Journal of INTERNATIONAL BANKING LAW AND REGULATION

VOLUME 32 ISSUE 6

CONTENTS

Articles

Mistake in Its Variety of Forms: The Injustice of Giving Securities Supporting Financial Institution Debts on an Error of Judgement or without Informed Consent
DR CHARLES Y.C. CHEW

Protection or Control: The Relative Advantages of Drafting International Finance Documents under Civil versus Common Law
GILLES THIEFFRY

Resolving English Law Financial Disputes Post-Brexit: Is Now the Time for the EU-27 to Create Its Own Specialist Financial Court?
MICHAEL HUERTAS AND KAI SCHAFFELHUBER

Luxembourg Loan Investment Structures: Alternative Investment Fund or Securitisation?
ANDREAS HEINZMANN AND NICOLAS RONZEL

The Role of Law in Constituting Financial Markets
PROFESSOR DR ROLF H. WEBER

Regulating the Culture of Banks in the UK: Strengthening Legal Accountability or Just Better Leadership?
PROFESSOR JAMES MCCALMAN, DR ANGUS YOUNG AND DR RAYMOND CHAN

Book Review

News Section

An International Review of Recent Cases and Legislation

SWEET & MAXWELL

Protection or Control: The Relative Advantages of Drafting International Finance Documents under Civil versus Common Law

Gilles Thieffry*

☞ Civil law; Common law; Comparative law; Dispute resolution; Documents; Drafting; International finance; Interpretation; Parol evidence

Abstract

With 30 years' experience practising international finance, qualified and practising in both common law and civil law jurisdictions, Gilles Thieffry explains the pros and cons of drafting international finance documents governed by either the laws of a common law or a civil law system.

After over 30 years in the legal profession in international finance, straddling four different jurisdictions (two being common law, two being civil law), I have often been asked whether finance documents should be governed by the laws of a civil law country or those of a common law jurisdiction. This question is not only raised because of perceived fee differentials, but primarily due to the intimidating length and complexity of instruments governed by common law. While fee differentials have narrowed, differences in terms of length and complexity are still an issue, especially for clients based in non-common law and non-English speaking countries. Even though English has been mastered by most of the business world, legal English and legal common law drafting can still be intimidating. While there are various legal systems, and the style of negotiating and drafting documents differs from one legal tradition to another, it is fair to say that international finance documents are increasingly influenced by common law, if not governed by a common law system.

Despite the fact that, geographically speaking, civil law is the most widespread legal system in the world, when it comes to international finance, an overwhelming proportion of transactions seem to rely on common law. This is not to say that civil law is completely overlooked in the drafting of financial documents (far from it, as many transactions involve companies incorporated or securing assets located in civil law countries). There is, however, a general difference in philosophy and approach to contract drafting and interpretation between the civil law and common law traditions.

Major transactions in global financial markets will normally involve a variety of legal documents, such as contracts required to obtain equity and debt financing, loan agreements, security and inter-creditor agreements and other Common Terms Agreements required for commodity finance, project finance, securitisations and derivatives, M&A, bond issuing etc. The question of how to draft the documents and on which systems of law to rely arises most commonly when one party is located in a code-based civil law tradition and another in a country whose laws are primarily case-based (i.e. common law), or when the international market practice in question essentially imposes the use of English law or New York law (both common law jurisdictions). This often causes difficulties when drafting and interpreting such documents.

Common law tradition

Common law, which was originally developed in England, has dominated the legal systems of North America and the Commonwealth of Nations for almost 10 centuries. It particularly emphasises judicial law making, property rights and the assertion of the law over the state. It is known to be less rigid and formalistic than civil law as it gives more power to judges, allowing them to essentially manoeuvre around the law.[1] Nevertheless, common law tends to favour the enforcement of contracts *as drafted*. This, alongside various other factors discussed below, may be one reason why, in modern practice, most commercial contracts and finance documents tend to be written on the basis of English and American models, regardless of the governing law of the parties to the transaction.[2]

The common law system is primarily based on case law as its main source. Case law forms the core of the law expressed through specific rules applicable to specific facts. One of the key distinguishing features of common law is that judges take into consideration other cases with similar facts in order to extract the reasoning applied in previous decisions and narrow the scope of legal rules on a case-by-case basis. Common law judges are given extensive power to overrule prior decisions and essentially to create the law by interpreting legislation and adding to it by proposing obiter dictum to establish case law for circumstances not previously covered. Judicial interpretation is an essential attribute of the common law

* Solicitor (England and Wales), Member of the New York Bar, Avocat aux Barreaux de Genève et de Paris. The author wishes to express his thanks to Anna Zatsepina, MA/LPC at BPP University, London, for her assistance in researching this article.

[1] John Niehuss, *International Project Finance in a Nutshell*, 2nd edn (London: Thomson Reuters, 2010).

[2] Giuditta Cordero Moss, "International Contracts between Common Law and Civil Law: Is Non-State Law to Be Preferred? The Difficulty of Interpreting Legal Standards Such as Good Faith" (2007) 7(1) *(Advances) Global Jurist Article* 3.

