby ruining the chances of a work-out or a negotiated pre-pack. The best way of dealing with financial problems is a private agreement out of court, not the trauma of a court process. If the deal needs a court stamp on it, the English courts allow that to be done in minutes.

England is the jurisdiction of choice for rescues via schemes of arrangement. The centre of main interest of many distressed companies have been migrated to England to take advantage of that flexibility. The English courts have jurisdiction to scheme a foreign company if the debts to be schemed are governed by English law.

English law has potent protections against the claw-back of preferences, eg in rescues or leveraged deals, protections which are weak in Germany and even weaker in France and the US. So that threatens the ability to carry out a work-out resue and increases the liability risks of the creditors. The English courts support transactions, not destroy them.

France has a doctrine of abusive credit, ie that it is the bank's fault for lending to rescue the company so that the bank can be held liable in damages for supporting the company.

One could cite many other situations. Bankruptcy is a destroyer and a spoliator, where the law has to decide who gets paid and who drowns, where passions run high. You test the credentials of legal system on bankruptcy.

4. Enforcement of judgements

The judgments of English courts have the best record of trusted acceptability throughout the world, coupled with world-wide pre-judgment freezes. The jurisdiction benefits from a huge network of treaties. The EU Brussels Judgments Regulation adds little to that situation in practice. A creditor still has the bargaining power of being able to enforce. The important EU countries readily enforce foreign judgments for a debt subject to conditions which are normally easy to fulfil, eg a judgment based on an express jurisdiction clause in the form usually found in large contracts.

Further the enforcement of judgments in a foreign country for debt in our context is rare – by the time you get that far in important cases, there is a standstill or a judicial insolvency freeze anyway.

So for these reasons the issue of enforceability based on the potential absence of Brussels is a non-point.

In addition it isn't necessary to hedge one's bets with optional arbitration clauses – which are often suspect in the countries where they are most needed.

Nor does a jurisdiction like England have to be a member of the EU to have its choices of law and courts and its insolvency proceedings recognised. These matters were settled long ago in all the relevant significant jurisdictions and the principles are a done deal.

US judgments have one of the worst records for international recognition – mainly because of the jury system, punitive damages and an ultra-aggressive litigation system.

5. Freedom of contract: non-assignability clauses

English law favours freedom of contract in financial and commercial dealings. Its motto is that any fettering or manacling of the parties is justified only if it liberates us, improves our chances. The purpose of a restriction is to free us, just as we have rules about our societies so that we can survive.

An example of this is that English law does not override non-assignment clauses in large commercial and financial contracts. France, Germany and the US do in significant cases. They don’t allow the parties to decide for themselves. Clauses restricting assignments are part of the English ideology of freedom of contract. They are also the first line of defence for netting which might otherwise be lost in the case of an assignment. They prevent the contract landing in the hands of an unfriendly counterparty or a competitor or another intervener who rocks the deal.

A further example is collective action clauses in bonds. The US Trust Indenture Act of 1939 does not permit the majority bondholders to bind the holdouts to changes of principal and most changes of interest. So the debtor has to go into Chapter 11. English law has substantial case law on bondholder voting and no-action clauses which respect market practices, which respect the benefits of a financial democracy in getting a deal through.

6. Preventing the nullity of transactions: title finance

English law has a strong policy in favour of upholding transactions and ensuring that they are not nullified by some formality.

An example of this is that English law recognises title finance transactions, such as repos and finance leasing, without recharacterising them as a security interest – in which case they might be void for lack of registration or filing. Predictability is fundamental to English law. The US generally does recharacterise. France wobbles on this issue for some versions. Title finance is everywhere – from the humble retention of title clause for sold goods to grand title transfers under the ISDA master.

7. Market acceptability

English law has a proven track record of market acceptability. It is acceptable in all markets, which helps the deal. It has had two centuries of history performing this role. You know what is on offer, the law is familiar from constant use by international parties, and no extra investigation is required. This not generally true of either Germany or France or indeed other EU systems.

In addition, by reason of the international use of English law world-wide for a couple of hundred years and its history as an economic super-power, England has built up a very large body of case law on commercial and financial transactions which is remarkably consistent with its originating principles of commerciality and freedom so that all may prosper. The motto was – and still is – "The railways must be built."

8. Language

English is the lingua franca of international business. It is hard to conduct litigation or to know your rights and protect yourself when statutes and case law are in a foreign language, as well as court proceedings. England has a large and accessible literature on international finance and the key points have been decided.

The language is historically two mainstream European language traditions bolted together and commingled – the Romance languages stemming from Rome and the Germanic languages stemming from the invaders of Rome, a symbolic fusion at this deeper level.

9. International role

The English judiciary consciously recognise their role as serving the international financial and commercial community, just as the Delaware courts consciously serve the US corporate community. The English judiciary know the main tenets of their ideology and that is what they consistently deliver. They have special courts to deal with financial disputes and they are centralised. These points are not true of France, Germany or even New York. You would not have had the maverick New York decision on the Argentinian pari passu clause in the English courts

10. Moderation

The English courts are renowned for their sense of proportion and moderation, for example in terms of damages. They are watchful of overreaching by the authorities.

The US has completely different policies, policies which are harsher. For example, the US vigorously punishes banks who are alleged to infringe its economic sanctions or against money-laundering. Cases involving foreign banks have been accompanied by colourful allegations from the authorities and led to very substantial administrative fines (a multiple of the fines in the UK) and private settlements, eg threats to cut the bank off from Chips which meant that the bank had little ability to argue its case. The litigation system is difficult - class actions, jury trials, unlimited discovery of documents, punitive damages, no costs even if the plaintiff loses, and hyperbolic accusations of criminality and racketeering. Contacts with the US via the use of New York law for transactions potentially attracts these unfavourable aspects of the US legal milieu.

Conclusion

I underline the point I made above that legal systems have to make choices in their policies. These choices do not suit everybody and so the positioning of a legal system is something which societies have to work out for themselves. The result at least is that the international business community has a choice between the competing ideologies on offer. Which is at it should be. At least until we can achieve international harmonisation on the flash points, on a single ideology which is just and fair and serves us best. The law is our servant, not our master.

The latest edition of the author's series of works on the law and practice of international finance is coming out in 2019 in nine volumes.