

# THE LAW OF CROSS-BORDER SECURITIZATION: *LEX JURIS*

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## I. INTRODUCTION

This article discusses the process by which the law of cross-border securitization evolves and becomes uniform. In a former article entitled *Cross-Border Securitization: Without Law, but Not Lawless*, I posited that “the laws governing cross-border securitization are developed first by decentralized lawmaking ‘markets,’ and then absorbed by centralized lawmaking of communities, large intermediaries, and corporations.”<sup>1</sup> I suggested that a cyclical process is involved. New forms of cross-border securitization and new legal issues emerge while old forms and settled issues solidify into rules. This article continues the inquiry. The first part of the article also defines the meaning of a unified cross-border securitization “law.” Because much has been written about cross-border securitization,<sup>2</sup> the first part of the article focuses on select features of the securitization transactions.

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1. Tamar Frankel, *Cross-Border Securitization: Without Law, but Not Lawless*, 8 DUKE J. COMP. & INT’L L. 255, 257 (1998).

2. See generally Symposium, *International Issues in Cross-Border Securitization and Structured Finance*, 8 DUKE J. COMP. & INT’L L. 229 (1998); 1 SECURITIZATION OF FINANCIAL ASSETS § 7.02[I] (Jason H.P. Kravitt ed., 2d ed. 1996 & Supp. 2002) (discussing the recent legal and regulatory changes in various countries, coupled with the development of structures that minimize local market risk, that have resulted in a significant increase in the number of international securitizations); Frankel, *supra* note 1, at 257 (describing decentralized and centralized nature of the law that governs cross-border securitizations); Steven L. Schwarcz, *The Universal Language of Cross-Border Finance*, 8 DUKE J. COMP. & INT’L L. 229, 235 (1998) [hereinafter Schwarcz, *Cross-Border Finance*] (providing an overview of the “fundamental legal principles of cross-border finance from the perspective of securitization”); Steven L. Schwarcz, *Towards a Centralized Perfection System for Cross-Border Receivables Financing*, 20 U. PA. J. INT’L ECON. L. 455 (1999); Yoshiki Shimada & Shinji Itohi, *Japanese Asset Securitization: A Guide for Practitioners*, 38 HARV. INT’L L.J. 171 (1997); Edwin E. Smith, *The Draft UNCITRAL Convention on Assignment in Receivables Financing: A Brief Overview*, 20 U. PA. J. INT’L ECON. L. 477 (1999); Thatcher E. Stone, *In Flight Between Geneva and Rome: Abandoning Choice of Law Systems for Substitute Legal Principles in International Aircraft Finance*, 20 U. PA. J. INT’L ECON. L. 487 (1999); Emil Arca, *Cross-Border Securitization*, REV. OF BANKING & FIN. SERVICES, Feb. 14, 1996, at 21.

These are the features relevant to the inquiry about unifying the laws that govern the transactions.

In the second part of this article I ask: Who makes the law of cross-border securitization? The law of cross-border securitization has been analogized to *lex Mercatoria*, that is, the law created by merchants in dealing with each other, and the rules created by their institutions to facilitate these dealings. I conclude that even though both laws are “market made,” they differ mainly because the law of cross-border securitization is developed not by the parties to the transactions, but by lawyers. I therefore call the law “*lex Juris*” after the name of its creators.

In the third part of the article I ask: How do lawyers create and produce unified law in a decentralized market? To answer this question, I examine lawyer-made law (LML) in the United States and in civil law countries, and discuss the differences between LML generally and the *lex Juris* governing cross-border securitization. The examination reveals how LML and *lex Juris* laws can be, and are, standardized in a decentralized, contract-driven market.

The fourth part asks: How is *lex Juris* distinguished from lawmaking by political units, that is, the courts and the legislatures? I suggest that *lex Juris* reflects both types of lawmaking, but the mix is different. *Lex Juris* offers guides for the future, like legislation, not resolution of past conflicts, like judicial decisions. Yet, it pertains to specific cases, like judicial decisions, and only later is it generalized in form contracts and processes, like legislation.

The last part of this article addresses a broader question: Does the system that is evolving today as *lex Juris* for cross-border securitization provide a useful model for other laws in a global context? This part anticipates the future of *lex Juris*. In a fast-moving and changeable environment, a system grounded in private lawmaking can be more flexible and very useful when conflicts ultimately arise. It can be copied by other actors and adjusted to their needs, natures, and cultures, to become a truly cosmopolitan private lawmaking process. This private lawmaking, however, requires a relatively small group of interacting private law-makers, and a peaceful coexistence with applicable domestic laws.

I conclude that *lex Juris* belongs to a growing number of cross-border contract-based legal systems, for example, laws concerning the

Internet.<sup>3</sup> *Lex Juris* may be the forerunner of a new type of lawmaking regulating global activities: law-like rules that escape tight control of domestic laws, but take them into account; rules that are highly flexible for a fast-changing environment, but quickly unified into standards and guidelines of sufficient predictability.

## II. ABOUT CROSS-BORDER SECURITIZATION

### A. Purpose and Process

Securitization is a process by which illiquid financial assets are converted into securities, to facilitate their sale and trade.<sup>4</sup> One salient feature of the securitization process is its “disjoined” or “decomposed” nature. It resembles a set of children’s Lego pieces that can be connected in different ways to produce different results. The activities that comprise a securitization can be performed by different actors in different places, and in some cases, at different times. Thus, a bank can make loans and either keep them to maturity, securitize them immediately, or securitize them later. A promoter can buy or make loans and securitize them immediately or build an inventory for later securitization.

