

COMPARATIVE COMMERCIAL LAW AND THE NLCIFT METHODOLOGY FOR ECONOMIC DEVELOPMENT

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I. THE COMPARATIVE METHOD OF THIS ARTICLE

A. Scientific Origins

The comparison of data for scientific purposes was practiced in antiquity. Greek geometry, for example, compared figures and dimensions, and synthesized observations by means of theorems. Nevertheless, comparative observation and verification as a method of searching for the truth in pure and applied science was not widely adopted in the Western world until the Renaissance. Astronomical observations and oceanographic chart making by the Spanish and Portuguese ocean voyagers had much to do with this intellectual awakening.¹

Regrettably, the comparison of legal institutions remained well behind the comparative empirical advances in the physical sciences. Suffice it to say that it was only during the second half of the nineteenth century that the first attempts to engage in systematic comparisons of legal institutions were undertaken and comparative law research societies were created.²

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1. See generally ALLEN G. DEBUS, *MAN AND NATURE IN THE RENAISSANCE* (1978).
2. See, e.g., *CENTRE FRANÇAIS DE DROIT COMPARE, ANNUAIRE DE LÉGISLATION ÉTRANGÈRE* (1876) available at <http://archive.org/stream/annuairedelgisl01compgoog#page/n14/mode/2up>. See Hessel E. Yntema, *Comparative Research and Unification of Law*, 41 MICH. L. REV. 261 (1942) [hereinafter Yntema, *Comparative Research*] (brief but insightful review of some of the leading European and North American ideas on the components of comparative legal research); see also Neville Brown, *A Century of Comparative Law in England: 1869-1969*, 19 AM. J. COMP. L. 232 (1971). Professor Brown traces the beginning of comparative law studies in Europe to the foundation of the French Society of Comparative Legislation in 1869, which was also the year Sir Henry Sumner Maine accepted the Chair of Comparative Jurisprudence at Oxford. According to Professor Brown, from 1869 until 1918 comparative legal studies in England followed the direction provided by Sir Henry. *Id.* at 232.

B. Different Methods of Comparison

1. The Static Comparison

In its nineteenth-century beginnings, the comparison of legal institutions was largely static or non-contextual. Only rarely was it pursued beyond establishing the textual meaning of concepts or rules as found in the laws of other countries or jurisdictions. Law was not examined contextually or “in action” or by measuring its accomplishments or failures and the reasons for both. Thus, much scholarly ink was invested in pinpointing the textual (but not contextual) differences between, say, the French civil law concept of *causa* and the common law “consideration” or between the equitable powers of the Roman *praetor* and the English Chancellor.

Similarly, not an insignificant number of professors in renowned centers of legal scholarship taught comparative law as an annotated lexicography as late as the post-World War II period. For instance, in a graduate course on comparative law that I attended at the University of Paris in 1958, the professor, after exhorting his students to be *comparatists* (“*soyez comparatistes*”), proceeded to discuss the meaning of a long list of terms in various languages, followed by short commentaries on each term and by citations to their respective codes or court decisions that used the terms. Obviously, the law that this professor failed to discuss was much more complex and vital (I like to call it “peopled”) than that reflected in his lists of equivalent terms and summaries of statutory and judicial applications.

Take, for example, some of the commercial aspects of the above-mentioned *causa* and consideration. As will be apparent when comparing the different attitudes toward commerce and especially commercial credit in French, German and Anglo-American law, serious socio-economic consequences followed from requiring a morality-laden *causa* when determining the negotiability of promissory notes, drafts and government bonds by French jurists.³ Our University of Paris comparative law professor failed to tell us that the broad definition of usury in effect in France during the eighteenth and much of the nineteenth century was a major reason why these negotiable instruments were deemed not only non-negotiable but also unenforceable, having been “vitiating” by an illegal cause. Consequently, secondary markets for the discount or purchase of negotiable instruments failed to materialize in nineteenth-century France and Spain.

He also failed to tell us that countries whose legal systems did not require a *causa* had developed healthy secondary markets for the same instruments during the same period. I would suggest that the relationship between *causa*, usury and other morality-laden concepts was an infinitely more important legal-contextual datum than our professor’s explanation of what Aristotle meant by first, material, and final causes.⁴ In addition, our Parisian class should have discussed how the giving of

3. See BORIS KOZOLCHYK, *THE LAW OF COMMERCIAL CONTRACTS IN A COMPARATIVE AND ECONOMIC DEVELOPMENT PERSPECTIVE* ch. XI at 22–23 (forthcoming 2013) (manuscript on file with author), on German law, including a discussion on the Rothschilds and the English barrister.

4. *Id.* ch. V(G).

something of value as consideration as an initial step in the formation of contracts had much to do with instilling trust between lenders and borrowers; a trust that helped build a commercial credit society in late sixteenth and early seventeenth-century England whose importance exceeded that in any other European nation.⁵

2. The Contextual Comparison and the Purpose of Legal Institutions:
Rudolf von Ihering's Views

Fortunately for comparative law studies, the great Romanist and legal philosopher, Rudolf von Ihering, called attention during the middle of the nineteenth century to the need to connect the study of legal institutions to their purposes. In his words:

[T]he stone does not fall in order to fall, but because it must fall . . . ; whilst the man who acts does so, not [necessarily] *because* of anything, but *in order* to attain to something As there can be no motion of the stone without a [gravitationally related] cause, so can there be no movement of the will without a purpose.⁶

The importance that von Ihering attributed to the purpose of legal institutions was reflected in his comparison of the Roman law contracts of immediate and simultaneous performance with those whose performance was to take place in the future, a recurrent theme throughout this book:

Not every contract requires compulsive coercion [such as an action for specific performance] for its [enforcement]; a contract of sale or exchange which is at once carried out . . . leaves nothing to be gotten by coercion For [its purpose is to facilitate the] simplest form of exchange, *viz.*, a cash business But this immediate fulfillment on both sides, which makes compulsive coercion unnecessary, is not practicable in all contracts. It is not practicable in a loan—[where] the lender must precede with his performance; the consideration, *viz.*, the payment of the loan, can only follow later. It is not practicable in a contract of lease—whether the rent is paid before or after permission is given to use the object; one of the two parties must come first with his performance and wait for the consideration. Thus certain contracts necessarily presuppose the postponement of the performance on the one side⁷

5. For a discussion of the omnipresence of credit in late sixteenth- and early seventeenth-century England, see *id.* ch. XXI(D)(3).

6. RUDOLF VON IHERING, *LAW AS A MEANS TO AN END* 2 (1913).

7. *Id.* at 198.

The above comparison highlights the diverse functions of two types of contracts, one designed for simultaneous exchanges and the other for extensions of credit. It also makes clear the function of executory promises: to bind their promisors to give or to do something at a future time despite the fact that nothing was given or promised to them prior to the utterance of the promise to perform at a future time. This purposive vision of contracts was behind the suggestion of a functional comparative law analysis by Konrad Zweigert and Heinrich Kötz, two of von Ihering's modern-day followers.⁸ In their opinion:

From this basic principle stem . . . [emerges] the choice of laws to compare, the scope of the undertaking The proposition rests on what every comparatist learns[:]. . . the legal system of every society faces essentially the same problems, and solves these problems by quite different means though very often with similar results [T]he problem must be stated without any reference to the concepts of one's own legal system [but, rather, to the objectives of the mechanisms under analysis]. Thus instead of asking, "What formal requirements are there for sales contracts in foreign law?" it is better to ask, "How does foreign law protect parties from surprise, or from being held to an agreement not seriously intended?"⁹

This is as clear a formulation of a purposive comparison as I have read anywhere, yet there is more to a purposive comparison if it is truly contextual.

3. The Contextual Comparison: Actual Purposes and Practices

The truism that "generalizations are a fertile soil for misperceptions" is worth repeating because static or non-contextual comparative legal analyses are often guilty of misperceptions. Zweigert and Kötz thus assumed that contractual formalities such as the requirement of a writing have a similar purpose, no matter where or when. That purpose, according to these authors, is the prevention of surprise so that the contracting parties do not wind up with a contractual outcome contrary to what they expected. Yet, legal cultures are relentless transformers of the original purposes of legal institutions.¹⁰ For example, the purpose of the requirement of a formal writing for the validity of contracts in Andres Bello's Chilean Civil Code, a code after which many Latin American civil codes were modeled,¹¹ was not merely

8. See KONRAD ZWIEGERT & HEIN KÖTZ, AN INTRODUCTION TO COMPARATIVE LAW 34 (1987). *But see* Yntema, *Comparative Research*, *supra* note 2, at 264 ("[A]s has been stressed notably by the two chief exponents of comparative law in recent years in France and Germany, Edouard Lambert and Ernst Rabel, the inquiry is functional.").

9. See ZWIEGERT & KÖTZ, *supra* note 8, at 34.

10. See KOZOLCHYK, *supra* note 3 ch. I (B)(1).

11. *Id.* ch. XIII(D)(1)(a), on Latin American law.

to discern the true contractual intent from the literal meaning formally stated in the contract. Bello's purpose was to stamp out the courts' reliance on fraudulent testimonies purchased by the parties or their attorneys from "witnesses" who offered their "testimony" to the highest bidder literally steps away from the courtroom where judges and their clerks adjudicated contractual intent.¹²

The ruptured link between the original and the transplanted purpose of legislation and their respective socio-economic contexts is quite common. I encountered it while discussing a newly drafted chapter on negotiable instruments law with its Nicaraguan drafter during the 1960s.¹³ His definition of a negotiable instrument expressly excluded those payable in metal or commodities and quoted as the source for this definition that which appeared in an Italian commercial law treatise.

Yet, my field research in rural Nicaragua revealed that "chips" (*fichas*) issued by the stores of large agricultural producers were among the most popular means of payment in that nation's countryside in the 1950s and 1960s. These chips were issued to company employees or third parties in exchange for the services they rendered to the agricultural company. They entitled their holders to purchase products in the company stores and in some instances they also entitled them to obtain the cash value of products sold by the company store. The chips were commonly transferred by their holders as if they were bearer negotiable instruments. As stated by many of their users, they trusted the intrinsic value of these chips more than they trusted other instruments. Not seeing any reference to these chips in the draft, I asked the drafter why he excluded them. His reply was:

Your datum on the use of chips is merely an empirical one. What is important to me as a drafter of a "scientific law" is to find the best scientific definition or concept of a payment instrument. The definition of a payment instrument I chose is by Professor X, my great Italian mentor.¹⁴

12. In his executive message to Chile's National Congress proposing the adoption of Chile's Civil Code of 1855 (written by Andrés Bello), Chile's president, Manuel Montt, made the following statement on the unreliability of evidence of contractual intent: "Well known among inferior classes of the population is the existence of an infamous class of men who earn their living by prostituting their testimonial oath" ("Conocida es en las poblaciones inferiores la existencia de una clase infame de hombres, que se labran un medio de subsistencia en la prostitución del juramento."). Manuel Montt, Mensaje del Ejecutivo al Congreso Proponiendo la Aprobación del Código Civil (Nov. 22, 1855), available at http://www.chilein.com/c_civil1.htm. The relevant rules are Cód. Civ. arts. 1708, 1709, 1710, 1711 (2000) (Chile). For a compendium of essays on Bello's Civil Code, see UNIVERSIDAD DE CHILE FACULTAD DE DERECHO, 4 ANALES DE LA FACULTAD DE CIENCIAS JURÍDICAS Y SOCIALES (1964-1965), available at <http://www.analesderecho.uchile.cl/index.php/ACJYS/issue/view/451>.

13. Interview with one of the drafters of a 1968 proposed revision of the Nicaraguan Commercial Code, who prefers to remain anonymous, in Managua (Sept. 12, 1968) (on file with author) [hereinafter Nicaraguan Conversation].

14. *Id.*

Notice this drafter's dismissal of the circulation of chips in rural Nicaragua as a mere empirical datum and his reliance on an Italian definition of a negotiable instrument as the appropriate datum of commercial legal science regardless of its socio-economic purpose and context. Yet, when shorn of its pseudo-scientific definitional purpose, the common purpose of an Italian and a Nicaraguan negotiable instrument is the same—to provide a widely acceptable means for the payment and extinction of obligations. And if a company store chip was trusted to extinguish obligations more than any other instrument in rural Nicaragua, why deny them the negotiability of bearer instruments that their everyday users were willing to accept in a business and economic environment so different from that of a highly commercialized Italian marketplace? While ignoring market practices, my Nicaraguan interlocutor revealed an important aspect of his country's legal culture: legal academics like him disdained empirical facts as a source of law making and preferred to rely on the logical symmetries of foreign legal concepts even though they had been shaped by very different socio-economic conditions and experiences.

In summary, a contextual comparison searches for the purposes of the compared legal institutions, and inquires into the socio-economic and legal needs that these institutions are expected to fulfill. And it does so by examining the relevant commercial practices as well as the official or positive law and the society's legal culture, i.e., the values and attitudes of market participants. This comparison also includes an assessment of the socio-economic consequences of the enactment in question. When a chosen legal institution fails its purposes, the comparative analyst must find out the reasons for the failure, and, based upon his findings of successful alternatives, suggest a suitable local or foreign replacement.¹⁵

4. Archetypal Behavior and Contextual Analysis

The contextual analysis is greatly facilitated by identifying the archetypal behavior that helps to shape both standard and best practices and their resulting legal institutions. Lord Mansfield was one of the first to identify accurately the behavior of the average merchant as he did in a landmark decision in which he stated that the average merchant is someone who does not need to rely on formalities because “[a] *nudum pactum* does not exist, in the usage of and law of merchants.¹⁶ The same was true with Justice Cardozo, whose fiduciary had to evince the punctilio “the most honorable.”¹⁷ Please note that by archetypal behavior, I mean the representative behavior of average merchants, bankers or professionals, as reflected not only in their standard practices, but also in the practices of highly respected and trusted merchants, bankers or professionals, which I refer to as their best practices. It is worth emphasizing that what matters to the contextual analyst is whether the conduct

15. See KOZOLCHYK, *supra* note 3, ch. I(D)(3), on contextual comparison.

16. *Pillans v. Van Mierop*, (1765) 97 Eng. Rep. 1035, 1038 (K.B.).

17. See KOZOLCHYK, *supra* note 3, ch. I(B)(3).

of the merchants selected as archetypes is truly representative of the behavior of a class or group of merchants.¹⁸

Max Weber, one of the founders of modern legal sociology, was among the first to call attention to the importance of representative social behavior in social science research.¹⁹ Think how hard it would be for social scientists to attribute features to the behavior of social groups or classes without being able to rely on the representative behavior of some of their members. Without it, social scientists and comparative lawyers would have to engage in endless and costly observation and analysis of the behavior of each member of the class or group in question.

a. The Costs of Relying on Inaccurate or Unrepresentative
Archetypes of Commercial Behavior when Making Commercial
Contract Law

Unfortunately, not all the archetypes relied on by lawmakers, lawyers, and adjudicators are representative of the commercial behavior of the classes or groups they are supposed to represent. Assume, for example, that the comparative analyst was trying to determine how best to resolve the problem of excessive litigation on the alleged intent of contracting parties. Assume further that the analyst was Andres Bello, the principal drafter of Chile's Civil Code of 1857 and that the legislative model he used to resolve this problem was the French *Code Civil* of 1804. This code requires that contracts over a certain sum be executed in a highly formal public or notarial deed (the *titre* or *acte authentique*), and when such a deed is executed it excludes most other evidence on the parties' intent.²⁰ Finally, assume that Bello blamed the practices of Chilean archetypal court witnesses for the excess and unpredictability of litigation on contractual intent. He referred to these witnesses as "an infamous class of men" in his introduction to Chile's Civil Code, and accused them of earning their living by offering their testimony on contractual intent to the highest bidder.²¹

Certain that this was the behavior of representative archetypal witnesses in contract litigation, and certain also that contracting parties would use them as witnesses and thereby would not hesitate to testify falsely themselves, Bello's

18. It is important not to confuse the archetypes used in this book with the heroes of Greek or subsequent mythologies. Our commercial archetypes are creatures of commercial cultures. Unlike the Greek mythical heroes, they did not earn emulation and, in some instances admiration, because of their strength or other extraordinary godlike powers but because of their reproducible human features. See *Archetype Definition*, MERRIAM-WEBSTER, <http://www.merriam-webster.com/dictionary/archetype> (last visited Apr. 6, 2013) ("1: the original pattern or model of which all things of the same type are representations or copies: prototype; *also*: a perfect example.").