 © 2017 Thomson Reuters (Professional) UK Limited and Contributors

system. Judges' experience and logical reasoning therefore allow the law to evolve on the basis of practice and a variety of facts.

In addition, by contrast to the complexity of civil codes, common law statutes are known to be more precise in providing detailed definitions and descriptions of specific applications or exceptions that the courts can subsequently apply to particular circumstances that the law covers.[3] However, when it comes to international finance, there are few statutory constraints restraining freedom to contract. This situation is often colloquially described as "what is not expressly forbidden is allowed". Notions of fairness, economic equilibrium, good faith and the search for the "real will" of the parties upon signing a contract between two or more commercial entities are less likely to be invoked in a common law than in a civil law system.

When drafting financial documents, lawyers have more freedom to include various terms as only a few provisions are expressly implied by statutes and contract law. Everything else should be established by the parties to the contract, looking at past precedents and similar transactions, which makes the common law system generally less prescriptive.[4] The fact that, in common law jurisdictions, lawyers can research the case law and apply it to a particular transaction as they see fit, without following too many rules, is an appealing factor in favour of drafting complex international financial documents in accordance with the rules of common law. The parties can therefore set all the terms governing their relationship in the contract itself, thereby rendering clear their various obligations within that document rather than with reference to a code in the civil system. As a result, it is often the case that financial documents that rely on common law are longer than their civil law counterparts, permitting such contracts to be more efficient in terms of protecting the parties' interests.[5] This approach also allows the parties to, in essence, regulate the "rules of the game" that will govern their future relations. The price to pay is the length and complexity of such documents as both parties will try to regulate even the least likely scenarios in order to avoid leaving decisions to the judge's (or arbitrator's) discretion (a good example for all involved in international finance is the mundane matter of interest reference rates and, sometimes, the pages of fallbacks in case the main rate is unavailable when needed).

Another important feature of a common law system is the doctrine of stare decisis, which establishes a hierarchy of the courts and binds the lower courts to follow the decisions of the higher courts.[6] This creates more certainty when writing contracts regarding the relative weights of precedents, affording the parties more protection by, when possible, incorporating terms which stem from decisions of higher courts from the outset.

Civil law tradition

Rooted in the Justinian Code and Roman law, the civil legal system developed complex civil codes that tend to incorporate terms into commercial contracts, provide clearer guidance on the steps of transactions and generally offer more governance regarding contractual obligations and performance. A strong central legal system represents the idea of the separation of powers (i.e. separation of the legislative, executive and judicial branches) by not allowing the judiciary into the law-making process and giving the state authority over the courts.[7] Nowadays, the jurisdictions governed by civil law do not rely on precedents and generally limit the power of judges to interpretation of the law.

After years of development, the civil codes of various jurisdictions are more coherent and complete, leaving few gaps for interpretation and idiosyncratic application in creating financial agreements. However, these codes differ across jurisdictions and, while some jurisdictions have extremely specific laws that can direct the drafting of complex financial documents for any transaction, others provide less clear guidance.

In general, the civil tradition expresses its main principles systematically and exhaustively. By contrast to common law jurisdictions, which place more emphasis on judicial decisions, the civil system places significance on certain sources of law. This particularly applies to statutes, which, though equally important in the common law system, as discussed above, play a slightly different role in this context.[8] In the civil system, the role of statutes is to make an addition to the codes by complementing them. The civil judges apply the law based on a doctrine that guides them in interpreting codes and statutes. In this sense, some may argue that, in the context of complex financial documents, the civil system can be preferable when it comes to litigation as there will be fewer "surprises" on the part of the judges who cannot exceed the scope of their interpretative powers and must clearly follow the relevant statutes.

Finance documents drafted under a civil law system tend to be shorter in length and more concise than under common law systems as any inadequacies or ambiguities can arguably be remedied and resolved through the operation of the law. They tend to be superficially more comprehensible to non-lawyers who are often unaware that the contract incorporates reference to complex codes and statutes.

In civil law litigation, the relevant legal principles are identified first, allowing the judge to then evaluate whether they can be applied to the facts of a particular case. However, the statutory analysis of each judge may differ, once again rendering the civil system less consistent than common law. The judges usually

[3] Niehuss, *International Project Finance in a Nutshell* (2010).
[4] World Bank Group, Public–Private Partnership in Infrastructure Resources Centre, "Key Features of Common Law or Civil Law Systems" (2016) available at: *https://ppp.worldbank.org/public-private-partnership/legislation-regulation/framework-assessment/legal-systems/common-vs-civil-law* [Accessed 29 March 2017].
[5] World Bank Group, Public–Private Partnership in Infrastructure Resources Centre, "Key Features of Common Law or Civil Law Systems" (2016).
[6] Niehuss, *International Project Finance in a Nutshell* (2010).
[7] Niehuss, *International Project Finance in a Nutshell* (2010).
[8] Niehuss, *International Project Finance in a Nutshell* (2010).

determine the area of application of the legal principles according to their own analysis of the statute. Case law, especially that of higher courts, naturally has a strong influence on the way judges will apply a code or a statute. However, case law is not, in and of itself, a source of law.