After the loans are transferred to a special purpose vehicle (SPV), control over the SPV may be vested in different actors depending on their interest in the SPV’s assets. If the transferor of the loans provides collateral for the transferred loans, the transferor is likely to hold the equity in the SPV, and seek control of it. If credit enhancement is provided by other institutions, the transferor may have no interest and no entitlement to control the SPV. The SPV distributes its securities either in a private placement or publicly. Underwriters of the SPV’s securities can be the promoter or other underwriters. Any qualified institution can service securitized loans, and the service contracts can be sold and transferred to others who will perform the task. Any qualified rating agency can evaluate the securitized loans. In sum, the time, functions, and actors, may vary. Further, the transactions are without borders. The subject matter of

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3. See, e.g., David Johnson & David Post, *And How Shall the Net Be Governed?: A Meditation on the Relative Virtues of Decentralized, Emergent Law*, in COORDINATING THE INTERNET 62 (Brian Kahin & James H. Keller eds., 1997).

4. See 1 TAMAR FRANKEL, SECURITIZATION: STRUCTURED FINANCING, FINANCIAL ASSETS POOLS, AND ASSET-BACKED SECURITIES § 1.1, at 3 (1991 & Supp. 2002) (other definitions focus on the process and the use of securitization, such as financing).

the transactions—money and documents—can be transferred electronically from anywhere to everywhere.

#### B. Search For the Right Location

The designers of cross-border securitization activities can search globally for countries in which the decomposed parts of the process can be placed and operated. The designers can then determine their priorities and select countries on a number of grounds. They can select countries that do not impose undesirable constraints, such as restrictive regulation. Or they may choose countries on the basis of amenities that they offer, such as efficient communications and service infrastructure. Parts of the transactions may be placed in countries that offer world-wide securities markets, such as the London or New York Stock Exchanges. Some countries are attractive because of the large institutional investors that are domiciled there.

Even so, securitization takes effect in the real world, among real people, institutions, or governments. These are anchored in real space and are subject to the laws of political entities. A country's laws can be optimal for the purpose of one objective of the transaction, but might not satisfy other objectives, such as minimizing taxes. The country may not be the home of the investors, or may lack a developed infrastructure to support efficient operations, or may suffer from political instability that increases the costs of doing business within its borders. Countries that attract the investors may repel promoters, because of strict regulation for the protection of investors. Countries that offer tax havens may not necessarily provide the required services and infrastructure.

Countries that do not offer a solid legal infrastructure for securitization, such as Italy, may allow transactions to be performed across borders.<sup>5</sup> Therefore, promoters of cross-border securitization are able to split activities and place them strategically to maximize the utility and benefits of their environment, whether legal or otherwise, and minimize costs.

#### C. *Lex Juris* Standardization

If the parts of cross-border securitization can change jurisdictions and if the same transactions can be performed under different laws,

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5. See *Securitisation: An International Perspective*, FIN. MARKET TRENDS, June 1995, at 33, available at LEXIS, News Library, Arcnws File (noting lack of specific legislative and regulatory framework; also noting problems with taxation and legal aspects of transfer of titles).

like a chameleon, how can *lex Juris* contain even a semblance of standardized rules?

Two areas of cross-border securitization are standardized already. One is the very process of securitization activities and the choice of jurisdictions in which the various parts of the process are carried out. For example, when the bond rating of the government of Venezuela fell because the country was experiencing political instability, the rating of the government-owned oil-producing corporation fell as well. The bond rating fell even though the corporation merited a higher rating, because its financial situation was strong. To reduce the cost of the corporation's financing, which had risen with the loss of rating, the corporation securitized part of its oil receivables from five of the largest oil companies in the world. The credit of these corporations was higher than that of the Venezuelan oil producer. To protect investors, the buyers' payments for the oil shipments were deposited in a U.S. bank, and payments to investors were transferred directly from the bank without crossing Venezuelan borders.<sup>6</sup>

Another example relates to the issuance of "disaster bonds." The bonds are a form of securitized reinsurance of catastrophic natural disasters such as floods or earthquakes. If domestic laws are hostile to the securitization, as the U.S. laws were, the issuers of the bonds go offshore, and their assets (reinsurance of disasters) may be globally diversified.<sup>7</sup> The design of these bonds has been standardized to a great extent.

The second area of standardization relevant here is unification of the laws of the countries in which securitization activities occur. For example, of immense importance to the investors and to the whole process are laws that apply to the transfer of financial assets to the SPVs, and bankruptcy laws applicable to the transferor of the financial assets. The price investors demand for asset-backed securities is affected by the degree to which the SPVs issuing these securities are "bankruptcy proof": that is, sheltered from the demands of the trans-

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6. See generally *PDVSA Pipeline to Begin Flowing*, ASSET SALES REP. INT'L, Apr. 20, 1998, at 1, available at LEXIS, News Library, Arcnws File; Leon Lazaroff, *Structuring Flows*, LATINFINANCE, May 1998, at 73, available at LEXIS, News Library, Arcnws File; Thomas S. Coleman, *Piercing the Sovereign Ceiling*, OIL & GAS J., Feb. 23, 1998, at 43, available at LEXIS, News Library, Arcnws File.