19. See KOZOLCHYK, *supra* note 3, ch. XIII n.24 and accompanying text. On Weber more generally, see *id.* chs. III, VII & XVIII.

20. See CODE CIVIL [C. CIV.] art. 1317 (Barrister 1804) (Fr.).

21. See *supra* note 12.

solution was to require a high level of contractual formality that would automatically dispense with the reliance on witnesses to determine a disputed contractual intent.

Yet, how representative was the behavior of these “infamous men” when compared with the behavior of the much larger class of merchants who entered into their commercial contracts in good faith, and with the intention to cooperate with each other’s ability to earn a profit? In addition, because the intent of regular participants in market transactions has to be manifested usually in informal, quick and standardized contracts or parts of them, their intent could best be established by determining what was customary for that trade or business as expressed in informal documents and not in time consuming and costly written and notarial documents. Finally, why assume that the decision to use purchased witnesses was invariably made by the merchants and not by the lawyers to whom they entrusted their litigation?

Justice Oliver Wendell Holmes Jr.’s “bad man” of contracts was as unrepresentative of the contractual behavior of merchants as was Andres Bello’s “infamous witness.”²² Yet, the reliance on Bello’s “infamous witness” and on Holmes’s “bad man” of contracts as archetypes of commercial contractual conduct led Bello to require costly, dilatory and anti-commercial contractual formalities for all contracting parties, and in Holmes’s case, led to a presumption of commercial bad faith in the performance (or non-performance) of contracts that is just as costly, if not more, than Bello’s. Imagine, for example, the cost incurred by the holders of checks about to be deposited with their banks if the banks’ presumption was that their check depositors were (*a la* Holmes) the “bad men of checks.” Such a presumption assumes that check depositors had acquired them in bad faith and that it was their burden to prove that they did not steal, embezzle or fraudulently procure and endorse them. Apart from the high cost of such a negative proof, check depositors could no longer count on receiving provisional credits for their deposited checks as are normally received by check depositors under existing law and practice.²³

But perhaps one of the most serious misperceptions of the nature of an archetypal banker was that of Alan Greenspan, the former chairman of the Federal Reserve. His archetypal banker was capable and willing to restrain and regulate himself against highly risky forms of lending and hedging. Yet, the Wall Street Journal version of Greenspan’s testimony before the House Oversight Committee on October 23, 2008 quotes Representative Henry Waxman making the following statement to Greenspan: “You had the authority to prevent irresponsible lending practices that led to the subprime-mortgage crisis. You were advised to do so by

22. See KOZOLCHYK, *supra* note 3, ch. XXV, n.1 and accompanying text, on Oliver Wendell Holmes’s “bad man.”

23. See U.C.C. § 4-214(a) (rev. 2002) (West, Westlaw 2012); *see also id.* § 4-214 cmt. 1 (“Under current bank practice, in a major portion of cases banks make provisional settlements for items [checks] when they are first received . . .”).

many others. And now our whole economy is paying its price.”²⁴ In response, Mr. Greenspan:

[S]aid he made “a mistake” in his hands-off regulatory philosophy, which many now blame in part for sparking the global economic troubles. He quoted something he had written in March: “Those of us who have looked to the self-interest of lending institutions to protect shareholder’s equity (myself especially) are in a state of shocked disbelief.”²⁵

Serious mischaracterizations of archetypal commercial behavior also abound in Marxist-Leninist dogma and legal literature. Karl Marx and Vladimir Illyich Lenin (among others) characterized ordinary merchants in many different ways, such as criminals bent on “exploiting someone else’s labor,” “speculators” with the goods or money of others, embezzlers of the excess value created by the work of their employees, or avaricious and selfish farmers (“*Kulaks*”).²⁶ These inaccurate archetypal characterizations of merchants and farmers became part of the Soviet living law of commercial contracts. Thus, sayings by Lenin on the avariciousness of merchants or farmers and how they profited by hiring and exploiting laborers were soon repeated by self-appointed accusers against the recipients of administrative bonuses who as “model” state employees were awarded: 1) automobiles (but used them as taxis with the help of hired drivers); 2) plots of land (when they were used to grow vegetables with hired help); or 3) *dachas*²⁷ (when rented out and maintained also with hired help).²⁸

b. Archetypal Behavior in Simple and Complex Transactions: Standard and Best Practices and their Economic Significance

Obviously, it is easier to identify archetypal behavior in simpler transactions than in complex ones. The archetypal behavior in a simple transaction such as in a sale of goods in a retail store or market is more easily standardized than that in a complex financial transaction with multiple parties, some supplying goods, others services, and with highly negotiated terms and conditions. Further, the behavior associated with familial (and “civil” or not-for-profit) archetypes such as the French

24. See the summary of Greenspan’s testimony in Kara Scannell & Sudeep Reddy, *Greenspan Admits Errors to Hostile House Panel*, WALL ST. J., Oct. 24, 2008, at A1, available at online.wsj.com/article/SB122476545437862295.html.

25. *Id.*

26. See KOZOLCHYK, *supra* note 3, chs. XIV, XV.

27. *Dachas* are country houses or villas.

28. See KOZOLCHYK, *supra* note 3, ch. XIV, on Soviet law.

“good father of a family” of the *Code Civil*²⁹ tends to change much less over time than that of commercial archetypes. Can you visualize why?

Consider, for example, the changes experienced by the archetypal United States commercial banker in the twentieth century alone. Prior to the enactment of the 1933 Glass-Steagall Act, he could be a deposit banker, a commercial banker and an investment banker or underwriter. After this enactment, he could no longer function as an investment banker.³⁰ In November 1999, however, the Gramm-Leach-Bliley Act authorized commercial bankers to engage in some of the same previously forbidden activities.³¹ Quickly thereafter, highly complex, new, archetypal standard banking practices were engaged in by United States banks, with greater powers and rights than ever experienced before.

As if on cue, shortly after the repeal of four provisions of Glass-Steagall that limited bank activities, an international financial “bubble” grew uncontrollably while new standard practices for complex and often risky transactions continued to be fashioned to meet the demands of a growing international clientele.³² Yet, while new standard practices were being created, no attention was paid to their effects upon the welfare of regular participants in those transactions as well as that of third parties. Among these third parties were millions of homeowners who lost their homes and approximately eight million workers made jobless in the United States alone.³³

Standard practices as governed by the market standard of fairness mandates that each party to a contract treat the other as a regular market participant would reasonably expect to be treated when viewing his own advantage. And, best practices are those that take into account the effect of their transactions upon third parties and in fiduciary transactions treat the counter party in an altruistic or brotherly fashion.

The fact that recent standard practices in the United States on sub-prime mortgages, including their sales to third parties, were the result of agreements between or among a small group of “primary” market participants, should not be missed. For the regular market participants who designed and negotiated the various agreements involved in the creation and distribution of sub-prime mortgage-backed bonds or certificates were the “originating” mortgagee banks, the underwriting banks or securities intermediaries or both, and, of course, their “special purpose” vehicles.

The third party purchasers of the bonds or certificates or of security interests in them were not regular participants in that primary or originating market and were

29. See, e.g., C. CIV. art. 1374 (Fr.) (*un bon père de famille*); see also Boris Kozolchyk, *The Commercialization of Civil Law and the Civilization of Commercial Law*, 40 LA. L. REV. 3, 16–20 (1979); KOZOLCHYK, *supra* note 3, ch. IX(B)(1).

30. See Glass-Steagall Act, 12 U.S.C. § 378 (West, Westlaw 2012) (effective 1933).

31. Also known as the Financial Services Modernization Act of 1999, Pub. L. No. 106-102, 113 Stat. 1338 (codified as amended in scattered sections of 12 U.S.C. and 15 U.S.C.) (West, Westlaw, 2012), available at <http://www.gpo.gov/fdsys/pkg/PLAW-106publ102/pdf/PLAW-106publ102.pdf>.

32. See *id.* § 101 Glass-Steagall Act Repeals, § 606 Management of Banks (West, Westlaw, 2012).

33. *Charlie Rose* (PBS television broadcast June 4, 2012) (interview by Charlie Rose with Gary Gensler, chairman of the U.S. Commodity Futures Trading Comm’n), available at www.charlierose.com/view/interview/12409.

not parties to the negotiation and drafting of the agreements that resulted in the standard practices of that primary market. They belonged to the secondary markets and their reasonable expectations of profitability and safety were taken into account only hypothetically by the drafters of the agreements and creators of the primary market practices. I say “hypothetically” because what the drafters of standard practices on the distribution of mortgage-backed sub-prime bonds or certificates calculated was a likely interest rate that would be attractive to these third parties. They did not truly attempt to assess the risk assumed by their third parties.

5. Von Ihering’s and Justice Cardozo’s Contextual Analysis and Cultural Anthropology

Justice Benjamin Nathan Cardozo was one of the most insightful and influential users of contextual and purposive legal analysis in Anglo-American law. He attributed its authorship to the “legal sociology” of von Ihering. After describing the lawmakers’ and especially the judge’s function as “thinking of the end which the law serves, and fitting its rules to the task of service,”³⁴ he added:

This conception of the end of the law as determining the direction of its growth, which was [I]hering’s great contribution to the theory of jurisprudence, finds its organon, its instrument, in the method of sociology. Not the origin, but the goal, is the main thing. There can be no wisdom in the choice of a path unless we know where it will lead. The teleological [or purposive] conception of his function must be ever in the judge’s mind.³⁵

By “the method of sociology,” Cardozo did not mean today’s widely practiced quantitative and statistical analysis of social institutions. His (and von Ihering’s) sociological methods relied on their observation of societal developments likely to impact statutory or judge-made law, and especially of those developments likely to prompt serious social or interpersonal conflicts. In Cardozo’s time, one such development was the increasing number of accidents related to the industrial manufacture and use of automobiles. Its likelihood of causing injuries to immediate and remote purchasers-users brought into question the manufacturers’ duty to foresee the injuries caused by their defective manufacture of vehicles.

Another conflict that attracted Cardozo’s attention was the relationship between trusted merchants and financial intermediaries at a time when the latter began to manage the investments of a growing number of savers who were not as professionally capable or economically powerful as managing merchants were. Cardozo’s observation of the interests and forces at stake in these conflicts was accompanied by his ability to identify the behavior that was customary among

34. BENJAMIN NATHAN CARDOZO, *THE NATURE OF THE JUDICIAL PROCESS* 102 (1921) [hereinafter *CARDOZO, JUDICIAL PROCESS*].

35. *Id.* (citation omitted).

average and model or highly respected participants in the legal and business relationships, especially when some or all were merchants. Yet, despite Justice Cardozo's references to legal sociology, I would suggest that his method is closer to the one used by legal-cultural anthropologists such as E. Adamson Hoebel and Marcel Mauss, and that Cardozo also relied considerably on archetypal behavior to formulate his concepts, principles, and rules of adjudication. The reason this is such a useful method is because it not only peers into human nature but also *focuses specifically on those activities* that eventually become legal institutions.³⁶

In pre-industrial societies, the behavior of average merchants when selling their goods was largely governed by the principle "let the buyer beware" (*caveat emptor*).³⁷ In contrast, in societies with a developed or developing commercial and financial marketplace, such as the mid-twentieth century United States, similar sales were increasingly accompanied by implied warranties.³⁸ Further, some commercial relationships required even a higher standard of diligence and concern for the interests of others. This was the case, as noted in the previous section, with trustees when dealing with their settlors and their beneficiaries. Cardozo's observations on the seminal role of trust in certain individuals and legal institutions made him conclude that the behavior that ought to be required from those who were most trusted was that of "a man of the most delicate conscience and the nicest sense of honor."³⁹

Because this behavior was archetypal and took place repeatedly, it could be ascertained objectively and was neither subjective nor capricious. As stated by Cardozo, the standards of behavior required from the highly entrusted were not the product of what some German jurists called "a jurisprudence of mere sentiment or feeling" (*die Gefühlsjurisprudenz*).⁴⁰

Similarly, although relying on historical observation, von Ihering identified the archetype that inspired the Roman law of contractual fortitude and duress for a considerable period of time. It was the stolid Roman legionnaire, whose standard of contractual behavior was of such fortitude that his contractual will could only be

36. See KOZOLCHYK, *supra* note 3, ch. III(C)(3) (discussing the landmark 1923 study THE GIFT by the cultural anthropologist Marcel Mauss, which reveals much about social man when attempting to improve his survival by exchanging goods and services). In this chapter, the insight of cultural anthropologists is particularly compelling when exploring the origins and functions of the Anglo-American doctrine of consideration in contract formation. *Id.* ch. XXII.

37. The decision commonly cited as exemplifying the principle of caveat emptor is *Chandelor v. Lopus*, (1603) 79 Eng. Rep. 3 (K.B.). See ROY GOODE, COMMERCIAL LAW 185 n.19 (2004) and accompanying text; see also LAWRENCE M. FRIEDMAN, A HISTORY OF AMERICAN LAW 264–65 (rev. ed. 2010). Professor Friedman points out that in *McFarland v. Newman*, Judge John Gibson restated a United States version of *caveat emptor* when deciding that "[h]e who is so simple as to contract without a specification of terms, is not a fit subject of judicial guardianship." 9 Watts 55, 57 (Pa. 1839).

38. See, e.g., *D'Onofrio v. First Nat'l Stores, Inc.*, 26 A.2d 758, 758–59 (R.I. 1942); see also KOZOLCHYK, *supra* note 3, ch. XXII) (discussing the emergence of implied warranties in English law).