Applying the features of the civil system to financial contracts demonstrates that there is also less freedom under this approach than in the case of common law. While it has been mentioned that, in common law, very few or no provisions can be legally implied in contracts, allowing the parties to draft these documents more freely, in civil law, references to codes and statutes are implied. For example, under English common law, parties are permitted to negotiate and agree the prices of goods and services and, even if these may appear unfair to an outsider, as soon as the agreement is finalised, there is very little possibility to terminate it on the basis of unfairness (see, for example, the classic English contract law case of *L'Estrange*).[9] On the other hand, certain civil law jurisdictions, such as Germany, impose a rule to the effect that an agreement of a price that is too low could constitute usury (*Wucher*) or could otherwise offend public morals (*sittenwidrig*).[10] Thus, if drafting a financial document based on the code of a specific jurisdiction, certain provisions will automatically be implied in the contract by law and the parties cannot contract out of these provisions by not explicitly including them in the document. A typical example is the very common compounding of interest that is widely used in international finance agreements governed by English or New York law. Many civil law countries severely restrict the possibility of compounding (see art.1343-2 of the French Civil Code) or even make compounding null (see art.314-3 of the Swiss Code of Obligations, which nullifies compounding provisions with the sole exception of banking practices for bank accounts). In this way, the civil system requires lawyers to inform the parties about their rights and obligations under a seemingly simple contract that imports many provisions from codes or statutes which do, in fact, supply many mandatory provisions.

Overall, the key differences between civil and common law traditions indicates common law is more popular when it comes to the drafting of contracts and financial instruments in an international context; the civil system places less importance on the actual content of the document for determining the terms that govern the relationship between the parties, as many of these terms will be indicated by the codes.

In addition, an important feature of civil law jurisdictions is that the judge is not strictly bound by the terms of a contract (unlike in common law systems—see below on parol evidence rule). One can cite art.1188 of the French Civil Code of 1804, which provides that

> "[t]he contract is interpreted according to the common intention of the parties rather than in the literal sense of its terms. Where such intention cannot be ascertained, the contract shall be interpreted in the sense to be given to it by a reasonable person in the same situation".[11]

One might also cite art.18 of the Swiss Code of Obligations:

> "In order to appreciate the form and terms of a contract, it is necessary to look for the real and common intention of the parties, without limiting interpretation to the inaccurate expressions or names that they may have used, either by mistake or to disguise the genuine nature of the contract."[12]

Lastly, but not least, civil law systems, as mentioned above, allow the judge to rebalance an unfair or unbalanced contract. Equally, in a civil law context, good faith provides a powerful tool to the judge, who will either "rewrite" or even annul a contract:

> "In many civil law systems, and perhaps in most legal systems outside the common law world, the law of obligations recognises and enforces an overriding principle that in making and carrying out contracts parties should act in good faith. This does not simply mean that they should not deceive each other, a principle which any legal system must recognise; its effect is perhaps most aptly conveyed by such metaphorical colloquialisms as 'playing fair', 'coming clean' or 'putting one's cards face upwards on the table'. It is in essence a principle of fair and open dealing."[13]

Civil law jurisdictions take an expansive approach to the obligation of good faith, applying it to both the formation of a contract and its performance (while common law enunciates the narrower view that good faith is, at best, only applicable to the performance of the contract and is most often only recognised by statute).[14] Indeed, the European Court of Justice has confirmed that good faith is one of the key principles of civil law through the case of *Messner*.[15] Other major civil jurisdictions, such as France, have included good faith provisions relating to contract implementation in their civil codes. Other

[9] *L'Estrange v F Graucob Ltd* [1934] 2 K.B. 394 KBD.
[10] Juliet Reingold, Sascha Kuhn and Ariel Nachman, "International Contracts—Common Law and Civil Law" (Simmons & Simmons presentation at ACC Israel Annual Conference, 2010).
[11] Original French: "Art. 1188.—Le contrat s'interprète d'après la commune intention des parties plutôt qu'en s'arrêtant au sens littéral de ses termes. Lorsque cette intention ne peut être décelée, le contrat s'interprète selon le sens que lui donnerait une personne raisonnable placée dans la même situation."
[12] Original French: "Pour apprécier la forme et les clauses d'un contrat, il y a lieu de rechercher la réelle et commune intention des parties, sans s'arrêter aux expressions ou dénominations inexactes dont elles ont pu se servir, soit par erreur, soit pour déguiser la nature véritable de la convention."
[13] *Interfoto Picture Library Ltd v Stiletto Visual Programmes Ltd* [1989] Q.B. 433 at 439 per Bingham LJ; [1988] 2 W.L.R. 615; (1988) 7 Tr. L.R. 187 CA (Civ Div).
[14] Bingham LJ indicates: "English law has, characteristically, committed itself to no such overriding principle but has developed piecemeal solutions in response to demonstrated problems of unfairness" (*Interfoto Picture Library* [1989] Q.B. 433 at 439).
[15] *Messner v Firma Stefan Kruger* (C-489/07) EU:C:2009:502; [2010] Bus. L.R. D78.