7. Tamar Frankel & Joseph LaPlume, *Securitizing Insurance Risks*, 19 ANN. REV. BANKING L. 203, 207 (2000). These bond issuers may come back to the United States, when the insurance laws are amended to receive them. For current developments in the securitization of insurance risk, see Ruth Gastel, *Reinsurance*, III INS. ISSUES UPDATE, Apr. 2001, available at LEXIS, News Library, Curnws File.

ferors' creditors, in the event that the transferor becomes bankrupt. Standardization of these laws is important to the process. In this respect, the question is: to what extent does *lex Juris* help not only to standardize the laws, but also to render them more sympathetic to investors?

### III. WHO CREATES CROSS-BORDER SECURITIZATION LAWS?

#### A. The Law of Securitization Includes *Lex Juris*

Lawyers have a crucial impact on the law of cross-border securitization. Lawyers and other professionals, such as investment bankers, create many innovative structures on which the success of the transactions may depend. Unlike other contract documents to which the parties rarely resort, the documents of cross-border securitization provide guidelines to which the parties refer frequently.

Therefore, a more accurate name and description of cross-border securitization lawmaking is *lex Juris*. This law is developed and established by the lawyers who structure these transactions. Lawyers determine most of these terms, the legal frameworks, and the choice of laws governing the transactions, as well as the location in which the components of the transaction will be performed.

Further, the institutions in which lawyers are organized, and which produce unified products, are not entirely similar to those of merchants' trade organizations. Generally, lawyers' institutions forge stronger ties among members because lawyers who are expelled from the organizations are expelled from their professions as well. Some trade organizations may exercise similar powers over their members, but many do not, and members who wish to follow their own lonely path can do so.<sup>8</sup> By rights, the law the lawyers produce should bear their name—*lex Juris*.

#### B. *Lex Juris* v. *Lex Mercatoria*

The lawmaking of cross-border securitization has been analogized to *lex Mercatoria*. *Lex Mercatoria* refers to the law created by merchants in dealing with each other, and the rules created by their

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8. See Lisa Bernstein, *Private Commercial Law in the Cotton Industry: Creating Cooperation Through Rules, Norms, and Institutions*, 90 MICH. L. REV. 1724, 1727 (2001) (noting that in domestic cash markets for purchase and sale of cotton, merchants and mills in trade organizations are not required to contract under trade rules nor arbitrate disputes with one another).

institutions to facilitate these dealings, such as the guilds.<sup>9</sup> However, there are significant distinctions between the two. Unlike the merchants and their institutions, the parties to cross-border securitization are not organized. Further, they are not necessarily, and need not be, repeat players. They do not structure the transactions or the rules under which they operate. Rather, they express their needs and business plans, which are then addressed in the transaction documents. These documents are prepared by lawyers. The actors rarely determine the structure, but rather dictate only the particular terms.

In *lex Mercatoria* the merchants and their trade organizations create the law among the members. Similarly, in the 1960s, when the number of actors in the Eurodollar markets was small and consisted of investment and large commercial banks, they followed a peaceful coexistence of standardized explicit written transactions. In the securitization area, including cross-border securitization, the equivalent institutions of merchants, promoters, underwriters, and investors are absent. The actors are diverse and dispersed. They do not negotiate all the terms or parts of the securitization transaction. The borrowers and the promoters may negotiate the terms of the loans, but not the credit enhancement, nor the structure and the law that governs the transaction, nor the placement of transactions and their components.

#### IV. HOW DO LAWYERS CREATE LAW AND HOW DO THEY, IN A DECENTRALIZED MARKET, PRODUCE UNIFIED LAW?

To answer this question, this section examines lawyer-made law (LML) in the United States and in civil law countries, and discusses the differences between LML generally and *lex Juris* governing cross-border securitization. The examination reveals how LML and *lex Juris* laws can be, and are, standardized in a decentralized, contract-driven market.

##### A. The Development and Existence of Lawyer-Made Law in the United States and Civil Law Countries

1. *The Scope of LMLs.* In civil law countries, courts give great weight to interpretative opinions of scholars. These opinions have a

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9. See Robert D. Cooter, *Decentralized Law for a Complex Economy: The Structural Approach to Adjudicating the New Law Merchant*, 144 U. PA. L. REV. 1643, 1646–47 (1996).

respectable place as part of the law of the land.<sup>10</sup> In these countries, rules and academic commentaries and opinions help achieve standardization.<sup>11</sup> American LMLs form part of the American law, but not as openly as in civil law countries. American lawyers' opinions play a significant role in shaping the law. Although their interpretations and opinions are not binding, the opinions often can provide shelters from liabilities to third parties and change the balance of liabilities among clients in their relationships with others.<sup>12</sup>

Other LMLs consist of the legal documents that lawyers draft, such as contracts, partnership agreements, trust instruments, and constitutional documents of organizations, such as those of corporations, limited liability companies, and so forth. These documents become the law for the parties.<sup>13</sup> Although contracts are hailed as the epitome of the parties' freedom to determine the rules by which they operate, and any variety would do, variety gives way to standardization, and for good reasons.<sup>14</sup>

2. *Standardization Is Efficient.*<sup>15</sup> Standardization facilitates the development of markets by reducing information costs and risks, offering predictability.<sup>16</sup> The courts, both in common law and civil law countries, have standardized property estates and limited their numbers for efficiency reasons, limiting the parties' contract freedom to

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10. Catherine Valcke, *Legal Education in a "Mixed Jurisdiction:" The Quebec Experience*, 10 TUL. EUR. & CIV. L.F. 61, 96 (1995).