39. CARDOZO, JUDICIAL PROCESS, *supra* note 34, at 109.

40. *Id.* at 106.

broken by the most severe of physical pressures. For this reason, very few contracting parties in classical Roman law were granted the remedy of rescission of contract on the grounds of duress.⁴¹

The reliance on archetypal behavior to fashion long-lasting commercial law rules is a trait of great jurists from the Ulpians to the Cardozos, confirmed by commercial law adjudication in the Middle Ages, and by the method used by Maimonides, the Jewish medieval sage and rabbinical authority.⁴² When instructing lower court judges on whom, between or among the disputing merchants, should take the oath that would decide the controversy, he often resorted to archetypal behavior. For example, where *force majeure* was alleged to have prevented one joint venturer or partner from rendering a proper accounting to the other,⁴³ he required that in the absence of written, oath-supported promises (such as in a formal promise known as a *shetar*), the partner or joint venturer whose behavior varied most from the customary norm had to take the oath reserved for archetypal partners or joint venturers (*shavuot shutaphim*).⁴⁴

Similarly, the codifiers of the model European civil and commercial codes resorted to archetypal behavior such as that of the “good father of family” (*bon père de famille*) of the French Civil Code or the “proper merchant” (*eines ordentlichen Kaufman*) of the German Commercial Code (*Handelsgesetzbuch*). The behavior of this standard but respectable merchant contrasts with that of a more highly trusted archetype, Mayer Amschel Rothschild, the international banker in late eighteenth-century Germany who protected the assets of his joint venturers in preference to his own.⁴⁵

Archetypal behavior generates what Harvard dean Roscoe Pound, the Australian legal philosopher Julius Stone, and the founder of U.S. legal anthropology E. Adamson Hoebel, among others, referred to as “jural postulates.” These postulates express the principles that shape the living law of a given legal culture. As such, they epitomize the moral criteria that govern archetypal legal behavior, whether officially or unofficially approved, and are therefore omnipresent throughout the history and

41. See Saul Litvinoff, *Vices and Consent, Error, Fraud, Duress and an Epilogue on Lesion*, 50 LA. L.R. 1, 83 (1989); see also John P. Dawson, *Economic Duress: An Essay in Perspective*, 45 MICH. L. REV. 253, 255, 264 (1947) (an enlightening study of the development of standards and fortitude in the law of duress); RUDOLF VON IHERING, *ABREVIATURA DE EL ESPÍRITU DEL DERECHO ROMANO* 59–60 (Fernando Vela, ed., trans., 2d ed. 1962) (1947) (abridging *GEIST DES RÖMISCHEN RECHTS* (5th ed. 1906)) (concluding that the early Roman law of property was enormously influenced by the model of behavior of the Roman warrior, a man whose favorite means of acquiring property was by the strength of his hands, his sword, and his spear); Boris Kozolchyk, *Toward a Theory on Law in Economic Development: The Costa Rican USAID-ROCAP Law Reform Project*, 1971 LAW & SOC. ORDER 681, 739 (1971).

42. See KOZOLCHYK, *supra* note 3, ch. V(J).

43. *Id.*

44. *Id.* (2) Question 63b (FG).

45. See KOZOLCHYK, *supra* note 3, ch. XI(D)(1)(f), for a more detailed discussion of this trusted archetype. See also NIALL FERGUSON, *THE HOUSE OF ROTHSCHILD, VOL. 1: MONEY’S PROPHETS 1798–1848*, at 64 (1998).

geography of commercial contract rights and duties. They range from the pre-industrial postulates such as “buyer beware” to Justice Cardozo’s turn of the twentieth century “punctilio of an honor the most sensitive.”⁴⁶

II. TWO METHODS OF LEGAL REASONING: LEGAL SCHOLASTICISM AND THE LOGIC OF THE REASONABLE

The methods of legal reasoning are part of a nation’s or a region’s legal culture, and as such, they influence and are influenced by its attitudes and values. For this reason, they also influence economic development. If, as a result of his method of legal reasoning, a judge or administrator denies validity to a transaction that is otherwise legal, moral, or consistent with public policy, and can contribute to the nation’s economic development, there is every reason to question his legal reasoning. For if that transaction’s only fault is that it conflicts with a legal definition or classification whose purpose was to better describe and classify transactions used during the life and times of the definer and classifier, but not those who were their necessary replacements, why block their use? After all, commercial legal definitions and classifications should reflect transactional life and not the other way around. The following sections explore the interaction between the two most utilized methods of legal reasoning and economic development.

A. Legal Scholasticism

During the Middle Ages, what eventually became the civil and common law jurisdictions started diverging in varying degrees from their common Roman law ancestry. This divergence was caused largely by the different methods of legal reasoning employed by the jurists, lawyers, and law professors within each system. Together with the attitudes and values of legislators, judges, lawyers, and law professors, these methods shaped the drafting, interpreting, practicing, and teaching of law on each side of the systemic divide.

Scholasticism became the prevailing method of legal and theological reasoning in southern and central European universities during the late Middle Ages (mostly from the twelfth to the fifteenth centuries), as well as in some other countries and regions, especially in France, Spain, Portugal, and Spanish and Portuguese America. One reason for its popularity was that it aimed at reconciling the teachings of Greek philosophers, especially those of Aristotle, with the prevailing Christian theology.

Christian theology was interested in establishing the permanence and universality of its teachings. Aristotle’s writings, particularly on logic and metaphysics, proved very helpful, especially to a mind as keen as that of Saint Thomas Aquinas. For Aristotle, the search for the essence of things was intended to

46. *Meinhard v. Salmon*, 164 N.E. 545, 546 (N.Y. 1928).

reveal what was unique, universal, and permanent about them. Unlike Plato, who believed in a world of forms and ideas that existed separately from the things perceived through our senses, Aristotle believed in universal features that exist within each of the objects discernible to our senses.⁴⁷ When successful, the search for the permanent and universal essences leads to definitions such as those admired the Nicaraguan colleague mentioned earlier.⁴⁸ As stated by Wilhelm Windelband, the distinguished German historian of ancient philosophy:

[According to Aristotle] . . . human knowledge can obtain a conception of the essential and the permanent only through exact and careful scrutiny of the facts [*i.e.*, what actually exists]. In these teachings Aristotle theoretically adjusted Platonism to empirical science.

...

The logical form of . . . [his empirical findings is through the process of d]efinition *in which the permanent essence is established as the ground of the changing conditions and manifestations for every single phenomenon*; [Hence, t]hese determinations of concepts are based *partly upon deduction and partly upon induction*⁴⁹

For example, Aristotle's definitions that apply to animals start with an observation of their peculiarities followed by their classification. Thus, a hierarchy was organized in accordance with the complexity and function of animal organs.⁵⁰ Similarly, the heirs of the scholastics in pre-codification civil law France⁵¹ (and in many other countries that followed the French example) classified legal institutions such as contracts according to their formalities, mutuality, gratuity, etc., and having done so, placed them within the family of voluntarily-assumed obligations that, in turn, belonged to the genus of obligations (both voluntary as contracts and involuntary as, say, the tort of negligence). The classification was followed by definitions that gathered the peculiarities of each species as part of a genus. Thus, a sale agreement could be defined as a "bilateral," "consensual," "synallagmatic," or "onerous" agreement.⁵²

47. See WILHELM WINDELBAND, HISTORY OF PHILOSOPHY 141–42 (James H. Tufts trans., Macmillan 2d ed. 1901); WILHELM WINDELBAND, HISTORY OF ANCIENT PHILOSOPHY 247 (Herbert Ernest Cushman, trans., 3d ed., Charles Scribner's Sons, 1921) [hereinafter WINDELBAND, HISTORY].

48. See Nicaraguan Conversation, *supra* note 13.

49. WINDELBAND, HISTORY, *supra* note 47, at 255–56 (emphasis added) (Greek terms omitted).

50. UNIV. OF EVANSVILLE, *The Road to Modern Evolutionary Biology*, <http://faculty.evansville.edu/de3/evolutionweb2/history.html> (last visited Mar. 24, 2013).

51. See 1 ROBERT JOSEPH POTHIER, A TREATISE ON OBLIGATIONS, CONSIDERED IN A MORAL AND LEGAL VIEW 3, 4–5 (Martin & Ogden trans.) (1802); see also KOZOLCHYK, *supra* note 3, ch. VIII(D)(1) (referring to Pothier).

52. KOZOLCHYK, *supra* note 3, ch. VIII(D)(2)(a) (on "classifications" and "synallagmatic").

Because of their logical rigor, these scholastic classifications and definitions were particularly well suited for the synthetic formulation of legal concepts, principles and rules that eventually populated many codes in civil law countries. Thus, the observed practices that had been “incorporated” into the Roman rules on the contract of sale (*emptio-venditio*) receded into the background, and the mere mention of a sale agreement was deemed by courts, lawyers, and legal commentators to be the result of the synthesis of concepts such as bilaterality, consensuality, etc. Similarly, it was enough to refer to “property” to suggest the existence of the attendant rights to use, enjoy (and for some, even to abuse), mortgage, pledge, or convey the subject property.

The importance ascribed by contemporary civil lawyers to the classification of contracts and to the precise features of the various types classified is in some measure attributable to the “typification” of contracts in Roman law.⁵³ This is particularly true of those trained to apply codes of the French *Code Civil* (definition- and classification-governed variety). Yet, please bear in mind that the Romans typified contracts because of the practical need to enable a high administrative and judicial official (the *praetor*) to fashion causes of action and defenses geared to different, albeit standardized, sets of contractual practices. For example, contracts of bailments or deposits of things required that a thing be delivered to their custodian or depositary to be enforceable. In contrast, other agreements such as the *emptio-venditio* did not require the delivery of the thing before the parties were bound; their mere agreement sufficed (*nudo consensu*). Thus, the buyer acquired an action to obtain the thing bought or its worth (*actio emptio*) and the seller to receive its price (*actio venditi*) from the time of the agreement.⁵⁴

The reason for the Roman classification of contracts, then, was not the search for universal and permanent essences, but rather for practical, mostly procedural or remedial, purposes.

1. Facts and Scholastic Legal Institutions

The scholastic search for essences started (as with Aristotle) with observation and was followed by definitions and classifications. Unlike Aristotle, however, the scholastics were not interested in an empirically based legal science.⁵⁵

53. *Id.* ch. IV(D)(4)(iii).

54. *Id.* ch. IV(F)(1)–(2); *see also id.* ch. VIII(A) (on Greeks and Babylonians).

55.

“Scholasticism” refers to the intellectual culture characteristic of the medieval schools The working language of the schools was Latin The universities got a great boost from the translation into Latin of the works of Aristotle, commentaries on Aristotle and related works These translations were made and copied because there was a public whose interest in Aristotle had been formed by the schools of the twelfth century, in which some works of Aristotle that had been translated earlier . . . were already objects of close study. In the universities, philosophy . . . was developed and employed . . . in the faculties of Theology. The study

Most of their classifications and definitions were intended for theological purposes and for theologically influenced argumentation and persuasion in law, ethics, and politics. In attaining these purposes, they relied not only on Aristotelian logic, but also employed Plato and other Greek philosophers' inspired dialectics. Traces of these methods can still be found in today's civil law reasoning, and the better one identifies them, the better one can separate what is factual from what is rhetorically persuasive but not necessarily factual.

2. Dialectics, Axioms, and Maxims

Dialectics in Ancient Greece was a form of dialogue among thinkers who held different ideas and wished to persuade each other by structured, although not necessarily syllogistic, arguments. Plato's dialectics additionally embodied a search for the truth, but this search was not supported by a previous Aristotelian-like collection of facts. In Professor Windelband's words:

[I]n a strict sense, [Plato's] dialectics consists of . . . suppositions that serve as bridges to enable [the discussants] to ascend to the principles that embody the truth [of the subject under discussion]; an axiom was such a principle [pure or] free of facts. It, in turn, supported the formulation of the sought after definition.⁵⁶

Ancient Roman law consisted of the frequent use of axiomatic reasoning, especially in its rules of law (*regulae iuris*).⁵⁷ These were maxims endowed with the persuasive power of self-evident propositions such as: "No one can convey what he does not have." (*Nemo plus iuris in alium transferre potest quam ipse habuit.*) One should not be deceived by the self-evident nature of these maxims, for often they are invoked to reach a conclusion whose factual assumptions have not been proven or have only been proven in part. For example, assume that the above maxim is applied to a conveyance by an owner's agent who lacked an express power of attorney but was clothed by the owner with every appearance of having such a power. Should this

of law was important in medieval universities and ideas derived from the law were influential in political thinking. Writers on political philosophy used a number of the literary genres characteristic of scholasticism, such as the commentary, the disputed question, the dialogue and the treatise. . . .

John Kilcullen, *Medieval Political Philosophy: The Scope of Medieval Political Philosophy*, in STANFORD ENCYCLOPEDIA OF PHILOSOPHY (Edward N. Zalta ed., 2010), available at <http://plato.stanford.edu/archives/fall2010/entries/medieval-political/>.

56. WILHELM WINDELBAND, *HISTORIA DE LA FILOSOFÍA ANTIGUA* 216 (Spanish trans. J. Rovira Armengol) (Nova 1955) (author's English translation).

57. See KOZOLCHYK, *supra* note 3, ch. IV.

maxim apply? At least German and Anglo-American commercial lawyers reject the unqualified application of this maxim for good commercial reasons.⁵⁸

Another method of reasoning used by the Greek dialecticians is the one known in U.S. law schools as “Socratic.” Imitating that which was attributed by Plato to Socrates, this method shows how a given hypothesis (or in our case a legal argument, rule of law or statement about it) can be tested for its reasonableness and can lead to a contradiction or to an absurdity (*reductio ad absurdum*).⁵⁹

3. The Syllogism

The main focus of Aristotelian thinking—the essence of things as species, identified by placing each species within its corresponding genus—is the relationship between the universal and the particular. Starting from this relationship, Aristotle created what Windelband refers to as “the *science of logic*.”⁶⁰ In this science, the essence of a thing is what is peculiar to the thing. The ultimate mission of Aristotle’s science of logic is to make possible the deduction of the particular and peculiar from the general or universal.

And since knowledge requires the validation of unknown concepts by known concepts, the “scientific” explanation consists of the deduction of minor (unknown) premises from general (known) premises. Following such a deduction, it is possible to define the thing, whether tangible or intangible. This is why the central point and most-resorted-to feature of Aristotelian logic is its syllogism.⁶¹ I used the word “validation” to remind the reader of my earlier discussion with the Nicaraguan commercial law professor who dismissed his need to include “chips” (*fichas*) in his definition of payment instruments as merely an “empirical” endeavor. His scholastic legal training required that his proposed rules be validated by “scientific” definitions. Unlike Aristotle, however, he did not think it necessary to take into account the full range of observations or sensorial perceptions of payment instruments used in the Nicaraguan marketplace.⁶²

Yet, the validity of what a syllogism concludes depends upon the quality of the data assumed by its major premise. And unlike Aristotle’s attempt to verify the accuracy of his observations, however imperfectly at times, the scholastics seldom went beyond what they perceived with their senses. Thus, after having observed an

58. See *id.* ch. XII(E)(1) n.110 and accompanying text, on Prokura (signing power). As stated by Original Section 49, when a commercial establishment conferred the power to sign in its name (*Prokura*), it authorized “juridical and extra-juridical acts and legal transactions, of all kinds, which are involved in the conduct of a commercial enterprise.” HANDELSGESETZBUCH [HGB] [COMMERCIAL CODE], May 10, 1897, as rev. and amended to Oct. 28, 1994, § 49 (Ger.) (Translation cited from SIMON L. GOREN, *THE GERMAN COMMERCIAL CODE* 20 (2d ed. 1998)).

59. See generally ROBERT C. PINTO, *ARGUMENT, INFERENCE AND DIALECTIC: COLLECTED PAPERS ON INFORMAL LOGIC* 1–2 (2001).

60. WINDELBAND, *HISTORY*, *supra* note 47, at 248–49.

61. *Id.* at 251.