non-European jurisdictions also include such good faith provisions, such as in the Fundamental Principles of Japan's Civil Code: "The exercise of rights and performance of duties must be done in good faith."[16]

If, therefore, a party is required to act in good faith under civil law, depending on the jurisdiction, certain obligations can be imposed. These can include, for example, informing the other side of all relevant points that it could not discover otherwise during negotiation, preserving reasonable diligence in the performance of pre-contractual and contractual obligations, and exercising caution when varying terms in pre-contractual letters of intent or withdrawing from negotiations without reasonable justification.[17]

An analytical report by the European Commission regarding European contract law in business-to-business (B2B) transactions[18] has also revealed that civil law creates many obstacles for international business transactions. Apart from the obvious barriers, such as language and communication, the analysed enterprises identified differences in legislations and codes as one of their major concerns when engaging in cross-border trade. While common law tends to be more flexible and adaptable between jurisdictions, civil codes differ from country to country and, as has been discussed, reliance on such codes is much greater. According to the report, 35% of companies that are involved (or interested in being involved) in cross-border B2B transactions said that difficulties in understanding foreign European law provisions prevented them from executing international sales.

This tendency can be explained by reference to some of the above-mentioned features of civil law. The system tends to impose certain obligations on the parties and does not offer the level of freedom of contract permitted by common law. While these formalities tend to provide extra protection to vulnerable individuals and smaller companies, or in cases of uneven bargaining power between the parties, when it comes to international transactions, it is usually more desirable for the parties to be able to ensure that their actual intentions will prevail. For instance, many civil law countries have separate administrative laws governing certain types of agreements, such as public–private partnerships (PPPs). Some civil codes also include a provision that mandatory notice periods are required before termination for breach of contract[19] etc.

Theory of law and finance

The theory of law and finance contends that common law jurisdictions provide a better environment for financial development than civil law systems do. In practice, it is difficult to say for sure whether this theory is entirely accurate, yet there is certainly a link between the origin of a state's legal system and its financial development. Legal tradition is one of the major factors that shapes corporate law[20] and the adaptability of the laws within a given legal system is one important factor in determining the development of the financial sector.[21] This means that laws should be allowed to evolve in response to changing socioeconomic conditions.[22] Laws that are slow and costly to change cause gaps to grow in terms of meeting the financial needs of an economy and hinder efficient financing and financial development.[23] The ability of a legal system to evolve quickly depends on its main sources, i.e. judicial decisions, case law and statutes. Under common law, which is based on case law and judicial decisions, inefficient laws can be quickly replaced with efficient laws—through, for example, litigation. Common law rules, also, can change from time to time due to the implied doctrine of stare decisis,[24] as discussed above. Therefore, according to the theory, the common law system based on case law and judicial discretion is more flexible, adaptable and practical, and can respond more quickly to changing financial conditions.

In the civil law system, laws and statutes are developed and amended by the legislative branch and subsequently applied by the courts. As a result, the efficiency and adaptability of laws are adversely affected, given the absence of common law, case law and the fact that statutory law tends to be much slower and costlier to change in civil law systems since such judges lack any legislative power. Therefore, by developing financial documents based on the civil law system, companies are likely to face greater financial obstacles since judicial decisions are based on codes rather than principles of equity. This might explain why many such companies choose common law and the general benefits of that system when constructing financial agreements. This hypothesis is supported by empirical studies conducted by Beck, Levine[25] and La Porta,[26] which further confirms that case law as a source of law is positively linked with stock market and banking development.[27] In addition, Beck et al[28] find that the adaptability concept has a significant effect on the obstacles that firms face in

[16] Ministry of Justice, "About the Civil Code Reform (Law of Obligations)" available at: *http://www.moj.go.jp/ENGLISH/ccr/CCR_00001.html* [Accessed 29 March 2017].
[17] Reingold, Kuhn and Nachman, "International Contracts" (2010).
[18] European Commission, *European Contract Law in Business-to-Business Transitions: Analytical Report* (2011), Flash Eurobarometer No.320.
[19] World Bank Group, Public–Private Partnership in Infrastructure Resources Centre, "Key Features of Common Law or Civil Law Systems" (2016).
[20] Michael Graff, "Law and Finance: Common Law and Civil Law Countries Compared: An Empirical Critique" (2008) 75(297) *Economica* 60–83.
[21] O. Emre Ergungor, "Legal Systems and Bank Development" (Federal Reserve Bank of Cleveland Research Department Economic Commentary, 2002).
[22] Graff, "Law and Finance" (2008) 75(297) *Economica* 60–83.
[23] Ergungor, "Legal Systems and Bank Development" (2002).
[24] Ergungor, "Legal Systems and Bank Development" (2002).
[25] Thorsten Beck, Asli Demirgüç-Kunt and Ross Levine, "The Financial Structure Database" in Asli Demirguc-Kunt and Ross Levine (eds), *Financial Structure and Economic Growth: A Cross-Country Comparison of Banks, Markets, and Development* (Cambridge, MA: MIT Press, 2001).
[26] Simon Johnson, Rafael La Porta, Florencio Lopez de Silanes and Andrei Shleifer, "Tunneling" (2000) 90(2) *American Economic Review Papers and Proceedings* 22–27.
[27] Thorston Beck and Ross Levine, *Legal Institutions and Financial Development*, NBER Working Paper No.10126 (National Bureau of Economic Research, 2003) and Rafael La Porta, Florencio Lopez-De-Silanes and Andrei Shleifer, "Government Ownership of Banks" (2002) 57(1) *Journal of Finance, American Finance Association* 265–301.
[28] Thorsten Beck, Asli Demirgüç-Kunt and Ross Levine, *Finance, Inequality, and Poverty: Cross-Country Evidence*, NBER Working Paper No.10979 (December 2004).