11. See James E. Herget & Stephen Wallace, *The German Free Law Movement as the Source of American Legal Realism*, 73 VA. L. REV. 399, 407 (1987) (noting that German civil law code and its concepts were a "logically closed system").

12. George M. Cohen et al., *Whose Word Is Law?* (unpublished manuscript, on file with the Duke Journal of Comparative and International Law).

The impact of *lex Juris* in the United States and academic works in civil law systems can be explained by the relatively greater involvement of United States lawyers in transactions and the lesser involvement of academics in the practice of the law as compared to civil law countries. In both cases, however, there is a body of law that is not produced by the formally authorized lawmakers, the legislatures and the courts, and their delegates such as administrative agencies or prosecutors and police.

13. See David F. Cavers, *Legal Education and Lawyer-Made Law*, 54 W. VA. L. REV. 177, 179 (1952) (listing examples of "laws that the lawyer writes").

14. This approach contrasts with the judicial approach to property law, in which courts seek standardization. Thomas W. Merrill & Henry E. Smith, *Optimal Standardization in the Law of Property; The Numerus Clausus Principle*, 110 YALE L.J. 1, 3-4 (2000).

15. See, e.g., Lucian Arye Bebchuk & Andrew T. Guzman, *An Economic Analysis of Transnational Bankruptcies*, 42 J.L. & ECON. 775-808 (1999) (arguing that a universal bankruptcy law is more efficient than numerous country-specific laws).

16. See Tamar Frankel, *The Legal Infrastructure of Markets: The Role of Contract and Property Law*, 73 B.U. L. REV. 389, 398 (1993).

change the number and terms of real property estates.<sup>17</sup> Similar reasons facilitate standardization in other areas.

Following precedent is also a form of efficient standardization.<sup>18</sup> So is “path dependence.”<sup>19</sup> Many contract terms are standardized and their impact is significant. In the United States, while law firms create innovative and unique contracts, they also adhere without many or frequent revisions to the forms they have created,<sup>20</sup> or follow forms that other lawyers have created.<sup>21</sup> Shops offer standard lawyer-drafted contract forms for many occasions, and many books contain lawyer-drafted standard corporate and other forms. So do other publications. Similarly, databases are developed that allow lawyers easy access to accurate information about domestic laws all over the globe. These databases enhance uniformity of cross-border securitization.<sup>22</sup> Standardized contracts and other forms drafted by lawyers may indirectly shape the applicable laws because the courts are likely to interpret the same or similar provisions consistently. That renders the interpretations more uniform, and the law more predictable.

3. *It Is Lucrative for Lawyers to Create Innovative Contracts, and Efficient for Lawyers to Convert the Contracts into Reproducible Forms.* Standardization helps both lawyers and their clients. Forms can be adjusted when the laws change and can be kept up to date at minimum expense, while new contracts require extensive checking

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17. See Thomas W. Merrill & Henry E. Smith, *supra* note 14 (noting that this principle is recognized both in common and civil law countries); *id.* at 6 (suggesting an economic explanation for the principle).

18. See Ronald J. Gilson, *Value Creation by Business Lawyers: Legal Skills and Asset Pricing*, 94 *YALE L.J.* 239, 257–58 (1984).

19. See, e.g., Lucian Arye Bebchuk & Mark J. Roe, *A Theory of Path Dependence in Corporate Ownership and Governance*, 52 *STAN. L. REV.* 127 (1999).

20. See, e.g., Gilson, *supra* note 18, at 258 n.46 (noting that firms create and urge use of in-house form files) (citing JAMES C. FREUND, *ANATOMY OF A MERGER: STRATEGIES AND TECHNIQUES FOR NEGOTIATING CORPORATE ACQUISITIONS* 140–41 (1975)).

21. See, e.g., *Legal Education Center to Open*, *AUSTIN BUS. J.*, Sept. 7, 2001, at <http://austin.bizjournals.com/austin/stories/2001/09/03/daily42.html> (last visited Apr. 16, 2002) (noting continuing legal education program, *Drafting Corporate Agreements, Converting the Deal into an Effective Contract*, to be broadcast to continuing legal education centers by satellite).

22. See *Global Capital Markets Internet Library*, at <http://onlinestore.cch.com/default.asp?ProductID=1655> (last visited Feb. 13, 2002). Some of the publications of such databases also provide, in select areas, advisory service such as standardized contracts, and documents. See *Investment Planning Course (Second Edition)*, at <http://www.onlinestore.cch.com/default.asp?ProductID=519> (last visited Feb. 13, 2002) (describing Investment Planning Course, which includes diskette containing sample investment advisory agreement and engagement letter). Such documents are not yet available in the securitization area; they may become available with time.

and are exposed to the risks of judicial interpretation. A standard form that has weathered attacks, especially if it has been revised in reaction to judicial decisions, is more reliable and predictable than a new form. Lawyers can inform clients about the predictable results of the contractual arrangements should conflicts arise. Thus, even in an area where customized arrangements are presumed to be the rule, lawyers can standardize and unify the rules that govern the parties' behavior.