62. See KOZOLCHYK, *supra* note 3, ch. II(A)(2)(c).

elephant that had been painted white (for whatever reason) they could easily fashion a major premise, such as “Elephants are white,” and this premise would inexorably lead to the conclusion that because X is an elephant, he must be white. Or, as Jeremy Bentham (the influential eighteenth- and nineteenth-century English utilitarian philosopher and jurist) quipped with respect to Aristotle’s conclusion that money was a barren commodity and therefore not entitled to earn interest when lent, Aristotle missed the fact that, in a credit economy, money does indeed have reproductive organs.⁶³

Similarly, in connection with the “juristic act” of the German *Bürgerliches Gesetzbuch* (BGB) of the 1900s, an equally faulty observation of the universe of binding promises could lead to a premise such as “contracts are the only binding voluntary obligations.”⁶⁴ Such a logical major premise would preclude the reliance on promises that in the world of business are binding upon the promisors from the moment they are issued and therefore not the product of a pre-existing contract between the promisor and the promisee.⁶⁵

4. Economic Development Consequences of Scholastic Classifications and Definitions

The explicit or implicit aim at permanence and universality of scholastic definitions and classifications was and continues to be at the expense of changing socio-economic reality. In one of my first lectures at a Spanish law school during the 1960s, a professor of “civil law contracts” (non-commercial contracts) objected to the title of my lecture “Conditional Sales or Sales with Retention or Reservation of Title” as follows:

How could such sales *exist*? Has it not been clear for centuries now that sales *are* consensual contracts which transfer title to what is bought from the moment that the buyer and seller agree on the subject matter and price of the sale?⁶⁶

My reply was that if he was referring to the physical existence of conditional sales, the physically verifiable fact was that while he was formulating his objection, millions of these agreements (labeled as contracts) were being concluded throughout the trading world. And if he was referring to their legal existence, all that was required in those jurisdictions that deemed them unenforceable was to replace the

63. See JEREMY BENTHAM, DEFENSE OF USURY 100–01 (1816).

64. KOZOLCHYK, *supra* note 3, ch. XII(C)(3); see *id.*, for a discussion of the views of Phillip Heck’s, a follower of von Ihering, on this subject.

65. *Id.*

66. He was referring to Article 1450 of the Spanish Civil Code of 1887, which states: “The sale agreement is perfected between buyer and seller and is binding on both if the parties had agreed on the subject matter of the sale and on its price, even though neither was delivered or paid.” (Author’s translation).

invalidating definition or classification with validating ones. This replacement would take into consideration that the former were conceived at a time in which there was little if any commercial and installment credit and that sales were mostly on a “cash on the barrel head” basis, while the latter would reflect the omnipresence of a credit economy.

Not only did the scholastically inspired code definitions of “consensual” sales continue to challenge the enforcement of conditional sales in some jurisdictions at least as late as in 1968,⁶⁷ but, as I will discuss shortly, other nineteenth-century definitions and classifications do the same to other contracts. In their Roman law days, some of these contracts were classified as gratuitous, such as those of deposit or bailment and agency, and continue to be classified as such in the *Code Civil* and its progeny despite the fact that in the transactional life of those countries most depositories, custodians and agents do charge for their services.

Please note that the scholastic definitions of legal institutions use the verb “is” (as in “a deposit is,” or “an agency is” or in the above assertion by my Spanish colleague that sales “are” consensual) to signify that such is the legal nature (meaning the Aristotelian essence) of deposits, agencies and sales, now and forever, here and elsewhere. Not surprisingly, a contemporary decision by the Spanish Supreme Court distinguished between a loan and a financial lease by comparing their “essences,” even though the essence of the loan it was comparing relied upon thirteenth-century observations by Thomas Aquinas regarding loans of things “consumed by their use.”⁶⁸

From an economic development standpoint, this method of reasoning not only causes the above unjustified and unnecessary obstacles traceable to anachronistic definitions and classifications, it also precludes the validation of new legal institutions by imposing closed-number (*numerus clausus*) criteria to contracts or rights in rem.⁶⁹ After all, if the list of contracts, rights in rem, or “acts of commerce” is supposed to be a list of all contracts, rights in rem, and acts of commerce endowed with uniqueness and universality, how could there be any other? It also undermines trust in legal institutions in general, and in commercial legal institutions in particular, especially as interpreted in scholastically inspired judicial or arbitral disputes. The repeated clashes between judicial or arbitral decisions (or “individual” norms) and marketplace customs and practices create commercially

67. While teaching at the University of Costa Rica School of Law in 1968, I repeatedly heard the following reasoning from trial court judges on their inability to enforce conditional sales: Article 442 of the Commercial Code of Costa Rica provides that even the most informal of oral sale agreements (*de viva voz*) are perfected when the parties agree on subject matter and price, resulting in a transfer of title to the purchaser *ipso facto* and *ipso jure*. CÓDIGO COMMERCIAL, art. 442. Article 457 of the same Code, in turn, provides the only instance in which title is transferred back to the seller is the event of buyer default, and in such an instance the seller must pay back the price received from the buyer. *Id.* art. 457.

68. See KOZOLCHYK, *supra* note 3, ch. XXVII, on Spanish case law; see also *id.* ch. V(G)(2)(a), for observations by Aquinas.

69. See, e.g., *id.* chs. X(B)(2)(a), XII(B)(1).

counterintuitive and thus unpredictable or “irrational” legal institutions.⁷⁰ Many of the courts that apply the scholastic method ignore the inequity or unreasonableness of their decisions and support their reasoning by invoking the scientific truth, comprehensiveness and precision of their scholastic definitions and classifications. That being the truth, there is nothing the judges or arbiters could do about them.⁷¹

Hence, the pseudo-scientific definitions of a methodology that does not require much by way of factual findings become helpful tools in the hands of corrupt judges who hide their disregard of facts behind such definitions. The bribed judge does not have to explain the irrationality and unfairness of his decisions. All he has to do is to point to a classification such as “obligations to do and to give” with its inherent factual and semantic uncertainties and claim that his hands are tied because the contract before him required, say, the issuance of a public deed, which is an obligation to do, and not one to give, and, failing such an issuance, whatever the parties actually agreed to is irrelevant.⁷²

The following are examples of scholastically inspired definitions and classifications of contracts in the *Code Civil*:

From article 1102: A contract is *synallagmatical* or *bilateral* when the contractors bind themselves mutually some of them towards the remainder.⁷³

70. See Philip von Mehren & Tim Sawers, *Revitalizing the Law and Development Movement: A Case Study of Title in Thailand*, 33 HARV. INT’L L.J. 67, 68–73 (1992). These authors aptly summarize Max Weber’s typology of legal logic, where economic development was concerned, as including among his four categories of logic a first type which was “formally irrational.” *Id.* 69–70.

[This was] characteristic of systems that depend on primitive procedures for deciding disputes, such as the Delphic oracle in ancient Greece. Stringent observance of procedural rules is of utmost importance, but these rules have no relationship to the rational determination of the rights and liabilities of the parties in the particular case. One imagines a priest examining the viscera of a goat and proclaiming the guilt or innocence of the accused.

The second type of legal system is the “substantively irrational.” Kronman cites, as an example, “khadi-justice” of the Mideast. Weber characterizes these systems as using an *ad hoc* process to determine the outcome of a particular case. The system is “irrational” because it espouses no general rules; it is “substantive” because of its willingness to consider the widest range of factors in determining the outcome of a case. The picture of a Bedouin chief handing out rough-and-tumble justice springs to mind.

Id. at 70, n.13 (citations omitted) (internal quotation marks omitted).

71. See Kozolchyk, *supra* note 3, ch. XXII.

72. *Id.* ch. XXII, App. (D)(2)(c), on the Maria Trinidad Gomez decision.

73. C. CIV., art. 1102 (Fr.), author’s translation, published at THE NAPOLEON SERIES, *Research Subjects: Government & Politics, French Civil Code*, <http://www.napoleon->

From article 1103: It is *unilateral* when it binds one person or several towards one other or several others, without any engagement being made on the part of such latter.⁷⁴

From article 1104: It is *commutative* when each of the parties binds himself to give or to do a thing which is regarded as the equivalent for that which is given him, or for that which is done for him.⁷⁵

From article 1104: When the equivalent consists in the chance of gain or loss for each of the parties, in consequence of an uncertain event, the contract is *aleatory*.⁷⁶

From article 1105: The contract of *beneficence* is that in which one of the parties procures for the other an advantage purely gratuitous.⁷⁷

B. The Logic of the Reasonable

In his *Revolt of the Masses*, a classic analysis of European philosophical culture and ideas at the turn of the twentieth century, the Spanish philosopher José Ortega y Gasset decried the French and German intellectuals' veneration of the revolutionary spirit; for these intellectuals, if what took place was revolutionary, it had to be good.⁷⁸ The French were elegant masters of rhetoric, and the Germans plumbed the depths of metaphysics deeper than others, but both found it very difficult to bring about social change in their own countries in an evolutionary, non-violent manner.

In contrast, the British were neither as elegant in their rhetoric nor as deep in their metaphysics, but through centuries of war, revolution and turmoil had learned how to find practical solutions to the conflicts engendered by social change and did so in an evolutionary manner that was respectful of man's "right to the continuity" of his life.⁷⁹ After all, Ortega argued, man, unlike other animals, has a memory built up each second of every day by the accumulation of daily experiences.⁸⁰ Thus, it is most unnatural for man to go to bed at night believing, on the basis of all those accumulated experiences, that he had a family and a status in life which he acquired

series.org/research/government/code/book3/c_title03.html#Kozolchyk (last visited Apr. 11, 2013).

74. *Id.* art. 1103.

75. *Id.* art. 1104.

76. *Id.*

77. *Id.* art. 1105.

78. JOSÉ ORTEGA Y GASSET, LA REBELIÓN DE LAS MASAS 41, 64–66 (1930).

79. *Id.* prólogo para franceses, pt. IV (*el derecho a la continuidad*).

80. *Id.* prólogo para franceses, pt. IV (*de la más larga memoria*).

by honestly following certain rules only to wake up one morning to be told that he had neither family nor status and that the rules under which he acquired them were no longer in effect—and that all of this radical and unexpected change occurred because of someone else’s revolutionary inspiration or whim. This is why Britain, according to Ortega, had to become the “nurse” of a relentlessly revolutionary and violent Europe, a continent embroiled in violent and costly social change during most of its history.⁸¹

Ortega ascribed to the English what I could best describe as a “necessary intelligence.”⁸² As best as I can describe it from a legal standpoint, it is an intelligence that searches for the practical ways to resolve the problems of the here-and-now by relying on past experience as well as by reflecting on the likely consequences of one’s actions. Not surprisingly, that intelligence produced a utilitarian school of thought that spent much time calculating the costs and benefits of projected actions and also produced reliance on legal precedents as the products of past experiences. The method of legal reasoning that I am about to describe is a product of Ortega’s “necessary intelligence.” Because the nature and importance of this logic, especially for economic development purposes, is not widely appreciated, I will devote the remainder of this article to it.

One of the most common methods of legal reasoning in Anglo-American countries can best be described as “the logic of the reasonable.” It is not the only method of reasoning used in these countries, as Anglo-American lawyers, jurists and scholars frequently resort to syllogistic logic. Neither is it exclusive to the common law, as more and more commercial lawyers in civil law countries resort to it when drafting statutes, treaties, contracts or arguing cases. Nonetheless, the logic of the reasonable prevails in common law countries when addressing issues as basic as: Is there a contract? What was the intent of the contracting parties? Was there a breach and what remedy or remedies should be granted?

Luis Recasens Siches was a Spanish legal philosopher who admired Ortega’s teachings and became a government official and law professor during the Spanish Republic. He fled Franco’s Spain and spent a major part of his academic career as an exiled law professor and researcher at the National University of Mexico School of Law. Despite this background, and as a reflection of the universality of legal phenomena, Recasens Siches’s writings (mostly in Spanish) provide one of the best introductions to the logic of the reasonable.⁸³

81. *Id.* prólogo para franceses, pt. IV (*como la nurse de Europa*).

82. *Id.* prólogo para franceses, pt. IV, pp. 32–33.

83. See generally Luis Recasens-Siches, *The Logic of the Reasonable as Differentiated from the Logic of the Rational (Human Reason in the Making and the Interpretation of the Law)*, in *ESSAYS IN JURISPRUDENCE IN HONOR OF ROSCOE POUND 192–221* (Ralph A. Newman, ed. 1962); see also Luis Recasens Siches, *Situación Presente y Proyección de Futuro de la Filosofía Jurídica*, 3 *ANALES DE LA FACULTAD DE CIENCIAS JURÍDICAS Y SOCIALES* (1956) [hereinafter Recasens, *Filosofía Jurídica*] available at <http://www.juridicas.unam.mx/publica/librev/rev/facdermx/cont/22/dtr/dtr7.pdf>. Because of conflicting pagination, I will cite to this lecture’s numbered paragraphs.

As did von Ihering when he distinguished between causation in the legal and physical sciences,⁸⁴ Recasens Siches singled out purposive action as characteristic of man's legally relevant conduct.⁸⁵ The logic of the reasonable guides the choice of legal courses of action, although they are limited in number.⁸⁶ In making these choices, man relies on value judgments such as: 1) the appropriateness of the means and purposes to satisfy his perceived needs; 2) the utility of the considered action; 3) the morality of the action (for those who regard morals as independent of utility); 4) its justice and fairness; and so on.⁸⁷ A law student once asked me for an illustration of reasonableness between means and ends, as discussed by Recasens Siches. As an answer, I asked him about his reaction to a court decision which required that a sale of a loaf of bread at a local market had to be documented by a notary public's deed (*escritura pública*) or it would be unenforceable. He answered by saying that under the circumstances, such a requirement would be unreasonable. I told him that my illustration was the same given by Professor Lon Fuller: "We must preserve a proportion between means and end[s]; it will scarcely do to require a sealed and witnessed document for the effective sale of a loaf of bread."⁸⁸

I added that the choice of reasonable conduct is guided not so much by the opinions of experts, but by what similarly situated contracting parties would do, as the student said, "under the circumstances." As discussed in earlier sections, these similarly situated contracting parties are the archetypes of average (or standard) and best commercial behavior that often become standard and best practices. In addition, and as I will discuss shortly, the logic of the reasonable often resorts to analogies or close similarities between precedents and the facts at hand and the law applicable to them. Moreover, when the disputes or competing claims are likely to adversely affect the interests of third parties, the logic of the reasonable is a very helpful tool in shaping best commercial practices by providing the reasons involved in the selection of protected parties and the manner in which they should be protected.

In sum, the logic of the reasonable uses many sources of wisdom, but unlike the exact sciences, it does not intend to uncover the ultimately truthful course of action. Rather, it only aims to suggest the wisest conduct *under the circumstances*. It also operates under the assumption that no general rule, no matter how wisely conceived, is self-executing or automatically implementable. Implementation

84. See VON IHERING, *LAW AS A MEANS TO AN END*, *supra* note 6, at 2–3.

85. See Recasens, *Filosofía Jurídica*, *supra* note 83, para. 20.

86. *Id.* paras. 21–23. Although through a different route, i.e., the inherently cooperative nature of viable commercial conduct, I came to the same conclusion and expressed it as one of the principles that guide commercial lawmaking. See, e.g., Boris Kozolchyk, *Modernization of Commercial Law: International Uniformity and Economic Development*, 34 *BROOK. J. INT'L L.* 709, 712 (2009) (stating that the need for commercial cooperation among merchants, no matter where and when, "imposes serious limits on both the operational and moral components of [its] ingredients"); see also KOZOLCHYK, *supra* note 3, ch. I(C)(6)(b), for the enumeration of some of the key principles that made possible the emergence of commercial law as a branch of private law.