securing external finance, which is an important factor in various financial transactions. Specifically, according to the research, firms in civil law system jurisdictions tend to face higher financing obstacles than those in common law countries, since the application of case law is easier, quicker and cheaper. Indeed, it seems to be the case that, in common law jurisdictions, it is easier to obtain financing to complete a transaction, for instance, as a greater number of options are available through equity rather than prescribed laws.

Legal traditions and financial systems

Those countries that follow common law are generally considered to be more market-orientated, while those that follow civil law, such as France, have a marked preference for banks.[29] The wider scope of discretion enjoyed by common law judges in interpreting both contracts and statutes reduces the cost of writing contracts and favours market-orientated financial systems. Differences in legal traditions are therefore important factors in shaping individual countries' financial systems.[30] This directly affects the way in which financial documents are drafted in order to support the development of both sectors.

As discussed above, obedience to the word of the law by judges has become an integral part of the civil law tradition. Under civil law, a judge's duty is strict application of the law as laid down in codes and enactments. However, no legislation can be applied in a purely mechanical way, so judges are nevertheless required to analyse the relevant documents and apply the law using their own reasoning and understanding. Jurisdictions with more advanced civil codes, however, provide explicit directions for interpreting texts. One of the most well known of these interpretive directives is art.1 of the Swiss Civil Code 1907, which instructs the judge that, if he can find no relevant rule in enacted law, he must decide in accordance with customary law and, failing that, in accordance with the rule that he as a legislator would adopt, consistent with approved legal doctrine and judicial tradition.

Based on the above, it can be argued that the benefits of a legal system for governing a specific financial document will depend on several factors: the type of transaction itself, the aims to be achieved, the complexity of the deal, and the home jurisdictions of the parties and the benefits of those particular systems.

Differences in settling disputes

The power of judges to issue opinions that go beyond the literal interpretation of a statute is an important difference between civil and common law. It is especially relevant when settling contractual disputes as judges in common law jurisdictions tend to leave extensive commentary, particularly with regards to large transactions. In the common law tradition, judges are often "creating the law". This creation process has been described as "the discovery of the old unwritten custom of the land"[31] (in the declaratory theory of common law). Some legal scholars compare common law to Newton's laws of nature, which had always existed; Newton, they say, did no more than discover and label these physical laws.[32] Judges' rulings often rely on precedents established by past decisions; that is, judges can base their decisions on more than the specific terms of existing laws, as they can apply other judges' arguments and interpretations, and they can extend the general principles underlying previous decisions to situations they view to be similar.

Other beneficial qualities attributed to common law in application to financial transactions are that it is frequently much simpler, more straightforward and less time consuming to follow precedents than to pursue solutions that have already been discovered by administering pre-existing laws. Precedents also enable judges to draw on wisdom accumulated by earlier generations outside of legal statutes. Therefore, in common law traditions, judges can rely on other judges, potentially from higher courts and with more specialised knowledge, in order to decide. This feature is quite appealing for the case of financial documents, as applying precedents arguably minimises the risk of litigation and helps less experienced judges issue fair decisions. The parties to these transactions can therefore plan their conduct, knowing that they can expect past decisions to be honoured in the future.[33]

It is practically impossible to create a document that includes clauses to cover every contingency. Thus, taking a case to court in order to settle a dispute is a feasible option in a country with a common law legal system where judges are not strictly bound by the clauses of the contract and can easily interpret the contract and the relevant laws in order to determine whether the parties acted in accordance with the spirit of the contract.

Recent research suggests that, in the civil law tradition, constraints on judges' interpretive powers affect the way contracts are written and enforced. When a country's civil law courts are not effective in settling disputes between credit market participants, banks emerge as institutions that can resolve conflicts and enforce contracts without a court's intervention (see Ergungor for a full discussion).[34] Such situations might occur, for instance, when a borrower has devised a fraudulent means of transferring assets or profits, causing damage to the lender. In such a situation, the civil law courts will not always be able to grant a remedy since the borrower's scheme is not specifically covered in the statutes. Civil