4. *Institutions in Which Lawyers Interact Contribute to Standardization of Legal Documents.* The institutional structures of lawyers and the rules that govern them facilitate free transfer of expertise and information on a regular basis.<sup>23</sup> Lawyers' organizations do not prohibit, but rather encourage, specialization.<sup>24</sup> Groups of specialists facilitate interaction among the members because their interests are similar and their number is relatively small.<sup>25</sup> Referrals follow specialization and strengthen information transfers.

Many American states' and lawyers' organizations require lawyers to continue their education throughout their professional careers. Numerous academic and commercial "schools," seminars, and conferences offer short-term periodic classes to meet this requirement. These schools also help networking among the attendees through mealtime and weekend interactions in attractive locations. The teachers in such schools are expert lawyers, eager to share their ideas and experience with the audience as a form of advertising. Thus, significant interaction and discussions on professional issues are ongoing in legal communities.

Lawyers' opinions of counsel and due diligence documents also offer information and expertise and enhance uniformity. Lawyers discuss, argue, and provide a critical evaluation of new structures just as they do interpretations of the law. On one hand, they do not blindly follow one another, especially if they are required to give opinions or recommend other lawyers. In such a case, their reputa-

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23. For example, ALI-ABA, a collaboration of the American Bar Association (ABA) and the American Law Institute (ALI), provides continuing professional education for lawyers in different areas of law. See *This Is ALI-ABA*, at <http://www.ali-aba.org/aliaba/Thisis.htm> (last visited Feb. 5, 2002).

24. See *id.*

25. For an example of how lawyers help other lawyers understand the rules of cross-border securitization, see generally Schwarcz, *Cross-Border Finance*, *supra* note 2, at 235, 254 (suggesting that lawyers involved in cross-border securitization retain local counsel and ask relevant questions).

tion and exposure to liability are at stake. On the other hand, while they are not eager to write an opinion that courts would openly criticize, they rarely seek to criticize their colleagues.

The tested and mass-produced transactional documents that emerge from this process are the product of numerous revisions, suggestions, and critical evaluations. As clients and lawyers seek new designs, and as the legal environment continuously changes, the process of innovation and adjustments on the one hand, and the process of unifying novel arrangements on the other hand, continue. Therefore, the institutions of the legal profession constitute a mechanism for innovating, adjusting, and unifying legal documents that lawyers produce.

5. *LML Enforcement. Lawyers Prefer to Shelter Transactions They Design from Litigation.* Litigation demonstrates the inadequacy of the contracts and documents that the lawyers had prepared. The law firms' practices, even if they have a litigation department, usually litigate in protection and defense of their main clients. The freedom of their litigation departments to develop a practice in conflict with these interests is quite limited. Hence, these law firms take great pains to ensure a smooth and cooperative execution of their transactions. The transaction documents include the substantive rules of behavior for the parties; the manner in which the rules are enforced; and the institutions or persons which enforce the rules. Thus, the creators of LMLs are not inclined to encourage litigation and design LMLs that incorporate other enforcement mechanisms.

In sum, voluntary arrangements, such as contracts, partnership agreements, corporations, and the like are based on rules designed by lawyers for the parties. These documents are standardized over time. After courts have interpreted standardized documents, judicial interpretations are incorporated into these forms when necessary, for example, by changing the terms to reach a result that is supported by the decisions.

## B. *Lex Juris* Differs From LML in a Number of Ways

1. *Lawyers' Ability to Choose the Applicable Domestic Law.* The choice of law made by lawyers must be embodied in the contracts, subject to the final control of the courts.<sup>26</sup> Because the choice

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26. EUGENE F. SCOLES ET AL., *CONFLICT OF LAWS* § 18.1, at 858 (3d ed. 2000) (stating that contracting parties may select governing law, subject to limitations).

of law in cross-border securitization is determined by locating the activity in the chosen jurisdiction, at least with respect to that jurisdiction, the choice of law is final.<sup>27</sup> Although other jurisdictions may have judicial supervision, if the questions reach their shores, the case for overruling the parties' choices is weaker.<sup>28</sup>

2. *Choice of the Place of Operation Affects Chosen, as Well as Bypassed, Countries.* This gives countries incentives to develop their services, ameliorate their regulatory regimes, or permit their business to go cross-border to securitize their assets. Thus, the lawyers that choose the host countries and design the documents for cross-border securitization provide the forms that substitute for governing domestic laws or affect domestic laws of the countries with which the process comes in touch. The reach of domestic laws is not merely stated in the document but is determined by the parties' choice of location for their activities.<sup>29</sup>

3. *As Compared to LML, Lex Juris Is Broader in Scope and Coverage and Freer of Domestic Regulation.* The transactions covered by *lex Juris* are subject to weaker domestic regulation. The very nature, techniques, and objectives of cross-border securitization allow the parties to choose those jurisdictions that leave them the most freedom to design their own laws.<sup>30</sup> The custom-made restrictive rules are contained in the lawyer-prepared documents.<sup>31</sup> In my opinion there is a relationship between weak interference by domestic law and the regulatory strength of the transactions documents prepared by the lawyers. I believe that the weaker the domestic laws' interference is, the stronger the impact of the transaction documents will be, not only on the parties but also on third parties.

Further, the more entrenched the pattern of behavior of the parties, the more notice third parties will have of that mode of behavior

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27. See Schwarcz, *Cross-Border Finance*, *supra* note 2, at 237 (stating that French law applies to a financing involving French parties).