87. Recasens, *Filosofía Jurídica*, *supra* note 81, para. 25(C).

88. Lon L. Fuller, *Consideration and Form*, 41 *COLUMBIA L. REV.* 799, 805 (1941).

requires fashioning what Recasens Siches refers to as the appropriate individual norms most often found in court administrative or arbitral decisions and the product of the informed application of general rules to concrete sets of facts.⁸⁹ He suggests that the time is ripe for this logic to replace its scholastic counterpart and, as you could have predicted by now, I heartily agree.⁹⁰

1. The Logic of the Reasonable as a Commercially “Peopled” Logic. Especially in Anglo-American Law

Anglo-American commercial legal reasoning makes particular use of two additional features of the logic of the reasonable. I alluded to the first of these sources in previous sections and I would like to identify it now in more precise fashion as a commercially “peopled” logic. This logic compares the behavior of the parties to the contract with the behavior of representative merchants, as in the question, What would ‘X,’ an average merchant, or ‘Y,’ an exemplary merchant, have done under the circumstances, i.e., while negotiating or performing the contract? Thus, much of the behavioral comparison in this book tries to find out the extent to which the contracting parties’ behavior approximates that of commercial archetypes.

The use of a commercially peopled logic is not peculiar to Anglo-American law. The reader will find a singularly effective use of it in an opinion by the Roman jurist Ulpian where he measured the conduct expected from a contracting party faced with a discretionary clause against the conduct of a respected man of affairs (*bonus vir*).⁹¹ References to exemplary, average, and bad faith behavior can also be found in French, German, Italian, and Anglo-American court decisions. In the following summaries of important Anglo American commercial decisions, examples of standard, bad faith or sub-standard, and exemplary commercial behaviors are illustrated.

a. Lord Mansfield’s Landmark Decision on the Law of Negotiable Instruments: How Standard and Best Commercial Practices Are Established and Secured

In *Miller v. Race*, a decision by Lord Mansfield, one of England’s and the Western world’s great commercial judges, the main issue was: As between an innocent maker of a stolen promissory note and an equally innocent purchaser of it, who had better title to the note.⁹² The note was issued by the Bank of England (the defendant) to a “William Finney or bearer on demand.”⁹³ Finney mailed the note to a certain Odenharty, but while en route the note was stolen and used by the robber to

89. Recasens, *Filosofia Juridica*, *supra* note 81, paras. 30–33.

90. *Id.* para. 29.

91. See Kozolchyk, *supra* note 3, ch. IV(F).

92. *Miller v. Race*, (1758) 97 Eng. Rep. 398, 399 (K.B.).

93. *Id.* at 398.

pay a debt to Miller (the plaintiff).⁹⁴ Miller was an innocent innkeeper who took the note in the ordinary course of his business from someone whom Mansfield described as having the “appearance of a gentleman.”⁹⁵

Once he learned of the robbery, Finney applied to the Bank of England to stop payment on the note.⁹⁶ The Bank did so and Lord Mansfield held that Miller enjoyed the protected status of a good faith purchaser of the note and that his title was superior to that of Finney.⁹⁷ He stated: “A bank-note is *constantly and universally*, both at home and abroad, treated as money, as cash; and paid and received, as cash; and it is necessary, for the purposes of commerce, that their currency should be established and secured.”⁹⁸

b. Judge Friendly’s Explanation of What Is “Contractually Reasonable”

In *Frigalment Importing Co. v. B.N.S. International Sales Corp.*, the issue before the court was seemingly straightforward: What did the parties mean when they agreed on the purchase and sale of animals that their contract described as “chicken?”⁹⁹ As it turned out, there were many types of chickens available for purchase in that market and depending upon their variety, prices and profits varied considerably.¹⁰⁰ If the court agreed with the buyer, the type of chicken he claimed to have purchased would have resulted in a significant loss to the seller. After examining numerous sources to establish the meaning of “chicken” and comparing their market prices to the seller’s costs, Judge Friendly remarked that: “Plaintiff must have expected defendant [sic] to make some profit—certainly it could not have expected defendant deliberately to incur a loss.”¹⁰¹

c. Fiduciaries and Their Brotherly Behavior: Justice Cardozo’s Decision in *Meinhard v. Salmon*

Occasionally, Anglo-American courts and legislators require a commercial behavior that exceeds the standard of good faith practiced by an average merchant. In *Meinhard v. Salmon*, a 1928 decision by the New York Court of Appeals, Justice Cardozo characterized some of practices of a commercial trade or profession as those

94. *Id.*

95. *Id.* at 401-02.

96. *Id.* at 399.

97. *Miller v. Race*, (1758) 97 Eng. Rep. 398, 401 (K.B.).

98. *Id.* at 402 (emphasis added).

99. *Frigalment Importing Co. v. B.N.S. Int’l Sales Corp.*, 190 F. Supp. 116, 117 (S.D.N.Y. 1960). This case is fully discussed in KOZOLCHYK, *supra* note 3, ch. XXII.

100. *Frigalment Importing Co.*, 190 F. Supp. at 118.

101. *Id.* at 120.

of the “workaday world” or the ones “trodden by the crowd.”¹⁰² He also referred to other practices in more admiring terms.¹⁰³ In this case, defendant Salmon entered into a lease with the owner of a building who agreed to convert the building into stores and offices.¹⁰⁴ Plaintiff Meinhard was a third party who invested half of the cost for the reconstruction and in exchange was to receive forty percent of the profits for the first five years of the lease and half of the profits for the remaining fifteen years of the lease.¹⁰⁵ Salmon was to be the sole managing partner of the lease.¹⁰⁶ Near the end of the lease, the owner of the building, who also owned the adjoining land, proposed that Salmon tear down the building and build a larger building on the adjoining properties.¹⁰⁷ Without informing Meinhard of the proposed deal, Salmon created a company to manage the new construction and lease.¹⁰⁸ The annual receipts of the new rentals would be almost ten times greater than the amount of the original annual receipts.¹⁰⁹

Meinhard did not find out about this new lease until the new lease had come into effect.¹¹⁰ He sued Salmon, alleging that he had been left out of the new venture wrongfully and that were it not for his original investment, the new venture would not have been possible. As a remedy, he claimed a participation in the new venture.¹¹¹ On appeal, the appellate division held that Meinhard was entitled to almost one half of the interest in the new lease as long as he also assumed half of the liabilities.¹¹² Cardozo’s opinion stressed the fiduciary nature of Salmon’s position and the forthright conduct required by his status as the sole trustee in charge of managing the original venture.¹¹³ As his partner, he was required to disclose to Meinhard that the owner of the building and adjoining land had proposed a new project to him.¹¹⁴

In Cardozo’s words, such joint venturers were subject to fiduciary duties akin to those of trustees and owed each other, “while the enterprise continue[d], the duty of the finest loyalty.”¹¹⁵ His following statement became a seminal principle of U.S. law of investment trusts, especially in financial ventures, and has been cited on numerous occasions by U.S. and foreign courts:

102. *Meinhard*, 164 N.E. at 546; see also KOZOLCHYK, *supra* note 3, ch. XXII, for a full discussion of this case.

103. *Id.*

104. *Id.* at 545–46.

105. *Id.* at 546.

106. *Id.*

107. *Meinhard*, 164 N.E. at 546.

108. *Id.*

109. *See id.*

110. *Id.*

111. *Id.*

112. *Meinhard*, 164 N.E. at 546.

113. *Id.*

114. *Id.* at 547

115. *Id.* at 546.

Many forms of conduct permissible in a workaday world for those acting at arm's length, are forbidden to those bound by fiduciary ties. A trustee is held to something stricter than the morals of the market place. Not honesty alone, but the punctilio of an honor the most sensitive, is then the standard of behavior Only thus has the level of conduct for fiduciaries been kept at a level higher than that trodden by the crowd.¹¹⁶

C. Preponderantly Factual and Analogical Logic

I. Preponderantly Factual Logic

The second feature of the logic of the reasonable, as applied in Anglo-American law, is that it is preponderantly factual or dependent upon a careful determination of the relevant transactional and disputed facts. Some of its best judges also use sets of facts upon which decisions have been rendered in a legal analogical manner, i.e., they search for a common legal principle behind a similar holding even though the things or objects involved are physically different. And by finding the common legal principle behind the previous judicial decisions involving the use of different things, they develop a justification for extending this principle to a different category of acts and things. But before I discuss reasoning “by example,” I need to clarify what I mean by the preponderance of facts in Anglo-American judicial decision-making.

Unlike what happens in many a civil law court proceeding, the factual universe of an Anglo-American judge is not confined to what was alleged by the parties in their pleadings, as required by the principle of the “prayed-for justice” (*justicia rogada*) observed in some European and most Latin American jurisdictions.¹¹⁷ It is also not confined to what the parties managed to prove in court. The adjudicator who relies on the preponderance of facts in arriving at his final decision is not precluded from initiating his own fact finding or allowing facts that were discovered after the filing of the pleadings or after the period of proof to be introduced in evidence. Neither are the parties precluded from delving into the socio-economic context of the dispute and from ascertaining a more realistic meaning of the relevant facts, as the Supreme Court of the United States did when reassessing its own previous conclusion that “separate” was the functional equivalent of “equal” when it came to the education of African-American children in the United States.¹¹⁸

The logic of the reasonable also encourages the lawmaker or adjudicator to examine the socio-economic consequences of the rule he is about to fashion. At times, he is discouraged by what appears to be a reasonable outcome of a rule under consideration, such as its “opening the floodgates of costly and unnecessary litigation,” and for this, among other reasons, he will discard the considered rule. At

116. *Id.*

117. See KOZOLCHYK, *supra* note 3, ch. XXIII(B)(2).

118. *Brown v. Bd. of Educ.*, 347 U.S. 483, 495 (1954).

other times, he will reject a projected outcome as either unlikely or worth the risk in light of the benefits it would confer upon society at large.

Historically, fact finding was intimately connected to the role of juries since the birth of the common law. At first, jurors as residents in the vicinity were expected to know the facts that allegedly occurred. Yet, as England and the population of its judicial circuits grew, juries heard the facts from the parties and their lawyers and eventually were tasked with determining which version was the most credible and, inferentially, reasonable. This function continues to this day. However, when the facts are highly technical or complicated, the parties may agree to have the judge find the facts, in so-called “bench” trials, or have the fact-finding done by a specially designated judicial official.¹¹⁹ A favorite aphorism of Justice Louis D. Brandeis still sums up the assumption that lies at the root of the preponderance of fact in applying the logic of the reasonable: “From the facts the law is born (*ex facto ius oritur*).”

As a short-time practitioner in U.S. courts, I learned the importance of proven facts in jury and bench trials. Often the hardest battles of advocacy were spent in trying to get persuasive evidence before the jury or judge who was the trier of fact. Victory or defeat could be reliably prognosticated once certain facts had “got into the record.” But it must be remembered that this is a battle that starts during the pre-trial phase of “discovery.” During this phase, witnesses, documents and other credible forms of evidence are examined and cross-examined seemingly endlessly in search for a kernel of persuasive evidence. As Alexis de Tocqueville is supposed to have commented to an American commercial trial lawyer who asked him about de Tocqueville’s trial work in France compared to what he observed in the United States:

In the United States, lawyers spend much of their time finding facts on their own as if they were a detective of facts, in France I hear the facts from my client and it is my job to dress them up with the appropriate legal arguments and citations and with that version of facts we march to court.¹²⁰

During a commercial arbitration procedure that I chaired, the decisive motion by the victorious party requesting the surrender by the losing party of non-privileged, informal communications between the comptroller and the president of the company.¹²¹ The losing party fiercely fought this request as part of the pre-trial discovery, using every possible argument under the sun, and for good reason. Once

119. See Kozolchyk, *supra* note 3, ch. XXVII(C)(1). In this chapter I address a meaning of “facts” in some civil jurisdictions totally at odds with the meaning described in the principal text.

120. I owe this description of Alexis de Tocqueville’s comparison to the late and lamented Professor Saul Litvinoff of the Louisiana State University Law Center. Even though I could not find a reference to it in De Tocqueville’s *Democracy in America*, knowing Saul I am certain he had another good source for it.

121. See KOZOLCHYK, *supra* note 3, ch. XXIII(G)(3)(b)(ii).

the document was surrendered, it contradicted the facts that this party alleged to have occurred in connection with the losing party's interpretation of the agreement in dispute and conceded the validity of the opponent's version of facts.

Facts also act as an acid test for the validity of what at first sight looks like a highly persuasive logical argument. One such an instance involved Justice Cardozo when he was an appellate judge at the New York Court of Appeals. For a good number of years, courts even in the most sophisticated commercial centers of the world, such as was the New York Court of Appeals, applied letter of credit principles in a syllogistic-formal logical manner. One such a principle was that of the independence of the letter of credit promise from the defenses and equities that the buyers and sellers or other parties of the underlying transactions could raise in connection with the payment of the letter of credit. As in a manner that became customary of the keenness of his factual and purposive analysis, Cardozo taught us all the importance of a factually based distinction.

In *Maurice O'Meara Co. v. National Park Bank*, the underlying contract was for the sale of newsprint paper of a specified tensile strength.¹²² The plaintiff presented documents that on their face complied strictly with the terms and conditions of the letter of credit, but the defendant-issuing bank refused to pay the drafts.¹²³ It alleged that the plaintiff-beneficiary was obligated to provide "evidence reasonably satisfactory" that the paper it shipped complied with the agreed standards, and that "a reasonable doubt" arose "regarding the quality of the newsprint paper."¹²⁴ The plaintiff-beneficiary sued the issuing bank for the damages he sustained by the bank's dishonor and the issuer countered by maintaining that the paper shipped by the beneficiary "was not, in fact, of the [quality] specified in the letter of credit."¹²⁵ The majority of the Court of Appeals of New York decided, in a syllogistic manner, that it was established letter of credit law that the issuing bank was concerned only with the strict compliance of draft and documents and if the documents tendered by the beneficiary complied on their face with the terms and conditions of the letter of credit.¹²⁶ If that was the case, the bank was absolutely bound to pay, regardless of whether it knew or had reasons to believe that the paper was not of the tensile strength contracted for.¹²⁷

Justice Cardozo agreed that the general rule was indeed that the issuing bank had no duty to investigate the performance of the underlying contract, but he disagreed that if the bank chooses to investigate and discovers that the merchandise tendered is not the merchandise which the documents describe, "it may be forced by the delinquent seller to make payment of the price irrespective of its knowledge."¹²⁸

122. See *Maurice O'Meara Co. v. Nat'l Park Bank*, 146 N.E. 636, 637-38 (N.Y. 1925).

123. *Id.* at 637.

124. *Id.* at 638-39.

125. *Id.* at 637-38.

126. *Id.* at 639.

127. *Maurice O'Meara Co.*, 146 N.E. at 639.

128. *Id.* at 641 (Cardozo, J., dissenting).

Then, he focused on the critical facts and the distinction ignored by the majority:

We are to bear in mind that this controversy is not one between the bank on the one side and on the other a holder of the drafts who has taken them without notice and for value. The controversy arises between the bank and a seller who has misrepresented the security upon which advances are demanded. Between parties so situated payment may be resisted if the documents are false.