[29] Johnson, La Porta, Lopez de Silanes and Shleifer, "Tunneling" (2000) 90(2) *American Economic Review Papers and Proceedings* 22–27.
[30] Johnson, La Porta, Lopez de Silanes and Shleifer, "Tunneling" (2000) 90(2) *American Economic Review Papers and Proceedings* 22–27.
[31] O. Emre Ergungor, *Market- vs. Bank-Based Financial Systems: Do Investor Rights Really Matter?* Working Paper No.01-01R (Federal Reserve Bank of Cleveland, 6 March 2002), p.12.
[32] See John L. Greenberg, "Mathematical Physics in Eighteenth-Century France" (1986) 77 *Isis* 59–78.
[33] Steven Vago, *Law and Society* (Upper Saddle River, NJ: Prentice Hall, 2001).
[34] Ergungor, "Legal Systems and Bank Development" (2002).

law courts will therefore be unable to punish the party at fault, as, strictly speaking, their actions are not illegal, even if they are immoral. This is because civil law courts place special weight on the exact wording of a statute regarding a specific offence. This characteristic of civil law allows insiders of countries with such legal systems to structure unfair transactions that nevertheless conform to the letter of the law. Johnson confirms the example above, explaining how civil law courts fail to appropriately act in conflicts between minority and controlling shareholders when controlling shareholders transfer assets and profits out of the firm.[35]

For reasons similar to those that weaken promises made by individual borrowers, promises by individual lenders lack credibility under this system: individual lenders are more inclined towards opportunistic behaviour because, even though they put their reputation and future business opportunities at risk, they collect all the benefits of their actions. By contrast, an institution's shareholders would have to share those benefits with all other shareholders, while each individual shareholder puts his entire reputation at risk by engaging in such opportunistic behaviours.[36] The ability to offer services that markets cannot, lends banks superior bargaining power.

Differences in interpreting contracts

Some legal elements that comprise financial documents also differ depending on the legal system. For example, the requirement of certainty of commercial contracts and agreements is an important one since, in most jurisdictions, the contract will be rendered void unless the terms of the agreement are sufficiently certain. This is of particular importance for international finance contracts usually involving parties of different nationalities, languages and traditions.

Civil law jurisdiction judges, by contrast, are more likely to "fill in the gaps" when a document does not specifically address a particular issue. If any elements are missing, the rules of interpretation based on written statutes, case law and the spirit of agreement are incorporated. Only in instances where these so-called "fallback" rules do not lead to a result do the courts look at the "will of the parties" to determine which provisions should have been included. On the other hand, shorter legal documents that do not require the specific inclusion of all possibilities and considerations can be appealing, but one must be aware that this may mean a judge will later rewrite the contract. This is why civil law countries tend to produce less detailed agreements, as terms will either be already implied by reference to the relevant codes and statutes, or the judge can complement or rewrite a contract by ascertaining the initial intent of the parties, subject to some important principles, such as good faith, fairness, economic balance and the intention of the parliament when creating the laws.

This is also relevant to legislation and dispute resolution: in some civil jurisdictions, if the contract does not specify the details of arbitration, the contract's enforcement will be passed onto the administrative courts. Such strict imposition, again, may not always be the best option for financial contracts as it does not allow parties to freely choose an appropriate dispute resolution procedure unless it is expressly specified in the contract.[37]

When it comes to common law, the court will rarely complete bargains for the parties by filling in what is missing in the original contract. There are no codified rules to indicate the terms that were intended to be directly expressed by the parties. Thus, in common law countries, judges do not "rewrite" contracts, which can be seen as one of the many reasons for the popularity of using common law systems in international financing situations. Therefore, one consideration in choosing how to draft a financial document, and in which jurisdiction to do so, should be that, in common law countries, judges are more likely to take into account the specific transaction and what was intended by both parties.

Moreover, this applies even for multijurisdictional transactions. According to the decision in *Kleinwort Sons*,[38] even if an English law contract violates the laws of a country in which one of the parties is resident or incorporated, this shall not affect the legality of the contract. English law still requires that each party perform its obligations and be bound by the contract in such circumstances. The only exception to this rule is when the parties specifically choose English law in order to perform an act that would otherwise have been illegal under the laws of the country in which the performance is to be executed.[39]

This might be considered an advantage for certain transactions, where one of the parties is treated unfairly or has agreed to an unjust agreement. In practice, however, when it comes to complex international financial transactions, the parties clearly understand their intentions (or at least should understand their intentions), which might differ from those that the court considers to be "fair".

On the other hand, some common law jurisdictions, such as England and Wales, Canada, Australia, Singapore and Hong Kong, which also happen to be popular destinations for international dispute resolution, are rather reluctant to strictly impose the principle of good faith on the parties. This could be explained by the fact that, under English common law, the imposition of the good faith requirement clashes with the long-established doctrine of freedom of contract, discussed above. It is therefore

[35] Johnson, La Porta, Lopez de Silanes and Shleifer, "Tunneling" (2000) 90(2) *American Economic Review Papers and Proceedings* 22–27.
[36] Arnoud Boot, Anjan Thakor and Gregory Udell, "Secured Lending and Default Risk: Equilibrium Analysis, Policy Implications and Empirical Results" (1991) 101(406) *The Economic Journal* 458–472.
[37] World Bank Group, Public–Private Partnership in Infrastructure Resources Centre, "Key Features of Common Law or Civil Law Systems" (2016).
[38] *Kleinwort Sons & Co v Ungarische Baumwolle Industrie AG* [1939] 2 K.B. 678 CA.
[39] Ota Hajek, "In Search of a Safe and Friendly Harbour: Choice of Law in International Commercial Transactions—Why Parties Choose English Law and Not Czech" (2009) 10 *Common Law Review* 29–32.

self-evident why major financial institutions choose these jurisdictions in their contracts as sites of dispute resolution: the courts are less likely to focus on what they consider to be fair and in "good faith" according to the statute, but rather on what was initially intended by each party and the exact terms of the agreement.