28. See RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 188(2), at 575 (1971) (stating that in contract law, in the absence of effective choice of law by parties, contacts to be considered in determining applicable law include place of contracting, place of contract negotiation, place of performance, location of the subject matter of the contract, and location of the parties).

29. See Schwarcz, *Cross-Border Finance*, *supra* note 2, at 244 (noting that in a securitization investors must determine whether the jurisdiction(s) of the investors and/or SPV would enforce the arrangement).

30. See Frankel, *supra* note 1, at 275 (stating that cross-border securitization requires parties to "be free to design the applicable law").

31. See *id.* (noting use of such rules in cross-border securitization).

and the more bound the third parties will become to agreements concerning outsiders.<sup>32</sup> As domestic laws become more permissive, *lex Juris* fills the gap and provides substitutes for domestic laws.<sup>33</sup> Most other lawyers dealing with similar situations share similar concepts, and produce an evolving legal regime.

While LML is subject to the jurisdiction of the domestic courts, enforcement in the cross-border context may be far more complicated, and the courts are far less effective.<sup>34</sup> Hence parties resort to self-enforcing mechanisms, for example, mediations, arbitration or enforcement by other intermediaries such as banks.<sup>35</sup> If both parties are in the same jurisdiction, such as the United States, they may resort to the courts in that jurisdiction. However, usually this type of conflict among the parties does not relate to the documents of the transactions.<sup>36</sup>

4. *Lex Juris Provides the Substantive Rules of Behavior Among the Parties to the Transactions. It Affects, Though Does Not Determine, the Rights of Outside Third Parties.* In cross-border securitization, enforcement is performed by mechanisms other than the courts.<sup>37</sup> Courts rarely deal with conflicts among the parties. In the United States, which is notoriously litigious, only a few cases have been litigated concerning securitization transactions. These involved mainly bankruptcy cases, involving parties such as the creditors of the bankrupt transferor of the securitized financial assets.<sup>38</sup> For the most part, the parties to the transaction do not appear in these court

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32. See RESTATEMENT (SECOND) OF CONTRACTS § 222(3) (1981) (stating that “usage of trade” may supplement or qualify an agreement); U.C.C. § 1-205(3) (2001) (stating that course of dealing and usage of trade “give particular meaning to and supplement or qualify terms of an agreement”).

33. See Frankel, *supra* note 1, at 275 (noting that designs and contracts become customs and are “eventually absorbed into domestic laws that facilitate securitization”).

34. See *id.* at 278–79 (noting that with cross-border securitization, “the reach of government regulators is reduced”).

35. See *id.* at 279 (noting that “[r]eliable, regulated intermediaries . . . provide an effective private self enforcement”).

36. The LEXIS search “international and securitization” in the Mega library and Mega file retrieved 50 cases, of which only two pertained to international securitization documents. Search of LEXIS, Mega Library, Mega File (Feb. 5, 2002). These cases are *Argonaut P’ship, L.P. v. Grupo Sidek, S.A. de C.V.*, No. 96 Civ. 1967 (MBM), 1996 U.S. Dist. LEXIS 15925 (S.D.N.Y. Oct. 24, 1996), *aff’d*, 141 F.3d 1151 (2d Cir. 1998); and *J.L.B. Equities, Inc. v. Ocwen Fin. Corp.*, 131 F. Supp. 2d 544 (S.D.N.Y. 2001).

37. See Frankel, *supra* note 1, at 278–80 (discussing various forms of private enforcement).

38. See 1 FRANKEL, *supra* note 4, §§ 10.7–16.

cases.<sup>39</sup> There is no international court or organization to which the parties resort in the case of disagreements.<sup>40</sup>

Thus, the parties' agreements govern their rules of behavior. However, these agreements do not govern those who are not parties to the agreements,<sup>41</sup> such as the creditors of the transferors who have become bankrupt. The agreements do not prevent the creditors from claiming the securitized loans, unless, of course, the creditors are deemed to have agreed to the transfer by notice of the transfers. In some countries such an agreement must be made before the creditors extended credit to the transferor.<sup>42</sup> In some countries the agreement must be explicit.<sup>43</sup> In other countries, such as the United States, if the parties follow certain procedures, such as perfection, the agreements are implicit.<sup>44</sup> Nonetheless, because third parties can resort to domestic courts and domestic laws, *lex Juris* does not afford full protection for the parties to these agreements.

## V. DISTINGUISHING *LEX JURIS* FROM LEGISLATIVE AND JUDICIAL LAWMAKING

*Lex Juris* shares features of both legislation and judicial decisions. But the mix of these features differs. This type of law is similar to the common law in the sense that it starts not from general principles and rules, but from particular cases. To conserve resources by avoiding repetition lawyers prepare and use documents repeatedly. The documents are changed to reflect changes in applicable laws, and adjustments to particular situations. Lawyers also prepare research memoranda that are kept in their libraries. Members of the law firms

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39. Cf. *Realtex Indus., Inc. v. Nomura Sec.*, 939 F. Supp. 572 (N.D. Ohio 1996) (borrower sued the investment banker in an aborted arrangement and in which the status of the parties' arrangement is unclear).