I think we lose sight of the true nature of the transaction when we view the bank as acting upon the credit of its customer to the exclusion of all else. It acts not merely upon the credit of its customer, but upon the credit also of the merchandise which is to be tendered as security I cannot accept the statement of the majority opinion that the bank was not concerned with any question as to the character of the paper. If that is so, the bales tendered might have been rags instead of paper, and still the bank would have been helpless, though it had knowledge of the truth, if the documents tendered by the seller were sufficient on their face.¹²⁹

The first critical, yet basic, fact was simply: Who is the plaintiff? Is it an innocent holder of a draft or negotiable instrument as was Mr. Miller in Mansfield's *Miller v. Race* (the innkeeper who innocently gave value for a stolen and forged draft without knowing anything about its past)? Or, was it the very same person who as a beneficiary tendered the documents that misrepresented the tensile strength of the paper that both the buyer and the issuing bank had every reason to expect? If it was the latter, and "between parties so situated" as the misrepresenting beneficiary and the innocent payor-issuing bank, payment may be resisted. The second critical fact was the meaning of possibly valueless cargo to an issuing bank, which in the 1920s and almost through the end of the twentieth century regarded the negotiable bill of lading and the goods it covered as an important component of its security.¹³⁰ His analysis showed that the bank's position was supported by both the most relevant facts and the soundest banking practice.

As I said in the preface to my book *Commercial Letters of Credit in the Americas*, having read this decision as a law student who came from a civil law country in which facts such as those identified by Cardozo were seldom considered by judges, my interest in letter of credit law such as articulated by Cardozo and my

129. *Id.* (Cardozo, J., dissenting).

130. During the 1990s, letter of credit banks gradually relied less and less on the bill of lading as collateral and more on prepayments of the amount of the issuance or on perfected security interests on the applicant debtor's inventory, accounts receivable and proceeds.

outlook on judges and on the role of facts was a crucial discovery.¹³¹ Add to this discovery Cardozo's analysis of the purpose of documents of title as collateral and as a critical component in the issuance of letters of credit at that time, and an entire new panorama of purposive commercial adjudication opened before my eyes.

2. Analogy and Reasoning by Example

My change of outlook was confirmed when I read Justice Cardozo's decision in *MacPherson v. Buick Motor Company*.¹³² MacPherson bought a Buick from an automobile dealer and was injured when one of the automobile's wheels collapsed as a result of defective spokes.¹³³ The wheel was manufactured not by the defendant, but by another manufacturer.¹³⁴ Anglo-American law did not have a codified or statutory provision that enabled bringing an action against anyone guilty of negligent conduct in terms such as found in Article 1382 of the *Code Civil*: "Any act whatever of man, which causes damage to another, obliges the one by whose fault it occurred, to compensate it."¹³⁵

Under the common law, the MacPhersons of this world could not sue a remote manufacturer seller such as Buick. It was neither in a direct contractual relationship with them ("privity of contract") nor had Buick *directly* harmed them, at least not in a manner that could be easily established. A negligence action required the existence of a duty recognized by the courts flowing from the defendant to the plaintiff or class of plaintiffs. As framed by Justice Cardozo, then, the main issue before the New York Court of Appeals was "whether the defendant owed a duty of care and vigilance to anyone but the immediate purchaser," that is, to anyone but the dealer.¹³⁶

Cardozo reviewed court decisions he regarded as the foundations of this area of the law. The first involved poison falsely labeled by the druggist-seller as a harmless substance.¹³⁷ In this case, the injured customer was awarded damages from the careless seller. The court held that defendant's negligence had put "human life in imminent danger" as any poison falsely labeled was likely to do.¹³⁸ To this, Cardozo added that "[b]ecause *the danger is to be foreseen*, there is a duty to avoid the injury."¹³⁹ He then turned to a decision in which the defendant, a contractor, built a

131. See BORIS KOZOLCHYK, *COMMERCIAL LETTERS OF CREDIT IN THE AMERICAS* ix (1966).

132. *MacPherson v. Buick Motor Co.*, 111 N.E. 1050 (N.Y. 1916).

133. *Id.* at 1051.

134. *Id.*

135. C. CIV. art. 1382 (2008) (Fr.) (*Tout fait quelconque de l'homme, qui cause à autrui un dommage, oblige celui par la faute duquel il est arrivé à le réparer.*).

136. *MacPherson*, 111 N.E. at 1051.

137. *Thomas v. Winchester*, 6 N.Y. 397, 405 (1852). For other decisions by Cardozo, see Boris Kozolchik, *A Roadmap to Economic Development Through Law: Third Parties and Comparative Legal Structure*, 23 *ARIZ. J. INT'L & COMP. L.* 1, 25–34 (2005).

138. *Thomas*, 6 N.Y. at 409.

139. *MacPherson*, 111 N.E. at 1051.

scaffold for a painter whose employees were seriously injured when the scaffold collapsed.¹⁴⁰ The court held the contractor-builder liable because he knew that an improper construction of the scaffold was also highly likely to injure its users. In Cardozo's words, "Building it for their use, he owed them a duty, irrespective of his contract with their master, to build it with care."¹⁴¹

He then analyzed a decision which imposed liability upon the manufacturer of a coffee urn which, when heated in preparation for the dispensing of coffee in a restaurant, exploded and injured the plaintiff, a customer of the restaurant.¹⁴² Cardozo reasoned that the manufacturer was liable because the urn "was of such a character inherently that, when applied to the purposes for which it was designed, it was liable to become a source of great danger to many people if not carefully and properly constructed."¹⁴³ Cardozo then concluded that although the facts differed in some respects from those in the preceding cases, their governing principle was not limited to poisons, explosives, and things that in their normal operation are implements of destruction. If the nature of a thing is such that it is "reasonably certain to place life and limb in peril when negligently made, it is then a thing of danger. Its nature gives warning of the consequences to be expected."¹⁴⁴

Please notice how the reasoning employed by Cardozo made use of a legal principle that could be applied analogically to different things only because the principle was the same: liability for the effects caused by negligently manufactured, built, erected, or packaged items. Thus poison was analogized to scaffoldings and the latter to coffee urns and automobile wheels. This was indeed reasoning from example to example, but the example was a composite of factual and legal considerations, and thus the reasoning was sound.¹⁴⁵ Factually and legally, what the objects had in common was that they were all negligently manufactured and all injured either buyers or third parties. Thus Cardozo chose that legal analogy they had in common—the likelihood of causing injury when negligently manufactured. As a legal analogy, it was "open-ended" and supported by the logic of the reasonable and the principle of foreseeability of likely harm to innocent victims. If the defendant knew of the danger posed by a defective product or should have known of such a danger, he was under a duty to foresee the consequences of his actions and prevent them.¹⁴⁶

With this statement, Cardozo bridged the gap between a universal duty of diligence toward third parties (as set forth in Article 1382 of the French *Code Civil*)

140. *Devlin v. Smith*, 89 N.Y. 470 (1882).

141. *MacPherson*, 111 N.E. at 1052.

142. *Statler v. Ray Mfg. Co.*, 195 N.Y. 478, 480 (1909).

143. *MacPherson*, 111 N.E. at 1052.

144. *Id.* at 1053.

145. See EDWARD H. LEVI, AN INTRODUCTION TO LEGAL REASONING 1–2 (12th prt. 1968). Mr. Levi was Dean of the University of Chicago Law School and Attorney General of the United States. As far as I know, the term "reasoning by example" was coined in the United States by Mr. Levi.

146. See THOMAS M. COOLEY & JOHN LEWIS, 2 A TREATISE ON THE LAW OF TORTS 1488 (3d ed. 1906); see also Kozolchik, *A Roadmap*, *supra* note 112, at 27–28.

and the duty only to those parties who had a cause of action under the traditional conceptual categories of the common law, such as those who were in privity of contract. Reasonableness made this bridging possible by asking the key question: Is it not reasonable to impose the duty to foresee the consequences of a negligently manufactured product upon a defendant with knowledge of the harmful consequences of his acts?

One could hardly miss the central role played by fact finding in *MacPherson v. Buick*, even when expertly and subtly blended with the legal principle of foreseeability in order to make new law. Reasoning by example, then, is used by those appellate judges who are convinced that the state of the law is unsatisfactory and that new judicial and “interstitial” law is more likely to be put in motion by courts than by a legislature. In *MacPherson v. Buick*, the changed socio-economic circumstance was the increased number of victims of automobile accidents caused directly or indirectly by defendants who were not in contractual privity or in direct contractual relationships with the plaintiffs.

III. SUMMARY AND CONCLUSIONS: A PROPOSED RESEARCH AND DRAFTING METHODOLOGY

By finding out the purpose of legal institutions, one discovers whether they work and hopefully why they have or have not worked. In the case of the Nicaraguan drafter of a negotiable instruments law, his purpose was “to render an homage to Professor X’s theory of negotiable instruments,”¹⁴⁷ not to improve the reliability of all the instruments that circulated in Nicaragua as negotiable instruments. Thus, from the very moment the purpose was formulated, one could predict that it was not going to fulfill its economic purpose. His method lacked the right goal, the proper analytical tool and the required data.

Aristotelian-scholastic logic is a useful tool for attaining precision and symmetry in the drafting of rules, but because of its aims at permanence and universality (which leads inevitably to a closed number of legal institutions whether they are types of contracts, rights in rem or causes of action), it impedes progress and economic development. This logic could be helpful in adding precision to the formulation of rules, such as by avoiding redundant or contradictory definitions, but it is not helpful in fashioning market sensitive commercial norms.

The logic most suitable for using commercial law as a tool for development is the “logic of the reasonable” because it takes into account past experience with legal institutions as well as the likely future experience with the new institutions, i.e., what the legislator, judge or administrator should reasonably expect to happen once the new institution is operative. In addition, by encouraging lawmakers and the governed alike to consider the reasonable expectations of “the other,” including counterparties and third parties, it is the most likely to produce standard and best practices and with them economic development.

147. See Nicaraguan Conversation, *supra* note 13.

Because it is a fact-driven logic, it depends upon the comparative law researcher's ability to collect not only the above described experiences with official legal institutions, but also thorough and accurate comprehension of commercial and consumer customs and practices and their socio-economic context. This task is greatly facilitated by identifying representative or archetypal behavior of merchants and their counterparties and third parties including consumers. It is also facilitated by the fact that only those commercial legal institutions that are guided by certain immanent principles or standards can aspire to long-term viability. Such principles or standards include fair competition and cooperation among merchants and the protection of third parties acting in good faith. Others are apparent when considering the selfish but also altruistic nature of social man, reflected in customs and practices that required the giving of something of value as a means to gain the trust of contracting and third parties.

The logic of the reasonable also serves as a valuable drafting tool. Highly precise rules are no doubt helpful in bringing about a high degree of predictability, but the more precise the rules are, the narrower is their scope of application. Yet, entrepreneurial and constantly exploring commerce often needs broader guidelines than those offered by the highly precise rules. It is for this reason that the law of commercial contracts of the United States is governed increasingly by standards rather than by rules.¹⁴⁸ And it is precisely in the drafting of such a law that the principles and standards derived from standard and best practices are highly effective tools, as will be illustrated in the following section.

IV. APPENDIX: COMPARATIVE COMMERCIAL CONTRACT LAW ACCESS TO COMMERCIAL CREDIT AT REASONABLE RATES OF INTEREST IN COUNTRY X.

This Appendix illustrates the use of the methodology discussed in this article when applied to an economic development project. Assume that the cost of commercial credit in country X, particularly for micro, small and medium-sized businesses—if and when available—is approximately fifty percent per annum, thereby undermining the creation and growth of micro, small and medium-sized enterprises. Assume also that many of these enterprises wind up paying rates in excess of 300% per year to usurious lenders. Country X has requested multi-national organizations to help it fund studies and drafts of laws that could help it obtain commercial credit at reasonable rates of interest. One of these multi-national financial organizations has heard good things about your law firm and about the fact that you have a group of lawyers trained in the law of comparative commercial contracts. It requests that you send them a proposal outlining what your firm could do for X and what you would charge.

148. On the use of standards and rules in the law of commercial contracts of the United States, see the late Professor Richard E. Speidel, *Restatement Second: Omitted Terms and Contract Method*, 67 *CORNELL L. REV.* 785 (1982).

The following sections will illustrate what could be an important part of your description of the “technical” work involved in that request. It will also illustrate how to use the comparative contextual method in this course with real life problems, and hopefully in your future professional endeavors.

A. Country X’s Socio-economic Context

Up to date socio-economic data on country X can be obtained, in part, from widely available printed and electronic sources. The subjects usually covered by these sources are: 1) X’s population, including average age, life span and access to medical services; 2) country X’s annual gross domestic product and per capita income; 3) its education and literacy, graduation rates and presence of viable commercial and industrial professionals in various sectors; 4) X’s principal sources of income, including exports and the sectors on which its economy depends on most; 5) X’s proximity to profitable markets for its goods and services and the adequacy of its infrastructure and means of communication; and 6) governmental institutions, including type of government, role and importance of its branches, taxation, tax evasion and corruption, and so on.

These data help identify those goods and services that are the most likely to serve as collateral for commercial loans. For example, if the statistics on health services indicate that a sufficient number of X’s residents have regular access to physicians and hospitals, this may bode well for the utilization of medical bills or invoices as accounts receivable collateral for loans made to physicians and hospitals. The same would be true with members of other professions such as artisans and craftsmen. Clearly, this initial statistical data would require further inquiry on, say, the patients’ or clients’ ability and willingness to repay their credit obligations. Incidentally, a similarly promising initial datum on the importance of tourism for country X led to the suggestion that widely circulating “travel vouchers” be used as collateral for loans granted to travel agencies, and their lodging and transportation contractors or subcontractors who are also holders of travel vouchers. Up until that time, X’s travel agencies were under the impression that the only reliable and liquid collateral they could offer were their bank deposits of the amounts paid to them under these vouchers. They were unaware that credit card receipts, and travel vouchers given to them in exchange for their services—while not as liquid as bank deposits—were desirable collateral as contractually promised payments owed by reputable payors. Once X enacted its law on secured transactions, the reliance on credit card receipts and travel vouchers as collateral markedly increased.

Another frequently underestimated datum when visualizing the viability of collateral is the adequacy of a country or region’s transportation infrastructure and means of communication. Depending upon its adequacy, it may be possible to increase the utilization of air, rail or truck waybills, ocean bills of lading and warehouse receipts (paper or electronic) and their transported or stored goods as collateral. In addition, it may be possible to create a national collateral (or personal

property security interest) registry either as part of a network of local registries or as a directly accessible central registry or both.

Recall that in the first sentence of this section, I qualified the use of sources of socio-economic data by using the words “in part” in relation to up-to-date standard printed or electronic sources. The other and perhaps most important source of the socio-economic data is that provided by local experts. There is no substitute for the qualitative information provided by national or local researchers and consultants. What may look clear and convincing to foreign eyes, even when armed with the most current statistical reports, may be quite different through discerning local eyes.

For example, certain goods or services may appear at first sight to be highly valuable collateral because of their scarcity and exclusive distribution. Yet, the local expert may be aware that a monopoly or exclusive franchise for the distribution of a certain product is scheduled to disappear in the immediate future. The same may be true with a cleverly hidden and corrupt governmental subsidy available only to certain farmers, or with unreliable means of communication. Or, based upon experiences elsewhere, the comparative analyst may be convinced that a secured transactions law could not be enacted in X without the support of the local bankers’ association. But, thanks to the local experts, he may soon discover that a large demonstration of farmers in front of the legislature, who have never had access to credit at low interest rates, may get the statute enacted.