In common law jurisdictions, therefore, to ensure better protection for the parties to a contract, the agreements and pre-contractual negotiations must manage the role of good faith by, for example, negotiating specific circumstances in which a party will be liable for damages if negotiations break down and making sure to incorporate those terms into the initial document directly.[40]

Pre-contractual obligations

Another important factor that must be considered when discussing the differences in drafting financial documents based on these two legal systems, is that some obligations apply to the parties even before they enter into a contract. Importantly, under common law an offer is revocable before acceptance, whereas under civil law it is generally more difficult to revoke the offer without incurring damages. Thus, in common law, it is common practice to exclude liability if any contractual negotiations break down. The losses incurred by the parties at this stage will not be considered and generally cannot be recovered. In civil systems, however, it is quite often the case that the commencement of negotiation in itself can lead to certain contractual obligations between the parties.

Up until the present day, English courts have refused to regulate the pre-contractual period, save in exceptional circumstances. The most important tool seems to be the theory of unjust enrichment. In US law, generally, emphasis is placed on the theory of promissory estoppel as a justification of pre-contractual liability.

The parol evidence rule

While good faith and imposition of pre-contractual obligations in completing financial documents are features of civil law jurisdictions, the parol evidence rule is an important one to consider when it comes to common law. Broadly speaking, this rule stipulates that, when the parties have entered into a contract in writing and assented to it as the complete and accurate integration of that contract, any prior and contemporaneous oral or written declarations made prior to incorporation or not referenced in the contract shall not be admitted as part of the contract for the purposes of altering or contradicting the writing.[41] The court, therefore, will not allow evidence extrinsic to the contract to be used to interpret the contract. Integrated contracts will not be altered in any way that contradicts the terms of the written agreement between the parties. The rule belongs to the common law tradition and provides that a written instrument, intended by the parties, is the final manifestation of their mutual understanding.[42] The rule is particularly important in the common law tradition of England and Wales. In the 1897 case of *Palmer*,[43] Lord Morris highlighted that parol (i.e. oral) evidence shall not be received by the court to "contradict, vary, add to or subtract from the terms of a written contract, or the terms in which the parties have deliberately agreed to record any part of their contract". The rule, therefore, also excludes any previous agreements, letters, negotiations or drafts, and eliminates the parties' option to litigate in case the terms of a written contract differ from any prior arrangements.[44] Indeed, the applicability of such a rule is very important in the context of finance documents as it promotes legal certainty and prevents the parties from claiming that something negotiated or discussed prior to reaching the final agreement should be performed. The rule is also important in terms of preventing fraud and perjury as well as in contributing to the determination of justice and truth by a legal device. The rule essentially assists the parties by allowing them to rely on the terms of a written agreement in its final version and to exclude any unreliable or dishonest evidence.[45]

This rule is, however, subject to a number of exceptions. For instance, in England, courts have tended to admit some additional evidence of terms to a written contract if the parties can prove that the contract does not fully reflect what has been agreed upon. This was stipulated by Lord Russell in *Gillespie Bros*,[46] where he suggested that it is only a presumption that a written contract always contains all the terms intended by the parties. The parties can challenge that presumption by proving there were additional intentions to those expressed in the written contract.[47] Such exceptions particularly apply to those contracts that are partly written and partly oral, and have less relevance to thorough finance documents. However, according to *Chitty on Contracts*,[48] the scope of the parol evidence rule itself is not as broad: the rule only applies when it is absolutely clear that all of the terms intended by the parties are written in the contract (which explains, in large part, the length of common law contracts). Since the intention of the parties is a very important factor in common law, the courts look at whether the parties intended the final written document to constitute their entire agreement, as

[40] Reingold, Kuhn and Nachman, "International Contracts" (2010).
[41] Arthur L. Corbin, "The Parol Evidence Rule" (1944) 53(4) *The Yale Law Journal* 603–663.
[42] *Shore v Wilson* 8 E.R. 450; (1842) 9 Cl. & F. 355.
[43] *Bank of Australasia v Palmer* [1897] A.C. 540 PC at 545.
[44] *Chitty on Contracts*, edited by Hugh G. Beale, 32nd edn (London: Sweet & Maxwell, 2015), Vol.1, para.13–099.
[45] David G. Epstein, Timothy Archer and Shalayne Davis, "Extrinsic Evidence, Parol Evidence, and the Parol Evidence Rule: A Call for Courts to Use the Reasoning of the Restatements Rather than the Rhetoric of Common Law" (2014) 44 NML Rev. 49–87.
[46] *Gillespie Bros & Co v Cheney Eggar & Co* [1896] 2 Q.B. 59 QBD.
[47] *Gillespie Bros* [1896] 2 Q.B. 59 at 62.
[48] *Chitty on Contracts* (2015), Pt 4, Ch.13, s.4(a).