40. See Steven L. Schwarcz, *Sovereign Debt Restructuring: A Bankruptcy Reorganization Approach*, 85 CORNELL L. REV. 956, 1023 (2000) ("Established international courts . . . are only competent to hear cases between States." (citing BARRY EICHENGREEN & RICHARD PORTES, *CRISIS? WHAT CRISIS? ORDERLY WORKOUTS FOR SOVEREIGN DEBTORS* 38-39 (1995))).

41. A contract is defined as "a promise or a set of promises for the breach of which the law gives a remedy, or the performance of which the law in some way recognizes as a duty." RESTATEMENT (SECOND) OF CONTRACTS § 1, at 5 (1981). Since a party that is not a party to the contract makes no promises, it is not bound under the contract.

42. Spiro V. Bazinas, *An International Legal Regime for Receivables Financing: UNCITRAL's Contribution*, 8 DUKE J. COMP. & INT'L L. 315, 345-46 (1998) (citing German law).

43. *Id.* at 346 (citing PHILIP R. WOOD, *COMPARATIVE LAW OF SECURITY AND GUARANTEES* 39 (1995) (discussing Japanese and Spanish law)).

44. *Id.* at 347 (citing U.C.C. § 9-302 (1) (1994)).

then resort to the memoranda, making additions or amendments to reflect and add to them with experience and legal changes. This practice is especially prevalent before a publication appears, addressing the developing area of law. Law firms today periodically publish news of developments in many areas of the law and send them to clients as scholars, marking the in-house experts in the areas.

*Lex Juris* is similar to legislation, however, because it is designed mainly to provide rules for future behavior rather than resolve conflicts that arise from past behavior. Yet, the form contracts of *lex Juris* and processes often contain mechanisms for resolving disputes, usually by arbitration. In this way, *lex Juris* resembles private legislation that is later codified into more general rules. Arguably, contracts and processes are different from legislation and rules because they do not contain general principles. The difference, however, depends on how we define law. The arguments over whether courts, for example, create law are long-standing. Whether implementing, applying, or interpreting law is lawmaking depends on the definition. I submit that contract is law made by the parties for the parties, and sometimes with effects on third parties as well. While memoranda are not enforced by the courts, contracts, corporate documents and other documents are. That is why these documents can be viewed as private law among the parties and others that are affected by them.

*Lex Juris* is similar to a reverse restatement of the law.<sup>45</sup> It consists of numerous examples that follow certain underlying rules. While many lawyers continuously update their documents and memoranda in-house, they also offer updates to clients and other lawyers in publications that serve to advertise their skills and in-house talents.<sup>46</sup> The individual contracts and the information about their contents result, however, in “best practices” and accepted norms of behavior. Courts often adopt these norms of behavior, at times in spite of the parties’ explicit contract provisions.<sup>47</sup> So does the Uniform Commer-

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45. See RESTATEMENT OF TORTS § 8 (1934) (stating that the object of the Restatement is “to present an orderly statement of the general common law of the United States”).

46. This author receives at least ten periodic publications of this type from various law firms in her area of interest. ALI-ABA and other organizations offer lawyers conferences, seminars or courses in which the law is updated. A significant number of the faculty in these seminars consists of practicing lawyers. For example, the author has co-chaired an advanced course on the regulation of investment companies for the past seven years in which practicing lawyers as well as regulators share their understanding and knowledge with the audience of lawyers. Information often includes the arrangements and contracts among the parties in addition to court decisions, regulators’ actions, and legislation.

47. To be sure, “best practices” are used when the terms of the contracts are deemed vague. But often vagueness is in the eye of the beholder, and may depend on the chosen rule of

cial Code.<sup>48</sup> Thus, specific contracts and best practices feed on each other.

If the effectiveness of a lawmaking system is tested by the low number of court cases that are generated, then *lex Juris* in cross-border securitization transactions should be viewed as a great success. As mentioned, the American community is considered by many to be one of the most litigious, and yet I found only two cases—*J.L.B. Equities* and *Argonaut Partnership*—that involved securitization outside the United States.<sup>49</sup>

## VI. A NEW MODEL FOR PRIVATE LAWMAKING IN A GLOBAL CONTEXT

In a fast-moving and changeable environment, a system grounded in private lawmaking can be very useful. It is more flexible than domestic or international legislation and can be copied by different actors and adjusted to their needs, nature, and culture to become a truly cosmopolitan private lawmaking process.

This private lawmaking, however, requires a relatively small group of interactive lawmakers, and a peaceful coexistence with applicable domestic laws. Even though its members live in different countries and different cultures the group must share skills and concepts, goals and institutional interactions. These are the glues that bind them together and provide them with a common language. As such groups proliferate, we can expect them to create the kind of rules that govern not only themselves and their members but also those whom they affect. Lawyers across the globe constitute one such group, and became part of the private lawmaker population.<sup>50</sup> Hack-

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interpretation. A dictionary meaning of a word may bring a different result and different ambiguities as compared to the meaning of the word in a particular context. A dictionary meaning of vehicle may include a pram and an ambulance, both of which are modes of transportation. In the context of a prohibition on vehicles in the park both forms of transportation may be excluded. A pram—because it makes no noise and is not a danger to pedestrians—and an ambulance—because even strollers' convenience should give way to the need for medical help.