B. Country X’s Legal Context

Another guiding theme of this book is the sharp separation between the official or positive law and the unwritten or living law in developing nations. After more than forty years of doing comparative legal studies in developed and developing nations, the only plausible explanation I have for the sharpness and significance of that separation is another guiding theme of this book: the familistic component of the legal culture of developing nations. Familism is omnipresent in the legal cultures of Latin America, Russia, and China and is the force that shapes many of their living law institutions as developing nations (another guiding theme of this book). It accounts for the privileged or monopolistic rights of the select few, which, in turn, allow them to write their own rules (or have their governmental connections write them on their behalf). And this continues to occur despite written laws that customarily proclaim the equality of opportunity and the freedom of competition of all.

The vast majority of those who live on the other side of the tracks of economic success in developing nations are unaware of how the other side succeeded. Thus, they have no hesitation in creating their own rules and practices, whose common denominator is that they will obey the official law or the law of the powerful only when it is convenient for them to do so. When it is not, they spend much of their lives avoiding or evading the laws of the “others,” like the Spanish serf who answered his feudal lord’s question: “Don’t you obey the King’s Command?”

with “I obey it but I don’t fulfill it” (*lo obedezco pero no lo cumplo*), meaning he only pretends to obey, or simulates his obedience.

A legal system plagued with such unequal, unfair and deceptive attitudes can best be deciphered by those who live it, understand it and are capable of translating its legal institutions in a coherent manner for the comparative law analyst. Whenever possible, they must become the leaders of the drafting effort. Hence, one of the most important staffing decisions for X’s project is to find the local legal talent that best understands both the principles that guide the drafting of an effective secured transactions law as well as X’s written and living law.

Armed with the above described sources of information, the comparative analyst of X’s secured transactions law will learn that X’s written law provides only two security interests or rights in rem: one for real property (the *hipoteca* or mortgage) and one for personal or movable property (the *prenda* or pledge). And since according to X’s civil code, the number of rights in rem is closed or is a *numerus clausus* (such definitions being attributable to Aristotle’s essences as discussed in this article),¹⁴⁹ no more security interests in personal property can exist. These truisms are firmly believed by X’s lawyers and judges, who also believe that they came to them directly from Roman law. They must be made aware that this was simply not the case. For Roman jurists were eminently practical and non-dogmatic and invariably found ways to adapt their legal institutions to the needs of their admittedly rudimentary marketplace. Thus, in due course, the Roman pledger of personal property was allowed to remain in possession of the pledge by relabeling this non-possessory pledge a mortgage (*hypotheca*).¹⁵⁰ A similar flexibility will be needed by X’s lawyers, law professors and judges with the notions they inherited from the Spanish Civil Code that intangible things such as contract rights, accounts and trade names cannot be pledged because they are not movable or corporeal things.¹⁵¹

The comparative law researcher will also quickly learn that under X’s law, inventory could be used as collateral only when “immobilized” or locked up in a

149. See Kozolchyk, *supra* note 3, ch. II § (B)(1).

150. See ADOLF BERGER, *ENCYCLOPEDIA OF ROMAN LAW* 331, 490 (43 n.s. Transactions of the Am. Philosophical Society 331, 1953).

151. CÓDIGO CIVIL arts. 335, 336 (Spain), available at <http://html.rincondelvago.com/codigo-civil-espanol-de-1889.html>. It is true that Article 335 characterizes goods as movable if they are “susceptible of being appropriated . . . and generally all that can be transported from one place to another without harming the immovable property to which they were united” (Se reputan bienes muebles los susceptibles de apropiación . . . y en general todos los que se pueden transportar de un punto a otro sin menoscabo a la cosa inmueble a que estuvieren unidos). *Id.* art. 335. Yet, Article 336, also includes in the category of movable goods: “the rents or pensions, whether for the life of the recipient or as part of his inheritance . . .” (las rentas o pensiones, sean vitalicias o hereditarias . . .). *Id.* art. 336. This inclusion should have suggested to X’s legislator that it would have been enough to add commercial movable goods such as contract rights, invoices or accounts, and others as part of a growing list of new types of movables. Nonetheless, this provision was one of the most contentious and kept on being invoked against the use of such rights as collateral, because “movables are corporeal things.”

terminal warehouse, and thus could not be transformed, resold or re-pledged thereby facilitating the repayment of the commercial loan. Yet, was it at least possible under X's law for the seller or a third party custodian to foreclose on the collateral by reselling it publicly or privately without having to ask a court for its judicial remedy? The answer he would hear from the local lawyer was that private parties constantly tried to effectuate such extra judicial remedies and at times got away with them. However, courts continued to insist on the need for judicially ordered repossession or foreclosure and rejected extra-judicial remedies as violations of the civil codes' prohibition of the *pactum commissorium*, or the agreement that enabled the creditor to repossess or foreclose on collateral.

The prohibition of this *pactum* was enacted more than a thousand years ago by the Roman Emperor Constantine and is still found in most of the civil codes of Latin American nations.¹⁵² It has remained in force even though its purpose disappeared long ago. Its purpose was to enforce a definition of usury that forbade the charging of any interest, no matter how slight, by using the *pactum* as a subterfuge for the creditor to pocket the value of a thing pledged that was worth much more than the principal and interest due on the loan. It did not matter that the definition of usury in most, if not all, of the nations that proscribed the *pactum* had changed, and that a usurious rate was only one that exceeded the maximum allowable rate. And as if this were not enough, any clause that allowed a creditor or third party to repossess or foreclose on collateral, even if it was carried out pursuant to the parties' agreement and without breach of peace, was deemed to have violated constitutional due process by depriving the debtor of a court hearing.

C. The NLCIFT Twelve Principles of Secured Transactions Law in the Americas

A comparison of lending scenarios in developed and developing nations was made at a meeting of the NLCIFT and a group of Anglo-American and Latin American experts in 2001.¹⁵³ It shows that X's law shares most of its features with those of the laws of other developing nations. In contrast, while the secured lending laws of Canada and the United States were quite similar, they differed sharply from the laws of the developing nations.

152. See THE THEODOSIAN CODE AND NOVELS AND THE SIRMONTIAN CONSTITUTIONS 65 (Clyde Pharr, et al., eds., The Lawbook Exchange, 2008) (1952) (Theodosian Code 3.2.1 The Annulment of Provisions for Forfeiture (*De Commissoria Rescindenda*) (Quoniam inter alias captiones praecipue commissoriae legis crescit asperitas, placet infirmari eam et in posterum omnem eius memoriam aboleri. Si quis igitur tali contractu laborat, hac sanctione respiret, quae cum praeteritis praesentia quoque depellit et futura prohibet. Creditores enim re amissa iubemus recipere quod dederunt.)).

153. See Meeting of OAS-CIDIP VI Drafting Committee on Secured Transactions Conference Transcript, 18 ARIZ. J. INT'L & COMP. L. 334, 334-39 (2001). The author presided at this meeting.

At the meeting, the participants encouraged the NLCIFT to circulate its draft of the principles that inspired the secured transactions laws of Canada and the United States to all the nations in the hemisphere. They also proposed that these principles be used as a guide to draft what a year later became the OAS Inter-American Model Law on Secured Transactions of 2002 (OAS Model Law).¹⁵⁴ These principles, in turn, became known as the NLCIFT Twelve Principles of Secured Transactions Law in the Americas (NLCIFT Principles).¹⁵⁵

What is the importance of these principles as elements of a successful law reform process? Their importance is multi-faceted. First, they provide the justification for the selection of the standard and best practices that will eventually become part of the new law. Second, as justifiers of the proposed law, their legitimacy is earned by the successful legislative experiences that inspired them. In the case of the NLCIFT Principles, they were inspired by the standard and best secured transactions practices and laws in nations with developed market economies such as Canada and the United States. In the case of Canada the selected statute was its Personal Property Security Act (PPSA),¹⁵⁶ and in the United States it was Article 9 of the UCC.

As recommended by the 2001 meeting of hemispheric experts, the NLCIFT Principles, as inspired by the experience with these statutes were to be used as a guide when drafting the OAS Model Law. Thereafter they also continued to be used as a guide for the drafting of the statutes enacted by Latin American nations, such as those of Guatemala and Honduras, and for the draft laws currently before the congresses of Mexico, El Salvador, Colombia, Costa Rica and Peru.¹⁵⁷ Third, because the principles provide the justification for the new provisions they also embody the new law's purposes and as such they act as reminders to the drafters of the new laws that may have neglected an important goal or deviated from it. For the benefit of the reader, the NLCIFT Principles are included here:¹⁵⁸

1. Secured commercial and consumer credit is an effective tool for economic development because it allows the debtor's use, transformation, sale or barter of collateral (mobilization). The mobilization of these assets leading to their sale or disposition

154. For the English text of the OAS Model Inter-American Law on Secured Transactions, see http://www.oas.org/dil/cidip-vi-securedtransactions_eng.htm.

155. NAT'L LAW CTR. FOR INTER-AM. FREE TRADE, NLCIFT 12 PRINCIPLES OF SECURED TRANSACTIONS LAW IN THE AMERICAS (2006), available at <http://db.natlaw.com/bci9.pdf>.

156. See, e.g., Personal Property Security Act, R.S.O. 1990, c. P.10 (Can.), available at http://www.e-laws.gov.on.ca/html/statutes/english/elaws_statutes_90p10_e.htm.

157. See Boris Kozolchik, The Implementation of the OAS Model Law: Current Status, 28 ARIZ. J. INT'L & COMP. L. 1 (2011); Ley de Garantías Mobiliarias [Law on Secured Transactions], Decretos Nos. 294-2009, 284-2009, La Gaceta: Diario Oficial de la Republica de Honduras, 28 de Enero del 2010 (Hond.); Ley de Garantías Mobiliarias [Law on Secured Transactions] Decreto No. 51-2007, Diario de Centro América [DO], 16 de noviembre de 2007 (Guat.).

158. NLCIFT 12 PRINCIPLES OF SECURED TRANSACTIONS LAW IN THE AMERICAS, *supra* note 155.

makes possible the payment or self-liquidation of the loan. A single security interest can support a series of loans whose amount and collateral can vary during the life of the loan or loans. By executing a single security agreement and by giving public notice of the loan or line of credit, the secured creditor establishes his priority in the collateral over third parties without having to enter into new credit extension agreements or having to make successive filings. Self-liquidation can take place only when the following corollary principles are implemented by legislators, the parties, registries and courts.

2. A security interest is a preferential right to possession or control of personal property. As such, it does not require that the debtor who grants the interest have title to the personal property collateral; his right to its possession, even though co-existent with other possessory rights in the same property by other creditors and debtors, will allow the creation of the security interest.

3. The security interest may be created in any personal property susceptible to monetary valuation whether present or future, tangible or intangible including rights to the same, as well as in the proceeds of this collateral, whether in their first or future generations. Thus, personal property collateral as well as security interests in them are open in number (*numerus apertus*), and these security interests are not limited to pre-existing devices such as the pledge, with or without dispossession of the collateral, chattel mortgages, retention of title or conditional sales, etc.

4. Security interests may be created by contract or by law. The effectiveness of a security interest between the secured creditor and debtor arises from their contract or from a statutory or judicial imposition without any additional formality. Nevertheless, third party rights, including the rights of judgment creditors and trustees in bankruptcy, will not be affected by the security interest unless proper notice of it is provided to third parties.

5. A principal goal of a secured transactions public notice system is to eliminate secret liens. Public notice can either be attained by the creditor's or designated third party's possession or control of the collateral, or by registration. A perfected security interest in personal property can merge with a negotiable instrument, in which case it will become a negotiable security interest and, thus, an "abstract" undertaking, independent of rights and equities associated with the underlying transaction, thereby allowing its "true sale" or unrestricted negotiation to a *bona fide* purchaser.

6. Effective public notice by a specialized registry occurs when all known or future legal mechanisms with the effect of guaranteeing the payment of a debt against personal property are treated as a unitary security interest. The effect of such a recorded security interest, including its priority, upon third parties (such as other secured creditors and purchasers) commences from the time of its filing, irrespective of the time of its creation.

7. Registration should be inexpensive and should take place in a public registry easily accessible to third parties regardless of nationality or economic sector, if at all possible by electronic means. The filing, in standardized fashion, should contain only the essential data to identify the parties, the amount of the loan or line of credit and collateral, consistent with the needs of actual and potential third parties to discover all recorded liens against the debtor's assets. Generic descriptions of collateral such as "inventory" or "accounts receivable" should suffice. The registry should be indexed generally by the debtor's name and, only exceptionally, by the serial number of the goods.

8. A "purchase money," or "acquisition" security interest should take priority, to the extent that the credit provided is used directly to acquire the collateral, over prior existing perfected security interests in the same kind of collateral, as an incentive to those wishing to provide timely, valuable and needed loans and as a safeguard against the monopolization and immobilization of the collateral available by one or more secured creditors. Perfection of a purchase money security interest should require, in addition to the appropriate filing, a special notice to pre-existing security interests.

9. A buyer in the ordinary course of business takes free of a perfected security interest created by his seller, even when the buyer may know of that security interest. If the sale occurs outside the ordinary course of business, then the buyer takes subject to the security interest even if he pays a fair purchase price.

10. Self-liquidation of the security interests requires that repossession of the collateral and foreclosure take place by means of a contractual, rescissory and extrajudicial enforcement that confers upon the creditor or agreed-upon fiduciary the power to repossess or retain and foreclose on the collateral privately or by means of a highly expeditious judicial foreclosure.

11. Whenever possible—and until such time as a perfected and modern bankruptcy system that duly protects debtor and creditor rights has been adopted—the perfected security interest should not become part of bankruptcy proceedings and the law of bankruptcy or any other branch of the law should not become a tool to delay, avoid and evade secured obligations. Exceptionally, where the bankruptcy takes the form of a business reorganization, collateral may become part of the bankruptcy estate, subject to the exclusive jurisdiction of the bankruptcy court to confirm the perfection of the security interest and establish its priority against the claims of other creditors, to determine the extent and value of the security interest and ultimately to decide whether the collateral is essential to a feasible reorganization that shall protect valid security interests.

12. The harmonization of secured transaction laws—including conflict of law rules—is essential in order to promote cross-border extension of credit.

D. The Drafting of Country X's Secured Transactions Law: The UCC and the Canadian PPSA as Legislative Models

The experience of drafting or assisting in drafting about half a dozen secured transactions laws in Latin America and Africa taught that a three-step process was the most effective. The steps were:

- (1) Determination of the compatibility or incompatibility of local law and practice with the NLCIFT Principles, by means of a roadmap study of local secured lending practices;
- (2) Gathering the most pluralistic local drafting committee possible (to include all the sectors of the local economy and the legal profession affected by the law) to, on the basis of the roadmap study findings, its own legal and business experience, and the NLCIFT Principles, decide which principles, rules, or concepts of existing law could be retained and which not; and
- (3) Testing the effectiveness of proposed provisions with lenders and borrowers, and obtaining opinions on their constitutionality as well as possible difficulties of enforcement from supreme court justices, trial judges, practicing lawyers, and law professors.

In the following section, I will continue to discuss the method of drafting secured transactions law statutes in Latin America and the importance of the roadmap study. At this time, I would like to return for a moment to the Canadian PPSA and UCC Article 9 as models for the drafting of the OAS Model Law. The reason for this

detour is to answer those critics prone to regard the use of foreign legislative models by developing nations as “cultural imperialism.” I believe that a conversation I had with a member of the Mexican delegation to the NAFTA agreement in 1991 places the allegation of “cultural imperialism” in its proper perspective.