was decided in *Harris*.[49] Therefore, the parties are still able to provide some extrinsic evidence that the written agreement does not reflect their full intentions. While, on balance, it is very difficult to prove that there should be supplementary terms to a final written and signed document, this does not mean that no extrinsic evidence will be admitted by the courts.[50] Other scenarios that allow for extrinsic evidence to alter or cancel the contract include: when a contract has been entered into by mistake or misapprehension regarding the real nature of the transaction, contracts that lack consideration, conditional contracts, transactions that are deemed fraudulent or illegal etc.[51]

However, despite the parol evidence rule being an appealing reason for financial solutions to consult common law, it can also be subject to criticism as a source of confusion.[52] Indeed, in common law, the parol evidence rule has developed a number of exceptions that not only undermine its original principle but also render contractual obligations less certain. This is particularly applicable to the final stages of litigation, when the parties to a claim introduce any written statements to be interpreted by the tribunal. On the one hand, in the case of an ambiguously drafted contract, the judge may find it difficult to be sure that the meaning of the document can be established by looking at that document alone. Once again, the freedom of contract doctrine prevails as it controverts the parol evidence rule in cases where the parties have expressed themselves in writing, but in an ambiguous way. The court will then consider their original intentions despite the fact that the agreement was considered to be the final representation of these intentions. Even if the parties have chosen certain words, which does not always mean that they reflect their intentions. In this sense, the rule might be confusing and somewhat unreliable when choosing common law for a financial transaction. On the other hand, the rule promotes fairness and, by taking into consideration the other aspects of common law, the system tries to provide for an outcome that should have been foreseen by the parties.

Reasons behind common law's popularity for international finance documents

As has been illustrated above, English law is more commonly used in international financial transactions, regardless of the jurisdiction of the parties. In a common law context, there is greater reliance on lawyers and legal advisers to ensure that all relevant clauses are included, as otherwise they will not be part of the contract. In addition, even in those cases where a general concept is well understood and accepted by all parties, there are often significant differences in the way lawyers will draft the language used to represent the concept in the agreement. Aside from the appealing distinctive features of common law that have been discussed above, a number of major banks and financial institutions, both historically and currently, are headquartered in London and so have logically insisted on English law when issuing financing documents. However, the court system itself and the judges' knowledge of financial matters also explain why English law is even more important than the influence of the City of London. Indeed, in the case of England, many other factors can explain its jurisdiction being a popular destination for the largest financial deals and transactions, even if none of the parties or the subject matter of the transaction have any connection to the UK. The English legal system has a dependable, high-calibre and trustworthy judiciary. Due to the nature of the legal system, the judges are known to be more opinionated and have more experience in dealing with unusual cases. The precedents and obiter that have been recorded and compared over the years, together with an advanced court system that is divided into specialised courts and tribunals based on hierarchy, and the dependence on costs and public importance of courts that deal with various transactions, all explain why English common law is a good tool for financial documents and their completion.

In addition, financing documentation is already a well-developed practice under English law and, therefore, interpretation relating to this area of law is clear, established and requires relatively little effort.

Finally, the costs of the proceedings and the fact that the transactions are conducted in the English language are also two very important factors. The English judicial system is reasonably efficient and comparatively cheap, at least in terms of the costs of court proceedings themselves. These proceedings require less time as often one can apply for a summary judgment, making a submission based on existing precedents, rendering the process quicker and thereby cheaper. While the English language has traditionally been widely used for various transactions, it is generally recognised as the main language of international business and is the main language of the internet.

Conclusions

To conclude, the two different systems of law have each their own advantages and disadvantages when it comes to finance documents. As shown above, the systems significantly differ. As a result, the finance documents produced under various types of legislation are completely different: common law contracts tend to be longer as they must account for various possibilities and outcomes to ensure the fullest protection for each party. Civil law contracts tend to be shorter as they do not need to specify all terms. The parties have less freedom in the latter case, however, as certain obligations will normally be imposed

[49] *Harris, Assignees of Forman, a Bankrupt v Rickett* 157 E.R. 734; (1859) 4 Hurl. & N. 1 Ex Ct at 7.
[50] *Chitty on Contracts* (2015), Pt 4, Ch.13, s.4(a).
[51] *Chitty on Contracts* (2015), Pt 4, Ch.13, s.4(a).
[52] *Chitty on Contracts* (2015), Pt 4, Ch.13, s.4(a).

or denied by codes or applicable mandatory statutory provisions that may not have been designed for international finance transactions entered into by sophisticated companies, but rather for the protection of less sophisticated parties. Last, but not least, in a common law context, the parol evidence rule allows the parties to restrict the capacity of a judge to rewrite the contract.