48. See U.C.C. § 1-205(3) (2001) (stating that course of dealing and usage of trade “give particular meaning to and supplement or qualify terms of an agreement”). But see Lisa Bernstein, *Merchant Law in a Merchant Court: Rethinking the Code's Search for Immanent Business Norms*, 144 U. PA. L. REV. 1765 (1996) (arguing for enforcement of the contracts without regard to industry practices).

49. *Argonaut P'ship, L.P. v. Grupo Sidek, S.A. de C.V.*, No. 96 Civ. 1967 (MBM), 1996 U.S. Dist. LEXIS 15925 (S.D.N.Y. Oct. 24, 1996), *aff'd*, 141 F.3d 1151 (2d Cir. 1998); *J.L.B. Equities, Inc. v. Owcen Fin. Corp.*, 131 F. Supp. 2d 544 (S.D.N.Y. 2001).

50. “Doctors Without Borders” constitutes a similar group. See *What Is Doctors Without Borders/Médecins sans Frontières (MSF)*, at <http://doctorswithoutborders.org/about> (last visited

ers across the globe working on the development of the Internet constitute another such group. They are in contact with each other and have forged a powerful sense of community.<sup>51</sup> They too have become a part of the private lawmaker population.

There are interesting similarities between these technical and legal specialists and between the ways in which they interact. Like lawyers in cross-border transactions, the Internet technical personnel have tools to create constraints and rules necessary for a predictable and orderly interaction among actors. “Open codes” that compete with proprietary technical innovations are similar to information sharing among lawyers that competes with proprietary innovations in the legal profession.<sup>52</sup> The Internet professionals create and abide by protocols that are crucial to the smooth functioning of the Internet, yet entirely voluntary.<sup>53</sup> Lawyers have adopted similar processes that are crucial for cross-border securitization yet entirely voluntary.<sup>54</sup>

*Lex Juris* and the rules under which the Internet functions belong to a species of cross-border, contract-based systems.<sup>55</sup> Uniformity of the laws, rules, and forms, whether in the context of cross-border securitization or Internet protocols, is driven by the quest for efficiency, the desire to avoid risk, and the need for order. At the same time, the pattern of achieving these objectives allows for experimentation and creativity, and greater and faster adjustments to changes in the environment.<sup>56</sup> These features are necessary for maintaining the respec-

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Feb. 1, 2002) (stating that doctors and other health professionals volunteer with the organization to provide health care in over 80 countries).

51. See *Overview of the IETF*, at <http://www.ietf.org/overview.html> (last visited Feb. 5, 2002) (“The Internet Engineering Task Force (IETF) is a large open international community of network designers, operators, vendors, and researchers concerned with the evolution of the Internet architecture and the smooth operation of the Internet. It is open to any interested individual.”).

52. For example, in ALI-ABA courses, lawyers “volunteer their time and expertise to lecture and prepare written materials for the benefit of their professional colleagues.” See *This Is ALI-ABA*, at <http://www.ali-aba.org/aliaba/Thisis.htm> (last visited Feb. 5, 2002).

53. See *Overview of the IETF*, *supra* note 51.

54. See generally MODEL CODE OF PROF'L RESPONSIBILITY (1981); MODEL RULES OF PROF'L CONDUCT (2002).

55. See, e.g., David Johnson & David Post, *And How Shall the Net Be Governed?: A Meditation on the Relative Virtues of Decentralized, Emergent Law*, in COORDINATING THE INTERNET 62 (Brian Kahin & James H. Keller eds., 1997).

56. Whether a country will adopt *lex Juris* in its domestic laws sooner rather than later depends on its values and culture. That depends on whether the allure of stability will outweigh the limitations on creativity and flexibility. In any event, diversity among countries is beneficial in itself, for it helps weigh the benefits and drawbacks of each pattern and its suitability to a particular culture and to cross-border securitization as a system.

tive systems. I submit that if the Internet Engineering Task Force (IETF) protocols were not followed, the existence of the Internet as we know it today would be unlikely. Similarly, if *lex Juris* were not followed, securitization as we know it would be unlikely to exist.

As compared to the process of creating domestic laws and international treaties, the process of creating *lex Juris* is more flexible. That is because the process avoids the procedural and political straightjackets of domestic and international institutions. While *lex Juris* rules are flexible, they can be quickly unified into standards and guidelines of sufficient predictability. That is because the group that produces the rules is fairly homogeneous and interactive.

The law-like rules produced by such lawmaking establish a new kind of relationship with domestic laws. The rules escape the tight control of domestic laws, even though the planners of the transactions take domestic laws into consideration. At the same time, because the planners can choose where to place the components of their transactions, those countries that seek to host the transactions and reap the benefits they bring tend to meet, at least in part, the demands of the private lawmakers for legal accommodation.

Similarly, the Internet protocols are not imposed by any government, yet are followed not merely by IETF members but by all actors in the Internet infrastructure. That does not mean that the governments have no impact on the technical decisions through their own technical spokespersons. It means that governments play a role by voicing their opinions and concerns, which are taken into consideration.

While the details of *lex Juris* rules can be quickly standardized and changed, the norms on which the rules are based are not necessarily shifting and unpredictable. In a changing environment the way to preserve norms and values may be by changing the details of the rules. I believe that *lex Juris* and Internet protocols represent fundamental values that command a consensus. If these law-like rules deviate from these values, the choices for private lawmakers will narrow because domestic laws are likely to put them back on track. *Lex Juris* may be the forerunner of a new type of law-like rules that cut across nations to regulate specific global activities.