I had stated to members of the delegation that unless Mexico facilitated credit for its small businesses, tens of thousands of them would not be able to compete with their Canadian and United States counterparts who had access to commercial credit at rates of interest below ten percent per year, while their Mexican counterparts had to pay between forty and fifty percent annual rates of interest—when they had access to it. I then suggested that Mexico consider enacting an Article 9 or a PPSA-like law (properly adjusted to Mexico’s legal system and civil law tradition). In response to what he perceived as yet another instance of cultural imperialism, one of my Mexican colleagues asked: “Why is it that Mexico must import its trade and commercial laws from Canada and the United States and the same is not true the other way around?”

I responded that the question that he and his Mexican colleagues had to ask themselves was a different one: Does Mexico wish to have commercial credit at affordable interest rates so that its merchants can compete on a level playing field with their Canadian and United States colleagues? If so, a form of commercial credit that started out in England two centuries earlier and from there spread to the United States and Canada was the only one that would make such competition possible. It was a form of credit that allowed commercial, industrial, or professional borrowers to remain in possession of the raw materials, equipment, fixtures, inventory, and other business assets to enable them to produce, transform, exchange, or sell their products and, with the proceeds of the sale or exchange, pay the “self-liquidating” loan.

In fact, commercial experience has shown that, especially in credit transactions, usually only certain practices could accomplish the necessary cost-effectiveness that would make them competitive. Starting out with how a credit transaction is structured, how it is documented and who has to give what first to whom, standardization is a pre-requisite of cost-effectiveness.¹⁵⁹ I repeated the example of A.P. Herbert’s “negotiable cow” (used earlier in this article)¹⁶⁰ and suggested that because of the need for cost-effective practices, a negotiation clause stamped on the back of a cow could not compete with one written or stamped on paper as the means with which to issue and negotiate a promissory note. *Mutatis mutandis*, rules that required the debtor’s surrender of his assets as security for the loan could not compete with those that allowed him to make a productive use of those assets, for the key to choosing the right legal means, regardless of where they came from, was to select those means most appropriate to their purpose.

At this point, our conversation became friendlier and warmer. My interlocutor remembered similar words being uttered by his professor in a course on “Legal Methodology” at the National University of Mexico Law School (UNAM). And this professor was none other than Luis Recasens Siches (whose support for the

159. See Kozolchik, *supra* note 3, ch. XXI, on Formation of Contracts.

160. *Id.* ch. II § (B)(2)(i).

“logic of the reasonable” was discussed in this article).¹⁶¹ “Yes,” he said smilingly, “that is what Don Luis referred to as one of the principal features of reasonableness.” (Hopefully, you will now be tempted to re-visit the discussion on the logic of the reasonable in this article.)

My newly acquired friend asked me for examples of Mexican legal institutions that were incompatible with such a loan. I repeated to him some of the examples enumerated in the preceding section. I added that the most incompatible was the familistic nature of Mexico’s marketplace and legal culture, for secured lending is a form of credit extended to borrowers who are neither members of the lenders’ family nor are they his friends. In fact, they are often unknown to the lender. Consequently, the lender must treat family and stranger equally (and so must the borrower) and remember the principle that for a business asset to be relied upon as collateral, it has to have a discernible marketplace value. And one of the legal means to assure equality of treatment is a transparent system of perfection and priority of security interests. Additionally, one of the corollaries of equal treatment and transparency is to protect those who filed or acquired their possession of the collateral first.

However, such a system was certain to be opposed by those who, despite being lenders, labeled themselves in their contracts as conditional sellers, financial lessors, or settlers of goods entrusted to their debtors. At root, those transactions simulate or provide the appearance of a legally disguised status. In the case of the above listed lenders, they simulated the status of owners of the collateral, for as owners they would acquire a legal status superior to that of secured creditors even though the latter filed their security interests. And the reason for not wanting to file their security interests was not so much to avoid paying filing fees but to avoid appearing in a public record of transactions whose transfer taxes alone would be quite significant and worthy of a simulation. Keep in mind that sales or transfer taxes and not income taxes are usually the main source of tax revenue in developing countries. Keep also in mind that in the contemporary marketplace and personal property law most purported owners of this type of property are at best lawful possessors.¹⁶²

My friend tried to make a case for those who wish to file to be able to do so and those who did not want to file to be able to refrain from filing even though the latter’s rights or liens would remain secret. Incidentally, this was the formula first used by Mexico’s Decree law, which was the first version of its secured transactions law when enacted in 2003 and was also one of the reasons for its demise a few years later.¹⁶³ In response to his proposal, I quoted a fancy term that legal anthropologists use in connection with such a suggestion, “inherent incompatibility.” As translated into lay language by my friend and mentor E. Adamson Hoebel, this term means “a

161. See *supra* note 80 and accompanying text.

162. See Boris Kozolchik, *Transfer of Personal Property by a Non-Owner: Its Future in Light of Its Past*, 61 *TULANE L. REV.* 1453, 1490–99 (1987), for historical and comparative background.

163. See Boris Kozolchik & Dale Beck Furnish, *The OAS Model Law on Secured Transactions: A Comparative Analysis*, 12 *SW. J. L. & TRADE AM.* 235, 278–94 (2006).

people cannot cook the same piece of meat and eat it raw.”¹⁶⁴ In other words, a commercial self-liquidating loan could not be at the same time transparent and secret or unrecorded.

The same would be true with or among many other incompatible legal institutions, including: 1) a principle that requires that the debtor remain in possession of his productive assets in order to be able to repay the loan with their yield, and a definition of a pledge that requires the possession to be transferred to the creditor or to a third party custodian; 2) a definition of movable goods which excludes intangibles such as contract rights, accounts receivable, trade names, or trademarks; or 3) a procedure whose purpose is to preserve the value of perishable collateral in the event of debtor default and at the same time require that the remedy of repossession or foreclosure be adjudicated in a lengthy judicial procedure.

E. The Roadmap Study

A roadmap study describes and analyzes lending practices in representative sectors of the nation’s economy. It does this by identifying the archetypal behavior of borrowers, lenders, appraisers of the value of collateral, warehousemen or custodians, and other likely participants in the secured transaction, including lawyers and judges.

The roadmap refines the socio-economic data at hand by identifying the standard borrowers and lenders and the typical terms and conditions of existing functionally equivalent loans such as conditional sales, chattel mortgages, financial leases, or guarantee trusts. It also focuses on the collateral and on how it is used, repossessed, or foreclosed on. And it describes and analyzes legal and judicial practices in connection with the loans and their collection and obtains reactions on the effectiveness of proposed new concepts, rules, principles, and practices from their likely users.

As a rule, the NLCFIT’s roadmap studies are sectoral in nature. Thus, the lending practices are examined having in mind the participation by micro, small, and medium-sized businesses in the agricultural, commercial, industrial, and professional sectors.¹⁶⁵ Based upon the statistical socio-economic information for typical micro-, small-, and medium-sized businesses in country X, it became apparent to the roadmap researchers that the vast majority of these potential borrowers did not have the required business or professional licenses with which to do business and apply for loans from banks or cooperatives or other “non-usurious” sources of credit.

164. E. ADAMSON HOEBEL, *THE LAW OF PRIMITIVE MAN: A STUDY IN COMPARATIVE LEGAL DYNAMICS* 10 (2006).

165. For an analysis of the main features outlined in the principal text of micro and small businesses in representative Latin American nations, see Boris Kozolchik & Cristina Castañeda, *Invigorating Micro and Small Businesses Through Secured Commercial Credit in Latin America: The Need for Legal and Institutional Reform*, 28 *ARIZ. J. INT’L & COMP. L.* 43 (2011).

1. National Identity Card as a Qualifier for the Legal Status of a Securing Debtor (*Deudor Garante*)

This datum was made known to the designers of the software of the collateral registry. But at the same time, the roadmap showed that almost all the applicants for bank or cooperative credit had a national identity card with significant data and security features in them to make them acceptable as the functional equivalents of the debtor's personal or business name and address, especially those required for filing or registration purposes. This fact made it possible for the designers of the registry software to use the identity card number instead of the debtor's name as the key reference to the securing debtor in filed financing statements. It also made it easier for the banks and cooperatives to file their security interests and thereby make their lending decisions revolve not on formalities, but on the actual merits of the loan, i.e., whether the debtor had the willingness and ability to repay and whether the source of his repayment was reliable.

2. Archetypal Coyotes and Usurers in Agricultural Loans

As noted earlier, the sectoral data of the roadmap concerned the archetypal behavior of typical lenders and borrowers. Thus, in the agricultural sector, it became apparent that many of country X's poor farmers (either as micro or small businesses) relied on the credit of the so-called *coyotes*. These were the lenders who advanced moneys to facilitate the growing of the crops and at harvest time, paid the remainder of what became the purchase price for the crops. In other words, the archetypal *coyote* was a hybrid lender-buyer of the crops. Interestingly, the interviewed farmers did not resent the *coyotes'* financing as much as the interviewers expected, especially when taking into account the cruel connotations of the *coyote* designation.

The reason they were not resented as expected was that their financing was less oppressive than that of another archetypal lender—the omnipresent usurer and his oppressive rates of interest. What many of these poor farmers did not realize was that if they only had a vehicle or vehicles with which to transport their crops to a market often two or three hours away, they could have sold the same crops for as much as two to three times the price they received from the *coyotes*.

3. The Negative Effects of the Scholastic Classification of “Principal and Accessory”

The previous finding underscored the need for financing growing crops, tractors, and vehicles for the micro and small farmers. Yet, once the feasibility of such a loan was explored with banks and cooperatives, their response was that they could not finance the crops unless the borrowers either owned the land where they grew the crops or obtained a subordination agreement from the recorded owner,

usufructuary, or lessor of the land. As explained above, this reasoning by the bankers, cooperatives, and their lawyers was based upon the scholastic classification of “principal” and “accessory” things, and of the resulting principle that the principal things, i.e., the real property or land and the rights in it, invariably absorb the rights to the accessory things (i.e., the growing crops). This finding led the roadmap to recommend that growing crops and other accessories be given independent status as collateral in the proposed new law.

4. The Problems with Cattle Loans

The growing of cattle is also of considerable economic significance in Central America. Yet, surprisingly to the roadmap researchers, country X’s lenders only provide loans to the ranchers-cattlemen after their cattle has been slaughtered. Bad experiences and losses suffered with the methods of identifying cattle subject to their security interests, especially when the cattle could be easily moved and commingled with other cattle, discouraged this type of secured lending. It was the view of these potential lenders that unless a reliable system for identifying and tracking the movement of cattle is designed and implemented, they will remain reluctant to provide financing. Some of them suggested that the best solution would be to create a registry of cattle and ranchers and devise a more reliable system of cattle identification.

5. Loans to Market and Street Stall Operators: Taxes, Legal Culture and Its Effects On Transparency

How does an archetypal micro or small businessperson who operates a stall in a public market or in a street obtain credit with which to purchase and sell his wares in country X? The roadmap study found out that this type of business is still largely dependent upon the credit of an archetypal usurer. The roadmap also identified the pawn shop-like features of the municipal licenses obtained by usurious lenders to allow their secured borrowers to operate market stalls in country X as the lenders’ sub-licensees. The usurers as a rule lend paltry sums each week to their sub-licensees, who are then enabled to buy only a minimal amount of wares. Yet these borrowers-cum-sub-licensees pay interest rates that exceed twenty percent a month. If the stall operators fail to repay principal and interest, they will cease to be sub-licensees and will be evicted by their lender licensees.

Contrast such an immobilizing loan with the line of credit financing referred to in the NLCIFT Principles. With such a line of credit, the same stall operator can receive loans from banks or cooperatives at an affordable rate of interest now secured by his inventory, accounts, and proceeds. And, as a line of credit loan, the amount lent by the bank increases in proportion to the operators’ sales, proceeds, and profits, and is not limited to a percentage of the original value of the initial collateral. However, the legal culture of tax evasion is a major obstacle to this type of lending in

country X. When stall operators were asked why they had no books or records with which to document their cash flow and their profits and losses, many were at first reluctant to answer. Finally, some responded by asserting “*no one pays taxes in X.*”

Even after dramatic illustrations of how much more money the stall operators would make by providing that information to a bank, cooperative or other non-usurious lender and contrasting the costs of a twenty percent per month loan (with a very limited and fixed amount of principal) with a nine or ten percent loan per year with an open-ended line of credit proportional to the volume of sales and profits, many were still reluctant to supply that information. The effect that this aspect of the legal and business culture of country X had upon the lenders’ willingness to lend was obvious. On the other hand, the transparency of the filings of security interests in the collateral registry evoked fear in the borrowers that the availability of information on their borrowings would prompt the instances of tax collection raids or blackmail by tax collectors.

6. The Need for Reliable Accounting Data: The Importance of Accounts Receivable Collateral

Consistent with the findings on the lack of accounting or bookkeeping records among stall operators, the roadmap showed that micro and small businesses in country X kept very few records of their business transactions. Only those who sold on credit, such as the owners of small grocery shops, kept a “booklet” (*libreta*) to document their sales of groceries. This prompted the recommendation of professional accountants that as part of the roadmap the NLCIFT provide some simple but reliable forms of financial statements. This was done and much to the NLCIFT’s surprise and satisfaction, some of X’s banks started using these forms and this was soon reflected in the rise in the number of secured loans to small businesses.

A NLCIFT study on lending to micro and small businesses on a secured basis had shown the importance of accounts receivable as collateral. As summarized by a former Superintendent of Banks for Colombia: the invoices signed by the buyers of a delicious ice cream made and sold in his and surrounding buildings by a family of four (two parents and two children), even though payable thirty days later, were more liquid (or collectable) than many of the loans in the Colombian banks’ portfolios.

Nonetheless, the roadmap emphasized that to facilitate reliance on accounts receivable financing by micro-borrowers, their lenders will need to be satisfied that the statement of income flowing from the performance of services or sales of their wares is accurate and reflects a steady and reliable enough clientele (i.e., account debtors) to merit loans or lines of credit. This will require not only the micro-entrepreneur’s use of simple but reliable accounting records, but also a higher degree of specialization of the lenders to micro-businesses.

7. Some Remedial Lessons Learned from Experienced Trial Lawyers

On the remedial side of the law, asking experienced litigators how they would prevent an extra-judicial procedure of repossession or foreclosure from going forward yielded important lessons and a recommendation for new filing provisions. Many of the consulted trial lawyers responded to the roadmap question by asserting that their mere filing of a request for an interlocutory commercial attachment of all the assets of the defendant- borrower invariably led country X's courts to issue such an interlocutory attachment order that froze any other proceeding related to the debtor's property.

This finding led to the inclusion in the draft of X's law of the requirement that whoever wanted to obtain, judicially or extra-judicially, an attachment of the defendant's assets had to file a notice of the extra-judicial or judicial attachment, repossession and foreclosure. Accordingly, for a judicial order of interlocutory attachment to have priority over such a notice, it had to have been filed prior to all the other filers, including those by secured creditors seeking an extra-judicial remedy. Similarly, trial lawyers suggested that the naming of an agent for repossession and foreclosure by means of an "irrevocable mandate" (*mandato irrevocabile*) had proven more effective in practice and less vulnerable to judicial interference than the naming of a third party depositary or custodian.

F. Conclusion

The roadmap of country X's socio-economic, legal, business and cultural data contained many more findings and recommendations for legislative, contractual, administrative (mostly registry) and judicial practices. However, the main purpose for this Appendix is to illustrate the real life application of the methodology of the contextual comparison discussed in this article. If this illustration is successful, you should be able to start developing your own set of roadmap-like notes concerning your own future economic development projects.

